Crises and The Poor: A template for Action[1]

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The purpose of this note is to provide a template for areas of focus in the design of responses to a crisis.

The following is intended as a preliminary checklist of areas for action, that will be worked on in the coming months. In all areas, country-specific assessment will be central (and will feed back into ongoing synthesis work).

Transmission mechanisms

Any response needs to be designed around an understanding of the transmission mechanisms from economy-wide shocks to individuals and communities. The following are the most important processes.

1. ***Labor demand.*** The dominant short-run impact on households is via reduced labor demand, either directly via layoffs, or indirectly via reduced demand for the products of rural or urban household enterprises.

2. ***Prices.*** Price changes, including devaluations, commodity price changes, trade reforms, public sector price increases, tax/subsidy changes etc. cause significant relative price changes with effects dependent on the structure of production and consumption of households.

3. ***Public spending cuts.*** These are driven by the combination of fiscal retrenchment, falling revenues and (often) rises in interest bills. These both affect the demand for labor and the provision of services. While public spending is characteristically unequally distributed prior to a crisis, there is a particular concern over the cost of cutbacks in core services for the poor. There is widespread concern that fiscal retrenchment is frequently ad hoc or across-the-board.

(1)-(3) are the principal short-run determinants on the distribution of welfare. Shifts in distribution can significantly magnify or ameliorate the consequences for the poor of a general economic shock. There is no general pattern as to whether inequality rises or falls in downturns.

4. ***Changes in assets.*** Changes in the value of assets can be dramatic in a crisis, with significant distributional effects both on the rich (as with stock market and estate price falls) and the poor (if the inflation tax rises, for example). There are also potentially significant, if harder to measure, impacts on social capital that may become both more important in a shock and be undermined. There is at least a perception that the focus of action is to bail out the rich (externally or internally) and not protect asset losses of the poor.

While the above lays out the principal sources of shocks on people, the net effects depend crucially on responses at the individual, household and community level.
Examples of processes that have been documented:
--Changing consumption patterns

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--Use of savings, asset sales and increased borrowing
--Increased informal sector work of women
--Reverse migration
--Pulling children out of school and into work
--Increased inter-household transfers and mutual help

These can reduce immediate welfare costs, but often with longer-term adverse effects. Some are easily reversible, but others are not, at the individual, household, or community level.. Rising pressures on family and community can lead to measurable adverse effects, for example in increased street violence of male youth, and increased domestic violence.

The net effect of these processes raises a further central area of potential impact.

5. ***Long-term impacts on capabilities.*** An aggregate shock may have differential *irreversible* effects on different socio-economic groups through both cuts in public support and the range of coping responses. Putting children into work, reduced nutrition of young children, postponing preventive or curative health, and breakdowns in family or community can all have permanent effects, both on the individuals affected and on the longer-term distribution of income and social conditions.

Domains for action

Context. In the past the social dimensions of crises has generally been inadequately treated. This was markedly so in the 1980s debt crisis, when the characteristic response on social dimensions was years after the shock—frequently in the form of a social fund or measures to protect social spending. It was somewhat improved, but still weak, in the 1990s. With the current round of shocks, social issues have been put at the forefront of action, but we are still some way from applying an overall framework such as the one outlined here.

There will usually be inadequate information on likely and actual effects going into a crisis. It is recommended that the design of a response involves moving simultaneously on (a) immediate action based on both readily available analysis and general principles, and (b) a process of generation of information and diagnosis to inform future action. It is recommended that this be based on an assessment of the processes (along the lines outlined above) and should consider the case for action in each of the domains of the proposed social agenda. Often there will be greatest clarity on where to move in the public spending and information domains. We outline the issues in each area, and then conclude with a final point: that we need to be moving from crisis-management to designing permanent policy and institutional structures to manage household risk that are in place before a crisis.

A crisis may also present an opportunity to undertaken reforms that lead to positive and persistent distributional or social benefits. This will also depend crucially both on the extent to which such reforms have been prepared prior to a crisis and on political dynamics that may allow support governments or societal actors to support changes against previously entrenched interests. This potentially applies to all of the following areas.

1. Overall distributional effects from macroeconomic developments.

The context for any analysis should be based on an assessment—at least qualitative—of the overall distributional effects of a crisis, or alternatively, the allocation of the costs of a shock and the required adjustments, in relation to the three areas of changes in labor demand, prices and the value of assets.

Key questions:

What are the intertemporal tradeoffs between reduced consumption declines (for different groups) in the short run and longer-term adjustment and growth?

How do different choices over fiscal-monetary policy and exchange rate adjustment affect different groups, especially via labor demand and price effects?

What are the tradeoffs in external and internal financial workouts (including options for debt writedowns, and recapitalization and restructuring of banking systems) between internal and external confidence, efficiency and the present and future fiscal burden?

How do structural reforms—trade liberalization, price reforms, privatization, opening to foreign investment, labor market reform etc.—impact on different groups in the short and medium term and what are the costs and benefits of alternative sequences?

Tools: *Fully satisfactory tools are not available and short-cut methods will be needed. Conceptually the problem is of adjustment and transition in a general equilibrium context—computable general equilibrium models (e.g. of the macro-micro kind) can usefully inform options but are generally highly sensitive to parameters. Initial analysis can be done of a more partial character, linking impacts of economy-wide developments, especially labor demand and relative price changes, to the profile of key socio-economic groups, drawing on existing poverty profiles and survey information. There will be no substitute for tracking outcomes of different groups.*

2. ***Public tax and spending structures***

Direct public action, linked to public spending, is the most obvious area for pro-poor adjustment, and is the domain where there are the largest set of lessons of experience. However, this area can also be of particular difficulty because of weak information, political pressures to preserve fiscal support to the non-poor, and institutional rigidities. (It is often difficult to even conduct comprehensive public spending reviews in large countries). The design of a fiscal adjustment should be based on the above assessment of the impact of likely labor demand and price shocks, and on both the short and long-run effects on different groups of the processes outlined above. It is useful to separate overall services and safety net instruments, though in practice these are linked.

Key questions:

(a) ***Distributional effects of spending on social and economic services (in terms of both labor demand and service provision).*** This can draw on considerable work on the role of public services, and incidence studies.

Which spending lines are of particular value to the social and economic conditions of the poor (e.g. basic education, preventive health, rural roads, irrigation, water and sanitation, slum upgrading programs)?

What spending lines can be cut to preserve pro-poor spending—either through delaying investment or reducing spending that primarily benefits the non-poor?

How can the political economy of reduced middle class services or subsidies be managed to assure preservation or expansion of pro-poor spending?

What are the distributional consequences of alternative revenue-raising options?

(b) ***The design of safety nets to deal with both individual and systemic risks faced by the poor.*** This can draw on past and ongoing work on the optimal design of safety nets. Since information and capabilities will be limited, especially in a crisis, designs that have self-targeting properties are particularly important.
(refs)

Is there the institutional basis for significant expansion of workfare programs (generally the instrument of choice for poor workers, e.g. on the model of the Argentinian Trabajar program)?

Can subsidies for poor households to keep their children in schools be increased (on the model of the Brazilian Bolsa Escola, the Bangladeshi food-for-education etc.)?

Can programs affecting early childhood development (e.g. via mother and child feeding programs) be expanded?

Are there mechanisms for getting transfers to the poor who cannot work, such as the old, the sick and the disable?

Is there a rational mechanism (e.g. for severance payments) for the non-poor suffering from lay-offs that does not involve labor market distortions or divert transfers from the poor?

(c) ***Institutional issues.*** Short-run responses will often run up against issues of institutional capacity.

Are core government central, or especially local, agencies reasonably effective, or subject to corruption or political capture?

Can use of multiple channels and local participation both increase effectiveness and accountability?

Can a crisis be used to further longer-term objectives of decentralization and increased accountability of government and other agencies?

Is a social fund a viable short-run alternative? Can social fund type mechanisms be designed to support, rather than undermine, longer-term institutional objectives, with “parallel” institutions swiftly integrated into core governmental structures?

Can inclusion of the rich in the consensus-building process of crisis response improve the chances of success?

(d) ***Micro-finance.*** The impact of micro-finance on the poor remains controversial, but it can potentially play a role both in consumption-smoothing and in rebuilding capital after a shock.

Are existing micro-finance programs under strain? How can they be protected from large shocks (whether of financial crisis in East Asia or floods in Bangladesh)?

Is there a case for temporary subsidies to support post-shock recovery without jeopardizing institutional objectives of financial sustainability?

Tools: *Public expenditure surveys and incidence studies, both from past experience and from international experience; optimal design choices for safety nets from international experience. Practical lessons from decentralization and social fund design and implementation. Information on savings and borrowings of micro-finance institutions.*

3. ***Labor conditions***

While the World Bank has traditionally steered clear of taking a position from a rights perspective, much of the actual engagement will relate to core rights. It is proposed that the approach take an broad labor market perspective, assessing how policy choices can increase the degree to which the adjustment takes account of the interest of all workers, with respect to employment opportunities and labor conditions. With respect to the specific rights, a reasonable approach could be to assess whether either the crisis or the response is likely to lead to a *deterioration* in core rights:

Are existing rights to association and collective bargaining being respected?

Is there a heightened risk of exploitative forms of child labor? Can a combination of subsidy (notably to keep children in schools) and civil society engagement reduce this?

Are women subject to heightened discrimination or abuse in the workplace? Can unions or civil society help?

Can labor market reforms, that may reduce acquired rights of formal sector workers, be designed both to foster better overall labor prospects and with reasonable settlements to those adversely affected?

Are unions and representatives of informal workers being included in debate over the policy directions?

4. ***Effects on the social fabric***

As noted above, this domain is probably least-well treated—at least in Bank-supported work, but is often of great societal concern. While responses may not be clear it is recommended that the issues be raised and explored, for example along the following lines. *[this part to be strengthened by the social development family]*

Key questions:

How effective are existing community-based coping or risk-management mechanisms (a dimension of social capital)? Are these under heightened pressure under conditions of economic decline?

Are national distributional conflicts exacerbated by economic crisis? How effective are societal mechanisms for conflict resolution?

Is there a risk of rising violence (including within families) as a consequence of worsening economic conditions and services? Is there scope for direct action?

Are weak or corrupt governmental institutions subject to further worsening and loss of credibility as resources and salaries decline, or under conditions of political transition?

5. ***Information, diagnosis and public debate***

Information plays a central role (in and out of a crisis) on *understanding* the sources of changes in welfare and the impact of alternative responses, on *informing* societal debate on options, and on *fostering accountability* through increased transparency and provision of information on programs to civil societies and affected communities.

Key questions:

What is a minimum set of key indicators for tracking the conditions of core socio-economic groups? Is this incorporated into the monitoring of quick-disbursing operations to support countries in crisis?

Are statistical services providing current, and publicly available information on the shifting pattern of welfare and vulnerability?

Are there good participatory surveys of individual and community conditions and developments to complement quantitative sources of information?

Is there a sound structure for ongoing evaluation of the impacts of programs (using a range of quantitative and participatory techniques)?

Is there publicly available information on the intended and actual use of programs, using multiple sources, including civil society and the press, to increase the transparency and accountability?

Is there national capability to assess, synthesize and debate issues and options? How can short-run outside action both support information generation and sharing, and foster longer-term institutional development?

Permanent structures for crisis management

Economy-wide or geographically concentrated crises will always be with us—whether from the weather or future terms of trade or financial shocks—and this will be true however effective is the learning from the latest crisis. Rather than thinking about ways to respond when we are hit by a crisis, we have to build into our country strategies (including into short-run adjustment responses) the institution-building necessary for countries to better deal with the human dimension of future crises.

The key issue is to design institutional structures for reducing or managing the risks that households face. Many of the elements of such structures are known, but tend to be introduced in a rush in the midst of a crisis, where they are least effective, and too often end up in the too little, too late (or sometimes too much too late). Management of risks should be as much a part of long-term strategy as investing in economic or social services. As indicated in the above list of issues, the core of such a system is likely to involve:

i. a structure of safety nets that can expand counter-cyclically when shocks occur, without creating longer-term distortions;

ii. expanded understanding over the effects of the range of economy-wide and fiscal choices;

iii. a menu of piloted activities that could be expanded—and of spending lines that could be cut when aggregate fiscal cuts are required;

iv. information systems to track changes and impacts over time.