Responding to economic shocks: some microeconomic dimensions

WIDER Conference on Responding to Crises, Helsinki, 23-24 September 2016

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Introduction: economic crises

- World financial crisis 2007-8 as a clear example of a major economic crisis
- But there are many others e.g.
  - World food and fuel price increase in 2000s
  - Economic crises arising as a result of conflict
  - Droughts and floods can also lead to economic crises
  - Impacts of commodity price collapses
    - Not all economic in origin but have economic aspects
- These potentially can have major impacts in countries affected by these crises
Micro-level impacts of crises

- Crises certainly have micro level impacts
- Crises typically outside control of most individuals affected
- Can have substantial adverse impacts, for instance
  - Loss of jobs, livelihoods or incomes
  - Increases in costs of key consumption goods
  - Loss of property, lives or security e.g. conflict
  - Potentially reduced access to services
Micro-level impacts of crises (2)

But in many cases not everyone is affected or affected equally, e.g.

- Regional specific effects e.g. of commodity price collapses or conflict
- Some sectors may lose jobs, others may not – or may even gain
- Net sellers and net buyers affected differently by food price increases
Covariate and idiosyncratic shocks

Covariate shocks affect many people in the same neighbourhood e.g. a drought; idiosyncratic shocks e.g. injury affect a limited number.

Here the shocks are often more likely to be covariate; these are harder to respond to.
WIDER project on Insurance against poverty

- WIDER project more than 10 years ago on insurance against poverty
  - Absence of formal insurance in most cases
  - While credit sometimes used, poor have a range of informal mechanisms for responding to shocks
  - Income diversification; risk avoidance; self insurance; community based mutual insurance
Insurance mechanisms

- Income diversification and risk avoidance as a means of reducing risks or effects of adverse shocks
  - Can come at cost of lower average income

- Self insurance via savings, assets and credit as response to shocks
  - Often harder for poor to both save and borrow
  - Credit may not be a desirable response
  - May not want to sell productive assets, especially with covariate shock
Insurance mechanisms 2

- Mutual insurance; many examples of households providing insurance to others in their location: self help groups, rotating credit associations, funeral societies, etc.
  - Principle based on reciprocity
  - But will not work well for covariate shocks

- Both self and mutual insurance harder for poor; and difficult in face of covariate shocks
Other responses to shocks

Labour supply

- In face of loss of job or reduction of earnings of primary household earner, other household members may supply labour (added worker effect)
  - May include children
- But of course there needs to be demand for that labour
- Earnings from this work may well be lower or more uncertain though; and options less good for those with less education
Other responses (2)

Migration: common response to adverse shock,
- May take many different forms
  - Migration of one member or of whole household
  - Temporary or permanent
  - Internal or international

May be a response to limited work opportunities in area
- Or an escape from conflict or insecurity
- plus many other factors

Again those from poorer households may find it harder to migrate
Other responses (3)

Other responses may include withdrawing children from school (for work, to save costs); and reduced levels of nutrition

- Especially if other coping mechanisms cannot work or are considered undesirable

These almost certainly have adverse long term consequences
In summary so far ...

Households have many means of seeking to respond to shocks at micro level

But:
- These are almost all more difficult in the face of covariate shocks
- Poorer households typically have less easy access to these mechanisms
- Very unlikely to give full replacement of lost income
- Some may be quite counterproductive in the longer term
Can policy help?

How can policy respond to help people cope with shocks?

Vulnerability a key dimension of poverty; addressing vulnerability helps reduce poverty and helps people cope better with shocks.

Aspects

- Social protection
- Helping manage impacts of shocks at micro level
- Policy in relation to migration
- Employment
Social protection

- Increasingly common policy response to poverty/vulnerability, taking different forms
  - Cash transfers
  - Work programmes
  - Credit sometimes

- If social protection reaches poorer households, it may help people to cope better with shocks
  - In many countries social protection programmes still being developed; targeting is not always good; and amounts of payments often quite small
  - Mixed evidence on effectiveness
  - But several positive cases, Mexico, South Africa
Social protection needs to reach the persistently poor, not just those with a risk of falling into poverty

- Persistently poor may be those most likely to engage in counterproductive responses
Managing impact of shocks: responses to price changes

- Food price increases of 2000s risked to have major adverse impacts on consumers, especially poorer consumers.

- Some countries managed impact more effectively than others; e.g. rice in Vietnam:
  - Government intervened in different ways: rice export controls, procurement and stocking policies, with effect that domestic price fluctuate much less than world price.
  - Incentives to production too: production increased, more use of new varieties.

- Controversial but also effective.
Policies in relation to migration

Governments frequently seek to control migration within and between countries

- Concerns about ability to meet needs of migration populations; but also concerns about the political consequences of large scale migration

But policies to restrict migration limit a key means by which people can respond to shocks and make themselves better off ... this is a key development channel
Employment

- Lack of employment a key problem in many countries; this provides reasonable security
- A major policy priority especially in relation to youth and women
- Many issues: subject of a whole other session
Being better prepared for future crises

Issues that may make it easier to manage future crises:

- Higher levels of good quality education
- Enabling greater financial security
- Better employment opportunities
- Social protection
- An enabling approach to migration
- Lower inequality
- Increase roles for women
- May need regional or sector specific responses