

Responding to economic shocks: some microeconomic dimensions

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Andy McKay, University of Sussex
a.mckay@sussex.ac.uk

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 Africa¹⁴

Social protection (2)

- ◆ 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