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Lessons in designing safety nets

While labor-absorbing growth is required to reduce poverty, safety nets are also needed to help the destitute and those in temporary distress. Because poorly designed safety nets squander funds and fail to reach the needy, a recent World Bank book offers lessons on good design.

Poor people fall into three categories: those who are able to work but have low incomes arising from low productivity, those who are unable to work (the elderly, the handicapped), and those who are forced into temporary poverty by drought, recession, structural adjustment, or political transition.

Most poor people are members of the first group, and are best helped by growth-enhancing policies that foster labor absorption and raise productivity. Although safety nets are important components of such policies, they should never be conceived as solutions to poverty. Rather, they are important palliatives for the destitute and those in transient poverty. They also can help workers in slack seasons when jobs are scarce.

Main concerns

Several issues must be considered when designing safety nets. Are they tailored to local needs? Are they financially and politically sustainable? What are the costs and benefits of different safety nets? And how can they be targeted at needy groups?

A recent World Bank book, *Safety Net Programs and Poverty Reduction: Lessons from Cross-Country Experience,* answers these questions by distilling best practice from global experience. The book argues that good design can help ease the budgetary conflict between safety nets and growth-enhancing spending. One feature is crucial—safety nets designed to complement growth must include the poor in productive activity.

Safety nets aimed at complementing growth must include the poor in productive activity

In addition, safety nets can be combined with long-term programs that build human capital and transfer assets to the poor, raising growth potential. For example, public works programs can create growth-enhancing infrastructure, including irrigation (which increases productivity and reduces the impact of future droughts). The poor typically suffer the most from shocks like drought or transition because they have few insurance mechanisms and limited savings. As a result they tend to avoid risk rather than maximize productivity—they simply cannot afford to be entrepreneurial. By providing an insurance mechanism, safety nets help the poor become entrepreneurial, enhancing productivity and growth.

Private transfers within families and communities are traditional mechanisms for alleviating distress. Safety nets should try not to displace these. Rather, publicly funded safety nets should, where possible, strengthen informal and traditional arrangements.

All assistance affects the behavior of recipients. High-wage public works programs will lead to employment diversion from private jobs rather than employment creation. Cash transfers and subsidized food may make recipients work less. Transfers are fungible, so subsidies to feed schoolchild-

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Targeting must be carefully designed to ensure a good tradeoff between costs and benefits; self-targeting is often the best approach

ren may cause parents to cut back on household meals. Such responses may increase real economic costs, and so must be kept in mind in designing safety nets.

Targeting focuses scarce funds on the needy, but it also has costs. Administrative mechanisms to screen out the nonpoor—for example, ration cards—may unwittingly screen out the poorest, who often are unaware of their rights and unable to afford the transactions costs of securing benefits. Subsidies that focus on too narrow a portion of the population may lose political support (as in Sri Lanka's food subsidy). Moreover, targeting has significant administrative costs. And it can distort incentives, inducing less work and reduced output. Thus targeting must be carefully designed to ensure a good tradeoff between costs and benefits.

The best schemes are often self-targeted, like public works programs at wages attractive only to the poor, or subsidies for foods consumed mainly by the poor. The worst schemes are those that fail to reach the poor.

Design guidelines

Cross-country experience highlights seven lessons for good safety net design:

- Avoid open, general subsidies, which are unsustainable, distortionary, and mainly benefit the nonpoor.
- Limit program costs to a small percentage of the total budget, ensuring sustainability.
- Use innovative designs and delivery mechanisms (like village-level nongovernmental organizations) to reach groups that standard safety nets often miss (poor women, indigenous groups).
- Keep transactions costs low to avoid eroding the real cost of benefits.
- Ensure that safety nets are broad enough to maintain political support—very fine targeting can undermine such support.
- Avoid excessive fine-tuning in targeting, since it may end up excluding the poor along with the nonpoor.
- Keep assistance modest to minimize changes in incentives and behavior, which can erode real benefits.

Choosing the approach

Turning from general principles to specifics, the book provides a framework for choosing among four types of safety nets: cash transfers, in-kind transfers, public works programs, and credit programs. Country circumstances—including institutional capacity, the nature of poverty and external shocks, and fiscal and delivery constraints—will determine which approach is most appropriate (figure 1).

Cash transfers

Cash transfers are effective if programs are relatively small and the poor are easily identifiable—as in countries where poverty is strongly correlated with family size or female-headed households. But in cases where identifying poor families is difficult and costly, other mechanisms (such as geographical targeting) may prove superior. Self-selection can be tried by linking cash transfers to a work requirement or to child nutrition programs. Alternatively, identifying and excluding the nonpoor (based on ownership of, say, land or automobiles) may be more effective than trying to identify the poor.

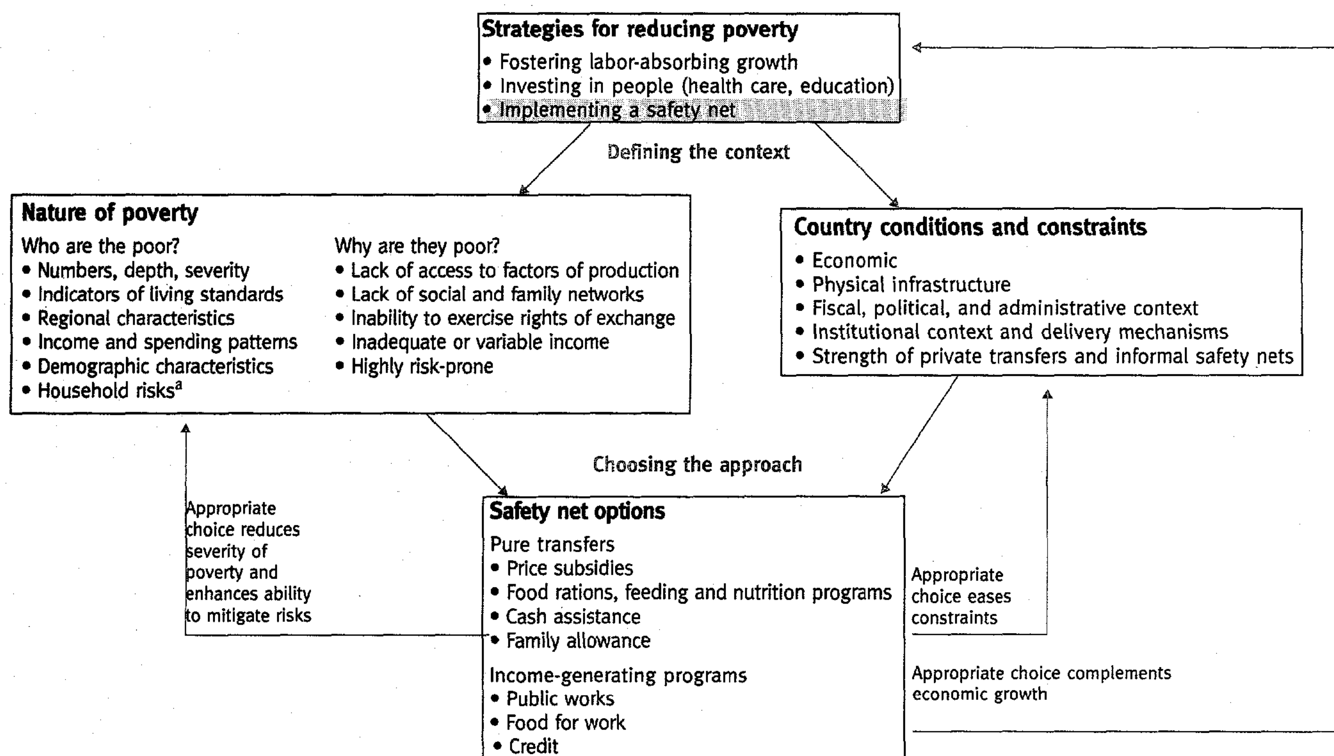
One advantage of cash transfers is that they do not distort commodity markets. But all cash transfers create problems. Poverty traps develop for people living just below the poverty line. Traditional safety nets (private transfers) may be displaced. And beneficiaries may work less. Program design should recognize and attempt to minimize such behavioral responses.

In-kind transfers

In-kind transfers include food stamps, nutritional supplements, and food, housing, and energy subsidies. Experience in many countries provides four lessons. First, universal subsidies are fiscally unsustainable, so targeting is essential. Second, the nonpoor can be screened out by attaching obligations (such as a work requirement) to recipients. These obligations should not raise transactions costs significantly, however, or the poor will be screened out.

Third, like cash transfers, in-kind transfers can generate incentive costs, and are

Figure 1. How should a safety net be chosen?



a. Risks include crop failure and entitlement failures, life-cycle risks (old age, disability), newly emerging risks (AIDS-orphaned children, orphans in postconflict societies), and inability to bear production risks.
Source: Subbarao 1996.

open to abuse and political rent seeking. Self-selection can lower such costs. Subsidies for lower-quality foods or for foods consumed mainly by the poor can be a useful form of self-selection that is also politically acceptable. Fourth, food transfers to schoolchildren or lactating mothers can be effective but require well-developed administrative and delivery systems.

Public works programs

Public works programs can be important countercyclical mechanisms during times of temporary distress (droughts, recessions), can smooth incomes by providing work in slack agricultural seasons, and can help countries undergoing transition or emerging from civil conflict. These programs are flexible and can be expanded or cut according to need. Moreover, they can be used to build infrastructure—village water tanks, rural roads, social forestry—and so increase growth potential.

There are, however, tradeoffs between employment intensity and the durability of such works. Unpaved roads provide immediate employment but will soon be washed away. Paved roads are durable but provide fewer jobs.

The wage rate is the most important design element in public works programs. If wages are at or below the market rate, only the poor are likely to participate. If wages are higher than the market rate, the nonpoor will be drawn away from productive work in the private sector, and excess demand will lead to job rationing in public works programs (as in Botswana, Kenya, and Tanzania and in India's Maharashtra Employment Guarantee Scheme after 1988). Paying a significant portion of wages in kind can attract more female workers (as in Lesotho and Zambia). India's Maharashtra Employment Guarantee Scheme obliges the administration to provide work within 5 kilometers of where five or more people demand employment. This program has helped reduce the

The poor are often better served by a line of credit at market interest rates than by one-shot loans at subsidized rates

severity (as distinct from the incidence) of poverty and eroded gender barriers in employment.

Public works programs are costly to administer and have high nonwage costs. So while they are a good means of targeting the needy, they should be wound up when times of need end. They must not be viewed as permanent solutions to poverty.

Credit programs

Credit programs improve the poor's access to credit. Credit increases self-employment, and can be important where underemployment and unemployment are widespread. Credit also helps alleviate the inefficiencies created by market failure in financial markets (banks are normally reluctant to lend to the productive poor because of information problems). Moreover, credit raises the poor's productivity and so aids economic growth. Finally, credit programs have been extremely successful in breaking down traditional gender barriers, especially when administered by nongovernmental organizations (NGOs). Women account for only 25 percent of beneficiaries in India's government-administered credit program, the Integrated Rural Development Program. In NGO credit programs, by contrast, women account for much larger shares of beneficiaries—60 percent in India's Mysore Resettlement and Development Agency and 90 percent in Bangladesh's Grameen Bank.

Credit programs have drawbacks, however. They require specialized skills that are often scarce in developing countries. Political pressures for writeoffs can lead to high levels of default—often willful default. The poorest are often excluded because they are illiterate and cannot handle the required paperwork or other transactions costs. Money is fungible, so credit for production may be diverted to consumption. To lower the cost of borrowing, many governments have subsidized interest rates—yet experience has shown that the poor are good credit risks, and are often better served by a line of credit at market rates than by a one-time loan at subsidized rates. Credit programs also run the risk of leakages to the nonpoor, especially when interest rates are subsidized and programs are administered without local participation and community oversight. Because of these and other challenges, even the most successful credit programs have a modest record in reaching the poor.

Government-run credit programs have the worst track record, and NGOs and other local groups (such as women's microcredit groups) provide better delivery. To ensure that credit-based work programs benefit the poor, rules should be clear and simple, and paperwork minimized to cut transactions costs. Moreover, savings should be promoted as an integral part of these programs (women's microcredit groups are typically thrift-and-loan societies). Finally, the risks credit programs pose to borrowers and lenders can be reduced through group lending and small loans that are repeated for those who repay on schedule.

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This brief, an earlier version of which appeared in *Poverty Lines*, was written by Swaminathan S.A. Aiyar under the supervision of K. Sarwar Lateef and Kalanidhi Subbarao for the Poverty Reduction and Economic Management (PREM) network. It is based on:

Subbarao, Kalanidhi. 1996. "Best Practice on Social Assistance and Poverty-Targeted Programs." World Bank, Poverty and Social Policy Department, Washington, D.C.

Subbarao, Kalanidhi, and others. 1997. *Safety Net Programs and Poverty Reduction: Lessons from Cross-Country Experience.* A Directions in Development book. Washington, D.C.: World Bank.

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