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Introduction

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One of the recent paradoxes is simultaneous increase in economic insecurity and per capita income. This paradox is true for both developing and developed countries. In developed countries, one reason for greater insecurity is increased (at least perceived) volatility of income. Even a billionaire may feel insecure if there is a strong chance for his or her portfolio value getting wiped out shortly. The second reason for heightened insecurity in developed countries is unequal distribution. Income growth in most of these countries in recent years was concentrated in the very upper echelons of income distribution. A vast number of people in developed countries live from pay check to pay check, and they are haunted by the prospect of losing their job.

Increased volatility and unequal distribution lie at the root of rising insecurity in developing countries too. Financial deregulation eased the movement of capital around the world. However, the procyclicality of these capital flows has become an increasing source of macroeconomic volatility in most developing countries. As a result, livelihood in these countries has become insecure even for those who are above the poverty line. While the standard trade theory suggests that increased openness will lead to greater use of labor and hence rise of labor income share in developing countries, this has generally not happened. Instead, globalization has been associated with rise in inequality in developing countries too. Since their per capita income is low, unequal distribution in these countries implies that significant portions of their populations lie at or below the poverty level. For these people, economic insecurity is a permanent or chronic feature of life.

Increased economic insecurity is harmful for human welfare in several ways. First, job and income insecurity affects directly the material and psychological well-being of a person. Second, economic volatility and high uncertainty generally exert negative influence on productive investment, thereby hurting long-term development prospects. Reducing insecurity is therefore an urgent necessity for both short-term relief and long-term growth.

However, formulation of policies necessary for reducing and coping with insecurity requires adequate understanding of the causes of insecurity and of steps and measures that have proved successful so far. This book aims at enhancing that understanding by presenting a set of chapters focused on economic insecurity problem and the policies that may be pursued to overcome the problem. These chapters were originally written as background papers for the UN annual flagship report, *World Economic and Social Survey* (WESS), devoted to the issue of economic insecurity. The data, analysis, and recommendations presented in these chapters can be of much help in understanding the causes and nature of economic insecurity and in identifying the steps that may be taken to deal with it.

Several features set this book apart from other books on the topic of economic insecurity. First, the chapters of this book not only cover the causes of rising insecurity, but also focus on the policies that may be pursued to overcome the insecurity problem. Second, the chapters include discussions of both macro- and microfinancing initiatives that may be taken to mitigate and cope with economic insecurity. It may be noted that many books on the subject deal with either macro- or microfinance issues. Yet, issues of microfinance are closely related to those of macrofinance. Third, instead of taking a narrow *financial* view of the problem, this book provides a broader perspective on the issue of economic insecurity, relating insecurity to the *real* life issues of jobs, unemployment, offshoring, and natural disasters. In other words, the issues of finance are discussed in close connection with issues of the real side of the economy.

Offshoring of jobs and rising economic insecurity in developed countries

The volume begins with Milberg and Winkler explaining (in Chapter 2) why economic insecurity has increased in developed countries and what the policy responses have been so far. It starts by documenting the rise in insecurity in most industrialized countries since mid-1970s, and observes that in many of them the

burden of economic risk has shifted from the state and corporations to private households. The chapter identifies offshoring of jobs caused by globalization as the main reason behind the rising insecurity, and predicts even more offshoring in the future, including that of jobs related to production of high-tech goods and high skilled services. The authors point out that, on the one hand, the threat of job offshoring has also helped employers to keep domestic wages low. On the other hand, exploitation of developing countries' cheap labor abroad and stagnant wages at home have resulted in huge increase in profit income.

The authors note that, despite the commonality of these structural processes, the actual insecurity outcome depends to a large extent on how the enhanced profit income is used. Focusing on employment protection and public expenditure on worker support (social security), the authors identify several models, namely the Anglo-Saxon, the Mediterranean, the Rhineland, and the hybrid model of "flexicurity." According to the authors, the Anglo-Saxon model combines low employment protection with low levels of public spending. At the other extreme is the Rhineland model that combines high employment protection with high levels of spending on worker support. The Mediterranean model is characterized by high employment protection with low levels of public spending, while the hybrid, flexicurity model (practiced in Denmark, Finland, and the Netherlands) combines low employment protection with high levels of public spending.

The authors observe that while greater levels of public spending can counteract, to some extent, the adverse impact of globalization on economic insecurity, it is more important in the long run to channel profit into productive domestic investment, instead of being spent on dividend payouts and share buyback. The authors also refute the commonly heard argument that greater spending on social protection harms global competitiveness. Citing the fact that countries such as Germany and Denmark have excelled in export while Anglo-Saxon countries have not, the chapter argues that appropriately directed high social spending may even help increase export competitiveness.

Volatile capital flows as a cause of economic insecurity in developing countries

While offshoring of jobs is one important aspect of globalization, its other important aspect is greater capital mobility. Akyüz identifies capital mobility as the most important source of volatility and income insecurity in developing countries. He provides (in Chapter 3) the details about how increased capital

mobility enhances the boom–bust pattern of output and leads to considerable human costs, because employment levels do not recover that fast after recessions. He thinks that management of international capital flows is now a greater challenge than attaining price stability.

Akyüz goes on to consider the policies that developing countries can adopt at the national level to mitigate increased insecurity arising from capital mobility. He considers three interrelated areas of such policies, namely (i) macroeconomic (mostly monetary) policies focusing on interest and exchange rate, (ii) prudential regulations of the financial sector, and (iii) building up of reserves. In general, Akyüz thinks that countercyclical policies should start during the expansion phase (when capital inflow surges) so that macroeconomic imbalances and exposure to a reversal of capital flow can be minimized. He offers a detailed discussion of the *pros* and *cons* and the challenges involved with each of these three types of policies.

Akyüz however reaches the conclusion that while national level policies can be helpful, they are neither effective nor optimal in counteracting the negative consequences of capital mobility. He notes that the magnitudes of private capital flows have become so huge that for most developing countries it is difficult to withstand their disrupting influence without an appropriate multilateral mechanism. Akyüz surveys the recent experience and points out the inadequacy of various IMF initiatives, which were mostly focused on repayment to creditors rather than on recovering employment and output of borrowing countries. He thinks that IMF should focus on lending for current account financing only, leaving resolution of capital account crises to the governments and financial institutions of major countries that host the creditors and investors.

Insurance as a way to overcome economic insecurity of the poor in developing countries

Considering the problem of economic insecurity of the poor of developing countries, Clarke and Dercon (in Chapter 4) ask how insurance can be delivered to the poor more effectively. They begin by documenting substantial risks faced by poor households in developing countries. In this regard, they contrast the “traditional, asset-focused view” of poverty that neglects risk, and the “vulnerability view” that puts emphasis on risk. Clarke and Dercon note that in recent years the “asset-focused view” has gained prominence, as evidenced by the

proliferation of “microcredit” programs. They however argue for a combination of both asset creation and risk reduction and coping.

Clarke and Dercon note the inherent difficulties with insurance programs meant for the poor, including difficulties arising from information asymmetries, high transaction costs, weak enforcement, and so on. They survey the experience of insurance programs offered so far for the poor, illustrating the difficulties earlier, and note their lack of success as compared to that of microcredit programs.

Clarke and Dercon take note of microcredit’s insurance role too, but view this role to be applicable mostly for small shocks, leaving for insurance programs the important role of dealing with large and catastrophic shocks. The authors reach a similar conclusion with regard to informal mechanisms. They however argue that in developing formal insurance programs, it is important to take note of the complex interconnections among formal insurance programs, microcredit programs, and informal insurance mechanisms. Clarke and Dercon recommend using the synergies among these different types of programs and mechanisms, while avoiding the negative effects of one on the other. They also discuss the interrelationships between insurance programs and safety-net programs, pointing out their specific attributes, and argue for the use of both.

Potential and limitations of microinsurance programs

While Clarke and Dercon use mostly theoretical and conceptual arguments to discuss the general relationship of insurance programs with other poverty alleviation programs, Mosley provides (in Chapter 5) empirical details about existing microinsurance programs, assesses their impact, and suggests ways of overcoming the difficulties they face in further expansion.

Like Clarke and Dercon, Mosley too notes the vast unmet demand for insurance, particularly among poor females. He thinks that previous attempts at providing insurance to the poor failed because of inappropriate configuration of the supply. He thinks that the current wave of microinsurance programs is faring better, though they have been limited so far mostly to risks to health and life and not expanded that much to weather-related risks and risks to assets.

Mosley presents positive evidence of impact of the microinsurance schemes, though his sample is small. However, he emphasizes that the impact has been mediated largely through microinsurance’s spillover effects on both the clients

and other institutions dealing with the clients. For example, loan repayment rates appear to be better for those who subscribe to microinsurance.

Despite the progress, Mosley thinks that microinsurance programs now face a dilemma with regard to the direction to take in expanding further. In his view, one option is to put emphasis on financial viability and pay less attention to the needs of the poor. However, he thinks that it is possible for microinsurance to expand in a pro-poor way too, and he suggests various policies that can help to do so. Pointing to its positive externalities, Mosley also suggests that external agencies (though not the government itself) have to come forward to fill the gap in the private supply of insurance. He also notes that microcredit, microsavings, and other pro-poor programs can serve as “quasi-insurance” programs.

Microsavings as a way of overcoming economic insecurity

While Clarke, Dercon, and Mosley point to *potential* insurance role of microsavings schemes, Hulme, Moore, and Barrientos (in Chapter 6) focus on the actual realization of this role. They lament the fact that while much attention in recent decades has been devoted to microcredit, savings programs, despite their potentiality, have been neglected. In fact, the authors think that there has been a “historic shift” from thrift (savings), as the foundation of finance for the poor in the early twentieth century, to debt in the early twenty-first century. In their view, this shift has been the result, in part, of a misperception that the poor does not or cannot save. The authors refute this perception and show many different ways in which poor actually save and use their savings to both reduce and cope with risks.

Hulme, Moore, and Barrientos offer a quantification of microsavings programs worldwide, noting however the difficulties regarding data, classification, and so on. They highlight the fact that, despite the spread of microsavings programs so far, these remain confined mostly in the informal sector. In their view, an enormous demand from the poor for formal deposit (savings) services still remains unmet.

Hulme, Moore, and Barrientos also offer some quantification of the impact of microsavings programs. Based on data from three microfinance programs in India, Peru, and Zimbabwe, they conduct regression analysis to show that savings help the poor to smooth consumption, avoid debilitating disinvestment, and build up fixed assets.

The authors note that, unlike insurance programs, which focus on specific risks, savings can serve as “general purpose” insurance, allowing the poor to deal with a wide range of risks, and without requiring anybody else’s approval. However, the authors agree with Clarke and Dercon that microsavings may not be enough to deal with large, catastrophic risks. Hulme, Moore, and Barrientos therefore recommend that microsavings should be strongly promoted as an “essential element” of the strategy to overcome economic insecurity of the poor, complemented by other schemes that can address the large, catastrophic risks.

Making use of complementarities among various microfinance programs

Islam offers (in Chapter 7) a synthesis of the papers on microfinance, putting emphasis on the complementariness among various microfinance programs (credit, savings, and insurance). He draws a distinction between *episodic* insecurity suffered by people who are much above the poverty line and *chronic* insecurity suffered by people who are below or near the poverty line. He notes the vicious circle characterizing the “poverty–insecurity” relationship and identifies various links connecting insecurity with poverty. To clarify the historical context of the current microfinance efforts, Islam provides a brief review of the international poverty reduction efforts so far, noting the oscillation between *indirect* and *direct* approaches to poverty reduction. He also notices that poverty and insecurity reduction policies may be classified into *aggregate-growth*, *within-growth*, and *outside-growth* types, depending on their effect on economic growth.

Islam draws attention to the fact that the vast expansion and high repayment rates of microcredit provide *prima facie* support for the novel idea of collateral-free lending to the poor. The success of microcredit has prompted expansion of microinsurance and microsavings programs too, making it necessary to ensure that the different types of microfinance program benefited from possible complementarity among them. In this regard, Islam identifies three different ways in which the complementarity may work, namely *economies of scale* (e.g. sharing of overhead cost by different programs), *extensive combination* (e.g. making it possible to extend one type of microfinance program to clients of other types of microfinance programs), and *internalization* (e.g. making it easier for insurance holders to make loan repayments and vice versa). He suggests that awareness about these different ways of interaction can be helpful in further expansion of microfinance programs. However, echoing Clarke and Dercon, Islam also draws

attention to the possibility of negative spillover among various microfinance schemes (e.g. loan burden from participation in microcredit program may make it difficult to pay premiums on microinsurance program).

With regard to the overall impact of microfinance, Islam distinguishes between its “narrow financial impact” and the “broader impact.” He notes that countries with significant presence of microfinance (such as Bangladesh, Bolivia, Indonesia, etc.) are not the leaders in poverty and insecurity reduction. By contrast, East Asian countries had dramatic success in poverty reduction with little or no microfinance. This contrasting experience suggests that the poverty and insecurity reduction impact (or the narrow financial impact) of microfinance may not be of “first-order” importance. However, Islam holds out the hope and the possibility that microfinance may be more potent through its broader role in ensuring a more egalitarian initial distribution of endowment (including access and voice) that is necessary for the “takeoff” to an equitable growth process.

Ways to overcome economic insecurity caused by natural hazards

While the previous chapters focus on insecurity caused by *economic* reasons, Linnerooth-Bayer and Mechler focus their attention (in Chapter 8) on insecurity caused by *natural* hazards. They focus on developing countries, though allude considerably to the relevant developed country experience too.

The authors notice that during 1980–2004, over 95 percent of natural disaster deaths occurred in developing countries and their direct economic losses averaged \$54 billion per annum. They observe that disasters are under-prevented in developing countries and even in developed countries. Also, due to the covarying nature of the risk and greater problems of moral hazard and adverse selection, insurance against natural disasters prove to be more difficult than against other risks.

Linnerooth-Bayer and Mechler survey recent attempts to insure natural disaster risks in developing countries, distinguishing between insurance schemes devised for households and businesses, agricultural farms, and governments. Among microinsurance schemes, the authors identify several models, including “community-based model,” “full service model,” “provider model,” and “partner-agent model.” They highlight the novelty of insurance programs that do not try to indemnify actual losses and instead base themselves on objective, but indirect indexes (such as rainfall, average price of cattle in the district, etc.).

Linnerooth-Bayer and Mechler note that while many rich countries have developed national programs of insurance against natural disasters, similar programs are almost nonexistent in developing countries. The authors emphasize that for many small developing countries, natural disasters may prove to be *national* disasters. There is therefore a need for pooling risk across countries, involving either developed countries (e.g. via donor agencies) or fellow vulnerable developing countries. The Caribbean Catastrophe Risk Insurance Facility (CCRIF), directed against losses caused by hurricanes, is an example of the latter. Linnerooth-Bayer and Mechler conclude that, despite the difficulties, it is necessary to continue the effort to expand insurance coverage of natural disaster risks by pooling across hazards, regions, and nations and across private and public sectors, because insurance is a better way to cope with risk than depending on post-disaster donor aid.

Overall, the book offers a rich array of experiences of both developing and developed countries in dealing with economic insecurity arising from both economic and non-economic reasons. It subjects these experiences to deep analysis and brings out practical policy recommendations. Both the insights derived from the analysis and the policy recommendations drawn from them should be of much help in overcoming economic insecurity by making available the appropriate types and amounts of financing.