

Social Insurance and Access to Credit & Finance

POLS 335: Special Topics in PE

PE of Development

Winter 2015

Instructor:

Jennifer Noveck, Ph. D. Candidate



Agenda

1. Administrative / Housekeeping
 - a. Review on Discussion boards
 - b. Mid quarter evaluation / survey

2. Intro to Finance, Microcredit, Social Insurance

3. 3rd Group Presentation

4. Discussion



B&D (2010) Lending to the Poor

- The majority of the poor have no access to formal credit
 - With the exception of microcredit, which reaches about 200 million people
- Why are formal lending programs difficult to establish?

B&D (2010) Lending to the Poor

- Formal lending to the poor is difficult because
 - High default rates
 - Patronage
- The poor turn to informal credit markets
 - Lending rates are higher than deposit rates
 - Extremely high interest rates
 - 5% per day!
 - One study in Pakistan found 78.5% annually

B&D (2010) Lending to the Poor

- Informal lending puts individuals, families, and economies at risk
 - Extremely variability in interest rates within same economy
- Rich are more likely to have loans (and bigger loans), and they get lower interest rates
 - Credit limits set to be proportional to net worth

Why do the poor not have access?

- Villagers and rural people are in the periphery
 - Formal institutions do not reach them
 - Formal institutions also face
 - High fixed costs and variable costs
 - Interest rate ceilings (legal limits)
 - Unable to lend unless they treat it as a subsidy program
- Informal money lenders do not have these problems, so they can lend to the poor

B&D (2010) Informal Lenders

- Informal lenders can impose large penalties if person flees
 - Interest rates are very high (risk is high)
 - There are often multiple informal lenders
- People often use the same lender regardless
 - Costly to switch because the lender and borrower have a relationship (less information problems)
 - And switching might look bad to other lenders
 - But this may actually lead to the lender charging even higher interest rates

Why do people borrow?

- According to B&D (2010) they borrow to invest, not out of desperation
- The point of microfinance was to help mitigate some of these problems

The Case for Microfinance

- Initially, many argued
 - Poor have low access to credit
 - Reliable borrowers
 - Group lending helps alleviate repayment problems
 - Can lift people out of poverty by
 - Increasing earnings
 - New business creation
 - Investments in human capital

Discussion

- Can microcredit help people even if they do not use it to set up businesses?
- Does it have to lift people out of poverty to be useful?
- How can people pay back their loans if they do not use them to invest?

Social Insurance

- Insurance relates more broadly to issues of
 - Social welfare
 - Social spending / social insurance
 - Health insurance
 - Unemployment
 - Pensions
 - Education (all levels)
 - Public health (hospitals, nurses, etc)
 - Maternity leave, daycare
- These programs usually require redistribution



Topics covered up to this point

- The list is oddly similar
 - Nutrition
 - Health
 - Education
 - Gender & Family issues
- If these issues are tightly linked to development, social insurance is pretty damn important!

Will spending improve outcomes?

- Balducci et al (2008) find in an IMF report
 - Education spending has an immediate & lagged effect on education attainment (human capital)
 - Health spending has a contemporaneous spending on health capital (no lagged effect)
 - Poor governance reduces spending
 - Poor governance reduces growth by negatively impacting human capital and investment

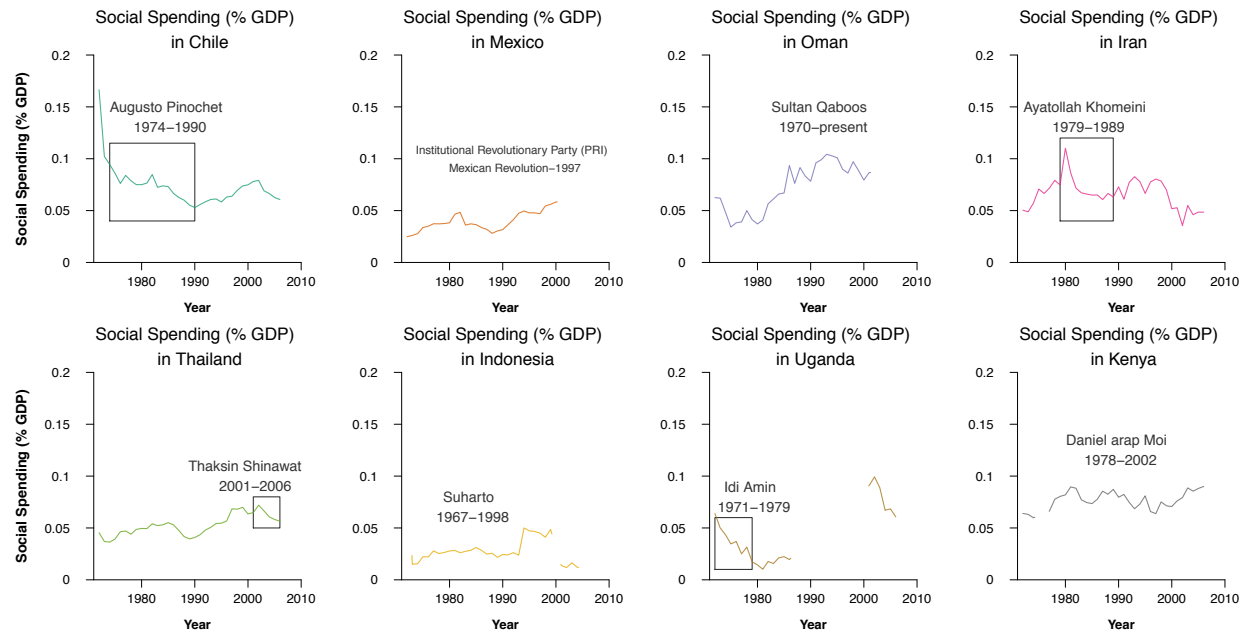
Anti Poverty Schemes

- World Bank found only 9 countries with NO anti poverty schemes (Economist 2015)
- Most have some income-contingent cash payments, subsidies for food or public-work schemes that offer low wages for labor
- No strings cash handouts
 - 37 countries in Africa in 2013 (21 in 2010)



Social Spending & Regime Type

**Social Spending (% GDP)
in eight non-democracies 1972–2010**



Problems with Gov Spending

- In developing countries, social safety nets that do exist are plagued with
 - Waste
 - Corruption
 - Fraud
 - Bad recording keeping
 - Targeted / selective spending to patrons
- But it is improving in some places

Types of Redistribution

- **Progressive** income tax
 - Those who make more, pay more
 - Those who make less, pay less
- Without income tax, govts resort to
 - Export taxes
 - Sales taxes
 - Luxury taxes (alcohol, cigarettes, etc)
 - Oil or natural resource revenue
 - Many of these forms are **regressive**

Ability to Tax & State Capacity

- State capacity is a prerequisite for a lot of political and economic activity
 - State's ability to define and defends its territory
 - Enforce laws within those boundaries, Demand obedience to its authority
 - Tax its population
- State capacity is defined as the power of the state to raise revenue, enforce contracts and regulate markets

Ability to Tax & State Capacity

- State capacity can be broken into parts
- According to Besley & Perrson (2012), there is fiscal capacity
 - The necessary infrastructure – in terms of administration, monitoring, and enforcement – to raise revenue from broad tax bases such as income and consumption

Ability to Tax & State Capacity

- And there is legal capacity
 - The necessary infrastructure – in terms of administration, monitoring, and enforcement – to raise private incomes by providing regulation and legal services such as the protection of property rights or the enforcement of contract rights

State Capacity & Its Outcomes

- Increasing state capacity can improve economic development and political stability
- Increase the protection of human rights
- Increase the provision of goods and services
- Improve property rights protection and contract enforcement

- **Importantly, it gives govts money to spend!**

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