Poverty

Lecture 3/1

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Poverty: conceptual issues

- A poverty line: a critical threshold of income, consumption, or access to goods and services below which individuals are declared to be poor.
  - A minimum level of 'acceptable' economic participation in a given society at a given point in time.

Concerns on poverty measurement:

- Overall expenditure or item-by-item consumption?
  - Look at actual, observed consumption basket or expenditure (overall income) falls below the minimum required/threshold
  - Elasticity may be high w.r.t. changes in income, but nutrient elasticities may not be correspondingly high.
  - Income represents the capacity to consume, not consumption

Concerns on poverty measurement

- Absolute or relative?
  - Absolute: independent of the contours of the society under consideration
  - Relative: evaluate relative to the prevailing socioeconomic standards
  - Poverty lines should share some common components, but vary from country to country
- Temporary or chronic?
  - People in a state of poverty often experience significant fluctuations in their income and consumption.
  - 'Temporary poverty' occurs when, because of bad economic shocks, people temporarily enter a poverty state.
  - 'Chronic poverty' is when they constantly stay in a poverty state for a long time.
  - Policies to deal with problems are also different.

Concerns on poverty measurement

- Households or individuals?
  - Often income and consumption data are available at household-level
  - Individuals: just do average?, but need adult equivalence scales to convert children's consumption as a fraction of a representative adult
  - what's about allocation of expenditures within the household >> intra-household
- Why a poverty line, anyway?
  - keep in mind: poverty is not a 'zero-one' concept

Poverty measures

- Poverty line, general definition: an expenditure threshold that is regarded as minimally necessary for 'adequate' participation in economic life. People below this threshold will be said to be poor.
- y – income/expenditure
- subscripts i, j – individuals
- p – poverty line
- m – mean income of the economy

- 'relative incidence': compared to the total population of the country or region under consideration

Poverty measures

- Head-count ratio
  - Head-count (HC): the number of individuals *i* such that $y_i < p$
  - Head-count ratio (HCR): HCR = HC/n

    n is the total population
  - Comments: fail to capture the extent to which individual income falls below the poverty line, lead to biased policy decisions toward individuals who are very close to the poverty line
  - Ignore ‘relative deprivation’ among the poor (inequality among the poor)

Poverty measures

- Poverty gap ratio (PGR)

$$PGR = [\Sigma_{yi < p}(p\text{-}y_i)]/nm$$

  - The ratio of the average of income needed to get all poor people to the poverty line, divided by the mean income of the society
  - a measure of resources required to eradicate the poverty
  - What if an economy is highly unequal but overall wealthy with a large number of poor people?

- Income gap ratio (IGR)

$$IGR = [\Sigma_{yi < p}(p\text{-}y_i)]/p\mathrm{HC}$$

  - Total shortfall of the poor from the poverty line, but also divide the shortfall by the total income required to bring all the poor people to the poverty line
  - Capture the acuteness of poverty

- PGR & IGR capture 'per capita intensity' of poverty

Characteristics of the poor

- Households with larger family size, high ratio of dependent members (often children)
  - The burden of poverty often falls on the young
- Live in rural areas
- Lack of ownership of productive assets (likely both directions)
- Most reside in the informal sector (self-employment: vendors, small traders, tea-stall owners, etc.), multiple occupations, lack of specialization
- Temporary migration to work, e.g., off-farming-season
- Few poor households have saving accounts
- High illiteracy rates, low education expenditure
- Undernutrition

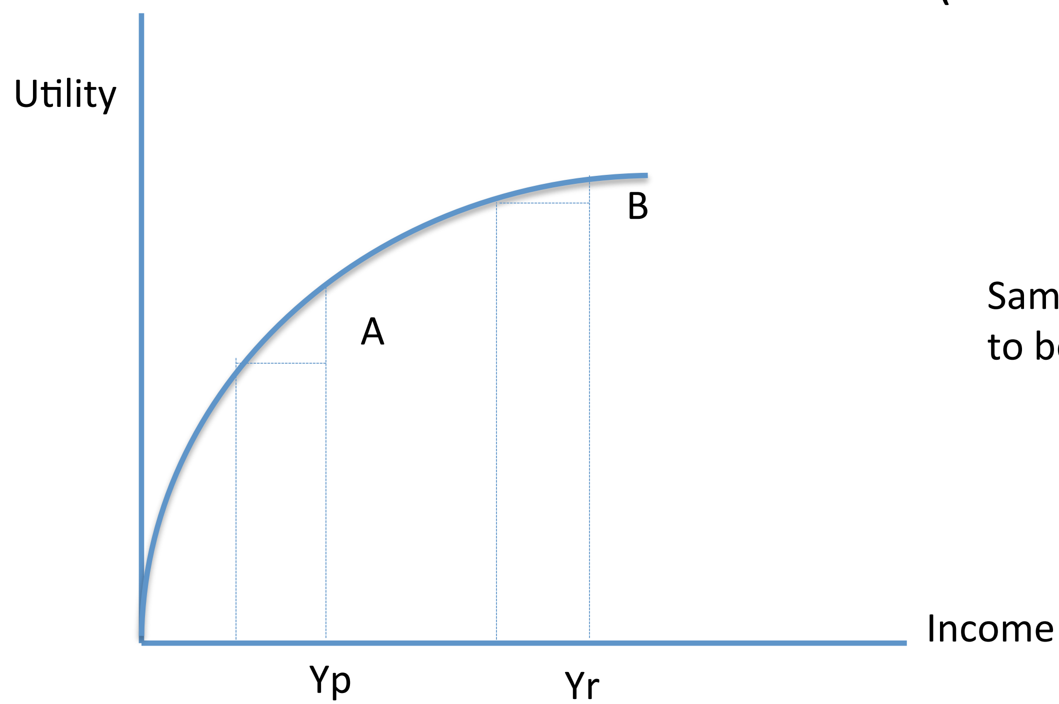
Poverty and nutrition

- Relationship between poverty and undernutrition in low-income countries
- Results: muscle wastage, stunting, underweight, increased susceptibility to illness and infection, low cognitive skill, lower capacity to do productive work
- But, the relationship between increases in income and increases in nutrition may or may not be strong.
- Look at elasticities: what is the percentage change in the consumption of calories when household budgets change by one percentage point?
  - 0.6-0.8 => individuals strongly adjust nutrition to income.
- Why don't the poor eat more?
  - Eating more might not help them much; lack of self-control (temptation to entertainment expenses)

Poverty, credit, and insurance

Market credit fails for the poor

- The poor lack collateral that can be put up for loan repayment
- The incentives to repay for the poor are limited, independent of their inability to put up collateral. Why?
  - Each additional unit of money means far more to a poor individual than to a rich individual (diminishing marginal utility)



Same amount of loan L to be repaid

Poverty, credit, and insurance

Market credit fails for the poor

- Can it be the other way around? the costs of default for the poor might be higher since they have more to lose from nonrepayment >> lacking of future access to credit
- Delay in repayment for loans
- High interest rates seem to occur as a result of high costs of contract enforcement
- Loan amount tend to be small for the poor. The profits from the transaction may not large enough to cover the cost of monitoring/screening >> lenders are reluctant to lend to the poor

Poverty, credit, and insurance

Insurance

- What's insurance?
- What's needed for successful insurance?
  - The incident must be verifiable

    crop revenue?
  - Whatever insuring against is not subject to moral hazard

    Many incidents you want to insure against have the probability of occurrence influenced by your actions >> no complete (perfect) insurance = some deductibles

Poverty, credit, and insurance

Insurance

- Formal insurance schemes are relatively rare in developing countries
- These are replaced by informal schemes at the level of the village community
  - Village members have access to better information, and therefor can self-insure as a group
- The moral hazard problems are likely to be smaller for the poor
  - The opportunity cost of labor for the poor is lower than that of richer people.
  - This feature permits them to credibly supply more effort to the task without a need for a large deductible in the degree of insurance they receive.