

Poverty

Lecture 3/2

EE461 – 2/2013

Chayanee Chawanote

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

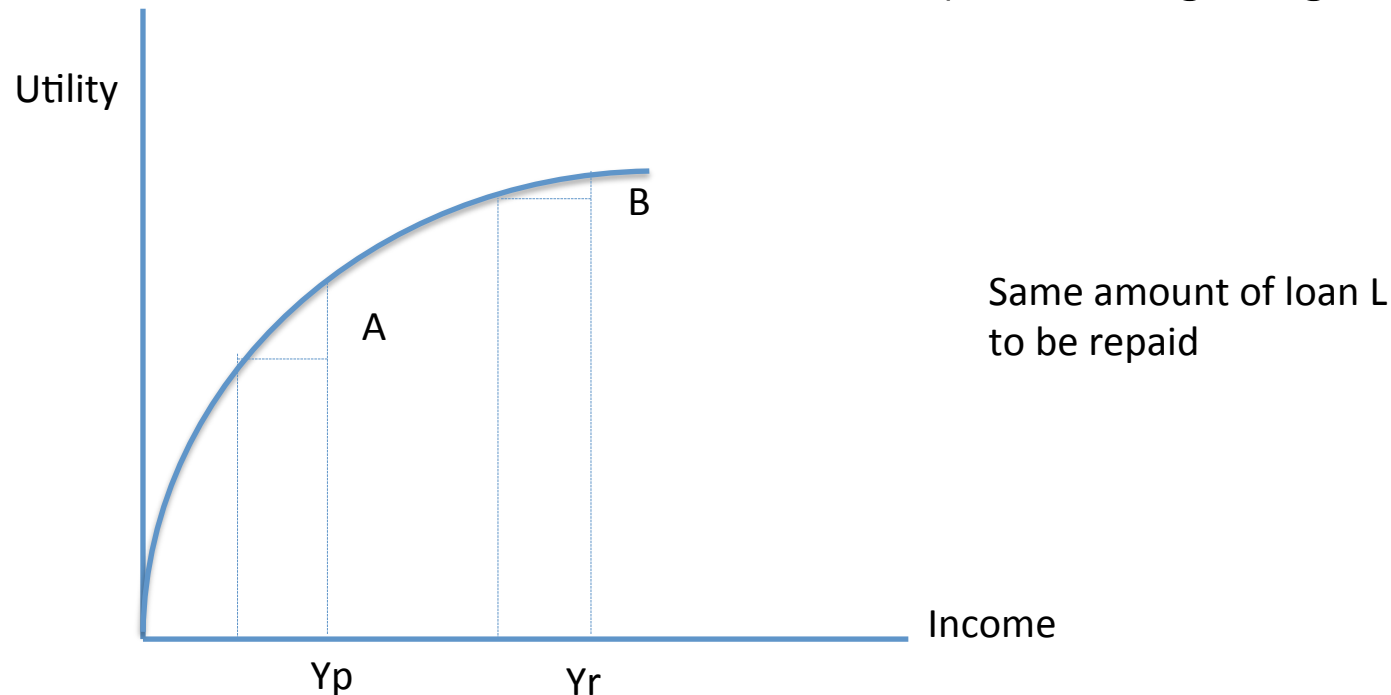
Poverty and nutrition

- 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)



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 therefore 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.