

Poverty I

9/30/2008

Today's Agenda

1. Inequality & Human Capital
2. Poverty: Conceptual Issues
3. Measuring Poverty
4. Empirical Observations
5. Functional Impacts of Poverty
 - A. Credit
 - B. Insurance

2. Poverty: Conceptual Issues

- Stark fact: world has generated significant growth in average incomes, but poverty is still major concerns
- As in the case with inequality, poverty has intrinsic and functional significance.
- Poverty line: minimal level of “acceptable” economic participation in a given society at a given point in time
- What determines the poverty line—nutrition? Mean income of country? Minimum wage?
- Fundamental questions surrounding poverty measurement
 - i. Overall expenditure or consumption basket?
 - ii. Absolute or relative?
 - iii. Temporary or chronic?
 - iv. Households or individuals?
 - v. Is a sharp line realistic?

3. Poverty Measures

- Assume we establish a poverty line, how do we measure incidence of poverty?
 - i. Headcount (HC): number of people below the poverty line
 - ii. Headcount ratio (HCR): relative incidence of povertyProblem: What about the “extent” of poverty? Example—

- iii. Poverty gap ratio (PGR): ratio of the average of extra consumption needed to get all poor people to the poverty line, divided by income of society.

Problem: in a highly unequal but overall wealthy society—large denominator makes PGR look small but a lot people still poor

- iv. Income gap ratio (IGR): ratio of the average of extra consumption needed to get all poor people to the poverty line, divided by total income needed to make poverty go away.
 - Pros and cons to previous headcount measures?
 - Example (in Excel).
 - Still not accounting for relative deprivation. More sophisticated measures developed to account for various aspects of poverty

4. Poverty: Empirical Observation

- Demographic features: Poor households tend to be larger
- Rural vs. urban
- Assets
- Nutrition

5. Functional Impact of Poverty

- Now we want to look at mechanisms that drive creation of poverty
- Mechanisms allow us to examine impact of poverty on overall economy as well as creation of policies to eradicate poverty
- Fundamental feature: poverty affects access of the poor to markets, and this change in access has repercussions for entire economy.

A. Credit

- Why does credit market fail for the poor?
 - i. Poor lack collateral to assure lender against involuntary and intentional default
 - Informal credit sources can step in to fill gap by accepting collateral in forms formal sector will not e.g. labor. But this is increasingly difficult in mobile economy.
 - ii. Incentives to repay for poor are limited (even independent of collateral)
- Illustration:

B. Insurance

- Why do people insure?
- Two ingredients for successful insurance: verifiability and absence of moral hazard.
- Formal insurance mechanism in developing countries relatively rare
- But informal mechanism may work well in some cases

Next time: Rest of chapter 8

