Prof. Abhijit Banerjee
Talks on

Breaking Out Of The Poverty Trap

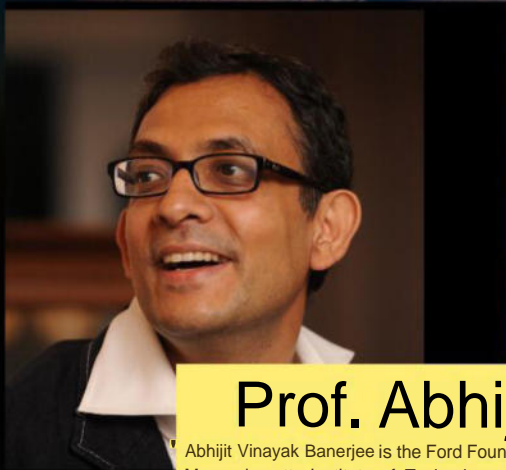PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS

Pakistan Institute of Development Economics

A talk with a Nobel Laureate on

Breaking Out of the Poverty Trap

Prof. Abhijit V. Banerjee

Abhijit Vinayak Banerjee is the Ford Foundation International Professor of Economics at the Massachusetts Institute of Technology. In 2003 he co-founded the Abdul Latif Jameel Poverty Action Lab (J-PAL) with Esther Duflo and Sendhil Mullainathan, and he remains one of the Lab's Directors. He has been a Guggenheim Fellow, an Alfred P. Sloan Fellow and a winner of the Infosys Prize. He is also a co-recipient of the 2019 Sveriges Rlksbank Prize in Economic Sciences in Memory of Alfred Nobel for his groundbreaking work in development economics research.

Banerjee is the author of a large number of articles and four books, including Poor Economics, which won the Goldman Sachs Business Book of the Year, and Good Economics for Hard Times, both co authored with Esther Duflo. Banerjee has served on the U.N. Secretary-General's High-level Panel of Eminent Persons on the Post-2015 Development Agenda.

Moderator
Dr. Nadeem ul Haque
VC, PIDE

January 12, 2021
7:00 PM PST

Introduction

Abhijit Banerjee is an Indian-American Economist and a Professor at the Massachusetts Institute of Technology. Banerjee shared the 2019 Nobel Memorial Prize in Economic Sciences with Esther Duflo and Michael Kremer "for their experimental approach to alleviating global poverty". They often worked with each other, focused on relatively small and specific problems that contributed to poverty, and identified the best solutions through carefully designed field experiments, which they conducted in several low- and middle-income countries for more than two decades. They show why the poor people, regardless of having similar desires and capacities as any other individual, end up with completely different lives. Their preferred policies entail small reforms which are based firmly on the belief that the path forward is not better by 'big thinking' but thinking small. Improving the quality of lives of the poor measurably and consistently is primarily a matter of making a series of small changes that don't require major political battles or adjustments within the funding structures.

PIDE has consistently worked on research projects related to poverty. PIDE has investigated the opportunities for the poor people, Rural Poverty Dynamics in Pakistan, and reducing poverty through Microfinance. Recently, PIDE invited Prof. Banerjee to gain his perspective on poverty in Pakistan.

Overview

Prof. Banerjee put forward two distinct strands of thinking on poverty; the First view is, if we temporarily boost the poor then this boost will fade away. In other words, there is no permanent way to improve them. The second view is persistent on the fact that individuals are poor solely because they are born into poverty i.e. poverty is inherited across generations.

The Growth model (poverty trap)

It is most often defined as a mechanism of self-reinforcement which causes the persistence of poverty. The amount of money you have now determines what you consume, how much money you spend on food, schooling, ways to improve your career, and so on, which in turn affects your income in the future. The poverty trap is seen as an "S-shaped" curve: the poor are trapped below the diagonal line on the left side of the graph, where future income is smaller than current income, and it tends to decline over time. This is one interpretation of why social mobility for poor people is much lower than for their higher-income peers.
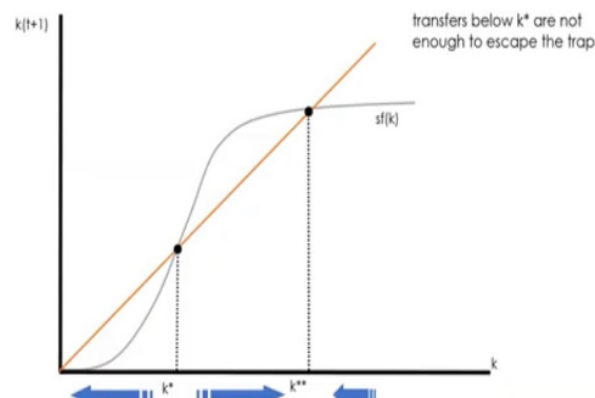
Nutrition based poverty trap

The basic idea is that the link between food intake and physical work capacity is non-linear, with increasing returns when one starts from a low consumption level. In this model poverty can be self-reinforcing since poor individuals are too malnourished to physically be able to do productive work, thereby not earning enough or producing enough food to alleviate this malnourishment.

Borrowing constraints and poverty traps

Banerjee and Newman (1993) and Galor and Zeira (1993) develop the idea of a poverty trap based on credit constraints. The intuition is that productive investments are lumpy, individuals then may choose between an activity that requires no fixed capital investment and entrepreneurial activity that requires a minimum outlay of capital. Individuals with low initial wealth who cannot borrow then begin in the subsistence production activity, while individuals with high initial wealth become entrepreneurs. Therefore, their productivity stays low and they remain poor.

Psychological poverty traps

For individuals to be able to grow out of poverty from a low initial level of capital, they need to continually save and re-invest. However, scarcity causes individuals in poverty to devote far more mental effort to meeting daily needs, leaving less attentional resources for other problems- such as perhaps thinking about how to grow their firm. As a result, poor people have no bandwidth to make long-term plans and good decisions which would gradually allow them to grow out of poverty.

Are poverty traps real?

Poverty traps can be understood as a set of self-reinforcing mechanisms whereby countries start poor and remain poor. While poverty traps appear rare, this does not mean they can never exist. It is important to know whether there is a poverty trap or not because a poverty trap leads to the prospect of a "big push" i.e. a one-time policy action could have big benefits. On the other hand, if we are in the case without the poverty trap, helping the poor in this way will simply be a form of redistribution of wealth, but it won't produce efficiency gains.

BRAC's Graduation program

Along with his fellow researchers, Mr. Banerjee in partnership with Bandhan conducted a randomized evaluation to test the impact of a comprehensive livelihoods program developed by Bangladeshi NGO BRAC ("the graduation approach") on the lives of the ultra-poor. To better understand the effects of these programs, they coordinated to conduct six randomized evaluations in Ethiopia, Ghana, Honduras, India, Pakistan, and Peru. The program consisted of five different components, each designed to address constraints faced by the poorest households. Results showed that the program caused broad and lasting economic impacts. Treatment group households consumed more, had more assets, and increased savings. The program likewise expanded basic entrepreneurial activities, which empowered the poor to work more evenly across the year.

Takeaways

- According to Dr. Nadeem Ul Haque, poor people tend to take more risks when compared to people belonging to an affluent background. The risk-taking tendency can be justified by implementing "cash transfer" on the impoverished community and scrutinizing their reaction. As several studies suggest, poor people indeed have a higher propensity for taking risks.
- Dr. Haque hypothesizes that over the past few decades, poverty has escalated in Pakistan. Prof. Banerjee juxtaposes this claim by putting forth an in-depth explanation regarding poverty. He claims that the fine line between perceived poverty and measured poverty is often blurred. While perceived poverty might suggest that poverty has increased in Pakistan, actual statistics prove otherwise. The reason why people tend to have such notions is the fact that their standards evolve drastically as years roll by.
- Prof. Banerjee also broadens his justification by suggesting that small amounts of money in the form of "cash transfers" have a negligible impact on the financial well-being of the destitute community. If the programs that offer these cash transfers truly intend to help the poor people, they should give them enough money to help them improve their financial stability in the long term.

Several questions were also raised in the Q/A session, such as

1: How does the distribution of assets such as land affect poverty alleviation regarding the land reforms in developing countries?
Prof. Banerjee answers this question by associating it with the concept of yeomen farmers and British Agrarian history. He claims that the British implemented those concepts in India by concentrating land distribution. This resulted in limited land being available for many people. He rationalizes his assertion by explaining that farming contributes to only 50 percent or less of the annual income of a farming household.

2: Micro-finance is considered a plausible way for people to escape the poverty trap. Do you agree with this statement or do you think countries need other interventions along with micro-finance?
According to Prof. Banerjee, micro-finance doesn't make the average borrower richer. Most of the micro-finance money is invested in household assets. This has been well-established due to several randomized control trials. However, for households who had a business before micro-finance, it does seem to have a long term effect. To conclude, micro-finance benefits people who are already able to manage the financial markets.

3: Before COVID-19 there was a lot of discursive and political debate on how China succeeded in eradicating poverty. Can you explain how RCTs provide an explanation of poverty alleviation in China?
A close look into China's policies proves that China is an experimental country. It tends to pass a policy and then collect the data during the time after the policy has been passed. If the data is in favor of the policy, it is pursued. A factor that has caused China to succeed is its willingness to give up on policies that fail, and move forward with generative policies.

4: Have the effects of life cycle events and other exogenous shocks been tested in the RCTs study?
Prof. Banerjee explains a study he initiated to investigate the effect of COVID-19. The region being investigated was Kenya. They studied how much the people were protected against the shock. It was revealed that only a limited amount was protected. According to Mr. Banerjee, this was because those people had invested in businesses. After COVID-19 shut the world down, they lost more income than the other people.

Conclusion

It is concluded from the above discussion that poor people find it increasingly tiring to ensure a better future for themselves and their families. It highlights the significance of a shift in our perspectives. We need to consider the repercussions of our actions on the poverty-stricken society. Poverty is not easy to escape. However, the slightest of help can have substantial consequences.

Prepared By

Ramla Zubair
Research Assistant, PIDE

Edited By

Hafsa Hina
Assistant Professor, PIDE

Designed By

Muhammad Ahsan Zeb
Graphic Designer, PIDE