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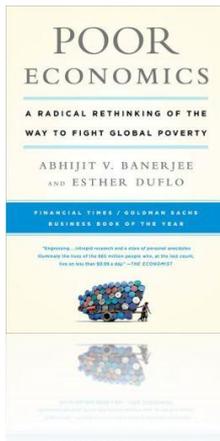
Book reviews on global economy and geopolitical readings

*ESADEgeo, under the supervision of Professor Javier Solana
and Professor Javier Santiso.*



Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty

Banerjee, Abhijit V. and Duflo, Esther, (2012), Public Affairs, New York.



“We must arm ourselves with patience and wisdom and listen to the poor, what they want. This is the best way to avoid the trap of ignorance, ideology and inertia on our side.”

“It is very helpful to think in terms of concrete problems which can have specific answers, rather than foreign assistance in general: “aid” rather than “Aid”.”

“Finding ways to finance medium-scale enterprises is the next big challenge for finance in developing countries.”

“Careful understanding of the motivations and the constraints of everyone can lead to policies and institutions that are better designed, and less likely to be perverted by corruption.”

Summary

In *Poor Economics*, Duflo and Banerjee radically review development policies and the tools traditionally used to fight poverty. They advocate listening to the poor and analysing the habits and ways of thinking of the 865 million people in the world who live on less than a dollar a day. The war on want is the world’s biggest problem and needs to be fought step by step, with each advance being carefully planned and executed, only taking measures once their impact has been weighed in the field. This requires patience and humility instead of the overly general questions often posed by other economists, such as “How should we fight poverty?”

In their analysis on this vast sector of the population, the authors travelled the world over the last 15 years to cull information directly from the poor. In the process, they uncovered many prejudices and misconceptions held by economists, politicians and activists. This book makes it much easier for readers to grasp the true nature of poverty. The harsh truth is that while poverty is often debated, we know very little about the poor themselves. Duflo and Banerjee tackle apparent paradoxes head-on, asking questions such as: Why it is that despite micro-credits, the businesses run by the poor fail to grow? Why do the poor spend so much on expensive health treatment instead of on cheap disease prevention? Why are increases in income not reflected in better nutrition? Many of the answers reside in the latent lack of information and the heavy responsibility carried by this layer of the population.

Despite the sheer size of the problem, the authors remain optimistic and opine that while national institutions are responsible for their citizens' development, one does not have to wait for a major revolution to change the situation. Rather, the authors advocate a succession of 'mini-revolutions': policies at the local level which can help to overcome what Banerjee and Duflo consider to be the three biggest hurdles in the fight against poverty: Ignorance, Ideology, and Inertia.

The authors

Abhijit V. Banerjee studied at the University of Calcutta, Jawaharlal Nehru University and Harvard University. He is currently Ford Foundation International Professor of Economics at the Massachusetts Institute of Technology (MIT). Banerjee has been awarded numerous prizes, such as Infosys in 2009, and worked as an advisor to The World Bank and the Indian Government.

Esther Duflo studied at the *École Normale Supérieure de Paris* and at MIT. She is Director of the Abdul Latif Jameel Poverty Action Lab (J-PAL), and Professor of Poverty Alleviation and Development Economics at MIT. She has received many awards, including: the John Bates Clark Medal in 2010 for the best economist under 40 and a Mac Arthur "genius" scholarship in 2009. She has featured in *The Economist* as one of the world's top eight young economists, in *Foreign Policy* as one of the 100 most influential thinkers, and in *Fortune* 2010 as one of the 40 most influential leaders under 40.

Key ideas and opinion

The authors split their book into two parts. The first covers the poor themselves and the second the mechanisms used to alleviate poverty. This scheme helps the reader grasp: (1) how the poor think about their circumstances and act; (2) the shortcomings of many of the plans for improving the lot of the poor. **Many strategies neither take account of individual and community circumstances nor of their worries and wishes concerning the future.** Throughout the book the authors insist on the need to **focus on details** to understand the situation truly faced by the poor instead of the situation as we see it from within rich nations. The best-meant policies can all too easily fail through ignorance of the situation on the ground.

Duflo and Banerjee's opus is based on extensive field work, personal interviews and community experiments. The authors also explain **paradoxes such as why a rise in living standards is not reflected in better nutrition and how businesses often fail to grow despite micro-credits.** Many of the mistakes made when grappling with these issues have given rise to a false, superficial image of the poor. As Duflo and Banerjee

point out, the biggest hurdles to the war on poverty are the “three Is”: Ignorance, Ideology, and Inertia.

Individuals

The first part of the book is based on wide-ranging field work and analyses **those living in poverty — that is to say, people living on less than a dollar a day**. The authors split the discussion into four problems on which poverty alleviation strategies tend to focus: (1) Hunger; (2) Health; (3) Education; (4) Population control.

Hunger

When we speak of poverty, we immediately think of the hungry, and the unfulfilled basic need which locks them into a spiral they are unable to exit from. It has been shown that child hunger reduces the productivity of adults and that malnutrition in pregnant women has grim consequences for child development. **If nutrition is so important, why does an increase in income does not lead to a better diet?** The poor do have options, and the authors find that they choose not to spend all they can on food. Given a bit of extra money, the poor tend to buy something that tastes better rather than something that is more nutritious: more expensive calories, but not necessarily more nutritious ones.

As Duflo and Banerjee note, **the idea that poverty stems from hunger must be obliterated**. Except in extreme circumstances, calories are cheap and most people can afford it. Indeed, in India, the percentage of the population stating they did not have enough to eat fell from 17% in 1983 to 2% in 2004. **Misinformation regarding nutrition and distrust of foreign advice on diet** are determining factors here. The poor often spurn the plans laid for them because: (1) they do not believe such schemes will work and (2) they have more important things to worry about than food. **The hunger issue is not so much a question of quantity as of quality** and the most vulnerable groups are fetuses and babies. The solution is not to send more grains (which is what most aid programmes do). Money does not help either — at least in the long-term. However, **a society that invests in raising nutrition standards for children and pregnant women reaps enormous benefits**.

Health

Each year, some nine million children under the age of five die from curable illnesses and diseases such as dysentery and malaria. Why is it then that the poor do not vaccinate their children, treat their parasites and so forth? Why do they spend much more on expensive cures than on cheap preventative care? **It is not that the poor care any less for their kids' health, but rather that they lack information**. It is this that leads them to spend a fortune on unnecessary antibiotics and surgery. Investment in anti-malaria campaigns and on drinking water projects gets excellent results but the

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problem is the lack of demand for such aid. That is because the resources are often not available where they are most needed or because the potential beneficiaries either do not know how to take full advantage of such programmes or do not want them.

Duflo and Banerjee stress throughout their book that the poor are neither stupid nor feckless. Rather, the **severe stress the poor suffer from makes them distrust others and renders them incapable of fully analysing their options**. One of the reasons for this distrust is the poor quality of preventative health care provided by public bodies. Furthermore, unschooled beneficiaries find it hard to understand medical advice. **The main purpose of health policies should therefore be to facilitate access to preventative health care for the poor and to regulate the quality of treatment**. In addition, these prevention services should be provided free and medicines should be both affordable and tightly controlled.

Education

Schools have proliferated in poor countries over the last few decades. However, this has not led to better standards of education given high student and teacher absenteeism. Most policymakers tend to think in terms of getting children into the classroom and making sure the teachers are well-trained. They naively think that one only needs to build a school and that the rest will follow automatically. The idea is a charming one but is hopelessly unrealistic. It has been shown that many other factors affect the success or failure of education schemes. Lack of demand, not of supply, is what needs fixing.

Parents do not see the advantages of a good education for their children even though it is highly effective in alleviating poverty. The problem is that it is **seen as a present cost with uncertain future benefits**. Other hurdles are: (1) discrimination in the family (where only the chosen child is sent to school while the other children stay at home) and (2) teachers who focus only on the more advanced students and leave the rest to flounder. Schools are falling down on the job because teachers lack incentives and parents have woefully low expectations. The authors argue **that the remedy is for schools to teach all their charges, not just the ones they want to**. Only thus can one hope to create equal opportunities for all.

Family

Population control policies have focused on contraceptives but the authors found evidence that these have little impact. **There are myriad reasons why the poor have many children**, including: (1) the economic dynamics of the family, which influence decisions on how many children to have and how to treat them; (2) discrimination against women (which is rampant in poor families), which means the decision to have children is often taken by men. Women, for example, are often pressured by their

husbands to have children, given that men see children as a good investment for the future.

Another mistake economists make is to treat the family as a unit rather than as a complex web whose interactions are hard to foresee. **Knowing how families work is vital if policies are to be effectively implemented.** For example, it has been shown that enhancing women's roles in the family leads to much better use of resources. The best population control policy would be to use **effective social networks** that would render it unnecessary to spawn a host of children to support parents later on.

Institutions

Insurance for the poor

In the second half of the book, Duflo and Banerjee analyse the institutional framework that the poor can call upon to escape the poverty trap. Risk is a key term in their conclusions. **The poor face very high business risks** — their livelihoods are affected by the weather, sickness and corruption — against which they are defenceless. The problem is that there are no formal insurance policies for the poor that they can draw on when disaster hits. Today's available alternatives lie in community-based mutual aid. Yet fear of losing everything means that farmers are risk-averse. They manage their fields very conservatively, do not buy much-needed fertilisers, and do not produce to their full capacity.

Despite these problems, **the poor are lukewarm about taking out insurance given the high premiums and/or because they do not grasp the idea behind it.** The idea of paying in advance to cover an eventuality that may never arise raises suspicion that the company is just trying to rip farmers off. Yet there is evidence that were the government to pay part of the insurance, premiums would drop and the poor would be more willing to sign on the dotted line. This in turn would help the insurance market take off and benefit all concerned.

The micro-credit miracle

Micro-credits have become the most effective measure in the fight against poverty, helping the poor get loans at lower interest rates and thus making it easier for them to fund their businesses and improve their lot. This system has proven successful where governments have failed. Despite its significant contributions, the authors warn that **micro-credits are far from being a magic wand** capable of changing destinies..

One of the limitations of micro-credits is the policy of 'zero default', entailing in-depth background checks to make sure borrowers can pay back loans. As a result, many people use local loan sharks instead, although they charge much more and are much more uncertain. The policy also puts off businessmen who need to take risks to

make their businesses grow. Mid-sized enterprises remain credit-less, as the loans they require are too small for banks and too big for micro-credits. **The challenge here is to set up a large-scale lending system for SMEs** so that such businesses are not starved of capital and can aim for true growth.

Saving for the future, brick by brick

The poor save, even though they find it hard to do so: firstly, they do not have much to save, and secondly, **banks are not interested in their savings, because of the high administration costs relative to the tiny accounts.** For obvious reasons, it is unsafe to keep the money at home. Furthermore, the poor — like the rich — are tempted to spend their money on life's little luxuries rather than saving for the future. Alas, there is little to stop them succumbing to temptation by facilitating saving, and thus no incentive to hoard money. The only alternative is simple but risky investments such as buying bricks for the day when they can add a room to their slowly-built houses, which always seem under construction. In the absence of a bank account, this is the only way of putting something by.

Optimism and hope can make a world of difference for those who believe in opportunities and are prone to save. By contrast, those who believe they have nothing to lose spend every penny they earn. **Micro-savers may therefore lead a revolution in the micro-credit field,** opening up prospects for the poor and giving them a brighter future. This might free them from the paralysing stress that often makes them spend their money instead of saving it. Hope and a few creature comforts could work wonders.

Unwilling entrepreneurs

There are billions of poor people in the world with their own businesses. This figure is often cited as an example of entrepreneurial spirit but, according to Duflo and Banerjee, it is largely an illusion. **Most of the poor have a business simply because they lack alternatives.** Furthermore, their businesses are tiny — often just a small patch of land on which they grow vegetables or a small stall selling a limited range of products. In this respect, micro-credits have helped business but done little for people's welfare. Their small schemes grind on and there comes a point where they need an injection of capital to make the business grow —something that the banks are unwilling to stump up. This is why many limit how much effort they invest in their businesses: they know their efforts will not bring riches. The truth of the matter is that a poor family's dream is to get a child into the civil service, not to set up a business. The solution lies in (1) creating a better job network (and hence more stable incomes) and (2) fostering an interest in schooling children for a better future.



Worthwhile policies in corrupt systems

There is a general belief that public policies cannot alleviate poverty in countries plagued by corrupt political and economic institutions. Many think change from outside would set things straight, or hope for a home-grown revolution. However, in many cases this is a utopian wish. Duflo and Banerjee's wide-ranging research reveals that ignorance, ideology and inertia are the main obstacles to progress — particularly in nations with backward political systems.

The authors firmly believe that one can fight corruption through pinpointed local measures, without having to change the system in one fell swoop. **Small local changes add up and this holds true even in bad institutional environments. Acting locally is the way to go.** The phenomenon can be seen in China, where local elections have improved life for the poor despite remaining under tight central government control. Yet another promising avenue is to boost the number of women occupying public positions in Indian villages, which has been proven to foster greater acceptance of female leaders.