*Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty*, by Abhijit Banerjee and Esther Duflo. PublicAffairs, 2011

Review for *Feminist Economics*

Nora Lustig

Department of Economics

Tulane University

September 2012

*Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty* is a gripping book about the very rich economics that emerges from understanding the economic lives of the poor. Firmly grounded in microeconomic theory and rigorous hypothesis testing, the underlying purpose of the book is to show how randomized control trials (RCTs) are both feasible and very useful tools for testing whether specific interventions work to improve the lives of the poor – and why they do.

In contrast to other existing books on poverty, *Poor Economics* does not try to answer "big questions" such as what the ultimate cause of poverty is or whether foreign aid works for the poor. Instead, Abhijit Banerjee and Esther Duflo tackle specific questions and do it with a razor-sharp approach: In which specific instances does aid work? Why do poor people consume insufficient and lower quality food even when they can afford better? Why do poor people not adopt inexpensive health-improving habits? Are poor people less educated because they live in areas where there are no schools or because parents choose to not send their children to school? How can changing some organizational characteristics make democracy more effective for the poor? These are some examples of questions the authors take on. The book is divided into two main parts: "Private Lives" and "Institutions." The first part addresses the factors that perpetuate poverty at the household level. The second part focuses on the market failures that constrain the ability of the poor to borrow, insure, and save.

One of the fundamental questions examined in the book is whether the poor are caught in poverty traps that make them likely to remain poor even over generations. At the household level, one typical poverty trap analyzed in the economic development literature is the nutrition-based poverty trap. The nutrition-based poverty trap is based on the hypothesis that poor people cannot afford to buy enough food to make them more productive and that because they are not productive enough their earnings are below what is needed to buy sufficient quantities of nutrients. This, in turn, creates a cycle of under-nourishment and poverty. Banerjee and Duflo demonstrate that – except in extraordinary circumstances – there is no evidence of a nutrition-based poverty trap: even the poorest households could potentially buy more food (especially more nutrients). However, a nutrition-based poverty trap does exist for the children of the poor. Children (including the unborn) do not participate in the consumption decisions of the family. If children are undernourished in the first years of their lives, their cognitive abilities and productivity may be impaired forever. They may therefore get caught in an intergenerational poverty trap.

Poor families could avoid children's malnutrition and many health-based poverty traps by investing in very inexpensive (or even free) actions: for example, consuming iodine during pregnancy, adding chlorine to water, vaccinating children, or using bed nets to prevent malaria. And yet, poor families frequently do not take these actions. Banerjee and Duflo are initially puzzled by this apparently irrational behavior. But they show that there are various explanations: poor parents may be imperfect decision-making agents for their children and may not make the right decisions for reasons other than affordability. "The poor seem to be trapped by the same kinds of problems that afflict the rest of us—lack of information, weak beliefs and procrastination among them" (p. 68).

Because of externalities (for example, spread of infectious diseases and education thresholds) and agency issues (for example, the fact that children do not decide what they eat), it is not only morally but also economically justified to invest in public resources that help the poor to overcome their conditions (even when the poor themselves "choose" not to do it). The book is full of examples of how RCTs shed light on the kinds of public interventions that work (or do not work) at the lowest cost.

One main message that emerges is the call to make it as easy as possible for the poor to improve nutrition, receive preventive healthcare, and keep their children in school. Interventions that might work include delivering preventive healthcare and education for free and even rewarding households for using these services (as conditional cash transfers do); setting up free chlorine dispensers next to water sources; rewarding parents for immunizing their children; distributing free deworming medicines and nutritional supplements to schoolchildren; and investing in water and sanitation infrastructure. Such interventions can have very, very high social (and private) returns. In Kenya, for example, deworming per child costs US$1.36 (in purchasing power parity or PPP) a year, while an additional year of deworming would lead to a lifetime income gain of US$3,269 (PPP).

At the level of institutions, access to subsidized forms of insurance can help the poor by replacing costly strategies –such as distressed sales of assets or borrowing at prohibitive interest rates--to mitigate the impact of adverse shocks and encouraging the use of more productive – but also more risky – technologies**.** Banerjee and Duflo argue that safety nets can encourage the poor to save. Microcredit can help small businesses to survive, and this is important because for millions of poor people in the world this may remain the only source of livelihood for the foreseeable future. Nevertheless, microcredit will not be the panacea that "pave[s] the way for a mass exit from poverty" (p. 234).

The book is very rich in analyzing the role of women and factors that affect women's education, health, access to markets and wealth, and empowerment. One type of study that is particularly relevant to feminist economics analyzes the use of contraceptives when the desired family size is different for women than for men. An RCT in Lusaka, Zambia showed that when women were given a voucher guaranteeing free and immediate access to contraception alone they were 23 percent more likely to visit a family-planning nurse than when the voucher was given in the presence of their husbands. Parental preferences for the gender of their children can also affect women's rights to birth and survival. *Poor Economics* presents evidence on how economic factors, such as parents having to pay a dowry or the potential inability of women to support them during old age because women do not control economic resources once they get married, affect preferences for the sex composition of children and how this may explain the "missing women" phenomenon first brought to notoriety by Amartya Sen in the 1980s.

Discrimination against women within the household by parents, spouses or others produces less efficient outcomes, but this does not stop discrimination from happening. For example, a study that uses panel data in rural Burkina Faso found that plots farmed by women were systematically allocated less fertilizer, less men's labor and less child labor than plots farmed by men. Had the resources been reallocated, families could have increased production by 6 percent without spending any additional amount on inputs. Yet, such a reallocation did not happen. As Banerjee and Duflo show through the studies they review in their book, understanding the dynamics of power between men and women within the household is found to be crucial not only for the sake of women but of children in poor households. Policies can help protect the most vulnerable members of a family (women, children, the elderly) from abuses perpetrated by the more dominant members.

In sum, Banerjee and Duflo suggest that poverty traps can exist but that their origin is not simply low incomes. Missing or incomplete markets, problems of agency, some social norms, and even some characteristics of normal human behavior can generate poverty traps. In this context one puzzle the book does not address is the following: If there is overwhelming evidence that in general the poor can afford to buy more nutrients and chlorine or that they do not immunize their children even when it is free, how can one explain the findings of an RCT in Malawi that showed unconditional cash transfers resulting in similar improvements in schooling as conditional cash transfers (CCT; where school attendance was a quid pro quo for receiving the transfer)? It seems odd that parents may be just as willing to invest in their children's education (that is, to do it without the "nudge" or push of conditions) but not spend smaller amounts on their children's nutrition and preventive health. This finding is even more odd in the context of the chapter on education (chapter 4) that shows the poor have low expectations regarding the benefits of education. If parents do not value much investing in their children's education, why are they willing to do it without the "nudge" of conditionality?

Here is where the limitations of RCTs become apparent. How much can results from specific RCTs be generalized? Before a reader concludes that the policy recommendation inspired by Malawi's RCT's result –even though Banerjee and Duflo do not make such a jump-- is that conditioning transfers on school attendance is unnecessary as a general rule, we need to understand the factors behind the puzzle outlined above. And we need to garner much more evidence – through RCTs or other methods – to conclude that conditions in cash transfers are redundant. RCTs have two important shortcomings as a method to gather evidence to illuminate policy: there is still too much we do not know about the actual mechanisms that make certain actions/results happen or not (the so-called "black box" problem). Second, because we may not know the mechanisms, we cannot be sure that what was found to work in India, Malawi, or

Mexico will work in Indonesia, Kenya, or Peru. This is what is known as the problem of "external validity." Critics sustain that there are other methods (full-scale panel studies, for example) that may shed more robust light. It would be useful for Banerjee and Duflo to acknowledge more forcefully the limitations of RCTs and what research strategy/methods should be used to address these limitations. Perhaps such a discussion can be added to the next edition of *Poor Economics,* which I am certain is soon to come.

In chapter 4, the authors argue that one of the reasons why parents "put all their educational eggs in the basket of the child they perceive to be the most promising" (p. 88) is parents' belief that the first years of education pay much less than the later ones (a more intelligent/motivated child is more likely to complete secondary school, for example). Banerjee and Duflo claim this belief is wrong: "available estimates show that each year of education increases earnings more or less proportionally" (p. 88). However, there is quite a bit of evidence that returns to education might be convex (see, for example, Francois Bourguignon, Francisco Ferreira, and Nora Lustig [2005]). So parents' beliefs are not necessarily wrong. The authors may want to revisit this section of the book in a future edition.

In the book jacket, *Poor Economics* is described as "a vital guide to policymakers, philanthropists, activists, and anyone else who cares about building a world without poverty." The intended audience is not the academic community but the educated public anywhere in the world interested in understanding and fighting poverty. However, *Poor Economics* can be an eye-opener for undergraduate students. Faculty may find it extremely useful for economics of gender and gender and development courses. (I myself have included it in an independent study on the Economics of Gender in Latin America). And it can be used as a companion to more technical texts in graduate level courses on development economics. Because the book is written in clear, nontechnical language and draws from anecdotal evidence, it is accessible and entertaining. Because the authors rely on powerful theoretical and empirical underpinnings (such as RTCs), take a multi-disciplinary perspective of human behavior, and are non-ideological in their frame of mind, the book is sophisticated, insightful, and – in contrast to polarized debates and "quick fixes" – refreshingly balanced and profound. Readers are likely to learn something new (a fact, a perspective, an intervention that works) at every step. More importantly, readers are likely to learn to ask difficult questions and become more demanding of what can be called "evidence" –including results from the Banerjee and Duflo's highly utilized RTC's--in a field that involves human behavior in vastly heterogeneous settings.

## REFERENCES

Bourguignon, Francois, Francisco Ferreira, and Nora Lustig. 2005. *The Microeconomics of Income Distribution Dynamics in East Asia and Latin America.* Washington, DC: Oxford University Press.