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Comment on Chapters 5 and 6

Stephen C. Smith

There has arguably become a recent imbalance in development economics, with the pendulum swinging too far away from theory; these two chapters may be seen as part of a trend toward rebalance between theory and empirics.

Comments on Chapter 5

Francisco J. Buera, Joseph P. Kaboski, and Yongseok Shin provide a useful targeted literature review set in context of a formal model. They offer some impressive innovations; in particular in the way they treat heterogeneity, and in making intriguing connections between micro programs and macro outcomes. Although highly stylized, the model has impressive properties, and its generality is one of its strengths. The model is compact and flexible enough to cleverly represent a range of recent empirics and theory, and its formulation provides for great tractability. The model is well deployed to guide intuition at various stages of the arguments. In particular, the authors provide an insightful way to model and study the role of productivity shocks, while allowing for relevant market failures with suitable model interpretation. Despite its flexibility, there are important limits to what the model can represent. However, it is unreasonable to expect one model to span the canon of trap analysis, even with respect to their more limited focus on microenterprise and programs to relax credit constraints.

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The literature review is a valuable overview of important papers on the impacts of microfinance interventions, particularly for those not working directly in that area. At the same time, if the authors are able to pursue the themes of this chapter in future research, an alternative framing and organization could provide different perspectives on what can be learned from the model. For example, it may be useful to pull the strands of the literature with a focus on examining commonalities across programmatic themes and specific components of the theory.

The empirical literature on this topic has grown rapidly, so it is necessary to be selective. Standards of evidence for what is to be included in the review are not set out explicitly. This is common in such reviews, but in my opinion it would be an improvement across the literature to state such standards as systematically as reasonably practical. Thus, readers will try to make inferences about what must have underpinned the selections. Most, though not all, papers in the review are based on randomized controlled trials (RCTs). Among RCTs, when they have not been included in the review, plausible criteria could be doubts about external validity or of insufficient study length for robust conclusions. Plausible criteria for when non-RCTs are included could include lack (to date) of availability of RCTs on an important topic, when impacts are not or cannot be well identified by RCTs, or results are similar to related RCT findings, among other things, lending credence to RCTs in which there are doubts about external validity or implementation issues. An explicit statement of standards of evidence may be considered particularly important when reviewing results on a topic for which the literature has not arrived at a consensus that is based on a decisive preponderance of evidence in a large number of studies.

It is worth stating again that the lack of clarity about why some papers are included and others not included extends to a wide range of literature reviews, whether full-fledged review articles or the customary brief reviews near the beginning of research articles. This point is not intended as a criticism of articles included or excluded. However, one strand that might be added concerns research on the impacts of microcredit into which has been integrated one or two additional programs or services that were viewed as having complementary roles, such as literacy training, business education, or maternal health care and education. These types of programs are otherwise relatively conventional (in particular, they provide no asset transfers) and are generally much narrower in their range of interventions than graduation programs (which do not necessarily involve provision of credit per se). Otherwise, this chapter is very impressive in the wide coverage of the research literature that it provides, with nearly fifty citations.

There are always limits to what can be covered in one chapter, but in future work it would be useful to know whether and how widely the model presented can span other relevant poverty trap concepts, including some covered in other parts of this volume. For example, the behavioral trap

literature and the literature on complementary traps (such as credit and health) highlight cases in which traps cannot in general be escaped with cash or assets alone. It would be helpful to know whether the general model could be recast to usefully represent at least some of those other cases examined elsewhere in this volume.

Moreover, it would be useful to explain more explicitly whether the cases addressed can be fully modeled with diminishing returns. Some microfinance literature emphasizes input complementarities and features the idea that there is likely to be a range of increasing returns even in a single, standard capital input. There may be some way to explicitly represent more of these cases using the general modeling framework, and it would be of interest to see how this can be addressed.

There are some other questions to consider regarding whether there is special significance to how the transfers are to be financed. At least part of the analysis assumes a transfer financed by a tax on the upper part of the income distribution: a one-time 100 percent tax on wealth above a threshold. Could an alternative revenue source have different effects in a model? For example, in practice, asset transfer programs are often financed through foreign aid. At scale this could have macrolevel effects, and it may be important to know whether these are likely to differ depending upon the method of financing. For example, could other models lead to smaller "dissipation" found in the empirics than in the formal model?

Last, regarding the lack of identified "dramatic" escapes from poverty traps: perhaps such escapes are rare, if not possible, but microfinance institutions and the microenterprises they help finance may represent "transitional institutions" as a necessary step to conventional jobs, and may thus facilitate later structural transformation. In any case, microenterprises—and some vehicle to provide credit to them—apparently will be needed for some time, where modern job growth is proceeding from a very low base.

Comments on Chapter 6

Munenobu Ikegami, Michael R. Carter, Christopher B. Barrett, and Sarah Janzen introduce several substantial points to this literature. First, they model high and low production activity in the presence of more than one type of trap, in particular dividing risk-driven and other poverty traps in a broad framework.

The authors provide a good framework for modeling heterogeneity—that generates their paradox—dividing ability into some types that are (treated as) immutable, and others that are improvable with appropriate interventions.

Their approach raises a possible benefit of triage across types of people who are "vulnerable" to falling into poverty as opposed to those who are already "poor." The vulnerable face a stochastic environment in which they

could fall into poverty deeply enough to drop to a worse equilibrium, losing a possible better equilibrium from their set of possible futures. This is addressed through a proposed form of subsidized insurance, in which payouts are based on the difference between preshock and postshock asset holdings. In the process, the authors frame the role of (safety net) insurance mechanisms in the asset-oriented poverty trap literature as a counterpoint to the programmatic approach based upon cash transfers.

The authors challenge cash transfers programs' reputation as a "silver bullet" for at least four reasons: Transfers may fail to lift beneficiaries out of poverty sustainably (recent empirics); relatedly, transfer programs may reduce incentives for the poor to accumulate assets (theory); transfers to the poor do not prevent "vulnerable" populations from falling below an asset threshold that results in chronic poverty; and, given a hard budget constraint for the poverty program, cash transfer programs may result in too-low benefits as the model evolves over time, or an "aid trap" as the total number of poor could grow.

An area for future work is to expand the way cash transfer programs are modeled. In the present chapter, transfers are characterized in ways that differ in some important respects to how many, if not most, such programs are implemented in practice. In particular, the transfer programs in the model provide cash unconditionally to those whose incomes are observed to fall below a poverty line. But many of the recently implemented large programs offer conditional cash transfers (CCTs), for which receipt depends upon behavioral requirements that, often intentionally, may be expected to lead to greater assets for the children of the household (i.e., for the next generation). Yet, this is an important distinction. The CCT programs require children to remain in school, get regular medical care and checkups, and take nutrition supplements when the checkups reveal deficiencies; schooling and childhood nutrition raise the children's productivity (after they grow up). The welfare comparisons may be altered if required behavioral change and consequent intergenerational dynamics are taken into account. Some evidence of the impact of CCT programs on outcomes such as enrollment is actually relatively strong. As the authors already note, a promising strategy in the context of their model is endogenizing α_j; and the impact on α_j could depend upon the type and extent of conditionality.

In addition, there may be distinct "third options" beyond asset insurance versus (conditional or unconditional) cash transfers, which could be at least as cost-effective. This is clearly outside the scope of the chapter, and this is raised only as a caveat to the approach. However, as an example, the most cost-effective solution to geographic poverty traps, such as may be found in mountainous China or semiarid areas in Africa, may be out-migration. Harsh as it may sound, if cost-effectiveness is a key criterion—as it is in this chapter—then using resources to subsidize migration of the poor to cities and facilitate their integration into urban job markets could turn out to be

the lowest-cost and most sustainable way to reduce income poverty. Even if this is not presently feasible, it could become so as structural transformation proceeds. In comparisons of even broadly defined and conceptual sets of antipoverty strategies—particularly those that emphasize triage options—we benefit from examining a full consideration of feasible options. This chapter provides an important building block toward that more complete structure.

The authors also innovate in the measurement literature with a proposed indicator of "unnecessary deprivation" of individuals who could be given a boost to "lift themselves out of poverty" through an insurance-based social protection policy. Their measure is analogous in structure to the FGT index, and is based on the difference between current income and the income associated with the model's optimal capital stock (conditional on "innate" skill endowment), absent credit constraints. The authors note this may have more conceptual than practical applied use because of the difficulty of estimating equilibrium capital (and thus potential permanent income), and ability is imperfectly observable. But one could consider developing imperfect, proxy-based estimates based on panel data studies, comparing those who did and did not break out of poverty over a long enough period of observation. Clearly, there will be a lot of noise, and the results will be very far from perfect—but perhaps the exercise would yield results that are much better than nothing.

In any case, the "unnecessary deprivation" measures would benefit from further examination of properties, including precisely what aggregation means, and clearer welfare interpretations. Properties do not transfer obviously from the FGT family of measures (or at least proofs are required). For example, Sen's focus principle does not apply; accordingly, what is called deprivation is not the same concept as income gaps in conventionally accepted poverty measures. If not defined carefully, the measure could give a nonzero value even when current deprived income—and equilibrium income—were both above an income poverty line (although this does not appear to be a concern in the authors' application.) Finally, even if a large part of skill endowment is indeed innate, optimal capital stock is in general a "moving target," as conditions in the local economy including prices and asset productivity evolve over time even in relatively stagnant regions such as northern Kenya (as Kwak and Smith find for Ethiopia).

On welfare comparisons: for those chronically trapped in poverty, it will be useful to show how welfare comparisons in the "triage" may change if they are calculated conforming to the distributional sensitivity principle (and consistent with marginal utility of income increasing as poverty becomes deeper), which can be accomplished by basing calculations on FGT P_2 (poverty severity), rather than just FGT P_1 (poverty depth). But even placing greater welfare weight on poorer people, it may still create more benefits to focus limited resources on observationally better-off people; it

is a substantial contribution to show how this protection trade-off can be analyzed rigorously.

Finally, as we move toward fully addressing the zero-poverty goal of the sustainable development goals, as also embraced by the World Bank, USAID, and other key development agencies, there is likely to be an enhanced focus on preventing people from falling into poverty. At least from a poverty head count or income shortfall perspective, ultimately we may view this as equally important to pulling people out of poverty.

In conclusion, both sets of authors have made innovative and stimulating contributions that deserve broad attention and could lead to useful strands in the poverty literature.