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Poor Economics

A Radical Rethinking of the
Way to Fight Global Poverty

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everything she ever hoped for, it would not change her life in any meaningful way. Given that her business is destined to remain small and never make much money, she may decide to devote her attention and her resources to other things.

In the same way that the poor may save less than the middle class because they know that their savings will not be enough to reach a consumption goal they are really looking forward to, they may not invest as much (not only money but also emotions and intellectual energy) in their businesses because they already know that they can't make a real difference. This may explain the gulf between the outlook of Ben Sedan, the Moroccan farmer, and that of Fouad Abdelmoumni: Fouad may well be right that Ben Sedan hadn't thought about the possibility of raising cattle in a barn. Or he may have thought about it, but concluded that going through the whole process of getting a loan, building a whole new stable for just four cows, and eventually selling them wasn't worth it—after all, his family would still be quite poor. So in a sense they were both right: Fouad because his business model could work, and Ben Sedan because it was not worth his while to make it work.

The fact that most micro-entrepreneurs may not be fully committed to making every penny count may also explain the disappointing effects of the business training programs that many MFIs have now started proposing to their clients as an added service. At weekly meetings, clients are told about how to keep better accounts, manage their inventories, understand interest rates, and so forth. Programs of this kind were evaluated in studies in Peru and India.⁷ The research results in both countries found some improvement in business knowledge but no changes in profits, sales, or assets. These programs are motivated by a sense that these businesses are not particularly well run, but if the businesses are run that way because of a lack of enthusiasm rather than a lack of knowledge, it is not particularly surprising that the training does very little to help. In the Dominican Republic, another training program tried, alongside the regular training module, a simplified curriculum, suggesting the entrepreneurs focus on simple “rules of thumb” (such as keeping the business and household expenses separate, and paying oneself a fixed salary).⁸ Here again, the regular training was ineffective, but giving the entrepreneurs the simplified tips did lead to

an increase in profit. This is probably because people were willing to adopt these rules of thumb, and they actually simplified their lives, rather than demanding even more intellectual resources from them.

Taken together, this evidence makes us seriously doubt the idea that the average small business owner is a natural “entrepreneur,” in the way we generally understand the term, meaning someone whose business has the potential to grow and who is able to take risks, work hard, and keep trying to make it happen even in the face of multiple hardships. We are, of course, not saying that there are no genuine entrepreneurs among the poor—we have met many such people. But there are also many of them who run a business that is doomed to remain small and unprofitable.

Buying a Job

This naturally begs the question: Why do so many poor people run a business in the first place? We got an answer to this question from Pak Awan and his wife, a young couple from Cica Das, the slum in Bandung, Indonesia. They owned a small shop that they were running out of one room in his parents' house. Pak Awan worked as a casual construction laborer, but more often than not, he could not find employment. When we met the couple in summer 2008, Pak Awan had not had a job for two months. With two young children, the family needed some extra income, so his wife needed to find work. She would have liked a factory job, but she was not qualified: Factories wanted people who were young or unmarried or who had experience. She had no such experience, because after high school she studied to be a secretary, but she couldn't get through the tests that are required to get the jobs and eventually gave up on this career. Starting a small business was the only option they had. Her first venture was to cook snacks and sell them in the city, but she wanted something she could do from home, so she could mind the children. So they started a shop with a loan Pak Awan got from a cooperative he belonged to, even though there were already two other shops within 50 yards.

Pak Awan and his wife did not enjoy running the business. They were eligible for a second loan from the cooperative, which would

have allowed them to expand their shop, but had decided that they didn't want it. Unfortunately for them, a fourth shop opened in the neighborhood and threatened their livelihood by offering a more diverse array of goods, and when we met them, they were in the process of taking out a new loan to buy more stock. Their hope for their children was that they would each grow up to get a salaried job, preferably in a government office.

The enterprises of the poor often seem more a way to buy a job when a more conventional employment opportunity is not available than a reflection of a particular entrepreneurial urge. Many of the businesses are run because someone in the family has (or is believed to have) some time on hand and every little bit helps. This person is often a woman, and she typically does it in addition to her housework; indeed it is not clear that she always has much of a choice when the opportunity to start a business comes up. It is only recently that men in the West have learned to at least pay lip service to the many things that their wife who "does not work" does for them; it would not be astonishing if their developing-country counterparts ascribed more leisure to their spouses than they actually enjoy. It is entirely possible, therefore, that many business owners, and especially female business owners, do not particularly enjoy running a business, and indeed, dread the thought of expanding it. This may be why, when women business owners in Sri Lanka were offered \$250 nominally for investing in their business, many of them did something else with it, unlike the male business owners we encountered above who invested the money and got high returns from it.⁹ Perhaps the many businesses of the poor are less a testimony to their entrepreneurial spirit than a symptom of the dramatic failure of the economies in which they live to provide them with something better.

GOOD JOBS

We have started including the question "What are your ambitions for your children?" in surveys given to poor people around the world. The results are striking. Everywhere we have asked, the most common dream of the poor is that their children become government workers.

Among very poor households in Udaipur, for example, 34 percent of the parents would like to see their son become a government teacher and another 41 percent want him to have a nonteaching government job; 18 percent more want him to be a salaried employee in a private firm. For girls, 31 percent would like her to be a teacher, 31 percent would want her to have another kind of government job, and 19 percent want her to be a nurse. The poor don't see becoming an entrepreneur as something to aspire to.

The emphasis on government jobs, in particular, suggests a desire for stability, as these jobs tend to be very secure even when they are not very exciting. And in fact, stability of employment appears to be the one thing that distinguishes the middle classes from the poor. In our eighteen-country data set, middle-class people are much more likely to have jobs that pay them weekly or monthly, rather than daily, which is a crude way to separate temporary and more permanent jobs. In Pakistan, for example, in urban areas, 74 percent of those who are employed and who live on 99 cents or less per day work for a weekly or monthly wage, but 90 percent of those earning \$6 to \$10 a day do. In rural areas, 44 percent of the very poor who are employed work for a regular wage, and 64 percent of the middle class do.

The availability of secure jobs can have a transformational effect. In much of rural Udaipur District, most families live on less than \$2 a day. But we once visited one village that superficially appeared to be not unlike many other villages we visited in the area, yet was in fact quite different. Signs of relative prosperity were apparent: an iron roof, two motorcycles in a courtyard, a neatly combed teenager in a starched school uniform. It turned out that a zinc factory had been set up near the village and at least one person in every family we met in the village had worked in the factory. In one of the families, the father of the current head of the household (a man in his late fifties) somehow got a job in the factory kitchen and parlayed that into a job on the factory floor. His son was part of the first batch of (eight) boys from the village to complete high school. Then he, too, went to work in the zinc factory, where he retired as a foreman. Both of his own sons finished high school. One of them works in the same zinc factory; the other has a job in Ahmedabad, the capital of the neighboring state of Gujarat. He

also has two daughters, who completed high school before getting married. For this family, the fact that the zinc factory was established in this location was an initial stroke of good luck, which started a virtuous circle of human capital investment, and the progression up the employment ladder.

A study by Andrew Foster and Mark Rosenzweig shows that the role of factory employment in promoting wage growth in Indian villages goes beyond this particular anecdote.¹⁰ Over the period 1960–1999, India experienced fast growth in the productivity of agriculture but also a very rapid increase in the number of individuals employed in factories located in or near villages, in part due to a pro-rural investment policy. Rural factory employment increased tenfold from the early 1980s to 1999. In 1999, about half of the villages Foster and Rosenzweig studied, which were initially all rural, were located near a factory, and in those villages, 10 percent of the male labor was employed at a factory. The factory was typically located in a village that had low wages to start with, and in those villages, the growth of factory employment did much more for wage growth than agricultural productivity growth resulting from the famed Green Revolution. Furthermore, the poor gained disproportionately from industrial growth, because higher-paid employment became available even to those with low skills.

Once such a job does materialize, it can make a tremendous difference in the lives of the people who get it. The middle class spends much more on health and education than the poor. Of course, in principle, it may be that patient, industrious people, inclined to invest in the future of their children, are better able to hang on to good jobs. But we suspect that this is not the entire explanation, and that this spending pattern has something to do with the fact that parents in better-off households have steady jobs: A stable job can, by itself, change people's outlook on life in decisive ways. A study of the height of Mexican children whose mothers worked in maquiladoras (export factories) in Mexico dramatically illustrates the power of a good job.¹¹ Maquiladoras generally have the reputation of being exploitative and paying poor wages. However, for many women without a high school education, the establishment of the maquiladoras offers the prospect of

a better job than the jobs in retail, food services, or transportation that would otherwise be their lot—the hourly wages are not much higher, but they work longer hours and with more regularity. David Atkin, from Yale University, compared the height of children born to mothers who lived in a town where a maquiladora opened when the woman was sixteen years old to that of children of mothers who did not have this opportunity. The children whose mother's town had a maquiladora were much taller than those born to similar women in different towns. This effect is so large that it can bridge the entire gap in height between a poor Mexican child and the “norm” for a well-fed American child.

Furthermore, Atkin shows that the effect of a job in a maquiladora on the level of family income is nowhere near large enough to explain the entire increase in height. Perhaps the sense of control over the future that people get from knowing there will be an income coming in every month—and not just the income itself—is what allows these women to focus on building their own careers and those of their children. Perhaps this idea that there is a future is what makes the difference between the poor and the middle class. The title of Atkin's study, “Working for the Future,” sums it up nicely.

In Chapter 6, we gave several examples of the effects of risk on household behavior: Poor families take preventive actions to limit risk even at the cost of higher levels of income. Here we see another consequence, possibly even deeper: A sense of stability may be necessary for people to be able to take the long view. It is possible that people who don't envision substantial improvements in their future quality of life opt to stop trying and therefore end up staying where they are. You will recall that many parents think (perhaps mistakenly) that the benefits of education have an S-shape. This means that there is no point for them to start investing in education if they do not think they will be able to continue to invest. If they are worried about their ability to afford schooling for their children in the future—say, because they think their business might fail—they may decide that it is not even worth trying.

A steady and predictable income makes it possible to commit to future expenditure and also makes it much easier and cheaper to borrow now. So, if a member of a family has a steady job, schools will accept

their children more readily; hospitals will give more expensive treatments, knowing they will be paid; and other members of the family may be able to make the investments in their own businesses that are necessary to allow them to grow.

This is why a “good job” is important. A good job is a steady, well-paid job, a job that allows a person the mental space needed to do all those things the middle class does well. This is an idea that economists have often resisted, on the reasonable grounds that good jobs may be expensive jobs, and expensive jobs might mean fewer jobs. But if good jobs mean that children grow up in an environment where they are able to make the most of their talents, it may well be worth the sacrifice of creating somewhat fewer of them.

Because most good jobs are in the city, moving can be the first step to changing a family’s trajectory. In summer 2009, we were in a slum of the Indian city of Hyderabad, talking to a woman in her fifties. She told us that she had never been to school and her daughter, who was born when this woman was sixteen, had started school but dropped out after third grade and had gotten married soon after. But her second son, she added almost in passing, was studying for his MCA. We had never heard of an MCA, and asked her what it was (our presumption was that it was a vocational degree of some kind). She didn’t know, but her son appeared and explained it was a Master in Computer Applications. Before that, he had gotten his bachelor’s degree in computer science. His elder brother had also graduated from college and had an office job in a private company, and the youngest, still in high school, was applying for college. They were hoping to send him to Australia to study, if they could get one of the preferential loans for Muslims.

What had happened to this family, somewhere between the time the first daughter dropped out of school and the first son graduated from high school, to transform the prospects for the younger children? The father retired from the army, and through his army connections had found a job as a guard in a public-sector firm in Hyderabad. Because he now had a job that did not involve frequent transfers, he moved his entire family to the city (except for his daughter, who was already mar-

ried). Hyderabad has a number of affordable and relatively high-quality schools for Muslim children, a legacy of the fact that it was a semi-independent Muslim kingdom until 1948. The sons were sent to these schools, and they prospered.

Why aren’t many more people adopting this strategy? After all, schools are better in most cities, even those that don’t have Hyderabad’s particular history. And the poor (particularly poor young men) are always moving in search of a job. In rural Udaipur for example, 60 percent of the families we interviewed had at least one member who had worked in some city over the last year. But very few of them migrate for long periods of time—the median duration of a trip is one month, and only 10 percent of the trips are longer than three months. And when they go on these trips, they mostly leave their families behind. The usual pattern is a few weeks at work, a few weeks at home. Permanent migration, even within the country, is relatively rare: In our eighteen-country data set, the share of extremely poor households that had one member who was born elsewhere and had migrated for work reasons was just 4 percent in Pakistan, 6 percent in Côte d’Ivoire, 6 percent in Nicaragua, and almost 10 percent in Peru. One of the consequences of temporary migration is that these workers never become indispensable enough to the employer to be made permanent or given any kind of special training; they remain casual laborers all their lives. Their families therefore never move to the city, and never benefit from the better city schools and peace of mind that come from a permanent job.

We asked a migrant construction worker from Orissa, on a visit back home, why he didn’t stay longer in the city. He explained that he could not take his family there: The housing conditions were too insalubrious. On the other hand, he did not want to stay away from them for too long. Most cities in the developing world have very little planned housing for the very poor. The result is that the poor have had to squeeze themselves into every piece of land they can somehow grab from the city, often in a swamp or even a garbage dump. By comparison, the places where even the poorest live in villages are greener, airier, quieter; the houses are bigger; there is space for children to play. Life may be unexciting, but for those who grew up in the village, that

is where their friends live. Moreover, a single male, going to the city for a few weeks or even a few months, does not need to actually find housing; he can sleep under a bridge or under some awning somewhere, or in the shop or construction site where he works. He can save the money he would have paid as rent and just go home more often. But he doesn't want this life for his family.

There is also the risk: Suppose you pay the cost of setting up a home in the city and moving your family there, only to lose your job. Indeed if you haven't already had a decent job before and saved up, how do you pay for the move? And what happens if someone gets very sick? It is true that health care is better in the city, but who will come with you to the hospital or have some cash handy if you need it? As long as your family is still in the village, even if you get sick in the city and end up in the hospital, you can rely on your connections in the village. But what if you actually pull up your roots and move?

This is why it is much easier to move if you know people in the city. They can house you and your family when you first arrive, help you out if someone suddenly gets sick, and help you find a job—by giving you a reference or hiring you themselves. Kaivan Munshi, for example, found that Mexican villagers migrate to cities where people from their village have already migrated, even if the original round of migration was purely accidental.¹² It is obviously also easier to move if you already have a steady job or some other source of steady income. The Muslim family from Hyderabad had both—an army pension and a job—which in turn was the product of having the right connections. In South Africa, when elderly parents get a pension, the most productive of their children permanently leave the household to move to the city.¹³ The pension must be what gives them this sense of security, and it allows them to pay for the cost of their own move.

How then can more “good jobs” be created? Clearly, it would help if it were easier to migrate to cities, so policies on urban land use and low-income housing are obviously vital. Less obviously, effective social safety nets, consisting of both public assistance and market insurance, can make migration easier by reducing dependence on social networks.

But because not everyone will be able to move to the city, it is also important that more good jobs be created not just in the largest cities

but in smaller towns all over the country. For this to be possible, there must be substantial improvements both in urban and in industrial infrastructure in towns of this sort. The regulatory environment is also important for creating jobs: Labor laws play a role in ensuring job security, but if they are so stringent that no one wants to hire, then they are counterproductive. Credit remains perhaps an even bigger problem, given the S-shaped nature of the production technologies: To set up businesses that create lots of jobs (rather than one job for the entrepreneur alone) takes more money than the average business owner in the developing world has access to, and as noted in Chapter 7 on credit, it is not clear how to get the financial sector to lend more to these people.

It follows, therefore (though it is not a particularly fashionable idea among economists), that there may be a case for using some governmental resources to help create enough large businesses by providing loan guarantees to medium-size ventures, for example. Something like that happened in China, where state businesses, or at least part of their equipment, land, and buildings, were quietly handed over to their employees. This was also, more explicitly, part of the Korean industrial policy. This may set off some virtuous circle: Stable and higher wages would give workers the financial resources, the mental space, and the necessary optimism both to invest in their children and save more. With those savings, and the access to easier credit that a steady job brings, the most talented among them would eventually be able to start businesses large enough to, in turn, hire other people.

So are there really a billion barefoot entrepreneurs, as the leaders of SMFIs and the socially minded business gurus seem to believe? Or is this just an illusion, stemming from a confusion about what we call an “entrepreneur”? There are more than a billion people who run their own farm or business, but most of them do this because they have no other options. Most of them manage to do this well enough to survive, but without the talent, the skills, or the appetite for risk needed to turn these small businesses into really successful enterprises. For every Xu Aihua, who started a clothing empire with nothing but a little training and a huge amount of talent, there are millions of Ben Sedans, who know that the way out of poverty is not one more shed with some

cows in it, but a son with a secure job in the army. Microcredit and other ways to help tiny businesses still have an important role to play in the lives of the poor, because these tiny businesses will remain, perhaps for the foreseeable future, the only way many of the poor can manage to survive. But we are kidding ourselves if we think that they can pave the way for a mass exit from poverty.

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Policies, Politics

Even the most well-intended and well-thought-out policies may not have an impact if they are not implemented properly. Unfortunately, the gap between intention and implementation can be quite wide. The many failings of governments are often given as the reason good policies cannot really be made to work. Government inadequacy is also one of the older arguments advanced by some of the aid skeptics to explain why foreign aid and other attempts by outsiders to influence social policy are likely to make things worse in poor countries rather than better.¹

The Ugandan government gives per-student grants to schools to maintain their buildings, buy textbooks, and fund any extra programs that their students might need (teacher salaries are paid directly out of the budget). In 1996, Ritva Reinikka and Jakob Svensson set out to answer a simple question: How much of these funds allocated to schools by the central government actually made it to the schools?² It was a relatively straightforward exercise. They just sent survey teams to the schools and asked them how much they had received. Then they compared the numbers to computer records of how much had been sent. The answer they got was nothing short of stunning: Only 13 percent of the funds ever reached the schools. More than half the schools