

Ec428

MSc Growth & Development

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Weeks 1-10

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Topic 1 : Introduction and Some Stylized Facts

Road Map for this Topic

- Discuss the measures/concept of development (based on Ghatak, 2016)
- Relation between growth and development
- A few remarks about the relation between theory, empirics, and policy
- Some macro-level stylized facts on economic growth (based on Jones, 2015)
- Some micro-level stylized facts on the lives of the poor (based on Banerjee and Duflo, 2007)

1. Development – Concepts and Measures

- Typical examples of development indicators in economics are
 - Per capita income
 - Percentage of the population below the poverty line
 - Human Development Index
- Robert Lucas' definition: Growth and Development is a subfield of Economics that studies what explains the variation over time and across individuals, households, regions, and countries of per capita income

ON THE MECHANICS OF ECONOMIC DEVELOPMENT*

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This paper considers the prospects for constructing a neoclassical theory of growth and international trade that is consistent with some of the main features of economic development. Three models are considered and compared to evidence: a model emphasizing physical capital accumulation and technological change, a model emphasizing human capital accumulation through schooling, and a model emphasizing specialized human capital accumulation through learning-by-doing.

1. Introduction

By the problem of economic development I mean simply the problem of accounting for the observed pattern, across countries and across time, in levels and rates of growth of per capita income. This may seem too narrow a definition, and perhaps it is, but thinking about income patterns will necessarily involve us in thinking about many other aspects of societies too, so I would suggest that we withhold judgment on the scope of this definition until we have a clearer idea of where it leads us.

- Indeed, the simplest and most widely used among the development indicators is per capita income and the rate of its growth.
- Despite its popularity, however, per capita income has many limitations as an index of development.
- For one, it can capture the value of only those *private* goods and services that are bought and sold in the market.
 - Ignores all non-market goods and services (e.g., unpaid household work)
 - Ignores externalities/public goods (e.g., environment, public services)
 - Ignores distributional concerns (e.g., poverty, inequality)
 - Ignores rights, freedoms
- Important elements of what one would think determines our quality of life, such as education, health, environment, infrastructure, and law and order, remain outside its ambit.

- Human development index (HDI) is a measure that takes into account some of “non-private good” aspects of development
- Geometric mean of measure of per capita income, a health indicator (life expectancy in years) and an education index that combines expected years of schooling and mean years of schooling (see link below for details)

http://hdr.undp.org/sites/default/files/hdr2016_technical_notes_0.pdf

- HDI is motivated by Amartya Sen's capability theory – roughly speaking, it says development should expand people's "budget sets" (broadly defined) – things that they are able to do
- According to this theory, the goal of development is the gradual enhancement of an individual's capability; while an individual's wellbeing cannot be determined by policies or cardinally measured, it can be safely said that enhancing her capability will enable her to realize her goals.

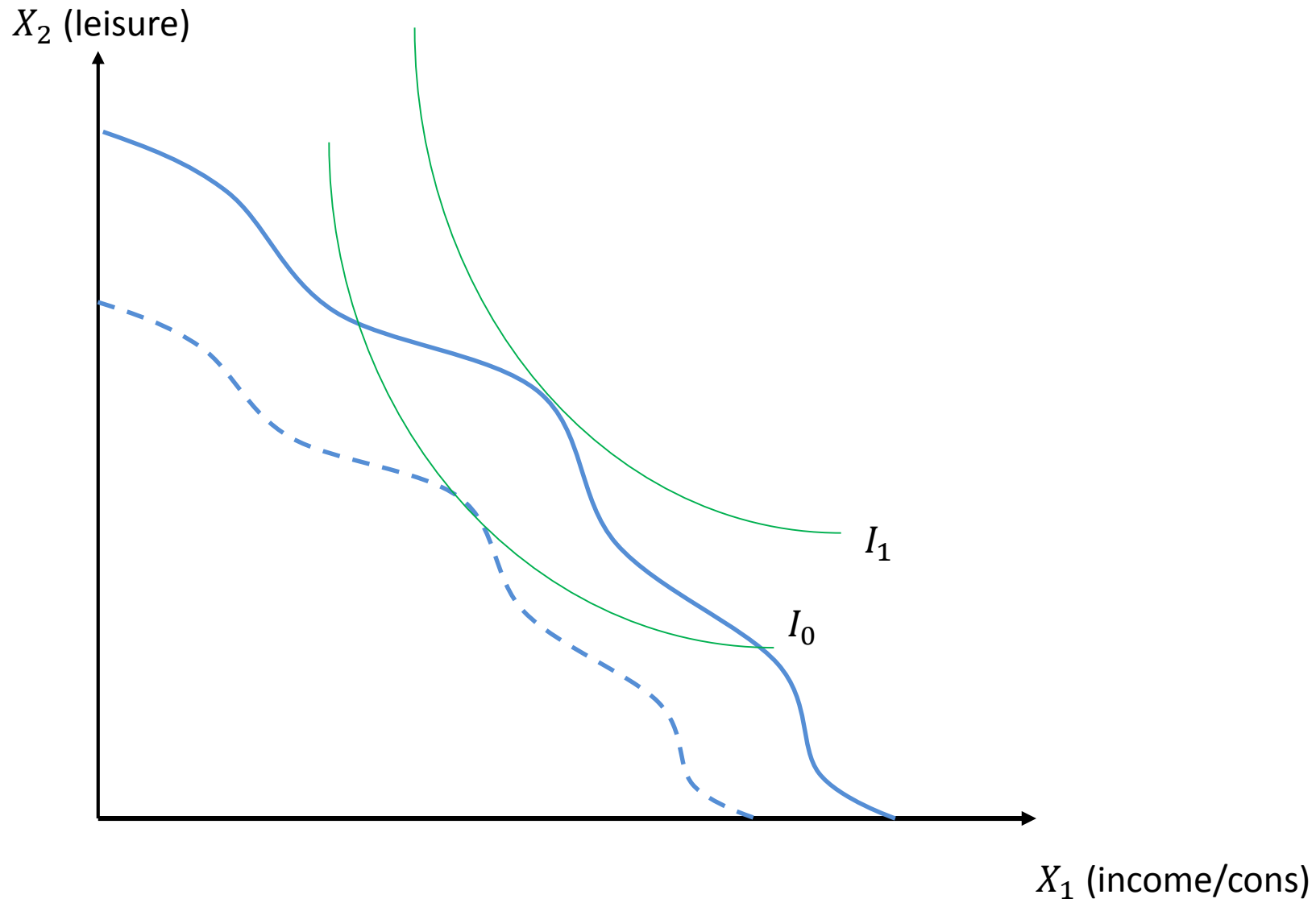
- Translating capability into welfare depends considerably on the rights that citizens enjoy
- Freedom Index (personal, social, and economic)
- What they do with it, whether they are happy as a result gets us into a muddle concerning utilities and choice, which are harder to evaluate
- There are also measures such as life satisfaction or happiness – more subjective

- Too many measures!
- What do these different indices have in common?
- Conceptually they link to different notions of development (or lack thereof)
- The word development means from developing or transitioning from one state to another, usually in a normatively desirable direction (think of a child developing to an adult)

- Behind the idea of development there are two notions
 - The gap between real and the potential
 - A dynamic process that (hopefully) translates potential into reality.
- Studying poverty, both at the individual and the economy-wide level is a key focus of development economics
 - Poverty is lack of development – stunting of potential
 - Undesirable for both reasons of equity and efficiency

A Way to Reconcile these Approaches – Consumer Theory Framework

- In the consumption or income approach, we look at observed choices that capture standard of living
- In the happiness approach we try to figure out the indifference curve that is reached
- In the capabilities approach we try to figure out the value of endowments (both tangible and intangible) that gives the potential to achieve a certain standard of living



The blue curves are Production Possibilities (or capabilities) Frontiers

- We can see that why comparing observed choices of income or consumption across individuals or countries may be a problem (people may *choose* to have lower consumption)
- We can see that “satisfaction” is going to be highly problematic due to subjectivity and inter-personal comparison issues
- However, if over time observed consumption or income grows, that must be a good thing
- Also, indicators of shifting of the PPF of individuals and countries (health, education, infrastructure, environmental quality) are good
- Improvements in rights of citizens or subsets of them (e.g., by gender, race) leads to a shift of the *effective* PPF (less constraints)

2. Relationship between Growth & Development

- Growth models (Ramsey, Solow, Cass, Koopmans) represents the *classical* view of development – in a world with perfect institutions, forward-looking agents, and well-behaved technology, the problem of development is essentially one of accumulating capital stock through savings and investment
- Given diminishing returns, the poor will catch up faster with growth (convergence) – just like children grow faster, adults slow down
- Long run differences in standard of living reflects preferences, technology, endowments (conditional convergence)

- Two major problems with the growth view – lack of empirical support and limited insights about causal mechanisms that can inform policy
 - Empirical evidence suggests limited support for convergence
 - Most of variation in level and growth rate of per capita income driven by productivity, which is a blackbox, as opposed to saving rates or population growth rates (see Caselli, 2005)
 - Also, compelling evidence that institutions matter – for very similar regions, different economic systems deliver different results (North/South Korea, East/West Germany, colonies were pro-growth as opposed to extractive institutions were established, as in the work of Acemoglu-Johnson-Robinson)

- Also, at a conceptual level, even if the growth model did have explanatory power, the explanatory variables they use are more like symptoms or correlates as opposed to causes
- For example, if saving rates are important, why don't the poor (countries or individuals) save at a high rate?
- Is it because those who are poor choose to save less, or the financial instruments needed to facilitate savings are absent?
- These have very different policy implications.
- So the challenge is to get to causal mechanisms: micro-foundations of development

- Compared to the classical focus on fundamental parameters such as preferences (e.g., how forward looking), technology, and resource endowments, the focus of development is how two economies that have the same fundamentals allocated resources differently due to differences in:
 - Formal institutions (defined as the rules of the game) - economic, political, social
 - Informal institutions (e.g., reputation), custom, social norms
- These determine how individual interact in these respective spheres, how they form expectations about how others are going to behave

- The growth view assumes that
 - Markets are complete and "perfect" (i.e., no frictions e.g., secure property rights, no costs of information, transaction, contracting)
 - For public goods, a benign government steps in and fixes problems of externalities by tax/subsidy/direct provision
 - There is a representative economic agent
 - Economic agents are rational

- The development view examines consequences of
 - Market Failure (e.g., credit rationing, poverty traps)
 - Government Failure (e.g., corruption, waste, leakage, predation)
 - Intra-household conflict (e.g., division of labour by gender, child labour)
 - Social constraints (e.g., discrimination due to gender, ethnicity, caste etc)
 - Bounded Rationality (e.g., temptation and self-control)

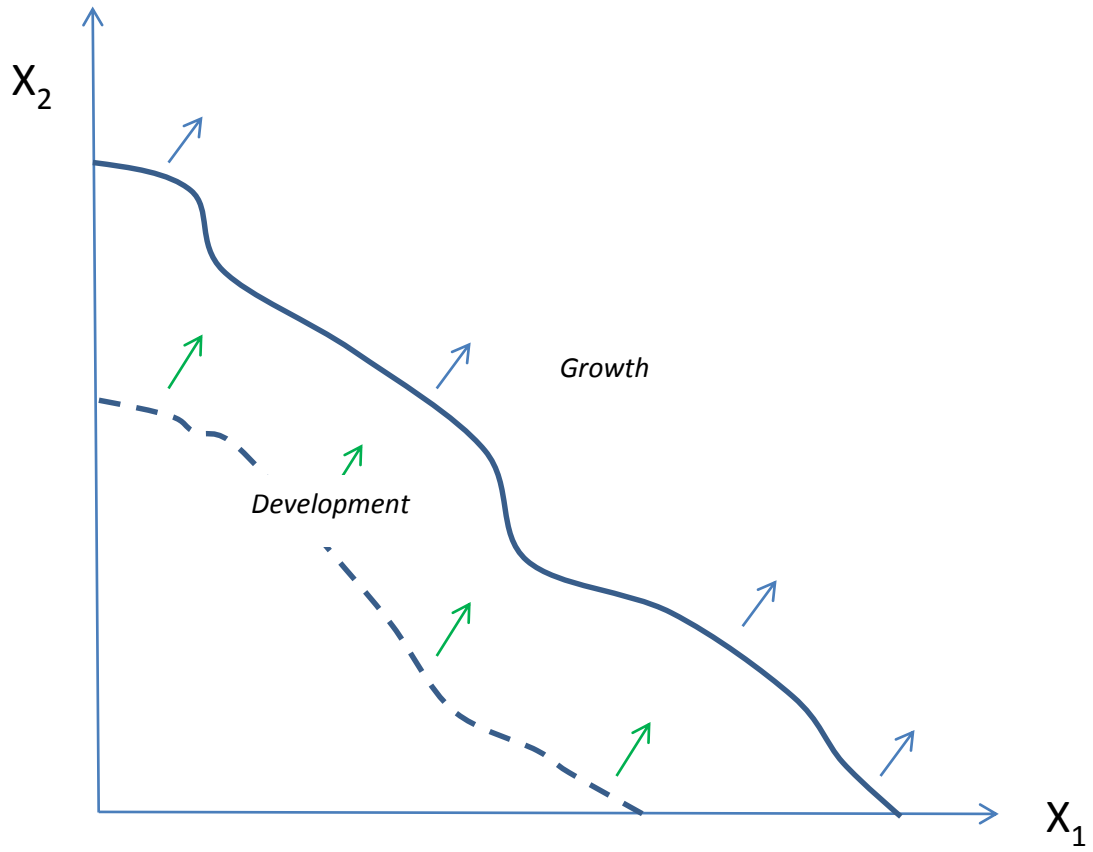


Figure 1

- In Figure 1, we show a production-possibilities frontier (PPF) with well-functioning institutions (the solid curve) that shifts out due to capital accumulation and technological change
- We also show a constrained PPF (the dashed curve) that causes the productive potential to be well below what is indicated by factor endowments and technology due to institutional frictions causing misallocation
- The development process – viewed as institutional improvements - shifts this out
- To take the human body analogy, all parts/organs of the body growing to their full capability is development, while growth is more weight or height

3. Connection between Theory, Empirics, and Policy

- Theory is our a priori view of how things work in a given context
 - E.g, lack of human capital prevents skill acquisition and is a key factor in persistence of poverty
- Empirics is a form of diagnostic test of the causal connection between determinants and outcomes
- Policy is like treatment (in the medical sense)

- Theory gives us alternative causal mechanisms as to how x affects y
- A theory of an owner-farmer hiring in labourers should also explain why tenants rent in land or labourers sell their labour (Hint: endowments, expertise, agency problems)
- The key is to identify deeper parameters whose range tell us which part of the map we are in, and that in turn tells us if what to expect if we do x
- Of course, we may have the wrong map – the role of falsification

Some general conceptual points on the role of Theory

- Theory is our a priori view of how things work in a given context
- Formally, any theory is a cause-effect statement: "If p then q"
- Here p includes some conditions, and q some outcome of interest
- Theory has to be falsifiable – or it is just tautologically true

Examples

- ❑ General example
 - ❑ The soil is wet because it rained
 - ❑ Could be a leaked pipe instead
- ❑ Economic examples:
 - ❑ Theory of supply-demand
 - ❑ Theory of compensating differentials
 - ❑ Theory of arbitrage – law of one price
 - ❑ Theory of comparative advantage in trade
 - ❑ Theory of poverty traps vs convergence

Where does empirics come in?

- A theory by design is internally consistent (or logically correct)
- But may not be relevant/correct in a given context
- Empirics needed to test implications of a given theory & find out which theory (mechanism) is relevant in a given context
- Theory without empirics is speculation
- Empirics without theory is description

Medical science analogy

- Exactly as in medical science
- Theory gives you a first hunch as to what has happened based on knowledge of how the human body works & how some diseases happen
- Empirics are diagnostic tests which may confirm or disprove or modify the original hunch
- This may lead to a revised theory and further tests
- Policy is the treatment

Three key roles of theory

1. Theory helps us design appropriate empirical tests & experiments
 - What to look for?
 - How to establish whether a particular effect is present?
2. Theory allows us to do counterfactual analysis
3. Theory Allows us to do Welfare Analysis

Design of Tests and Experiments

- Without a theory it is not clear what to look for, i.e., what kind of data to collect
- Helps us ask right questions: what are the causes and what are the consequences or symptoms
 - E.g., the poor may save little because they choose to (e.g., discount the future heavily) or structural problems like absence of savings facilities

- A lot of recent research in development economics is randomized control trials of policies
- The choice of a given policy reflects a researchers implicit priors about what is the binding constraint or scarce input in a given setting – i.e., theory.
- Without this, there is a risk of throwing darts in the dark, or applying a treatment or medicine on a patient without checking the symptoms.

Counterfactual analysis

- What happened in a given study is **one of many possible interventions** (x) on the dependent variable (y) in **one of many possible environments** (z)
- External validity would require many, many experiments that vary the environment & vary the intervention
- A theoretical framework allows us to generate alternative hypothetical scenarios by taking the empirical estimates of the elasticities, plugging them in a model, and doing various simulations of alternative policies and environments

- E.g., suppose you find effect of conditional cash transfers (CCT) on children's health using a RCT in a poor area
- This is very solid in terms of "identification" or internal validity but issues remain of
 - External validity
 - What alternative programmes could have done
- May be would not have worked well in a less poor area
- May be an unconditional cash transfer would have worked better

Welfare Analysis

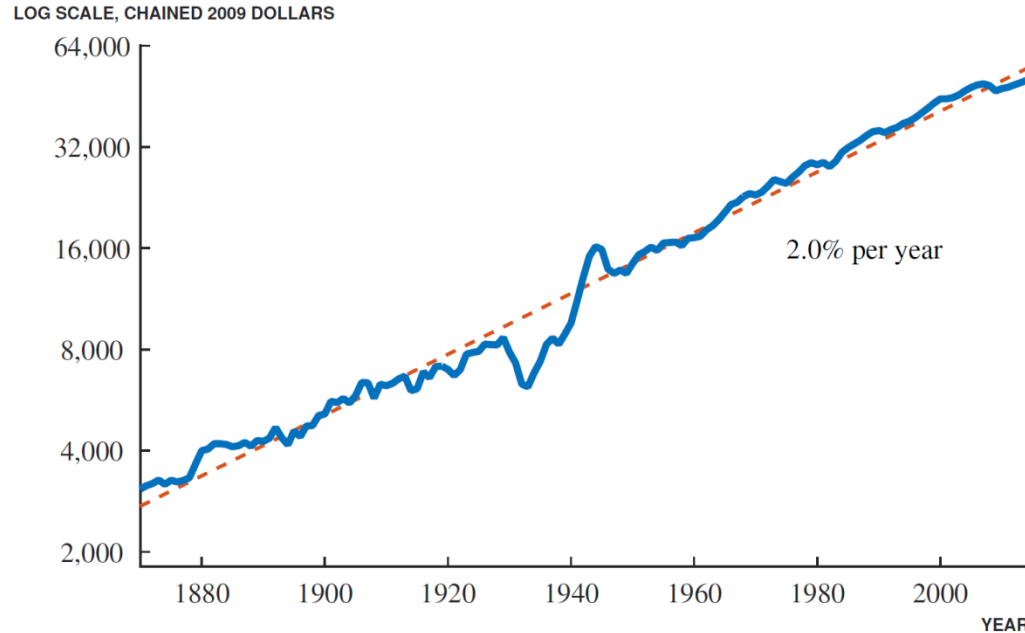
- Suppose you find programme X (say, AIDS awareness) causes outcome Y (use of contraception)
- Once we know this, can we assume that this programme will be implemented?
- For that we need to do social cost-benefit analysis
- But that requires a normative framework where the cost of funds, the benefit to the target group, externalities are all taken into account

4. Stylized Facts – Macro Level

- For **developed** countries, some stylized facts seem to reflect features of the steady state of the standard neo-classical growth model
- Assumption of constant returns to scale in the aggregate production function, and exogenous productivity growth using a production function like $Y = AK^\alpha L^{1-\alpha}$
- In steady state, we have capital-output ratio and the interest rates are constant, and share of capital and labour in income are constant
- Wages and average incomes rise due to improvements in productivity

Jones (2015) Growth Facts

Figure 1: GDP per person in the United States

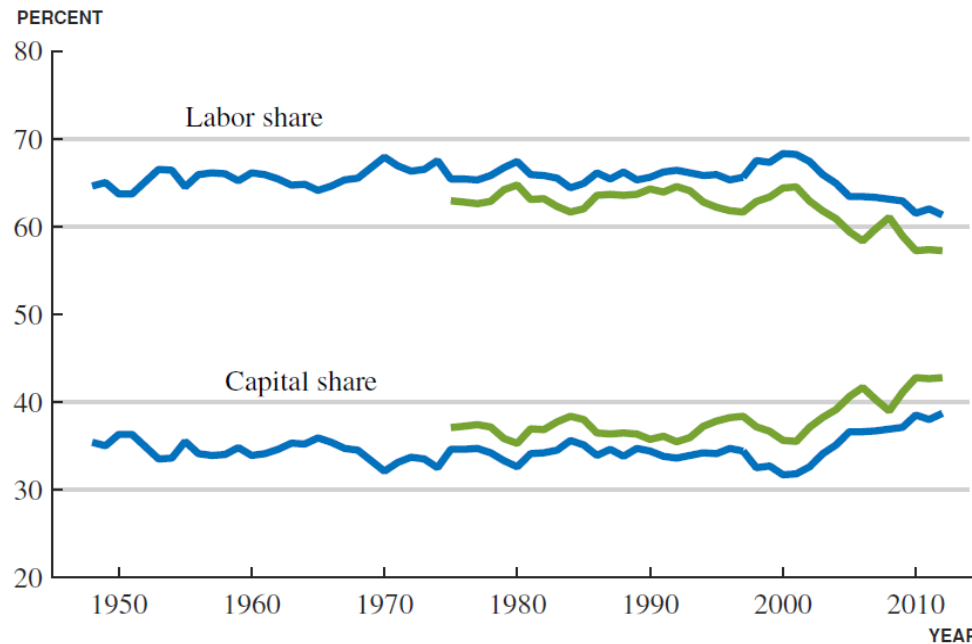


Note: Data for 1929–2014 are from the U.S. Bureau of Economic Analysis, NIPA Table 7.1. Data before 1929 are spliced from Maddison (2008).

Growth on the frontier has been steady

For nearly 150 years, GDP per person in the U.S. economy has grown at a remarkably steady average rate of around 2 percent per year. Post 1950, one could interpret the data as fluctuating around a steady state

Figure 6: Capital and Labor Shares of Factor Payments, United States

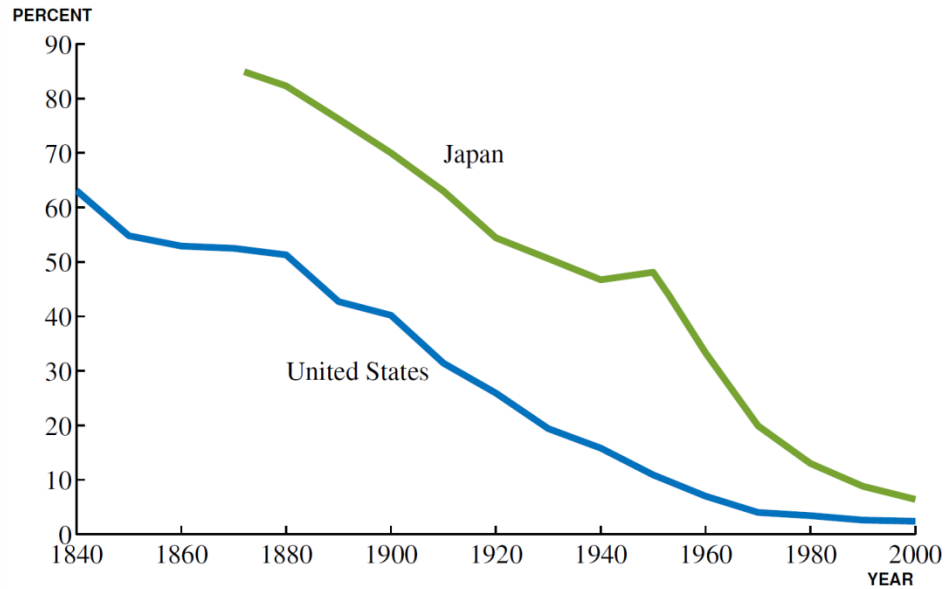


Note: The series starting in 1975 are from Karabarbounis and Neiman (2014) and measure the factor shares for the corporate sector, which the authors argue is helpful in eliminating issues related to self-employment. The series starting in 1948 is from the Bureau of Labor Statistics *Multifactor Productivity Trends*, August 21, 2014, for the private business sector. The factor shares add to 100 percent.

Capital & labour shares have been relatively stable in the US until 2000

The shares have been relatively stable for much of the period, with some decline in labour shares during the last two decades.

Figure 12: Employment in Agriculture as a Share of Total Employment

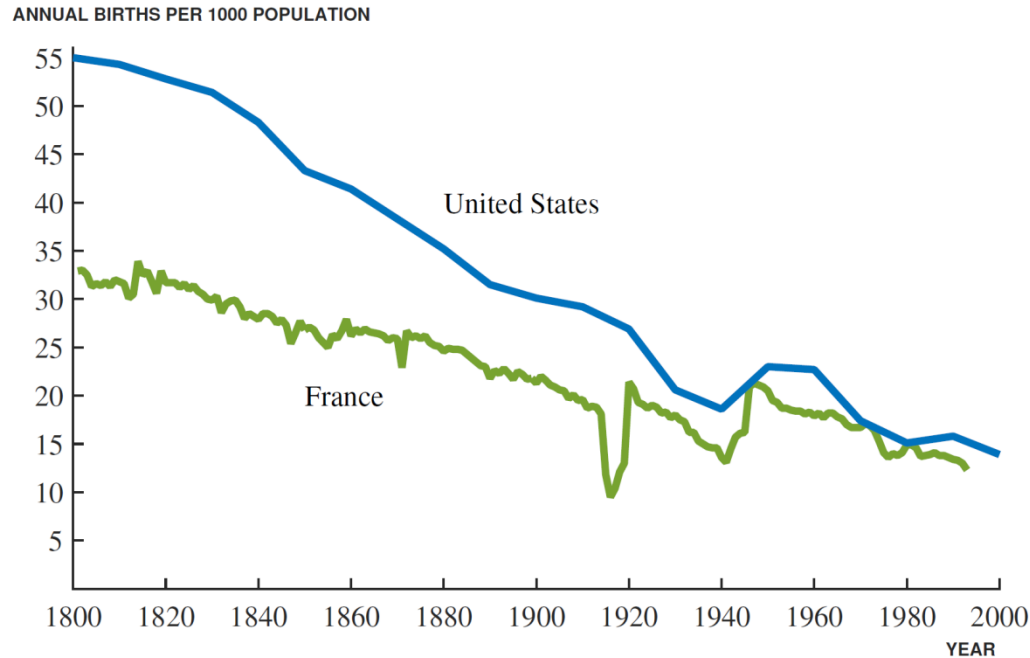


Source: Herrendorf, Rogerson and Valentinyi (2014).

Structural Transformation

Structural Transformation – As an economy grows, the share of agriculture falls, & that of industry and services rise

Figure 17: Fertility in the United States and France



Source: Data for the United States are from Haines (2008) and data for France are from Greenw and Vandenbroucke (2004).

Demographic Transition

As an economy develops, the fertility rate falls, and so does the death rate (not shown), but the net effect is decrease in population growth rate

Comparative Growth Performance of Countries

- We now put both developing and developed countries into the mix
- The first noticeable thing is in the modern era of growth starting with the industrial revolution the gap between high performers and low performers has increased

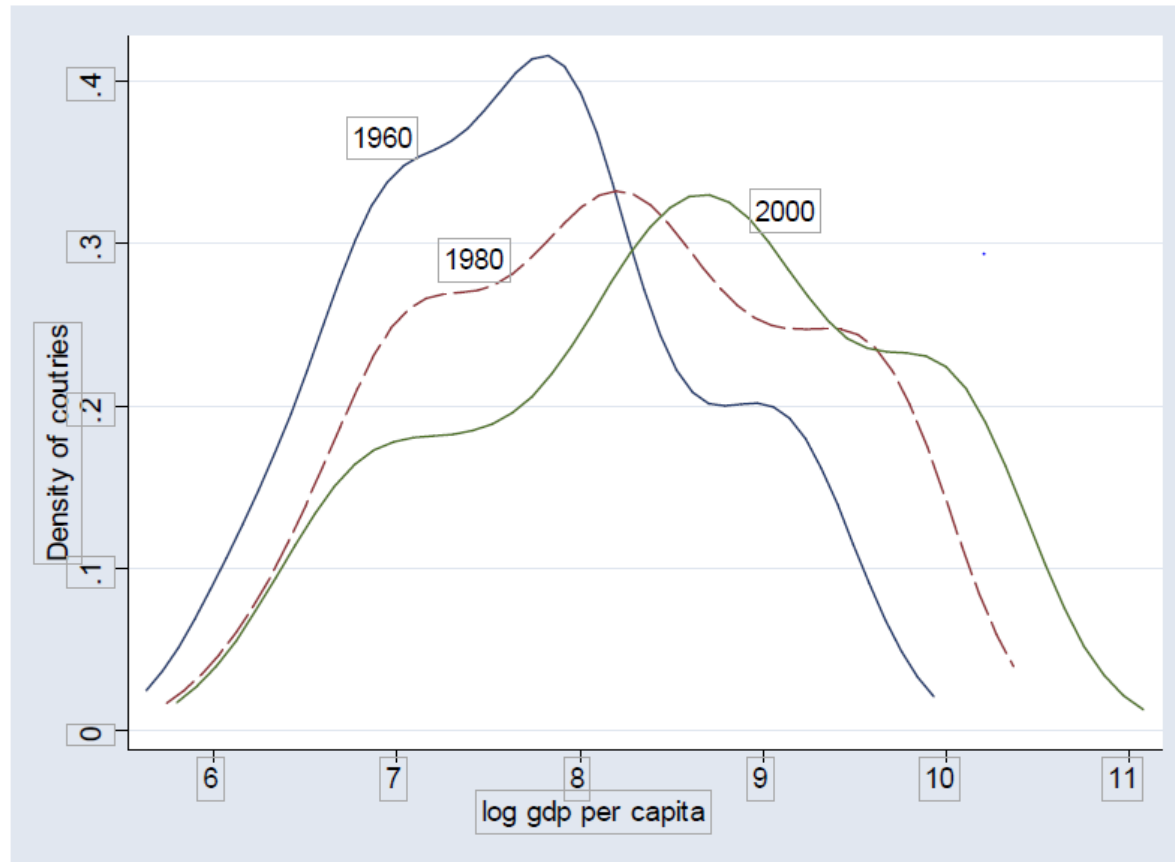


Figure: Estimates of the distribution of countries according to log GDP per capita (PPP-adjusted) in 1960, 1980 and 2000.

Shift to the left, suggesting overall growth, sticky at the bottom, suggesting persistence of poverty & widening inequality across countries

Growth in the Last 200 Years

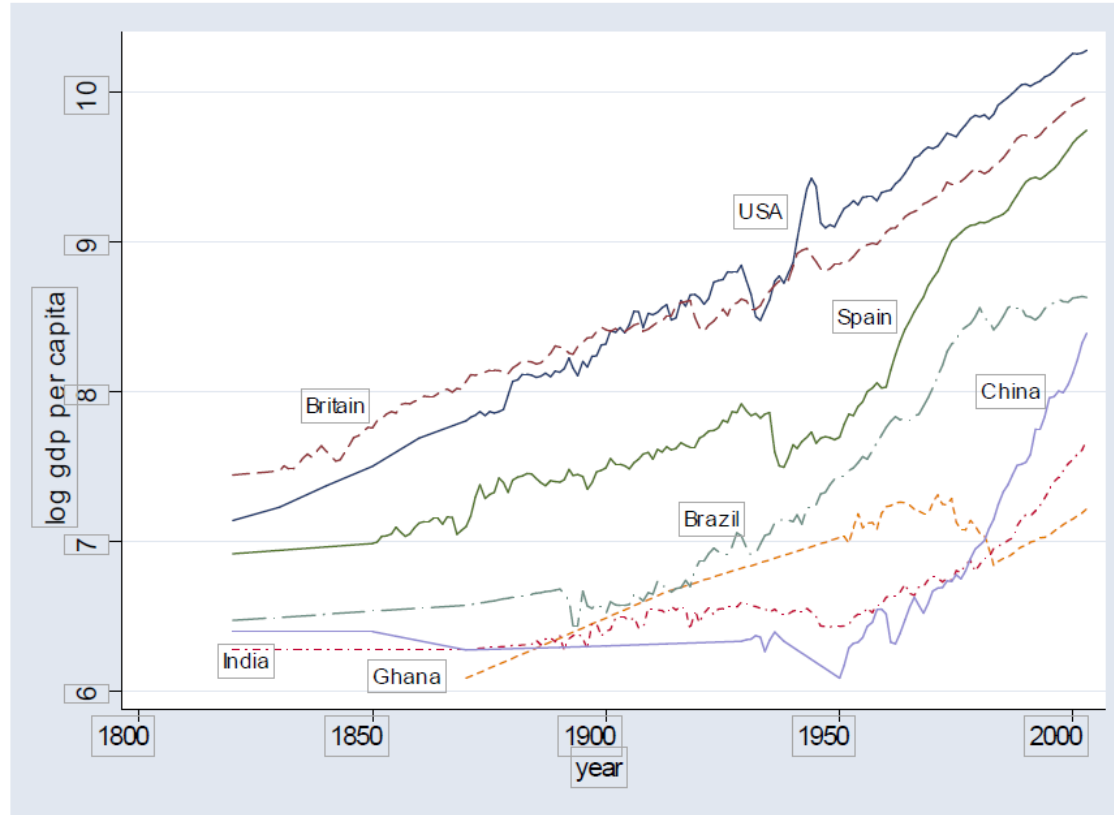


Figure: Evolution of income per capita in various countries.

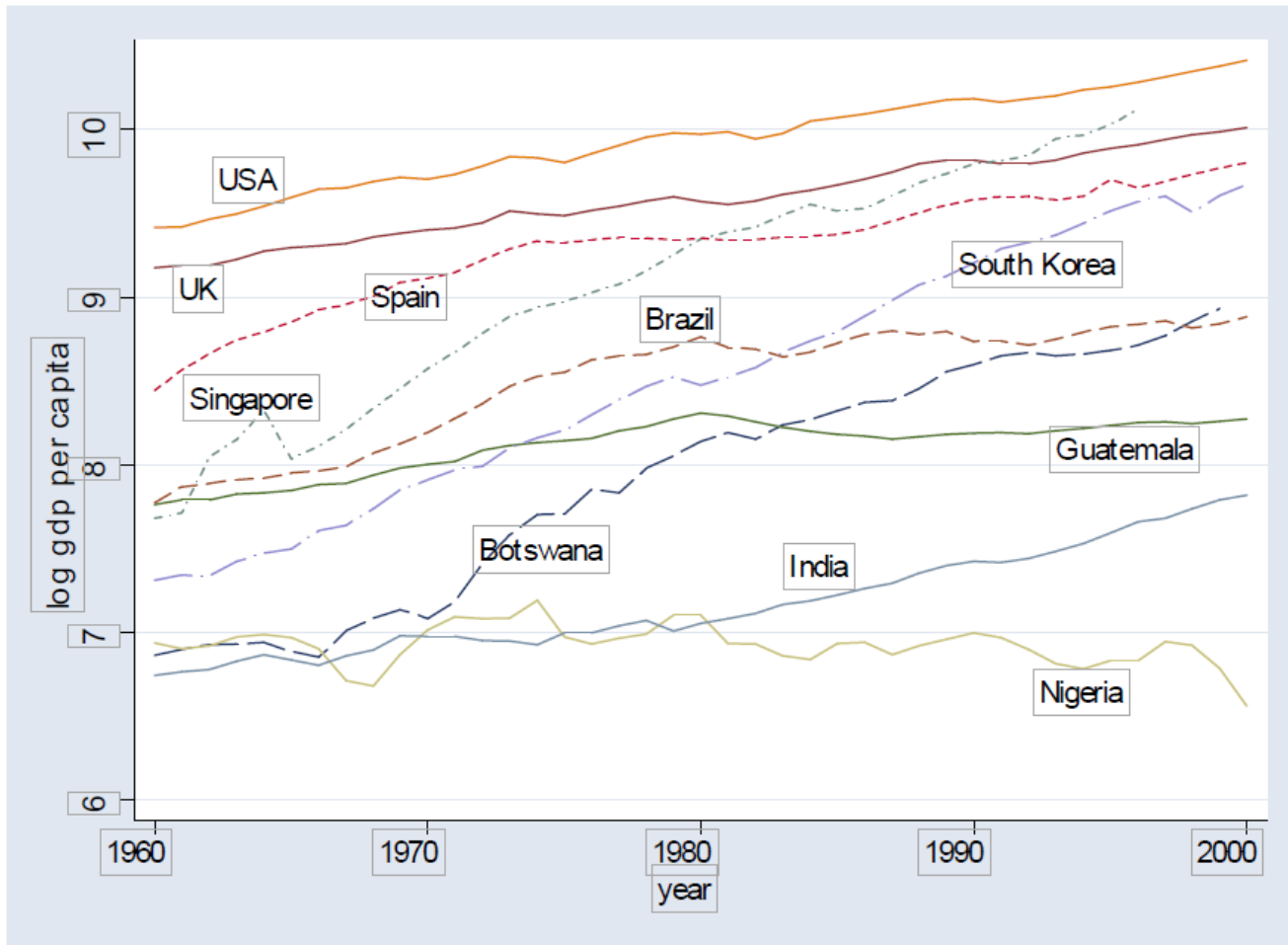
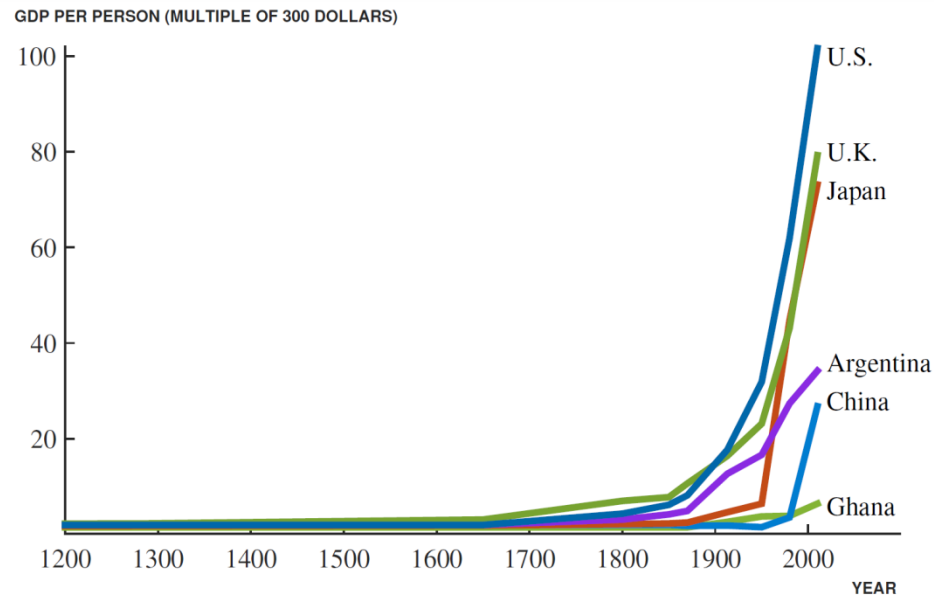


Figure: The evolution of income per capita 1960-2000.

Figure 21: The Great Divergence

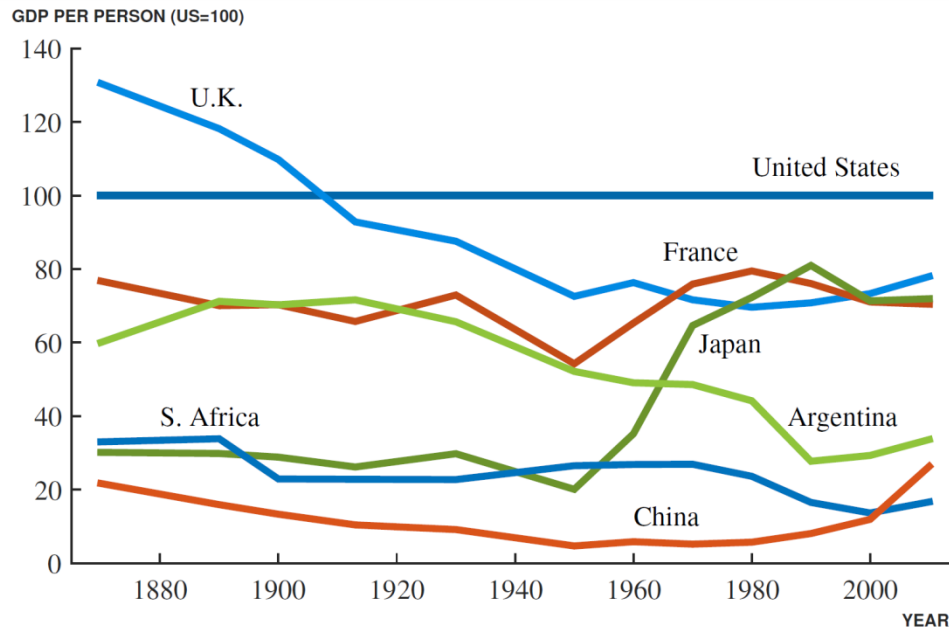


Note: The graph shows GDP per person for various countries, normalized by the value in the United Kingdom in the initial year. Source: The Maddison Project, Bolt and van Zanden (2014).

Comparative Growth Performance of Countries

However, with the modern era of growth the gap between developed and developing countries has increased, with some catch up (e.g., China, India)

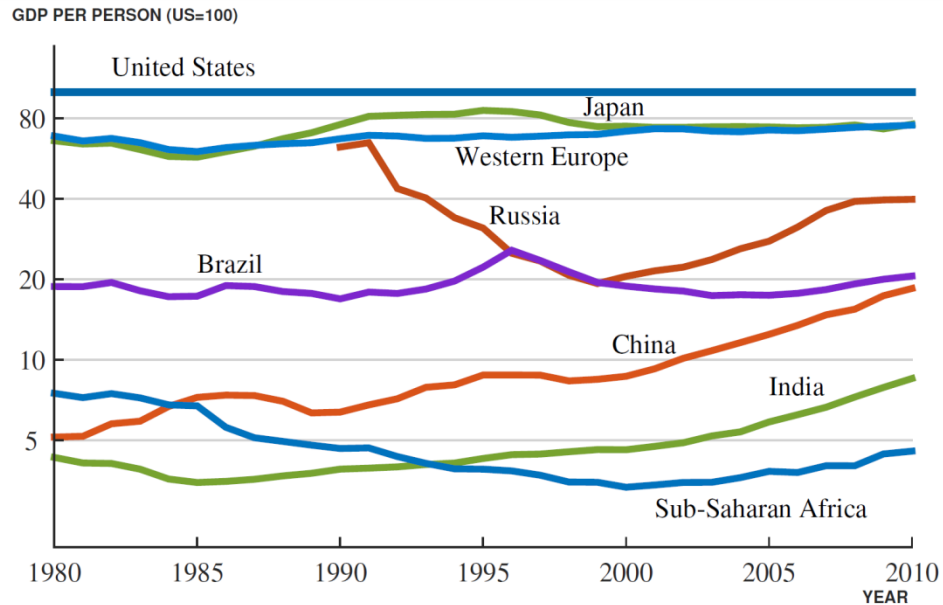
Figure 22: The Spread of Economic Growth since 1870



Source: The Maddison Project, Bolt and van Zanden (2014).

Figure 22 shows the spread of growth since 1870 in an alternative way, by plotting incomes relative to the U.S. level. See the difference in experience between Argentina and China – long run effects of growth

Figure 23: The Spread of Economic Growth since 1980



Source: The Penn World Tables 8.0.

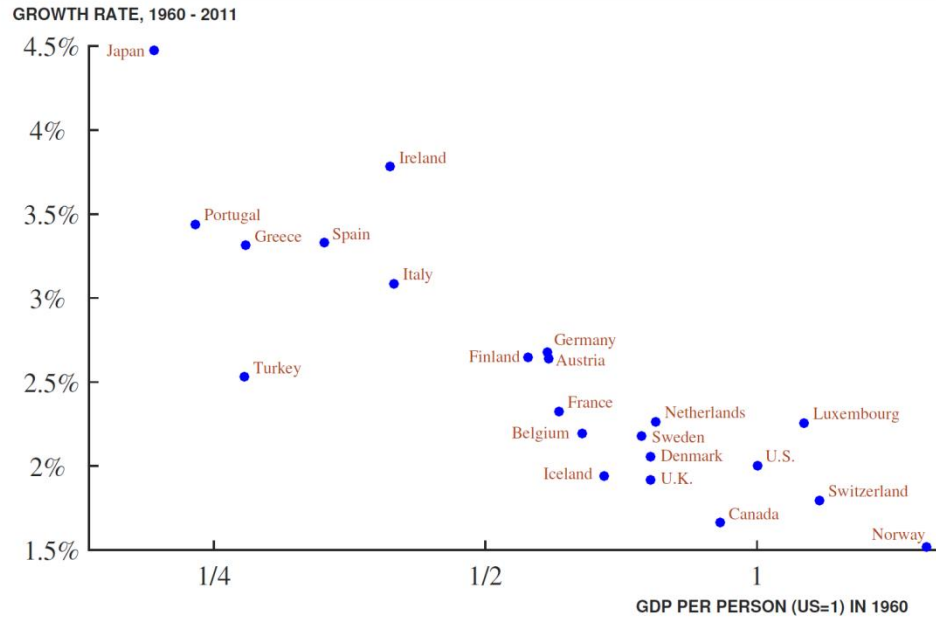
Growth since 1980. Rise of India and China. Western Europe has lower GDP per capita than the US, but GDP per hour is much closer as work hours per adult are substantially lower in Western Europe

Convergence or Divergence?

- If we just look at developed countries, then the implications of the Solow model hold up quite nicely – richer countries slow down, leading to convergence
- Unfortunately, if you put all countries into the mix, you do not see any evidence of convergence at all
- TFP differences seem to explain most of the variation in growth performance – which is not reassuring for the growth model as it is assumed exogenous

Solow was right - Convergence

Figure 25: Convergence in the OECD

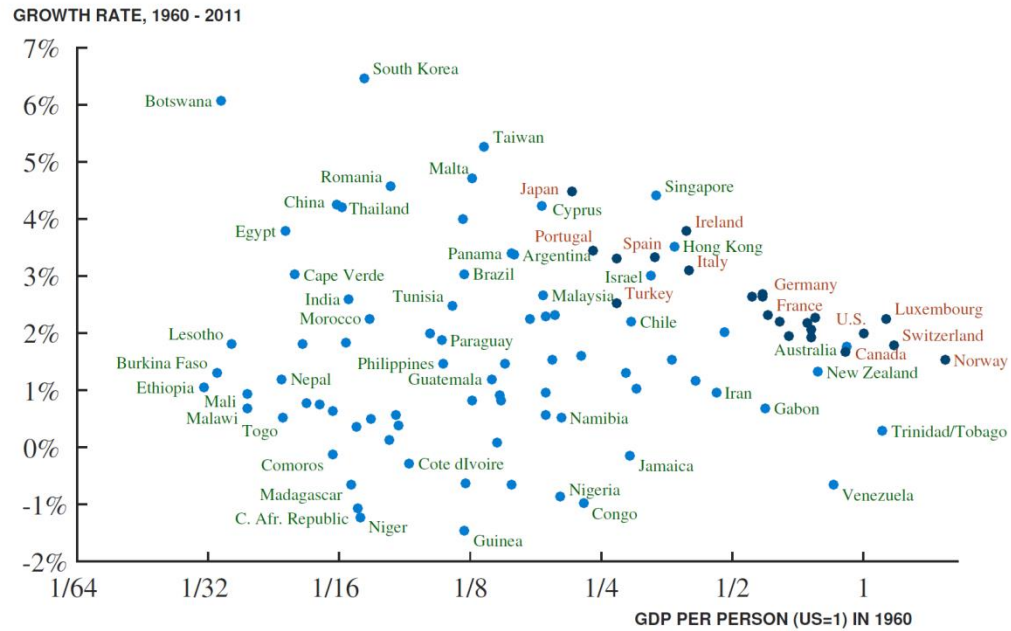


Source: The Penn World Tables 8.0. Countries in the OECD as of 1970 are shown.

“Catch-up” behaviour of OECD countries since 1960

Wait a second!

Figure 26: The Lack of Convergence Worldwide



Source: The Penn World Tables 8.0.

No evidence of catch-up worldwide. Conditional convergence?

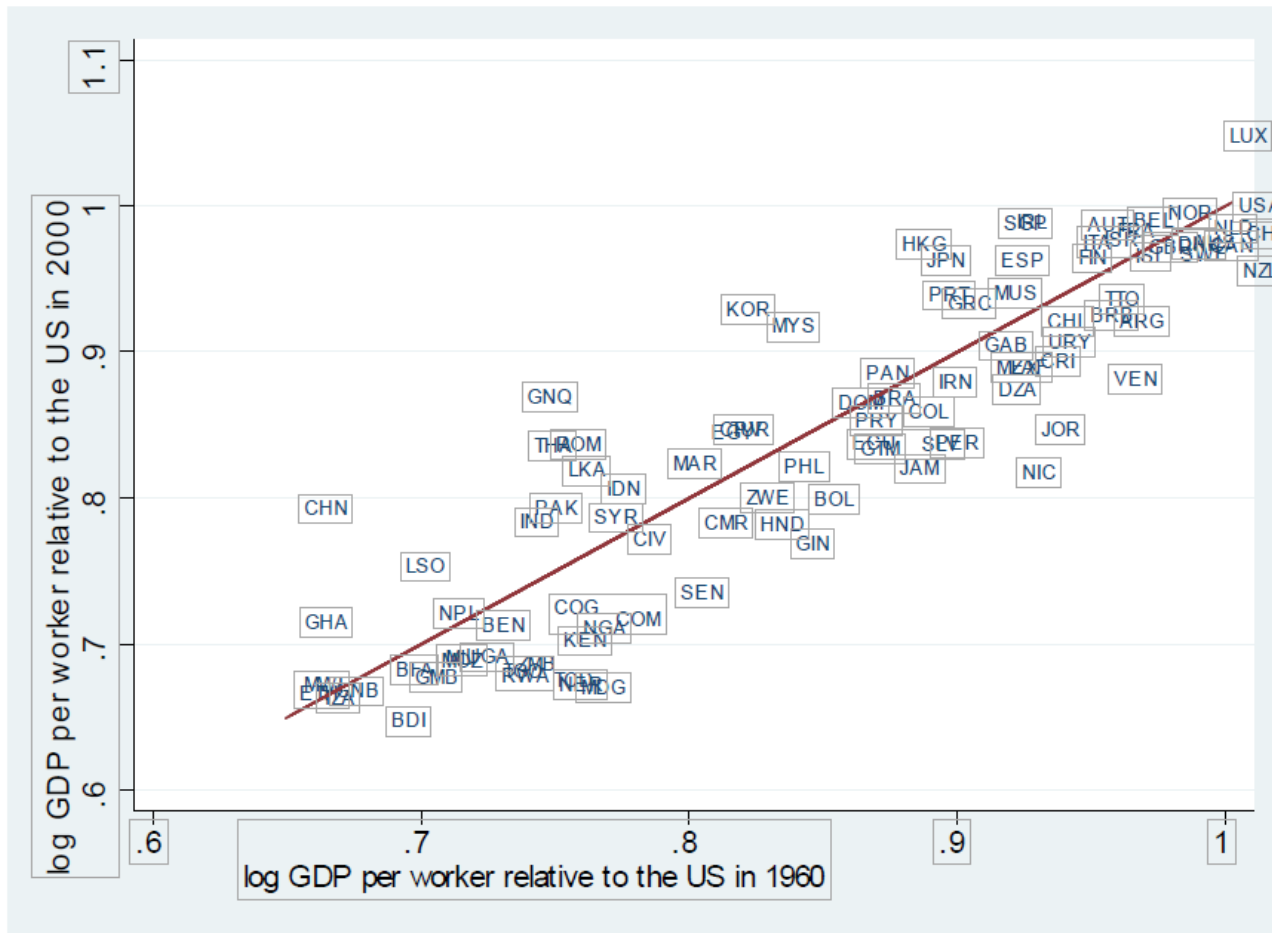


Figure: Log GDP per worker in 1960 and 2000.

Remarkable persistence - absolute improvements, but relative position of countries not changing

Could Institutions Explain TFP Variation?

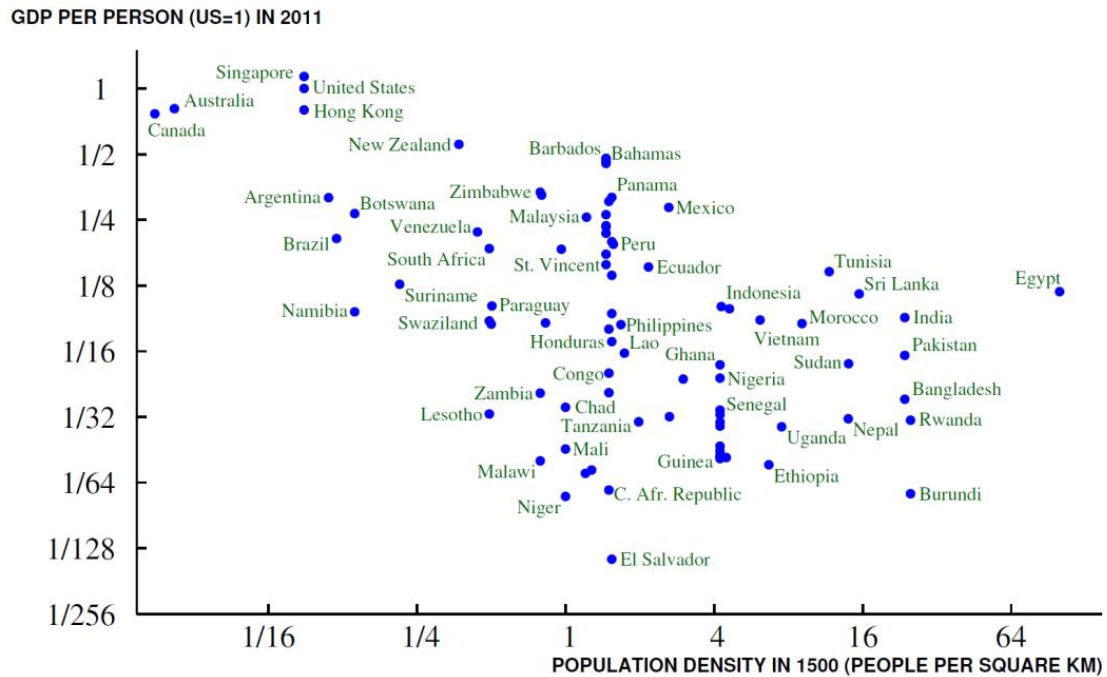
Figure 31: Korea at Night



Note: North Korea is the dark area in the center of the figure, between China to the north and South Korea to the south. Pyongyang is the isolated cluster in the center of the picture. Source: http://commons.wikimedia.org/wiki/File:North_and_South_Korea_at_night.jpg

Satellite picture of the two Koreas . North Korea lies between China above and South Korea below

Figure 32: The Reversal of Fortune



Note: Source: Population density is from Acemoglu, Johnson and Robinson (2002) and GDP per person is from the Penn World Tables 8.0.

Restricting our attention to former European colonies, economic success 500 years ago is negatively correlated with economic success today.

Role of Institutions

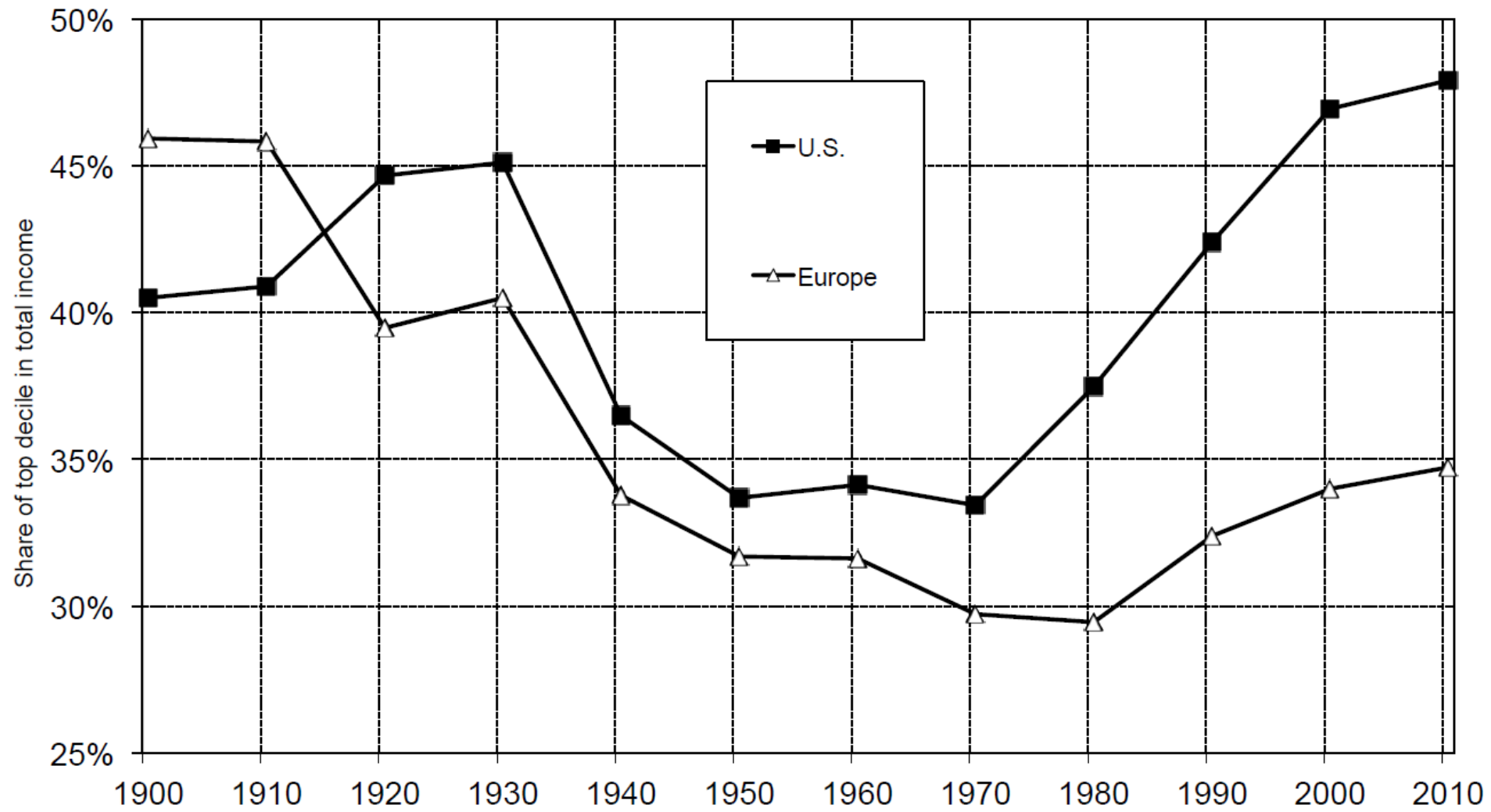
- That is, the places that were most successful 500 years ago, as measured by population density or urbanization, are on average comparatively poor today.
- AJR and Engerman-Sokoloff (1997) attribute it to the kind of institutions that were set up during the colonial era – extractive in more prosperous countries versus developmental in more sparsely populated countries that were viewed as conducive for settling in
- Debate about causality: did institutions cause growth, or the other way around or is it some omitted factor (human capital of early settlers as Glaeser and Shleifer have argued)

Final “macro” stylized facts

Rising income and wealth inequality

- Piketty (2014) uses income tax and estates records to create an impressive data base
- Goes beyond household surveys in scope as well as horizon (e.g., US income tax started in 1913 but household surveys from 1947)
- Goes much beyond Kuznets in establishing the dynamics of wealth and income inequality
- Empirical proposition: inequality has been historically high
- Some setbacks apart, growing steadily through late 20th century

Figure 9.8. Income inequality: Europe vs. the United States, 1900-2010



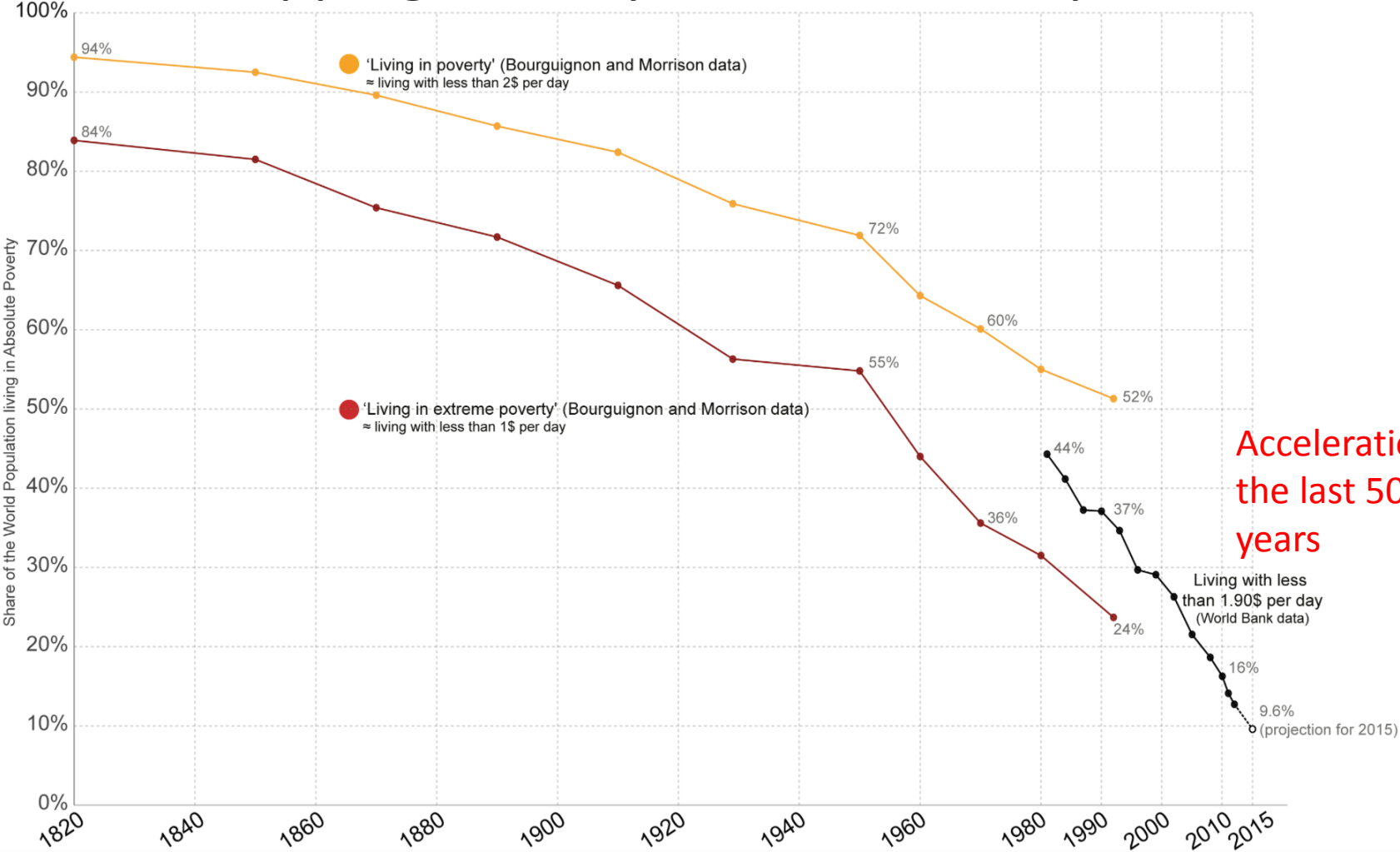
Source: Piketty (2014)

Final “macro” stylized facts

Declining Poverty but Persistence

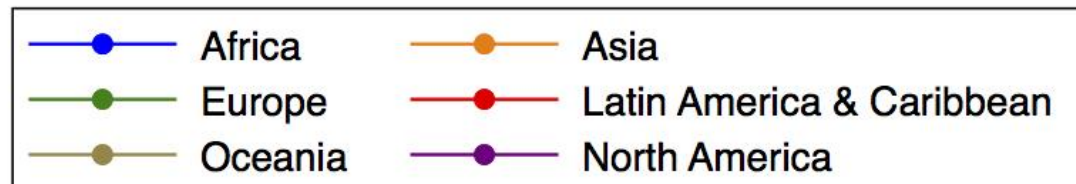
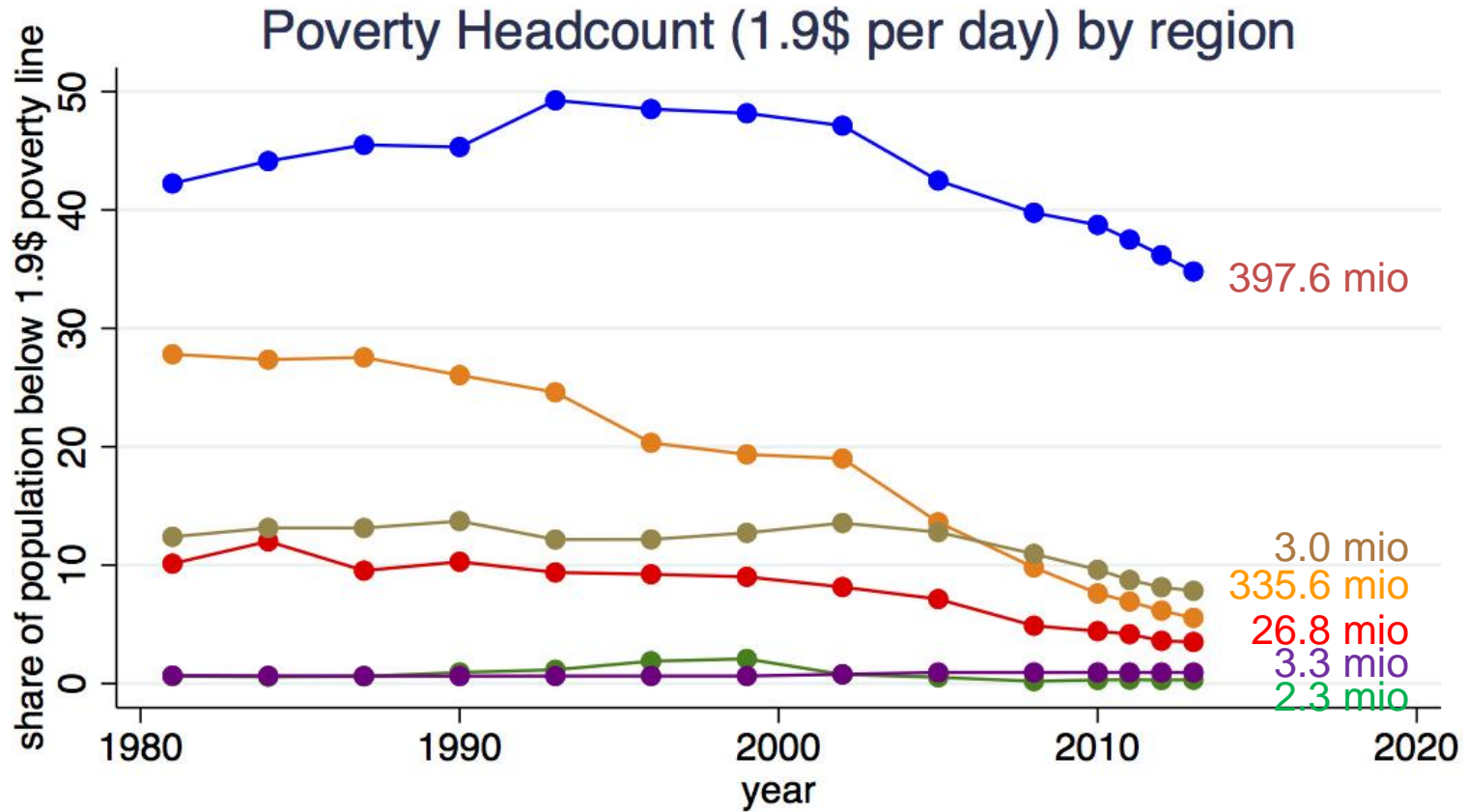
- *Global* poor are those whose income falls below the global poverty line, the famous “Dollar A Day” line
 - nowadays \$1.90

Share of people living in absolute poverty has been dropping steadily in the last 200 years



Acceleration in the last 50 years

Poverty has been decreasing but is still high in SSA & SA

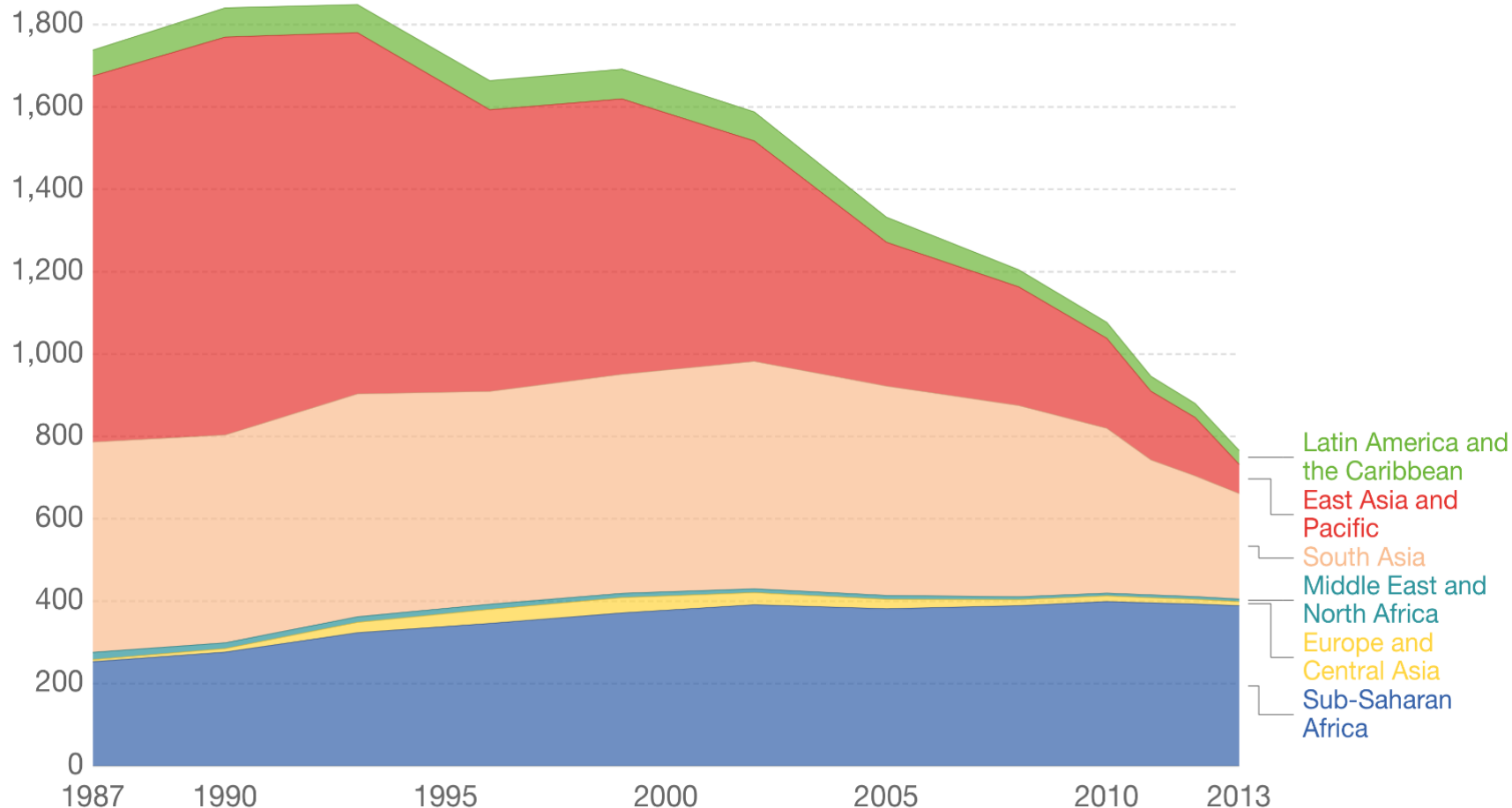


But numbers are stable in the poorest regions

Total population living in extreme poverty, by world region



Numbers are in millions of people. Extreme poverty is defined as living with per capita household consumption below 1.90 international dollars per day (in 2011 PPP prices). International dollars are adjusted for inflation and for price differences across countries.

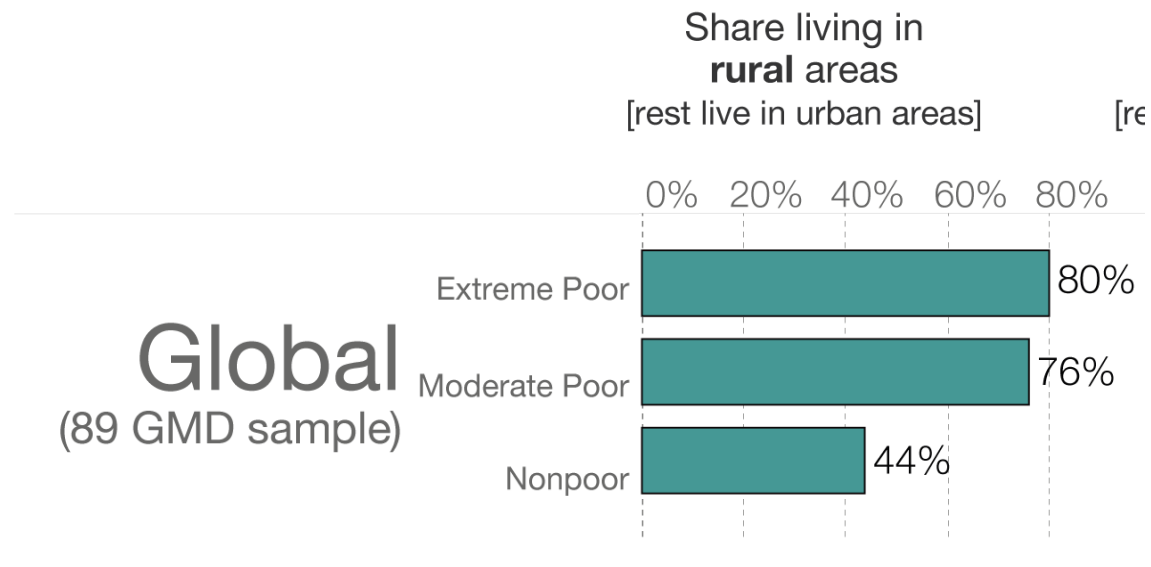


Source: World Poverty Absolute Number by Region - PovcalNet (World Bank)

OurWorldInData.org/extreme-poverty/ • CC BY-SA

Note: Consumption per capita is the preferred welfare indicator for the World Bank's analysis of global poverty. However, for about 25% of the countries, estimates correspond to income, rather than consumption.

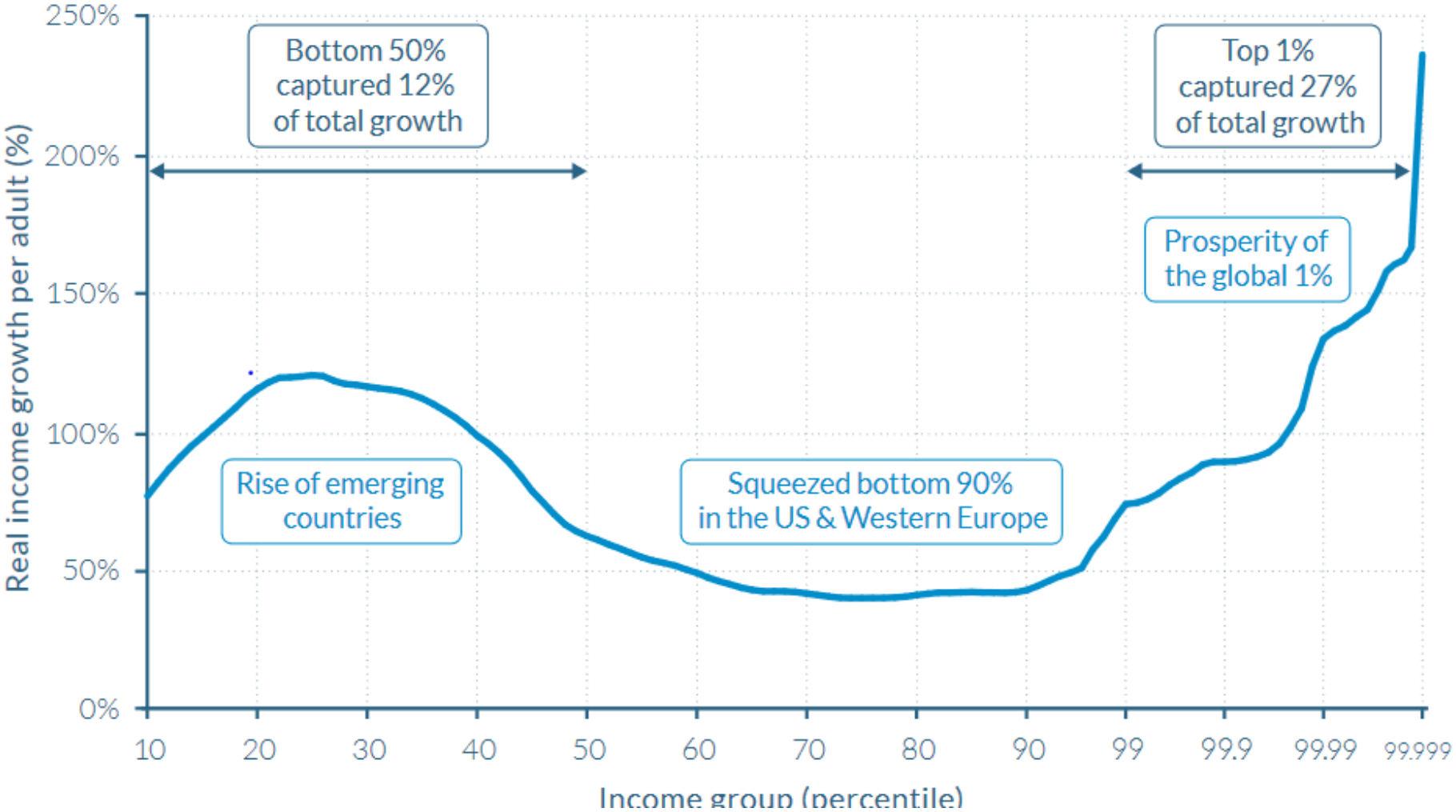
80% of the global poor live in RURAL areas



Has Growth Helped Reduce Poverty?

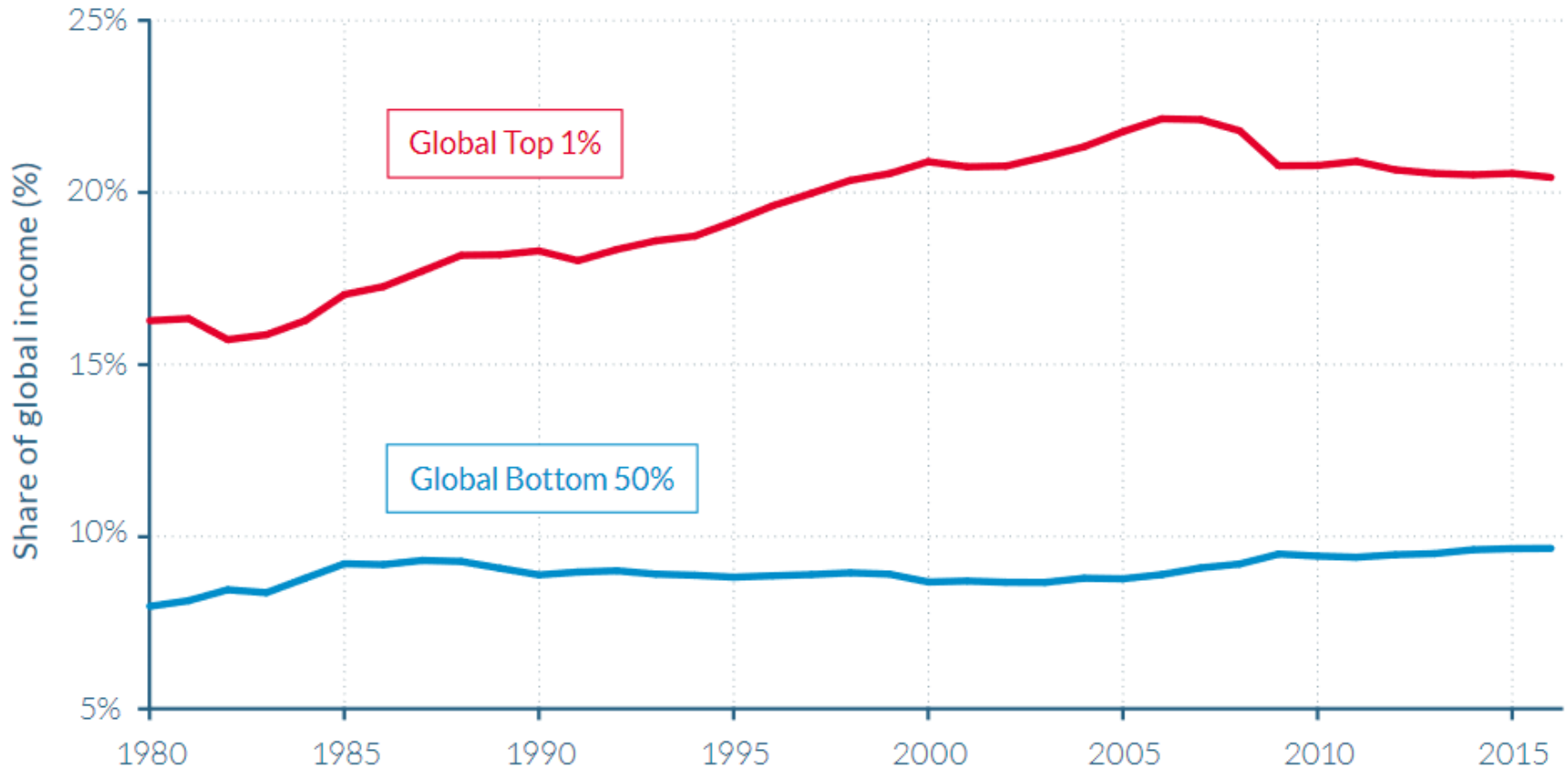
- World Inequality Report 2018 (Piketty et al)
<https://wir2018.wid.world/>
- Rich see much higher income growth, which comparatively swamps that of residents in poor countries.
- Poor residents in developing countries still gain, but their growth looks dismal compared to that of the global top 1, 0.1, 0.01, and even 0.001 percent.
- Indeed, they find that the global top 1 percent captured twice as much growth as the bottom 50 percent from 1980 to 2016.

The elephant curve of global inequality and growth, 1980-2016



- On the horizontal axis, the world population is divided into a hundred groups of equal population size and sorted in ascending order from left to right, according to each group's income level.
- The Top 1% group is divided into ten groups, the richest of these groups is also divided into ten groups, and the very top group is again divided into ten groups of equal population size.
- The vertical axis shows the total income growth of an average individual in each group between 1980 and 2016.
- The Top 1% captured 27% of total growth over this period, while the bottom 50% gained only 12%.
- Income estimates account for differences in the cost of living between countries and values are net of inflation

The rise of the global top 1% versus the stagnation of the global bottom 50%, 1980-2016



In 2016, 22% of global income was received by the Top 1% against 10% for the Bottom 50%. In 1980, 16% of global income was received by the Top 1% against 8% for the Bottom 50

4. Micro stylized facts

- In “Economic Lives of the Poor” Banerjee-Duflo, JEP 2007 use household survey data from 13 countries: Cote d’Ivoire, Guatemala, India (Udaipur – 100 villages, and Hyderabad – 2000 urban slum HHs), Indonesia, Mexico, Nicaragua, Pakistan, Panama, Papua New Guinea, Peru, South Africa, Tanzania, and Timor Leste
 - Data from the LSMS of the World Bank and FLS of the Rand Corp. Also, 2 J-PAL in-house surveys from India.
- To look at the lives of the:
- the Extremely Poor (EP) : consumption <\$1.08 per day per capita in '93 PPP), and the
- Poor : consumption <\$2.16 per day per capita in '93 PPP)
- To put all this in perspective, the poverty line in the US works out to be something like \$13 a day.

Economic Lives of the Poor

- Labour is the primary endowment of the poor → we need to understand what determines earnings
- Earnings = wage X hours worked + income from self-employment
- Need to understand occupational choice – e.g., between wage labour & self-employment
- What keeps earnings low?
 - Surplus labour?
 - Frictions in land-labour-credit markets?

“Stubborn poverty” problem

- A lot of poor people are left behind even as countries grow – limited economic & inter-generational mobility
- We need to understand why people stay poor in order to design policies that lift the poorest out of poverty
- 75% of extreme poor rural and of these majority work in agriculture (World Bank 2013)

Informal/Casual jobs

- Offered on a daily/ hourly basis with no guarantee of further employment
- Very common: 98% of agricultural wage employment in India is through casual employment (Kaur 2017)
- Wage is low & elasticity to production shocks is high (Jayachandran 05)
- Demand during the lean season is very low (Khandker and Mahmud, 2012; Bryan et al, 2014; Fink et al, 2017)
 - Hides a lot of underemployment

Snapshots of Lives of the Poor

Large Family Sizes

- **Larger family size:** median~7-8 vs. 2.5 in the US
- **No. of adults per HH (age >18y):** median 3
 - More than just 'husband and wife' – other adults co-habit like parents, siblings, uncles, cousins, etc.
 - Why? Helps to spread the fixed costs of living (housing, etc.) over a larger number of people
- **Large number of children:** ratio of HH members<18y to HH members>51y median 6 [vs. 1 in the US]
 - Why? High fertility and low life expectancy (high mortality of older adults)

Persistent Hunger

- Those in the EP category consume $\sim < 1400$ calories a day
 - This is half the recommended level of consumption for a male with moderate activity, or an adult woman with heavy physical activity
- Among the EP
 - Only 57% report that HH members had enough to eat throughout the year
 - 11-46% report having a member being either bedridden for the day or requiring a doctor in past month

Very Little Ownership of Productive Assets

- Land is major asset
 - Great variations in ownership across countries
 - 4% of EP own land in Mexico vs. 85% in Panama, and 99% in Udaipur sample
 - When EP own land, plots tend to be v small
 - Median landholding <3 hectares
- EP HHs own very few other assets
 - Udaipur data - Most have a bed or cot; only 10% have a chair or a stool; 5% have a table; 50% have a clock or watch; <1% has an electric fan, a sewing machine, a bullock cart, motor vehicle, tractor. No phones.
 - Despite the fact that most EP HHs own/ run businesses, have few productive assets

Puzzle : Why don't the poor expand cultivation?

- Rural poor cultivate the land they own – no more no less – why?
 - Insecure property rights?
 - Agency problems associated with renting land in or out?
 - Even though too little land relative to available family labour, still don't purchase land (lack of access to credit)
 - Few options to insure against risk – so get a second, temporary, non-agric job, while still holding onto some minimal farm production

Large fraction is self-employed

- Substantial fraction of the poor are at least part-time self-employed
 - Raise the capital, carry out the investment, and are the full residual claimants for the earnings
 - For example, they buy some fruits or vegetables at the wholesalers and sell them on the street.
 - 47%+ of the urban Poor operate a non-farm business
 - 25-98% of the rural EP report being self-employed in agric; 7-36% of the rural Poor also run a non-farm business

Involved in multiple occupations

- Pattern of multiple occupations stronger in rural areas
 - Poor cultivate own land – no more no less. Yet agric not main source of income.
 - Also work as daily labourers - 94% of EP report doing this; 74% claim this as the main source of income.
- In addition engage in self-employment (esp women)
 - Women do less direct agric work, more animal rearing, growing fruits and vegetables.
 - Women's other activities include teaching, sewing and embroidery, unpaid HH work, gathering fuel (almost 10% of the time of the average HH is spent gathering fuel for consumption or sale)
- Median family has 3 working members and 7 occupations

Small-scale & lack of specialization

- Engaged in multiple occupations, at multiple locations, but do not pursue/ specialize in one
- Very small landholdings; do not rent more agric land; seasonal cultivation (due to dependence on rain)
- Non-farm businesses also very small-scale
 - Median business of Poor (including EP) have close to no paid staff; operated by mostly family members; few assets; most common business assets are tables, scales and pushcarts.
- Small-scale usually means efficiency gains could be had through consolidation and specialization

Puzzle: Why so little specialization?

- Risk spreading very difficult, so cannot put all eggs in one basket; hence, shuttling between agric and non-agric jobs
- Occupations (farming, tiffin sales) tend to leave periods of time vacant ; hence pursue other jobs
- Also cannot raise the capital needed to expand business/ specialize in one occupation

Puzzle : Why so many are self-employed?

- Few specialized vocational skills, little capital, rigidities in local labour market (e.g. if you are a woman), so being a small-scale entrepreneur easier than finding a job
- Due to riskiness of borrowing for expansion, limit business to own/ family labour (do not employ others) – reinforces lack of jobs, and proliferation of other small-scale entrepreneurs

- In theory, access to markets -- for example, credit markets -- can potentially help the poor to climb their way out of poverty.
- But very few of these loans from formal lending source
- Credit from informal sources expensive
- Clearly reflects lack of access to financial markets
- Policy question - whether to subsidize or encourage this form of "petty" entrepreneurship (e.g., through microfinance) or whether to expand formal sector employment opportunities

Puzzle : Why don't the Poor save more?

- Why don't the poor show more evidence of accumulation for the future?
 - Saving at home is hard (live in non-lockable houses, need to share with relatives/ friends who ask for funds)
 - Have to battle temptation to spend surplus that is in-hand (small expenses that the rich may take for granted – e.g. chocolate for children)

Market for savings

- Difficult for Poor to find a safe place to save money and earn reasonable returns
 - Saving at home does not protect from inflation, needy relatives and friends, and the temptation to spend
- Few EP HHs have bank savings accounts
 - <14% in sample countries (except Cote d'Ivoire where 79%)
- Informal saving opportunities exist but are limited in scale
 - Savings clubs, chit funds, ROSCAs, credit unions, post office savings
 - Microcredit b/c allows them to systematically put aside some money (post-purchase) towards a particular needed expense (by paying down the loan)