Book Review

by Barbara J. Duffy

Bannerjee, Abhijit and Esther Duflo. 2011. *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty.* New York, NY: Public Affairs.

Billions of dollars are spent each year by governments and NGOs to alleviate poverty in developing countries, yet MIT development economists Abhijit Banerjee and Esther Duflo assert that most poverty-relief efforts receive little rigorous evaluation in order to understand how well they work or don't—and how they might be more effective as a result. Banerjee and Duflo are the co-founders, along with Sendhil Mullainathan, of the Abdul Latif Jameel Poverty Action Lab (J-PAL) at MIT, which has become a global network of researchers who use randomized evaluations to inform policymaking to reduce poverty.

Central to their discussion is the idea of a poverty trap, which exists

> "whenever the scope for growing income or wealth at a very fast rate is limited for those who have too little to invest, but expands dramatically for those who can invest a bit more. On the other hand, if the scope for fast growth is high among the poor, and then tapers off as one gets richer, there is no poverty trap." (p. 11)

Debates between development experts Jeffrey Sachs and William Easterly about whether government intervention or market-based solutions are the best approaches to poverty relief are based on their assumptions about whether poverty traps exist at the country level. But the scale for such a debate, the authors assert, is too broad to generate meaningful answers, and the question is not who should intervene but how best to design interventions. Banerjee and Duflo argue that by examining real world situations on a smaller scale they can learn how poverty relief

programs work in specific situations. At the same time they can gather insights about how individuals and families living in extreme poverty make economic decisions, insights that can guide policy choices.

The first half of the book is devoted to "private" decisions that extremely poor families (those living on less than $.99/person/day) make about nutrition, health, education, and family planning. The second half examines the institutions that can provide financial leverage (insurance, credit, savings and investment), but which are not always available to the poor. Drawing on data from an 18-country study, interviews, and the results of field experiments around the world, Banerjee and Duflo provide a compelling picture of poor individuals who make complex economic decisions without access to information and institutions taken for granted by people in rich countries. With a wealth of examples, the authors advocate the use of what they call a "new" tool for evaluating poverty-relief programs, the randomly controlled trial (RCT), a type of field experiment modeled on drug trials that uses random assignment and control groups.

Decisions of rich and poor alike are affected by social norms, tradition, closely-held beliefs, ignorance, lack of information, stress and "time inconsistency"—the inability to imagine today how we will behave in the future. But for the extremely poor, who are exposed to high levels of risk, their decisions have greater consequences, and they must make them with numbing frequency. Minor health setbacks have dramatic proportions and modest investments (in fertilizer, for example) can add substantially to earnings. Without low-cost access to tools like savings accounts, credit, or health insurance, the poor must exercise great self-discipline and ingenuity to save, invest, and manage risk, often in ways that are not efficient. Without "nudges"

in the form of subsidies or simple technological innovations, they are less likely to take action to improve their children's prospects or contribute to the collective well-being.

One tool that is widely advocated for poverty relief is microfinance; small loans that can help poor people (especially women) make investments to improve their future. In the chapter on credit, Banerjee and Duflo argue that there has been little evidence other than anecdotes and case studies to support the claims of microfinance advocates that this form of lending actually works. They cite the results of a series of field experiments they conducted to test the effectiveness of a microfinance program offered by Spandana in Hyderabad. Their findings: yes, in this case, microfinance works to improve people's lives. Compared with control groups where loans were not offered, people who borrow start businesses, buy durable goods, and spend less on nonessentials. But there is no sign of a radical transformation. Women are not exercising greater decision-making control, there are no differences in spending on education and health, and the establishment of new businesses is neither dramatic nor large enough in scale to create jobs. In response to a marketing campaign, launched by six microfinance institutions (MFIs) to challenge their findings (with case studies and anecdotes), the authors cautioned that overpromising results limits the ability of MFIs to expand their impact. In particular, they argue that the current microfinance model—very small loans, immediate and inflexible repayment terms, and very low tolerance for risk and default—does not help to promote the establishment of medium-sized businesses providing the security of steady jobs that can help people escape poverty traps where they exist.

Poor Economics is a book primarily about the power of research methods, with vivid examples that tell a compelling story. The book is supplemented with a website (http://www.pooreconomics.com) that provides details on the18-country data set, the studies that are cited in each chapter, teaching resources, and more. Additional resources include:

Parker, Ian. 2010. "The Poverty Lab." *The New Yorker*, May 17, 2010.
http://www.cas.umt.edu/econ/faculty/members/bookwalter/documents/ThePovertyLab.pdf

Esther Duflo TED Talk: "Social Experiments to Fight Poverty," May 3, 2010.
http://www.ted.com/talks/esther_duflo_social-experiments_to_fight_poverty.html

J-PAL: Translating Research into Action
http://www.povertyactionlab.org