THE CONCEPT OF POVERTY
Principles and Practices

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Poverty measurement assumes:

1) a distribution of living standards;

2) a critical level (poverty line) below which individuals are classified as “poor”.

3) a poverty measure.

EACH STEP IS OPEN TO DISAGREEMENT!
MOTIVATION

Poverty analysts face a number of questions:

1) *How do we measure “standard of living”?*
   - Individual measures of welfare

2) *When do we say someone is "poor"?*
   - Poverty lines

3) *How do we aggregate data on welfare into a measure of “poverty”?*
   - Poverty measures

4) *How robust are the answers?*
   - Poverty profiles and sensitivity analysis
INDIVIDUAL WELFARE MEASURE

- The concept of **standard of living** is inherently **multidimensional**, hence hard to measure.
- The indicator chosen is typically a single **monetary indicator**.
- Official poverty reports tend to use either **household expenditure on consumption** or **household income**.
WELFARE MEASURE
From Theory to Practice

- Assume that we agree on using household expenditure as our (theoretical) measure of welfare.
- To obtain a working definition, other questions must be answered:
  1) *Which expenditure items should such a measure include?*
    - The construction of the welfare indicator
  2) *How to account for the different needs of heterogeneous households?*
    - Equivalence scales & economies of scale
  3) How to deal with geographic differences in the cost of living?
    - Price indices
THE CONSTRUCTION OF THE WELFARE INDICATOR

- Assuming that ‘expenditure’ is a suitable choice, the question is: **What to include?**
  - Home production
  - Housing
  - Durables
  - Public goods and services (public education, health, police, ...)
  - Leisure
  - etc. etc.

- In practice, each item often requires an *ad hoc* solution.

- *Constructing consumption aggregates requires knowledge of the country and its institutions.*
ADJUSTING FOR DIFFERENT NEEDS

- Households differ in size and demographic structure.
- Total *household* expenditure does not allow comparisons of *individual* welfare.
- One way of adjusting for household composition is to use *equivalence scales*.

\[
x_{\text{INDIVIDUAL}} = \frac{\text{TOTAL HOUSEHOLD EXPENDITURE}}{\# \text{ ADULT EQUIVALENTS}}
\]

- Unfortunately, there are no accepted methods for calculating equivalence scales...
OECD equivalence scale

\[ AE = 0.3 + 0.7 \times \text{adult} + 0.5 \times \text{kid} \]

National Research Council (1995)

\[ AE = (A + \alpha K)^\theta \]

- \( AE \) = # Adult Equivalents;
- \( A \) = # Adults;
- \( K \) = # children;
- \( \alpha \) in \([0,1]\) = cost of a child relative to that of an adult;
- \( \theta \) in \([0,1]\) \(\rightarrow (1 - \theta)\) measures the extent of economies of scale.
WELFARE MEASURE AND EQUIVALENCE SCALES

PAKISTAN - PIHS 2001/02
(Kernel densities)

- PCE
- PAE - no EOS
- PAE - low EOS
- PAE - high EOS

Expenditure (RPs/month) vs. Density
A GENERAL REMARK

- The choice of a particular equivalence scale depends on
  - **technical assumptions** about economies of scale in consumption, as well as on
  - **value judgments** about the priority assigned to the needs of different individuals such as children or the elderly.
- Results are affected by judgments.
POVERTY
Concepts & Lines

- Practitioners and researchers use different meanings and concepts of poverty.

1) *Poverty is having less than an objectively defined, absolute minimum.*
   - Absolute poverty

2) *Poverty is having less than others in society*
   - Relative poverty

3) *Poverty is feeling you do not have enough to get along.*
   - Subjective poverty

- The choice of the poverty line (and measure) depends crucially on the concept one opts for.
CONCEPTS IN PRACTICE

Absolute, relative, subjective poverty... how to choose?

The choice of a certain definition is often driven by:

1. data availability
2. political decision
3. historical arguments

To illustrate, consider the following example...
TEA AND QAT

- (amphetamine-like) drug
- leaves of the *Catha edulis* shrub
- alleviates fatigue, reduces appetite

- beverage
- leaves of the *Camellia sinensis* plant
- aromatic stimulant
TEA AND QAT

- ROWNTREE (1901)
  - UK
  - TEA included in the list of basic goods
  - But tea has little/no nutritional value
  - Its replacement by a more nutritive soup... led to a riot (in Bradford Workhouse).

- WORLD BANK (2003)
  - YEMEN
  - QAT included in the bundle of basic goods
  - But qat is classified as a drug by the WHO
  - QAT was not removed from the basic good bundle.

  No riot was reported after publication of the WB Report No. 24422-YEM
THE THIRD QUESTION: WHICH POVERTY MEASURE?

- Once we have a welfare indicator and a poverty line, we need a poverty index to summarize the information.

- The practice of calculating poverty measures varies widely.

- The choice of different poverty measures can lead to conflicting results.

- Consider the following example…
POVERTY MEASURES
The change in poverty in Ireland 1987-1994

- Callan et al. (1996) studied the trend of poverty in Ireland, between 1987 and 1994. The key (stylized) finding:
POVERTY
The Multidimensional Approach

- Dissatisfaction with traditional approaches has put the concept of poverty (and inequality) under scrutiny.
- Poverty is not simply a matter of low income. Poverty is a multidimensional phenomenon...
- One approach is based on the concept of capability, developed by Amartya Sen.
Amartya Sen’s Approach

- **commodities** $\rightarrow$ **characteristics** $\rightarrow$ **capability** $\rightarrow$ **utility**

  - **bicycle** $\rightarrow$ **transportation** $\rightarrow$ **moving** $\rightarrow$ **utility**

- In this framework:
  - **capability** = standard of living
  - **poverty** = failure of several kinds of basic capabilities.

- The assessment of the incidence, depth and severity of poverty becomes immensely complicated.
COMPOSITE INDICES

- The **Human Development Index** (UNDP 1990) combines three indicators:
  1. income
  2. life expectancy
  3. educational attainment

- Usually available at the national level.
- Device useful more for advocacy than for monitoring.
- Best employed for making *ordinal* rather than *cardinal* ranking.
poverty = poor living

poor living = lack of freedom to undertake important activities that a person may wish to choose.

The literature abounds in definitions, whose interpretation is not always clear.


"Indeed [social exclusion] seems to have gained currency because it has no precise definition and means all things to all people."
WHAT AM I FORGETTING?

INEQUALITY!
REFERENCES