



# Short-term needs and long-term aspirations of the extreme poor: Irrational behaviour, agency and cash transfers in Bangladesh

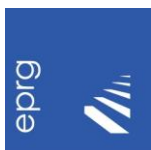
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**The Extreme Poverty Research Group (EPRG)** develops and disseminates knowledge about the nature of extreme poverty and the effectiveness of measures to address it. It initiates and oversees research and brings together a mix of thinkers and practitioners to actively feed knowledge into practice through interventions taking place in real time. It is an evolving forum for the shiree family to both design and share research findings.

The data used in this publication comes from the Economic Empowerment of the Poorest Programme ([www.shiree.org](http://www.shiree.org)), an initiative established by the Department for International Development (DFID) and the Government of Bangladesh (GoB) to help 1 million people lift themselves out of extreme poverty. The views expressed here are entirely those of the author(s).

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# Short-term needs and long-term aspirations of the extreme poor: Irrational behaviour, agency and cash transfers in Bangladesh

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## ABSTRACT

The extreme poor in Bangladesh suffer from a particularly severe form of multidimensional poverty. Despite opportunities for investment – which could ensure future subsistence and graduation from poverty – made available by things like microfinance, the extreme poor continue to under-invest in long-term income-generating activities, instead prioritising the satisfaction of immediate needs. While the evolving debate on multidimensional poverty has helped to unpack the structural causes behind these decisions, very little literature has sought to understand the decision process itself.

In this paper, we argue that low investment and the prioritisation of the present is due to the psychological context of life in extreme poverty, which frustrates ambitions and causes the future to be heavily discounted. This psychological impact of extreme poverty, which results in seemingly irrational decision-making, could be seen as an overarching and under-emphasised dimension of poverty itself.

Using a case study of a successful conditional cash transfer project in Bangladesh, we propose that this psychological context must be addressed in order to enable behavioural change and achieve lasting impact. Our findings add evidence to the ongoing debate on needs, investment, and irrational preferences, and suggest that providing households with demand-driven cash transfers can enable the extreme poor to respond to multidimensional poverty on their own terms. Much as motivational and psychological theories have suggested, these demand-driven CCTs can reduce the typically high discount rates of the extreme poor by satisfying priority needs first, making investment for the future more likely.

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## 1. INTRODUCTION

*'The labouring poor, to use a vulgar expression, seem always to live from hand to mouth. Their present wants employ their whole attention, and they seldom think of the future.'* Thomas Malthus, *An Essay on the Principle of Population*, 1798.

Individuals living in extreme poverty make daily decisions which make little sense to the typical economist. Counterintuitive to *homo economicus*, who makes rational decisions in order to achieve clearly defined goals at the least possible cost, the extreme poor consistently make seemingly irrational decisions in their expenditure patterns. Their prioritisation of the present, and their failure to invest effectively in the future – which could ensure their long-term sustenance and potential 'graduation' from poverty – means that they continue to live hand to mouth as Malthus described. William Easterly (2011, para 12) rightly pointed out, however, that 'What looks like irrationality may just be the failure of outsiders to fully appreciate the problem.' While the evolving debate on multidimensional poverty has helped to unpack the structural causes behind these decisions, very little literature has sought to understand the decision process itself.

What is the psychological context of life in extreme poverty? How does it impact on investment behaviour, as well as the ability of the extreme poor to engage in livelihood-creation projects and microfinance initiatives? Using a case study of a successful conditional cash transfer (CCT) project in Bangladesh, we argue that livelihood-stimulation initiatives must recognise that the psychological impact of life in extreme poverty frustrates ambitions and prioritises the satisfaction of immediate needs. Moreover, we propose that this psychological context must be challenged in order to enable behavioural change and achieve long-term impact. Our findings add evidence to the ongoing debate on needs, investment, and irrational preferences, and suggest that providing households with cash transfers can successfully increase the agency of beneficiaries and

widen the choices available to them, effectively allowing them to satisfy immediate needs, whilst developing a platform from which to look to future priorities and investment. This process helps to reduce the typically high discount rates of the extreme poor, making investment for the future possible. Moreover, we emphasise key operational steps in the CCT delivery mechanism which can make this possible.

In terms of structure, we first characterise extreme poverty as a particularly acute form of multidimensional poverty. We then explain the psychological context of extreme poverty, and its impact on investment. After providing a brief background of the existing operational responses to the problem, we present the IMPACT project. We then investigate the causes of IMPACT's relative success in enabling behavioural change, according to four main themes to do with flexibility, needs satisfaction, and the promotion of aspirations and agency. Finally, we make some conclusions and provide operational recommendations based on IMPACT's experience.

## 2. CHARACTERISING EXTREME POVERTY IN BANGLADESH

Despite economic growth averaging more than five per cent a year for the last 20 years (World Development Indicators, The World Bank), and a civil society awash with NGOs, the extreme poor in Bangladesh have largely missed out on the benefits of this development. These people are typically defined as 'the poorest of the poor', and efforts to assign monetary figures to this subgroup have estimated their daily incomes at less than \$0.30 to \$0.41 per household member (Narayan et al., 2007; Jackson, A, 2009). Simply assigning a monetary figure to the extreme poor in Bangladesh, however, undermines the acute form of multidimensional poverty which they experience.

Earlier work on destitution has underlined the qualitatively unique structural economic position of the extreme poor (Harriss-White, 2002; Devereux, 2003), while further research has highlighted not only their social exclusion, but their exclusion from development initiatives and from local, meso and national political structures (Devine and Wood, 2010). Working experiences in Bangladesh have shown that the extreme poor face multiple constraints in trying to lift themselves out of poverty, both in terms of building human capital (through



a lack of access to clean water and education, etc), as well as regarding direct livelihoods creation (through a lack of access to land and sustainable sources of employment). The few employment opportunities which are available to them often pull them into adverse economic relationships and low wages which serve to keep them poor (such as selling one's labour in advance or receiving low in-kind wages for household labour).

Valuable additions to our understanding of multi-dimensional poverty, such as the sustainable livelihoods model and the capabilities approach, have helped to unpack the concept, focussing on notions of personal asset accumulation, rights and capabilities, all within given contexts of vulnerabilities, institutions and processes.<sup>1</sup> Most recently, Alkire and Santos' (2010) well-regarded multidimensional poverty index (MPI) has been used to calculate the severity of multidimensional poverty at the household or national level. What this discourse has struggled to explain though, is how multidimensional poverty is *experienced* from the perspective of the individual. What is the psychological impact of extreme poverty? Does this impact on which options are available and/or which paths are chosen?

The blame for enduring poverty has typically been placed either on society for limiting opportunities available to the poor, or on the individual for failing to do anything about their poverty (Kane, 1987). The common view of multidimensional poverty promoted today leans towards the former; emphasising a failure of institutions, both governmental and social. Patricio Dalton, Sayantan Ghosal and Anandi Mani (2010), however, provide evidence that even when information and opportunity is increased, the *internal channel* – which represents the psychological and aspirational impact of poverty – provides a barrier to change. Social psychologists have long pointed towards 'learned helplessness' or 'adaptive preferences' as a reason for enduring poverty (Abramson et al. 1978). Olsen and Shober described the experience of poverty as a 'dead-end road' (1992: 173), where some people 'accept their lot', and resign to the idea that they can achieve nothing else, and in doing so, lose

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<sup>1</sup> See Sen (1985) and Scoones (1998) for the key texts on capabilities and the sustainable livelihoods model respectively.

their motivation for change. Psychosocial factors can work as a reinforcement mechanism for reproducing poverty, caused by a circle of low (or frustrated) aspirations (Appadurai, 2004). While this may seem on a simplistic level to be advocating for the 'culture of poverty' thesis which attributes blame for the cycle or reproduction of poverty on the poor themselves (Lewis, 1961), the message is actually much more subtle. Rather, this is a comment about *poverty*, not a comment about *poor people* (Ray, 2003). Poverty has an inextricable psychological impact on people, and could be seen as an underemphasised dimension of poverty itself.

### 3. THE PSYCHOLOGICAL CONTEXT OF LIFE IN EXTREME POVERTY, AND ITS IMPACT ON INVESTMENT

Poverty reduction strategies working one dimension at a time have unsurprisingly had little success at enabling graduation from poverty. When microfinance came along, however, it was optimistically seen as the potential tool to break this cycle of poverty. Although still only dealing with one dimension of poverty – a lack of financial capital – it was hoped that the capital investment it provided could enable a range of self-made paths to graduation. The reality, unfortunately, turned out to be less simple.

Despite its wide reach across Bangladesh – in December 2008 there were more than 11,700 branches and 5,000 microfinance institutions (MFIs) in the country (Microfinance Initiative for Asia, 2009) – microfinance's relative success with the moderate poor has not been mirrored with the extreme poor. The extreme poor do not appear to be as bankable as once hoped. Many extreme poor people proved reluctant to take out loans through fear of an inability to repay, and MFIs have tended to refuse loans for the extreme poor who lack the necessary complementary resources such as land, household labour and social capital with which to make productive use of loans (Alamgir and Mallorie, 2008). When the extreme poor have taken out loans, they have a track record of defaulting on them; evidence from a randomised control trial in India has shown that this is because households with characteristics of extreme poverty used their loans for consumption rather than investment in an income-generating activity (IGA) which could enable repayment (Banerjee et al, 2009).

This under-investment of the extreme poor persists even when potential returns are great. Markus Goldstein and Christopher Udry's investigation of resource management of poor farmers in Ghana (1998) showed that despite a rate of return of 531% for growing pineapples as opposed to 21% for traditional crops, only 24.4% of male farmers, and almost no female farmers, chose to grow pineapples. Although loans were readily available to cover the modest investment required, farmers were uncomfortable with the risk of investment, and the inflexible sales periods. Similarly, Susan Stonich found in her research on Honduras that only wealthier farmers with more stable conditions were willing to engage in long-term conservation efforts of their land, while poorer farmers preferred to leave their unusable land to find outside work which guaranteed immediate satisfaction of nutritional needs (cited in Gray and Mosely, 2005: 12). Yet, while these expenditure preferences are hugely relevant to policy response, we are yet to fully understand them; as Collins *et al.* emphasised: 'Being able to manage immediate needs is a precondition for considering long-term ambitions – but the way people achieve it has received scant attention from policy makers and others arguing for financial access for the poor' (2010: 30).

Why do the extreme poor prioritise immediate benefit rather than the long-term benefit that investment can bring? What explains their time-preference behaviour and irrationally high discount rates?<sup>2</sup> Generalisations are hard to make, due to the personal nature of the phenomenon. Moreover, behavioural economists Shane Frederick, George Lowenstein, and Ted O'Donoghue emphasised that the motivations for present-bias are many and, 'may be evoked to different degrees by different situations (and by different descriptions of the same situation)' (2002: 394). In this way, we see that high discounting of the future is not only caused by tangible situations, but the psychological context within which the individual perceives the situation. Some of the major features, both tangible and perceived, are presented below:

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<sup>2</sup> The discount rate is the extent to which current gains are prioritised over future gains. Numerous experiments (such as Richard Thaler, 1981) have shown that people are often willing to forego significantly larger amounts of money in the future for smaller, but immediate, figures now. While this is not an irrational behaviour in itself, very high discount rates can result in sub-optimal long-term outcomes.

*Extreme poverty can frustrate aspirations and reduce a sense of agency.*

One major characteristic of extreme poverty is its perseverance (Hossain, 2006). Often continuing intergenerationally, the extreme poor find themselves in the same positions as their parents did before. While typical economic analysis separates the external context of endowments from the aspirations of the individual, literature from the fields of psychology and economics are increasingly recognising the interrelated relationship between the two. In 'The Capacity to Aspire', Arjun Appadurai (2004) argues that the greater the initial disadvantage, the greater the difficulty of setting high aspirations and seeing feasible paths to achieve them. More recently, Dalton *et al.* (2010) have proposed a model of 'aspirations failure' that associates initial disadvantage with aspirations and choices.

For the socially marginalised extreme poor, who tend to have been in the same situation their whole lives, and who have few role models (if any), there are few 'reference points' which provide any opportunity for higher aspirations (Genicot and Ray, 2009). Evidence from experiments, psychological theory, and field experience, has shown this lack of aspirations to have significant impact on action; those with higher reference points try harder and persevere longer to achieve them.<sup>3</sup>

Closely related to aspirations failure is a loss of agency. Wood argued that a key feature of poverty is the experience of dependency on others for survival, and the need to buy-in to 'Faustian bargains' through informal, and often unequal, relationships (2007). Similarly, Sumner, Haddad, and Gomez-Climent (2008: 1) concluded that wellbeing is 'explicitly rather than inferentially about agency'. Theories of learned helplessness presented earlier built on the widely studied phenomenon of 'locus of control' (Rotter, 1954), where people with an 'external locus of control' see their fate as being outside of their control. Empirical

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<sup>3</sup> See Dalton, Ghosal and Mani (2010) for a superb summary of the literature available on reference points and aspirations.

evidence has shown that poorer people have more external loci of control than richer people (Furnham, 1986), and evidence of this can be seen from the field. While perception of control is often abdicated to elites, the government, or other social forces, this control is just as frequently abdicated to deity. In the same way as Virginia Moreira's (2003) study in North-eastern Brazil gave evidence that much of the poor population had Nihilistic tendencies, and saw destiny as chosen by God, our experience has shown that the extreme poor in Bangladesh often see their fate as being in the hands of Allah. This inability to aspire, and sensation of having decisions out of their hands, makes the active process of investment a particularly challenging step.

*The extreme poor are risk averse.*

Richard Thaler's seminal experiment on time-preference behaviour (1981) showed that discount rates tend to be significantly higher when dealing with smaller quantities. There is less incentive to take on the risk of higher returns later when dealing with the relatively small improvements (both literal and perceived) which are feasible for the extreme poor.

The costs of investment for the poor – meaning direct costs, opportunity costs, and psychological costs – are huge (Dalton *et al.*, 2010: 18). Research across asset-building programmes has found that even if financial capital comes in the form of a gift, some of the costs of saving, asset building, and investing in the future are borne by saver (Organisation for Economic Cooperation and Development, 2003). Moreover, as they lack a stable platform of savings and security, the extreme poor are disproportionately threatened by risk. This not only means the expected risk involved in enterprise development, but also physical, social, and unanticipated risks like illness (Sebstad and Cohen, 2000; Holmes *et al.*, 2008). These costs and risks – both within and outside the individual's control – are often perceived by the poor as too great a threat to merit investment worthwhile. As Esther Duflo summarised, 'It is reasonable to think that the poorer someone is, the more he dislikes taking risks' (2003: 6).

*The extreme poor tend to prioritise other needs.*

For those extreme poor who have multiple unsatisfied needs on an ongoing basis, any investment for the future involves a significant trade-off with short-term well-being. The outcome of the trade-off tends to be simple: ensure survival today.

B. Douglas Bernheim, Debraj Ray, and Sevin Yeltekin (2011) proposed that poverty damages self-control, as the very poor are often incapable of following through with plans due to their prioritisation of the satisfaction of immediate needs. In an ongoing investigation into under-investment in fertilizer in Western Kenya, Duflo and colleagues (Duflo, 2003; Banerjee and Duflo, 2011) found that despite awareness of the benefits of fertilizer use, as well as convenient systems to buy the fertilizer at reasonable prices, less than 20% of poor farmers used it. Why? Because by the time planting season came around, last year's harvest income has already been used for other priority needs. In trying to explain this irrational behaviour, Easterly explained that, 'Such urges are human nature, of course, but for the world's poorest people, such short-sightedness helps perpetuate poverty' (2011, para 10).

Yet while this behaviour may appear to be irrational to the average economist, Collins *et al.*'s in-depth study of income and expenditure patterns of the poor (2009) emphasised how these decisions are strategic and well thought out. Moreover, these decisions hold with the core concepts of leading motivational theories like Abraham Maslow's Hierarchy of Needs (1934) and Alderfer's Existence-Relatedness-Growth model (1972). Both of these theories posited that people will not be motivated to fulfil certain needs until other more priority needs have been satisfied. Alderfer's model in particular emphasised how individuals tend to focus on those most concrete needs before becoming motivated to fulfil more abstract needs. In this way, the satisfaction of immediate needs is likely to be prioritised over future security, meaning that underinvestment persists.

#### 4. OPERATIONAL RESPONSES TO THE PROBLEM

As Garance Genicot and Debraj Ray highlighted, 'aspirations, income (and its distribution), investment and economic mobility evolve jointly, and in many situations in a self-reinforcing way' (2009: 1). This statement presents an important message for practitioners; despite the threats already discussed above, understanding the psychological context of poverty can provide significant *opportunities* for operational response. Given the cyclical nature of this psychological context, policies that help the poor to break the cycle through asset accumulation, even if they are only temporary, can have significant impact (Bernheim *et al.*, 2011: 2). Appadurai even proposed that the same psychological impediments we discuss could become a 'natural ally' in supporting the poor to find paths out of poverty (2004: 59). How can, and have, projects managed to deal with this multidimensional poverty, particularly given the broader psychological context?

In Bangladesh, there is increased recognition of the need to focus efforts towards the *extreme* poor. A plethora of NGO and donor-led asset transfer programmes for income-generation have largely come in the shape of asset transfer, in some cases combined with skills training (Scott *et al.*, 2007; Hulme and Moore, 2007). These differ in their designs: in the extent to which the choice of asset is decided by the NGO or beneficiary, and on the extent to which they provide a mix of cash and physical assets. In Bangladesh, BRAC's Challenging the Frontiers of Poverty Reduction (CFPR) programme has most notably sought to sensitively design a graduation model which holds the hand of the extreme poor through a process of stipends, training, asset transfer, and hopefully, graduation into microfinance. This has been replicated elsewhere by the Consultative Group to Assist the Poor (CGAP), a World Bank-housed centre dedicated to increasing financial access for the world's poor, whose ten 'Graduation Program' pilots across eight countries involve consumption support, savings schemes, and skill and asset transfer. Does this sort of programme work? Das and Misha's impact evaluation of the CFPR programme (2010) provided some positive outcomes, but qualitative exploration showed that *internal channel* issues such as determination, confidence, and work ethic were some of the major factors which enabled effective use of CFPR. In other words, the psychological context of extreme poverty in many cases hindered successful engagement with the programme.

Without supporting those at the bottom to develop their aspirations, and confidence in taking risks, how can the short-term impacts of asset transfer be sustained? The majority of (well-managed) asset transfer projects do work on household microplanning to develop clear aspirations and goals, but does this promote sufficient behavioural change to enable continued investment when support has been removed? Evidence from cash transfer programmes provide one alternative, which appear to promote this sense of agency. Joseph Hanlon, Armando Barrientos and David Hulme (2010: 9) emphasised that 'Cash transfers are not charity or philanthropy but, rather, investments that enable poor people to take control of their own development and end their own poverty.' While evidence from cash transfer programmes show that cash tends to be spent by beneficiaries on consumption items like food, clothes, and school supplies (*ibid.*), the literature also emphasises that the poor are best-placed to make their own investment choices (Haarman et al., 2008, Chaudhry, 2010).<sup>4</sup> The rest of this paper focuses on one specific cash transfer project seeking to stimulate investment by the extreme poor. After outlining the research methodology and introducing the project, we explain its role in promoting behavioural change through addressing the psychological context of extreme multidimensional poverty.

## 5. METHODOLOGY

Our field research combined quantitative and qualitative sources of information. The analysis is strengthened by close involvement with the project since its inception, as well as triangulation of findings with field staff. We do not propose that the findings presented here are necessarily indicative of long-term sustainability, but rather they present a snap-shot of the current situation of beneficiaries at the time of data collection.<sup>5</sup> The specific sources of data were:

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<sup>4</sup> Supplemented by email correspondence with Standing, G. on the 21.3.2011.

<sup>5</sup> The role of shiree, for whom both the authors work, is to document and understand project impact during the project lifecycle, to improve operations in this project and others.



1. Field research with 37 beneficiary households (BHHs) in 16 villages conducted in March 2011. This involved 28 semi-structured interviews, 15 of which were with project beneficiaries who had participated in the project for more than one year (Phase 1), and 13 with recently selected beneficiaries (Phase 2), who had yet to begin project activities. These interviews included Likert scale closed questions, while quantitative-only surveys were conducted with an additional 9 Phase 1 BHHs.
2. A quantitative baseline of all 200 Phase 1 BHHs from March 2010.
3. Participatory monitoring exercises carried out with all Phase 1 BHHs in May 2010.
4. One researcher's own observations and recordings from a year of close operational work on the implementation of the project.

## 5. IMPACT – AN INNOVATIVE APPROACH TO CONDITIONAL CASH TRANSFERS

The Economic Empowerment of the Poorest (EEP) challenge fund (also known as shiree) is a partnership between UKaid from the Department for International Development (DFID) and the Government of Bangladesh, tasked with developing sustainable livelihoods for the extreme poor. One of the major components of shiree is the Innovation Fund, which supports innovative, untested, and in some cases radical interventions to help shiree achieve its goal of taking one million people out of extreme poverty.

One shiree-supported project is a demand-driven conditional cash transfer project called Improving Markets and Poverty Alleviation through Cash Transfer (IMPACT), implemented in the tribal region towards the Burmese border, called the Chittagong Hill Tracts (CHT). IMPACT seeks to enable agricultural and enterprise investment for the extreme poor by satisfying primary needs through cash transfers.

### **IMPACT Beneficiary Households - baseline status<sup>6</sup>**

- Average monthly income: 1,049Tk (\$14.15)
- Average monthly food expenditure: 958Tk (\$12.92)
- % of BHHs with cash savings: 6.5% (amount not mentioned).
- Education: 26.5% of household heads had been to school (Class I to X).
- Most cited source of daily income: Agricultural day labour (64.0% of total income).

The box above shows that when IMPACT started, its BHHs were faced with a range of dimensions to their poverty. Yet while these figures provide simple averages, each household faced these problems (and others) in varying severities. The extreme poor are a heterogeneous group, and while funding had been granted to the implementing NGO to develop a CCT project, the typical CCT model of providing cash for school attendance and immunisation appeared inapplicable when a large percentage of the beneficiary cohort had no children. Through needs assessments with BHHs, each household identified different needs, as well as different barriers to their graduation from poverty. Moreover, the funding was only available for 3 years; not long enough to break the intergenerational cycle of poverty in the same way that CCTs normally intend. What was required was a new form of a 'shot-in-the-arm' CCT.

The response of the NGO was to develop a CCT model which enabled different households to claim different transfers according to their own needs. Through extensive needs assessments seeking to identify barriers to investment, the NGO identified individual transfers which could enable some of these barriers to be confronted. These barriers included things like illness, prioritising expenditure on

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<sup>6</sup> This data is drawn from a baseline Household Profile questionnaire undertaken at the beginning of the IMPACT project with 200 beneficiaries (of which 199 of the surveys are valid).

non-IGA activities like schooling, and seasonal underemployment. The NGO then put together a menu, like that of any restaurant, from which beneficiaries could claim the transfers which they felt were the greatest priority for them. Each transfer (for things like building a latrine, paying for medication, or covering school expenses) had an equivalent cash sum, and a single condition. If these conditions were met, the households could claim again a few months later. If not, they couldn't. In addition to these primary needs transfers, the menu included emergency transfers in case of shocks at the household level, and transfers for income-generating activities. It was anticipated that, with other primary needs satisfied, these IGA transfers could be used efficiently and effectively by the beneficiaries.

Example: How IMPACT works

At the time of IMPACT's first needs assessment, Ching Prue Marma only made money from day labour and selling small amounts of rice wine. A young widow, her dream was to cultivate her own plot of land, but she said that she was not able to do so because she had no capital. Although she did earn money from day labour, she spent all of this money on food and her children's education, which she estimated to cost 200TK/month for each child. She also was often unable to work due to ill health. Food security, expenditure on education, and ill health were Ching Prue's primary barriers to developing an IGA – these needed to be ensured first, to enable her to use her money for land cultivation.

IMPACT therefore covered the cost of schooling (200tk/month for each of her two children), and provided cash transfers of 500tk to buy and install a latrine, and 300tk for de-worming tablets, to improve her family's health. This allowed Ching Prue to make two IGA claims (for 3000tk each), which she used to cultivate two different plots of land, one with ginger and the other with potato. She also used some of this money to cover her short-term food requirements, and later claimed for 500tk to visit the doctor when she fell ill.

The individual cash transfers on the menu were generously calculated. Not all of the cash was required to fulfil each transfers' conditions, and the exact way in which each Taka was spent was not monitored. This allowed that, beyond the satisfaction of some identified barriers, there was some element of unconditionality regarding the transfers' use. The NGO did not ensure that every Taka was spent.

## 6. IMPACT'S ROLE IN ENABLING BEHAVIOURAL CHANGE

Emerging evidence from the IMPACT project has shown significant changes in BHH income levels and income sources in the year since the project started. Phase 1 BHHs (who had been involved in the IMPACT project for a year) had on average earned 28,815Tk (\$388.55) from their primary IGAs supported by IMPACT, of which 22,108Tk (\$298.11) was profit.<sup>7</sup> This is more than double the entire annual income of the BHHs before the project, and does not even include the income from an ongoing process of reinvestment (which we estimate would increase this figure by 50%), or continued income from day labour. Ching Prue, from the example above, had done particularly well, earning more than 40,000Tk (\$539.37) from her primary investments in this period. All this came from an average cash transfer of only 10,082Tk (\$135.95) per household spread over the course of the year, of which only just over half was given directly for IGA development.

While at this stage we would not like to infer long-term behavioural change, the short-term income increases presented above, and the scale of reinvestment, did exhibit newly founded investment-behaviour from a demographic poorly primed to do so. At the time of research, 98.5% of Phase 1 BHHs were still involved in a range of investment activities (including long-term crops such as ginger and turmeric), despite the fact that all cash transfers had been disbursed months before. In comparison, not a single one of the Phase 2 BHHs (yet to receive cash support) were involved in any form of investment activity. Instead, they relied entirely on income from day labour, or begging and in-kind contributions. What enabled this efficient move to investment? We have identified four main factors in this change.

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<sup>7</sup> Enterprise tracking information was collected on an ongoing basis by field staff.

## 6.1. ENABLING BENEFICIARIES TO SATISFY THEIR PRIMARY NEEDS HELPED THEM BUILD A STABLE PLATFORM.

Given the psychological context presented in the opening sections, the extreme poor are unlikely to invest in the future without their more immediate concerns – or needs – satisfied first. IMPACT's CCT menu was developed by working with BHHs to identify their most significant needs, and BHHs claimed the transfers from this menu which they prioritised. Some transfers were claimed by most – 94% of BHHs claimed for de-worming treatment, and 76.5% for latrine installation – while other transfers related to the family were claimed only by those who needed it – 55.5% of BHHs claimed for school attendance for varying amounts of children, and 22.5% claimed for immunisation treatment. In addition to directly meeting conditions through transfer claims, flexibility in the cash disbursement mechanism (to be examined in the next section) allowed BHHs to meet other primary needs which were not on the menu.

The proposition that primary needs must be satisfied to encourage economic growth has received significant support from a macroeconomic perspective. Norman Hicks' (1979) World Bank study, comparing economic growth with the satisfaction of basic needs in 83 countries between 1960 and 1977 found that those countries that had satisfied more basic needs grew 2.5 times faster than those which had not. Likewise, Dréze and Sen (1995) argued that the cause of higher growth rates in China than India between 1980 and 1992 (9.1% compared to 5.2%) was due to significantly higher satisfaction of basic needs in China.

But how does this play out at the micro level? Our field research provides strong evidence that, much like the core concepts of Maslow or Alderfer's motivational literature would suggest, BHHs became motivated to satisfy less tangible needs like future security (through investment), only when their more priority needs were satisfied first. Oy Ching Marma, a Phase 1 BHH now cultivating rice, taro, and turmeric, typified the responses we heard. When asked why he had not invested in these activities before the project, he explained, 'If I have no food in my stomach, what will I be able to do?' Similarly, Swe Thui Marma explained why he prioritised food above all other needs: 'If there is food available, then I can do everything.' This conditional statement was indicative of the responses

collected throughout field research, and echoes the core concepts of needs approaches as well as capabilities theories.

It is important to highlight again that in this paper we are not focussing on the *physiological* implications of needs satisfaction as such (that good nutrition physically enables investment for instance), but rather the impact of needs satisfaction on time-preference and decision-making behaviour. Therefore, we are interested in the *perception* of needs satisfaction, which helps BHHs to reduce their discount of the future, and enables motivation for investment.

## 6.2 BHHS HAD THE FLEXIBILITY TO COVER THEIR OWN NEEDS

How did beneficiaries use their cash? According to conditions assigned in the menu, beneficiaries did indeed use cash to install latrines, send their children to school, and go to the doctor when needed (for example). Conditions were met in 95.4% of cases.<sup>8</sup> BHHs were keen to take the opportunity to ease their difficulties with the available cash. In addition to this finite menu of available transfers, there was further flexibility built into the system. The transfer sizes were always rounded up, meaning that more cash was given than was actually needed to fulfil the conditions. The expenditure of every taka was also not monitored.

These 'soft conditions' were designed to give BHHs the flexibility to respond to some of their other dimensions of poverty, by satisfying needs that the initial needs assessments could not capture. In addition to fulfilling the assigned conditions of their claims, BHHs took advantage of the loose conditions for larger IGA transfers to subsidise their primary needs. 73.3% of Phase 1 BHHs volunteered that they spent some of their IGA cash transfers on food, while 53.3% used some of their cash on house repairs, stockpiling of rice, or other non-condition-related needs. In fact, despite the already small sizes of IGA transfers (\$27-41), they spent on average 22% of these transfers on food.

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<sup>8</sup> Figure from the first round of transfers.

While 84.6% of Phase 2 beneficiaries reported that typical physiological needs like food, housing, and freedom from illness were their most important, there was significant diversity. Aung Ram Tanchanga explained why he gave a significant portion of his family income to the local temple, despite his stated inability to pay for sufficient food or shelter for his family: 'All of society donates 200Tk to the temple. It is a religious purpose. You have to do it. You have to... it is our social work.' Primary needs are identified differently by different people. In particular, for the extreme poor who suffer deprivation across multiple dimensions, the way in which they prioritise these needs varies greatly. Aung Ram prioritised his temple contributions, and was unlikely to invest in IGAs until this could be guaranteed.

In his excellent paper on household economic strengthening, Jason Wolfe recognised the value of '*conforming to* (rather than combating) the risk-mitigating behaviours followed by many vulnerable households' (forthcoming: 15, emphasis ours). While the necessary satisfaction of primary needs or priorities is often seen as a detractor of investment and thus economic sustainability, the evidence seems to suggest that the satisfaction of these needs can actually enable attention to be shifted to more abstract needs like future security (much like Maslow and Alderfer would argue).

Without individuals feeling that their needs are satisfied, what happens?

While present-bias has already been shown to cause microfinance loan defaults by the extreme poor (because they are used for immediate consumption), our research also suggests that this insecurity of needs satisfaction is one of the main reasons for the *low take-up* of microfinance with this group. As elsewhere in Bangladesh, microfinance institutions have a major presence in the IMPACT working area. None of the IMPACT BHHs had taken out microfinance loans (not surprising as this was an exclusion criteria of the project), yet while this is often blamed on MFIs failing to include the extreme poor as they are not credit-worthy, only 17.9% of BHHs we interviewed said that this was due to the MFIs. Rather, the vast majority – 82.1% – had voluntarily excluded themselves from microfinance, reporting that they were not confident in their financial ability to repay the loans.

BHHs complained that loans from MFIs require regular (weekly or monthly) repayments. Given their irregular income as day labourers, they did not trust that they could both satisfy their primary needs on a regular basis, and guarantee loan repayments. This trade-off between current needs satisfaction and investment repayments was very clearly illustrated by Cho Ching Marma: 'The money I get from daily labour I need for my food and children's education. Therefore I do not take out a loan. Who will I choose to give the money to? I would not choose the loan instalments.' Similar responses were heard across interviewees. U Hla Prue Marma explained, 'These farmers loans are very dangerous. You have to pay every week... In one week, I will maybe get five days' work, and I either can eat, or I will need all the taka to repay the loan. I have no other money in my house I can use. This would cause me too many problems.' Although BHHs recognised the potential long-term income that investment could provide, this future income was discounted without the satisfaction of primary needs guaranteed. Although the donor-funded IMPACT project cannot by any means be seen as an alternative to microfinance, the broader point about flexibility in funding, and necessary satisfaction of needs as a prerequisite to investment, is applicable to that field among others.

### 6.3 DEMAND-DRIVEN CCT CAN GIVE BHHs THE AGENCY TO INVEST IN IGAS ON THEIR OWN TERMS.

Flexibility in itself does little. Without agency, the individual cannot harness the opportunities provided by this flexibility, and may even be put at risk by it. Agency is of course difficult to cultivate with the extreme poor, who are forced to live 'hand to mouth' to meet immediate consumption needs. Our evidence suggests that, by enabling BHHs to guarantee their priority needs in the short-term, demand-driven CCT provides a platform from which aspirations can develop.

Supported by human development sessions which encouraged BHHs to visualise a 'dream' and develop plans for achieving their sustainable path out of poverty, BHHs claimed for the transfers *they* wanted. This made beneficiaries active rather than passive recipients of aid. They also fulfilled conditions *on their own terms*. The BHHs themselves needed to go out and buy the de-worming tablets, install their latrines, or go to the doctor (for example). This also built direct links between



beneficiaries and new institutions, which could be maintained after project completion.

The IGA transfers themselves were flexible – 82.3% of BHHs claimed IGA transfers for field crops, 12% for livestock, and the rest for homestead production or non-agricultural enterprise. The only condition was some visible investment, and that training was attended. This allowed BHHs to develop the IGA they wanted, at a pace which suited them.

Confronted with risk aversion and low aspirations, BHHs are not necessarily ready for wholesale investment immediately. Take the example of Ha Swe Marma. Although larger transfers were available for field crops (which require larger start-up costs), Ha Swe preferred to claim for a smaller transfer for non-agricultural investment, which he saw as providing immediate returns and involving less risk. After spending \$7 of the transfer on stockpiling rice, he invested \$20 in rice wine production, and was able to quickly turn this into about \$40. Soon after, he re-invested this into longer-term crops, but kept his rice wine facilities as rolling capital. Despite the fact that he could have received a larger transfer of this size in the first place for field crops, he preferred a less risky option at first, arguably until he was confident enough to make larger more risky investments. Such successes can be seen to be re-igniting a sense of agency on the part of the BHHs. Leandro Despouy highlighted the importance of ‘...these successes – which may seem insignificant in light of those countless battles that are lost daily – [but which] state in their own way (and in the wordless language of those who most of the time have not even learned to use these words), the reality of a fight’ (2001: 134). Referring back to the psychological literature presented earlier, enabling BHHs to achieve these small successes *on their own terms* can help create new ‘reference points’, enabling higher aspirations, and increased confidence.

It is important not to employ ‘overly protective tactics’ (Wolfe, forthcoming: 22) in projects, which create an unrealistic scenario that cannot easily be maintained after projects end. Demand-driven CCT can invite BHHs to take part in what Wolfe calls ‘riskable steps’ (ibid: 20), where they manage risk on their own terms *from a solid platform*. This can increase confidence and reduce the discount of the future.

#### *6.4 CASH TRANSFERS PROMOTED HEALTHY RELATIONSHIPS BETWEEN BHHS AND OTHER STAKEHOLDERS, AS WELL AS BETWEEN BHHS AND THEIR ASSETS.*

As discussed above, while cash was distributed by the project, the conditions were fulfilled by BHHs on their own terms. They bought the seeds, fertilizer, or livestock from the places they wanted to. While in some cases, this naturally meant a sub-standard item was purchased, many BHHs were actually able to acquire quality goods at a discounted rate from family members or others. Existing relationships evolved, and new relationships developed. Many BHHs visited government health clinics for the first time, and developed relationships with seed sellers, and landowners who they negotiated land rent deals with. The cash also forged a healthy relationship between BHHs and the NGO; rather than waiting to be told what to do next (as is frequently seen in asset transfer projects with the extreme poor), BHHs sequenced activities according to their own plans.

Field staff explained how BHHs receiving assets like livestock typically see them as property of the NGO, while BHHs with cash (which they were entitled to use according to a range of their own needs) saw it as their own, and sought to maximise its use. Cash distributed in this way is very different from the consumption smoothing stipends supplied in some asset transfer projects, which pay BHHs a weekly consumption subsidy, or a daily wage while they work their land. This stipend system can indirectly foster a client- or employee-based relationship between NGO and BHH, as well as between BHH and their asset, while flexibility of lump sum cash enables more ownership.

Ownership of cash enabled unexpected (but prioritised) expenditures. To the great surprise of field staff, numerous BHHs used their cash on private tuition for their children. Reinvestment was also immediate, and unexpectedly high, with many BHHs using smaller amounts of cash for multiple income streams. Also, at one transfer period, almost three quarters of BHHs chose to invest in potato, despite it not being the most profitable crop. Nevertheless, it was a crop which suited BHHs, as it was the only crop which could be stored for a long time and used by the household for consumption all year round. BHHs liked the fact that

they could simultaneously ensure their consumption and make money; this was more appealing than pure higher profit.

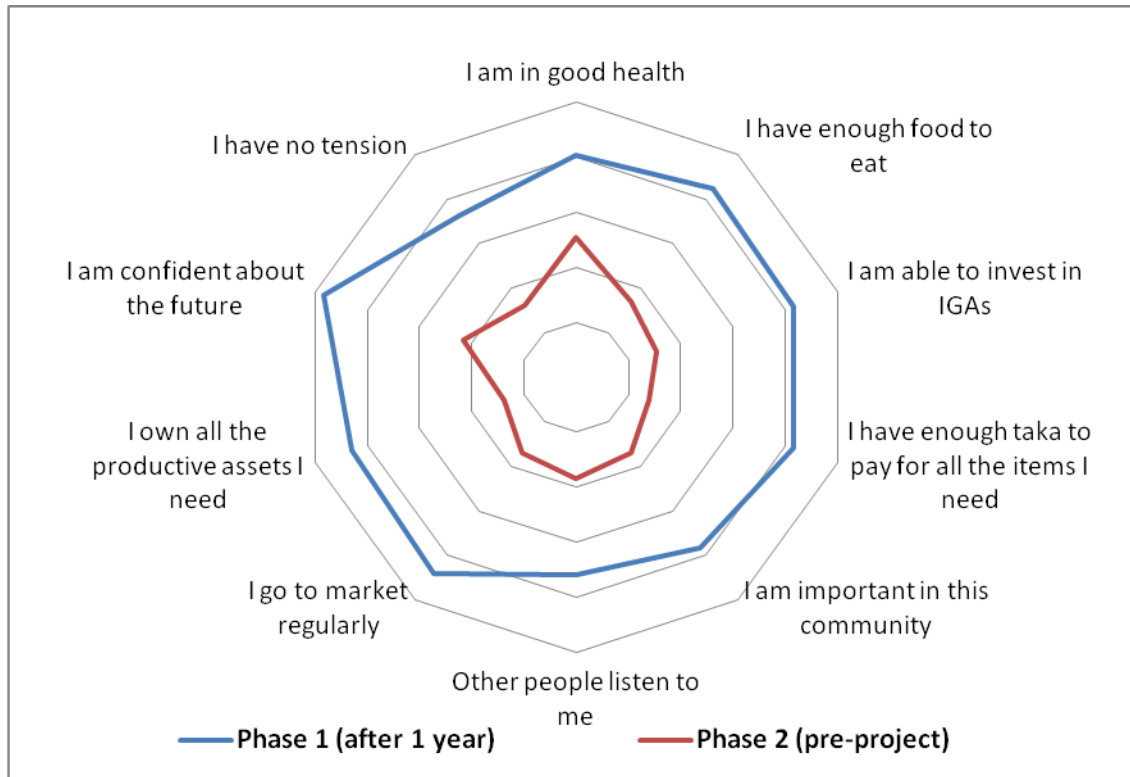
## 7. THE OUTCOME – A REDUCED DISCOUNT RATE

While the short-term income impacts have already been presented, and long-term behavioural changes are yet to be seen, the impacts on *attitudes* are clear.

After one year of participation in the project, 95.8% of beneficiaries either agreed or strongly agreed with the statement 'I have enough food to eat', compared to only 7.7% of those yet to start in the project. This of course does not necessarily represent a robust assessment of their nutritional condition, but rather their level of mental satisfaction of this need, which can be seen as a pre-requisite for investment due to the highly discounted future if food is not guaranteed. This without doubt contributed to the fact that 95.8% of Phase 1 BHHs agreed or agreed strongly with the statement 'I am confident about the future', with 87.5% strongly agreeing with it. This compares to 0% strongly agreeing with the statement from the Phase 2 cohort, in which 69.2% disagreed or strongly disagreed with the statement.

The graphic below shows the outcome of a Likert scale questionnaire with all interviewees, based on confidence levels in each of the five capitals in Scoones' (1998) asset pentagon – human capital, financial capital, social capital, physical capital and personal capital. While this may just appear to be a sign of a successful project, the significant growth across the board may not necessarily represent objective growth in this way, but personal confidence brought about from the cash stability and ability to satisfy primary needs.

Figure 1: A visual comparison of needs satisfaction perceptions between Phase 1 and Phase 2 BHHs



The impact of this confidence was a lowering of the discount rate. Possibly the most telling figures of confidence change came from a comparison of responses to the statement 'I am able to invest in income generating activities'. While not a single Phase 2 respondent agreed or strongly agreed with the statement, 87.5% of Phase 1 BHHs did. They felt comfortable to use their cash for things other than immediate gain. Without doubt, the presence of conditions were vital to stimulate the initial investment, but the success of this investment – the amount of effort put into the crop cultivation for example – and the reinvestment that followed, suggests a reduced discount rate on the future. At the time of research, 98.5% of Phase 1 BHHs were involved in IGA investment, some on a smaller scale, and others investing their entire asset base in IGAs. One beneficiary had even recently planted teak trees, which would not be ready for sale for thirty years.

The significant size of IMPACT's cash injection helped contribute to this increase in confidence and lowering of the discount rate. The typical incremental income increases that BHHs are likely to see in their daily lives are unlikely to allow this mentality shift. Macours and Vakis' (2008) review of a successful CCT project in Nicaragua emphasised the importance of having large enough transfers to enable behavioural change. Sa Sing Marma was just starting in the project when we spoke with her. When we asked 'What would you do if you received 1000Tk?', Sa Sing explained that she would just buy rice stock. 'What else could I do?' she asked. When the same question was repeated, but this time with a figure of 10,000Tk, she explained that she would buy good food, rice stock, put some money away for her funeral, and crucially, buy some pigs so that she could get an income when they had fattened. In fact, when asked what they would do if given 1000Tk, only 40% of Phase 2 BHHs said they would consider using it for investment purposes. This suggests that there may be some minimum efficient scale to trigger investment by the extreme poor, and might be one of the reasons why the small loans of microfinance (which can do little to change current household status) have struggled with this demographic. The extreme poor will continue to discount the future, unless they are given a solid, tangible, reason to believe that it will be good.

## 8. CONCLUSIONS AND LESSONS FOR OPERATIONS

This paper has sought to understand the psychological context of extreme poverty, which causes a discounting of the future and under-investment in income-generating activities. Moreover, through an analysis of one conditional cash transfer project, it has attempted to use this understanding positively, to provide practical guidance on how best to break this cycle. As with other studies on short-term CCT impact, whether or not this impact will be sustained is yet to be seen (Macours and Vakis, 2009), but even short-term impact can provide important messages. It is clear that the psychological side of poverty continues to be overlooked, which presents not only a significant flaw in the understanding we have of poverty as it is experienced, but also a missed opportunity for developing policy responses. While the primary goal of this paper was to bring increased recognition of the psychological context of extreme poverty, we are able to provide some practical operational recommendations for projects aiming to create livelihoods for the extreme poor:

1. Demand-driven conditional cash transfer systems can enable BHHs to satisfy needs.

This paper has clearly shown that the satisfaction of primary needs enables new motivations for investment. As this is a motivational issue rather than just a physiological one, it is essential that each individual feels that *their own* needs are satisfied according to *their own* priorities. While the IMPACT project involved claims and disbursements from a menu at periodic intervals in the year, we would advocate for an expanded form, which we call a 'Social Transfer Bank'. This institution (which could come in the form of an NGO project or a government body), would have an extensive menu of available transfers built out of work with the poor themselves. Transfers would be available for needs satisfaction, emergencies, as well as IGA stimulants. Whenever desired, BHHs would be able to claim their desired transfers, each of which would come with a condition, which must be met in order to continue claiming. The ongoing presence of this institution would promote confidence and reasonable risk-taking.

2. Confidence-building is crucial to extreme poor investment.

The platform from which IGAs are developed is vital to their success. Micro-insurance could build confidence in stability and reduce risk, but premiums would need to be suitably low, and payment systems suitably flexible, in order to enable buy-in from the extreme poor.

3. Focus on BHHs risk-management rather than just risk reduction.

The disproportionate amount of risk faced by the extreme poor is one of the key reasons why successful interventions with the moderate poor have failed with those most vulnerable (Wolfe, forthcoming). Most operational responses do recognise this, yet tend to respond by protecting beneficiaries from risk, rather than equipping them to deal with it.

4. Allow BHHs to develop livelihoods according to their own goals, at their own pace.

Livelihoods strategies vary both in the goal – those who prioritise physical asset development and income, compared to those who prioritise short-term wellbeing and primary needs satisfaction – and in the process by which these goals are achieved. Aspirations cannot be imposed, but must be owned by the individual. 'Soft conditionalities' can provide a flexibility which enables BHHs to respond to their own needs, as well as build agency and aspirations.

5. Cash transfers need to be large enough to promote a mentality shift.

The extreme poor need a bigger boost than the incremental increases they are likely to see in their daily lives, in order to stimulate investment. Further research should be conducted into the minimum efficient scale of extreme poor investment.

6. Employ psychologists.

Academics and practitioners have long pressed for the engagement of psychologists in programming – Robert Chambers felt that, 'the personal dimension is as paramount as it is perversely overlooked' (1995: 198) – but this continues to fail to materialise. Given the psychological context of extreme poverty and behavioural change, psychologists are needed both to design responses, and to support the field staff, whose facilitation is vital to promoting this change.

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