When Endowments and Opportunities Don’t Match: Understanding Chronic Poverty

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Motivation:

To contrast the roles of *level* and *structure* of assets/endowments in explaining chronic poverty.
Traditional focus: low level of assets/endowments; e.g. poverty trap literature.

Proposed focus: mismatch between the structure of endowments and the structure of opportunities – structural mismatch.
1. Characterization of chronic poverty

2. Endowments and opportunities

(a) Chronic poverty with or without trap
(b) Macro versus structural constraint
(c) Growth and chronic poverty
Characterization of chronic poverty

The income generation process over time can be described by the following recursive system of dynamic equations:

\[ Y_t = F(D_t, X_t) + e_t \]  \hspace{1cm} (1)

\[ D_t = G(Y_{t-1}, D_{t-1}, X_t) + \varepsilon_t \]  \hspace{1cm} (2)

where, \( Y = \) Income
\[ D = \) Endowments
\[ X = \) Exogenous factors
Characterization of chronic poverty (contd)

If the exogenous variables obtaining at time $\tau$ were to remain unchanged over the remainder of a person’s working life – denoted by the interval $[\tau, T]$ – then the income generation process can be expressed as:

$$Y_t = F(D_t, X_\tau) + e_t; \quad \text{for all } t \in [\tau, T] \quad (3)$$

$$D_t = G(Y_{t-1}, H_{t-1}, X_\tau) + \varepsilon_t \quad \text{for all } t \in [\tau, T] \quad (4)$$
Characterization of chronic poverty (contd)

Let \( D_t^* = \mathbb{E}(D_t) \).

Then the criterion by which we can identify the chronically poor is the time path of \( \mathbb{E}(Y_t \mid D_t^*, X_\tau) \).

The formal definition of chronic poverty can now be given as follows.

**Definition:** A person is chronically poor if \( \mathbb{E}(Y_t \mid D_t^*, X_\tau) < Z \), for all \( t \in [\tau, T] \), where \( Z \) is the poverty line income.
Fig. 1: Chronic Poverty
Fig. 2: Varieties of Poverty

CP → Chronic poverty
TP → Transitory poverty
LP → Life cycle poverty
Endowments and opportunities

(a) Chronic poverty with or without trap
(b) Macro versus structural constraint
(c) Growth and chronic poverty
Fig. 3: Varieties of Chronic Poverty
Macro versus structural constraint

(a) Macro: Limitation of Market Size

(b) Structural: Mismatch between the structure of endowments and structure of opportunities
Macro versus structural constraint (contd)

Examples of structural mismatch:

1. Mismatch of skills
2. Labour market imperfections
3. Gender
Growth and Chronic Poverty

Impact of growth depends on the nature of constraints:

1. Macro constraint: rate of growth matters

2. Structural constraint: pattern of growth and targeted interventions matter
Growth and Chronic Poverty (contd.)

Pattern of growth can alter the structure of opportunities

Targeted interventions can alter the structure of endowments