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# A review of the economic theories of poverty

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## ABSTRACT

This paper critically analyses the views of poverty adopted by different economic schools of thought which are relevant to the UK, as well as eclectic theories focused on social exclusion and social capital. We contend that each of the economic approaches has an important contribution to make to the understanding of poverty but that no theory is sufficient in itself; a selective synthesis is needed. Furthermore, economics by its nature omits important aspects of the nature and causes of poverty.

The key points that follow from this analysis are:

- The definitions of poverty adopted over time have reflected a shift in thinking from a focus on monetary aspects to wider issues such as political participation and social exclusion.
- Classical economic traditions contend that individuals are ultimately responsible for poverty and accordingly provide a foundation for laissez faire policies. By contrast, Neoclassical (mainstream) economics is more diverse and can provide explanations for poverty, notably market failures, that are beyond individuals' control.
- Both schools centre on the role of incentives and individual productivity in generating poverty but perhaps overemphasise monetary aspects, the individual as opposed to the group, and a limited role for government. They tend to be averse to policies of redistribution.
- Keynesian/neo-liberal schools, in contrast, focus on macroeconomic forces and emphasise the key role of government in providing not only economic stabilisation but also public goods. Poverty is considered largely involuntary and mainly caused by unemployment.
- Marxian/radical views see the role of class and group discrimination, which are largely political issues, as central to poverty. These theories assign a central role to the state in its intervention/regulation of markets. Prominent examples of anti-poverty proposals in this vein include minimum wages and anti discriminatory laws.
- Social exclusion and social capital theories recognise the role of social as well as economic factors in explaining poverty, giving them a similar weight. They offer a helpful contribution in understanding not only what the precursors of poverty are but also what underlies its persistence over time
- A selective synthesis of approaches is needed to maximise the relevance of economic insights in poverty reduction; furthermore, there is a need for a broader and richer range of motivations for human behaviour beyond the key focus of economics on purely material and individualistic aspects, such as the maximisation of one's own consumption less disutility of labour. This calls for an integrated approach that draws elements from other social disciplines such as political theory and sociology.
- The analysis implies a number of policy recommendations, notably the need to focus on provision of forms of capital (including education) to aid the poor; anti discriminatory laws; community development; and policies to offset adverse incentives and market failures that underlie poverty.

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## 1. INTRODUCTION

The aim of this report is to provide an overview of the main economic theories relating to the causes of and responses to poverty which are relevant to the UK. We critically analyse the views on poverty of different economic schools of thought such as the classical/neoclassical, neo-liberal/Keynesian and Marxist as well as looking at eclectic theories of social exclusion and social capital. We are concerned with both the positive (what is) and normative (what should be) aspects to the problem. Relevant UK empirical evidence which supports or contradicts the theories are referenced as part of the review, although as noted by Blank (2010), evidence is rarely conclusive, not least given the complexity of the issue of poverty.

A key challenge for the review is that much of the theoretical work on poverty relates to developing countries and absolute poverty (such as Dasgupta (1995) on absolute destitution) while a much slimmer body of research has been devoted to relative poverty in advanced countries. However, the extreme patterns observed for developing countries can still apply in attenuated form or to minority groups such as the homeless (Sen, 1983). Furthermore, a fresh look at the wider literature on world poverty may also provide new insights into UK poverty and its causes.

Another challenge is that the majority of the existing theoretical contributions on poverty are in the neoclassical tradition and we seek to balance this with other approaches, while remaining comprehensive. Furthermore, even though most of the theories we examine fall into a specific broader category, some of them are more eclectic. In these cases we have made use of our judgement to group them into the categories that we consider correspond most closely to them (for example in allocating the monetary approach to the neo-classical tradition).

The report is given added urgency by the facts; with 22.7% of the UK population considered to be at risk of poverty or social exclusion in 2011<sup>1</sup>, this social and economic phenomenon is a major challenge for policy. And the issue is not just one of joblessness; just over half of the 14 million people in poverty - surviving on less than 60% of the national median (middle) income - were from working families, while pensioner poverty is at historically low levels.

The rest of the report is organised as follows. In section 2 we provide a concise summary of key definitions of poverty in the literature. Section 3 introduces the main theories of poverty, with section 4 dealing with Classical theories, section 5 Neoclassical theories, section 6 Keynesian

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<sup>1</sup> This is equivalent to about 14 million people according to the official EU definition (ONS, 2013).

theories, Section 7 Marxist/radical theories and section 8 focusing on the social exclusion and social capital approaches. Finally, section 9 concludes with a summary and set of recommendations for JRF.

## 2. BRIEF OVERVIEW OF DEFINITIONS OF POVERTY

In order to effectively analyse economic causes and propose potential solutions to the problem, we need first to define what poverty is. We thus start our review by outlining available working definitions of poverty and then, as the paper progresses, we show the treatment each of them receives under different analytical perspectives. The views on the responses to poverty by the different schools of thought are highly influenced by the definition that each of them utilises. It is thus essential to consider departures from the particular definitions each one of them adopts. For example, while JRF (2013) defines poverty as the situation where "a person's resources (mainly their material resources) are not sufficient to meet minimum needs (including social participation)", the World Bank in one of its definitions emphasises more specific conditions such as "malnutrition", "illiteracy" and "disease", while also mentioning "human decency" (Coudouel et al., 2002). Some of these aspects may of course be more relevant to poor countries than to the UK, although their impact (e.g., via mortality and educational opportunities of the poor) is still noticeable.

Furthermore, the concept of poverty has typically been framed by accompanying qualifiers such as absolute and relative poverty. Most work focused on the UK has assumed that relative poverty is the key concept (Townsend, 1979) but Sen (1983) and other authors contend that absolute poverty, defined in terms of human capabilities in place of income or commodities, should be the relevant concept instead. There are other intimately related "contested concepts" in the field of poverty such as the poverty line and the poverty trap as well as the cycle of deprivation and the concept of social exclusion, all of which we analyse in the UK context.

Accordingly, before delving into the theories regarding the causes and responses to poverty envisaged by the different schools of economic thought, we provide a brief overview of some of the most salient definitions of poverty that have been suggested in the literature. We also discuss the interrelations between each definition and seek to establish whether there exist common elements reflecting the same fundamental principles that a unified idea of poverty would have (i.e., the points in which the different definitions of poverty intersect).

### **2.1 Historic definitions**

The father of modern economics, Adam Smith defined poverty as "the inability to purchase necessities required by nature or custom" (Smith, 1776). In this definition, the social/psychological status aspect of poverty (custom) receives implicitly the same weight as the material, purely economic condition (nature). He further elaborated on this definition by clarifying the type of necessities required to be considered *non-poor*: "by necessities I understand not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders indecent for creditable people, even of the lowest order, to be without" (Smith, 1776). Hence this mixes an absolute measure (necessities required by nature) with aspects of a relative measure (necessities required by custom).

On the latter, "a linen shirt, for example, is, strictly speaking, not a necessary of life. The Greeks and Romans lived, I suppose, very comfortably though they had no linen. But in the present times, through the greater part of Europe, a creditable day-labourer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty which, it is presumed, nobody can well fall into without extreme bad conduct" (Smith, 1776). The last claim thus confirms that, even for the pioneer of the classical school of economic thought, there must be an element of relativity concerning the state of being poor, while it also showcases the critical view at the time of those who are poor ("bad conduct"). This critical view is a key point, which stands at the core of the stigmatising and shaming of those in poverty.

Karl Marx was more explicit on the context-specific and relative dimension of the notion of poverty and did not mention an absolute measure: "Our needs and enjoyments spring from society; we measure them, therefore by society and not by the objects of their satisfaction. Because they are of a social nature, they are of a relative nature" (Wood, 1988)

The definition of poverty proposed by Joseph Rowntree in the early 20th century distinguished between *primary* and *secondary* poverty. He understood primary poverty as "earnings insufficient to obtain the minimum necessities for the maintenance of merely physical efficiency" (Rowntree 1901, quoted in Townsend, 1979)<sup>2</sup>. To his mind, the concept of *secondary* poverty was based on the more subjective judgement of whether the people he interviewed were "in obvious need and squalor", despite lying above the poverty line he delineated (Laderchi et al., 2003). However, Rowntree himself extended the definition of primary poverty later on by stating that a requirement for "non-poverty" included "having a bath and a garden" (Laderchi et al., 2003). This last consideration made the definition of poverty explicitly dependent on the socio-economic environment at the time (i.e., it had a strong relative as well as absolute component) and, thus, closer to the current measure

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<sup>2</sup> Note that this is an absolute measure of poverty based on living standards. In estimating the poverty line, Rowntree estimated the monetary requirements for a nutritionally adequate diet, clothing and rent.

employed by JRF and to other prevalent ones in the UK, such as that which considers 60% of median household income to be the relevant threshold level. Additionally, Rowntree identified a "cycle of poverty", whereby children, young married couples with children and old people constitute the social groups that bear the highest risk of falling into poverty. Even though the features defining the poor were described, no formal attempt was made by him to inquire into the possible causes of the occurrence of these states, such as labour market inequality or unequal access to employment. Townsend (1979) suggests that this classification represented a shift away from the paradigm of "conditional welfare for the few" that had prevailed before towards the idea of "minimum rights for the many".

## 2.2 Contemporary economists' definitions

Currently, JRF defines poverty as the situation where "a person's resources (mainly their material resources) are not sufficient to meet minimum needs (including social participation)" (JRF, 2013). This definition is based on historic definitions such as those above, but also adopts elements from broader definitions of poverty by acknowledging the importance of the social life of the individual and not merely his or her purely material circumstances. Hence, it captures both the absolute and relative characteristics of poverty.

Amartya Sen is one of the most important contributors to the poverty and development literature. He has cast light on the (still ongoing) debate between the proponents of *relative* definitions of poverty, on one hand, and those that advocate an *absolute* view on poverty instead, as highlighted in the definitions above.

He criticises both views as suffering from a number of shortcomings. In his opinion, "absolute deprivation in terms of a person's capabilities relates to relative deprivation in terms of commodities, incomes and resources" (Sen, 1983). Sen envisages a fixed (i.e., invariant across both societies and time) set of capabilities that every human being should be able to exercise in order for her not to be considered poor. The idea is that in order to fulfil this requirement, the level of material needs/resources necessary to develop these capabilities may change over time and across societies (as opposed to the capabilities themselves). Thus, poverty is context-dependent on the means to end it, but it is not context-dependent on the non-material goals whose fulfilment characterizes poverty.

He makes use of the aforementioned example by Adam Smith regarding the need for a linen shirt for dignity in the 18<sup>th</sup> Century to illustrate the point that the *absolute* satisfaction of certain needs ultimately depends on a person's *relative* position vis-a-vis others. The point is that linen shirts (i.e., the material/resource basis) were not a sine qua non for "public dignity" (i.e., the non-material

capability/goal) in Greek times, but it definitely was at the time of Adam Smith. So the same absolute goal (e.g., attaining "public dignity") requires different relative material needs in different contexts (e.g., Ancient Greeks vs. 18th century Britain).

Thus, the socio-economic environment surrounding the individual gives this notion of poverty a sense of relativity. In Sen's own words, "poverty is an absolute notion in the space of capabilities but very often it will take a relative form in the space of commodities or characteristics" (Sen, 1983). The need for certain absolute levels of capabilities/capacities may in turn translate into relative needs in terms of material commodities, resources and incomes. Another example of this would be the increasing need in today's network economies to have access to advanced communication technology services in order to fulfil the fundamental capability of being able to communicate with others and avoid social isolation; it is safe to say that the attainment of the (same) social participation goal did not require the use of such technology-intensive goods and services in the past as it does nowadays.

Households are deemed to start with a stock of assets/endowments that are mapped<sup>3</sup> into entitlements/capabilities, with the social, political and economic environments positively or negatively mediating in this transformation process of endowments into the goods and services needed to earn a *decent* human life. Poverty is the result of insufficient entitlements defined as a broad package of rights including health, education and freedom, which are "indicators of freedom to live a valued life" and realise human potential (Sen, 1999). Therefore, publicly produced goods as well as money are important.

Sen acknowledges that his *capability* approach is to a great extent inspired by John Rawls's (1971) moral analysis of justice, which revolves around the question of what any individual would choose behind the "veil of ignorance" about their social position and related "primary goods" the person has<sup>4</sup> (i.e., his approach could be deemed as a possible "extension" of the Rawlsian perspective). It follows that Sen's conceptualisation of poverty represents an implicit critique of classical and neoclassical approaches based solely on money income and/or utility, by focusing instead on the "objective" accomplishment of the freedom to live a valued life which is objective and not based (as

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<sup>3</sup> Sen explained his views on poverty in rather abstract and mathematical ways and interpreted poverty as the lack of enough elements in the "set" of material goods and services that are ultimately "mapped" (i.e. transformed) into the realization of capabilities.

<sup>4</sup> For Rawls, these are things every rational person is presumed to want, and are divided into natural primary goods (intelligence, imagination, health, etc.) and social primary goods (rights, liberties, income, wealth, social bases for self respect, etc.).

utility is) on individuals' "subjective" perceptions that may be affected by current conditions and possibilities<sup>5</sup> (Laderchi et al., 2003).

A problem with Sen's approach is the difficulty of measuring broad definitions of capabilities. Thus, research in this field tends to measure outcomes rather than capabilities; for instance, life expectancy and literacy rates are used in practice as proxies to capture non-directly-measurable concepts such as, respectively, the capability of attaining a disease and disability-free life and the capability of critical thinking and autonomy/freedom of thought. These measures are arguably the best approximation of the intangible concepts of capabilities in applied research.<sup>6</sup> Other criticisms of Sen's capability theory include it being regarded as excessively individualistic<sup>7</sup>, his omission of an explicit determination of which capabilities are important and which are not (he argues that those are political issues for the society itself to decide) and the problem of *illiberalism*, in the sense that it follows from Sen's paradigm that the delineation of what the good life is meant to be is externally imposed/evaluated, as opposed to decided upon by the individuals themselves<sup>8</sup>.

Peter Townsend defines poverty as "the lack of the resources necessary to permit participation in the activities, customs and diets commonly approved by society" (Townsend, 1979), which is a pure relative measure. From this definition, it follows that different kinds of resources, and not just earnings, need to be examined (e.g., inherited as well as accumulated wealth are also of key importance).

According to this author, the flow of resources accruing to individuals is governed by a set of different *systems* operating for each of them. Poverty is in part the outcome of the combination of these systems at work. Some, such as the wage and social security systems, affect larger shares of the population than others. His definition of relative poverty is a more refined version than some

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<sup>5</sup> For example, people can become satisfied with a low level of income and future possibilities on the assumption that nothing else is possible.

<sup>6</sup> Nussbaum (2000) has provided a list of available variables that could be used to measure basic capabilities. The set of capabilities and the suggested measures for them include: for life: normal length of life; for health: good health, adequate nutrition and shelter; for bodily integrity: movement; choice in reproduction; for senses: imagination and thought, informed by education; for emotions: attachments; for practical reason: critical reflection and planning life; for affiliation: social interaction; protection against discrimination; for other species: respect for and living with other species; for play; Control over one's environment, politically (choice) and materially (property).

<sup>7</sup> Gore (1997) criticises Sen's approach in its absence of consideration to certain goods which individuals may have reason to value and which are 'irreducibly social' because they cannot be reduced to properties of individuals, such as a shared language, set of moral norms, or political structure. A related criticism argues that Sen's emphasis on individual freedom fails to consider how one individual's freedom may affect others as conceptualised in (Nussbaum, 2003) as a sort of *clash* between individual freedoms.

<sup>8</sup> This is one of the aspects in which Sen's approach departs from Rawls', as the latter noted that the reason for liberals to focus on the fair allocation of general purpose resources rather than achievement (as the capability approach does) is that it best respects each individual's fundamental right to pursue their own conception of the good life, instead of a conception of life valued by a supra-individual entity (Wells, 2012).

others in that it contains explicit mention of the exclusion effect that poverty may carry with it; in his mind, relative poverty is a situation where someone's "resources are so seriously below those commanded by the average individual or family that they are, in effect, excluded from ordinary living patterns, customs and activities" (Seymour, 2009). As we will see, social exclusion is an important aspects for some of the explanations of poverty that have been proposed in the literature.

### **2.3 Contemporary institutions' definitions**

The World Bank (Ravallion and Chen, 2008) states that "a common method used to measure poverty is based on incomes or consumption levels. A person is considered poor if his or her consumption or income level falls below some minimum level necessary to meet basic needs. This minimum level is usually called the "poverty line"". When estimating poverty worldwide, the same benchmark poverty line has to be used, and expressed in a common unit across countries. Therefore, for the purpose of global aggregation and comparison, the World Bank uses reference lines set at \$1.25 and \$2 per day (in 2005 Purchasing Power Parity terms). Such a simple monetary approach to measuring poverty is widely used, for example in tracking progress towards the fulfilment of the Millennium Development Goals. Such extremely low income levels are very rare in the UK, although in certain cases of extreme poverty (e.g., the homeless), such levels of income might be relevant.

Nevertheless, the World Bank (2004) also offers a more detailed definition of poverty adaptable to different country conditions, whereby poverty is defined as "pronounced deprivation in well-being, comprising many dimensions. It includes low incomes and the inability to acquire the basic goods and services necessary for survival with dignity. Poverty also encompasses low levels of health and education, poor access to clean water and sanitation, inadequate physical security, lack of (political) voice, and insufficient capacity and opportunity to better one's life". Exhibiting both absolute and relative elements, this constitutes a very broad definition which includes the multi-dimensional character of poverty and the somewhat elusive concept of "dignity", while emphasising, more than any of the other definitions discussed, the importance of political and individual freedoms.

One of the broadest contemporary views of poverty is that of the European Commission, which claims that "people are said to be living in poverty if their income and resources are so inadequate as to preclude them from having a standard of living considered acceptable in the society in which they live. Because of their poverty they may experience multiple disadvantage through unemployment, low income, poor housing, inadequate health care and barriers to lifelong learning, culture, sport and recreation." (European Commission, 2004). This relative measure explicitly acknowledges the society-specific nature of poverty. It also points to a wide array of potential sources of economic and social deprivation that follow from experiencing deprivation in "income

and resources". Hence, there exists an implicit mapping between material resources and outcomes that are not necessarily material *per se*<sup>9</sup>.

The Commission continues, in line with Townsend's views, by highlighting the importance of the processes of exclusion and marginalization associated with poverty: "...They [the poor people] are often excluded and marginalised from participating in activities (economic, social and cultural) that are the norm for other people and their access to fundamental rights may be restricted" (European Commission, 2004). This is thus a far-reaching definition that comprises aspects that are absent in other views, such as the exclusion from cultural activities. Incorporation of social exclusion constitutes a step forward from other conceptions of poverty in being socially rather than individually defined as well as in highlighting the importance of the dynamics over time and the processes that bring about poverty (Atkinson, 1998). On the other hand, partly because of its wide scope, this definition suffers from lack of measurability and tractability at the practical level<sup>10</sup>. Note that differences with respect to the World Bank's definitions may partly relate to their constituencies, whereby EU countries are not generally characterised by destitution, unlike many of the World Bank's client states.

As noted by Gordon (2006) the UK government has traditionally had no official definition of poverty but has signed various treaties and agreements that incorporate definitions of poverty. Notably, the EU definitions discussed in Section 2.3 apply to the UK as a member state. Furthermore, government publications such as ONS (2013) "Households Below Average Income" work with the monetary measure "households in the UK with incomes below 60% of contemporary median net disposable household income before housing costs (BHC), or after housing costs (AHC)". This is a relative measure which changes with median income itself. This definition was enshrined in the 2010 Child Poverty Act which established four targets for 2020 to: (1) reduce the proportion of children who live in relative poverty (with incomes less than 60% of the median income) to less than 10% (2) reduce the proportion of children living in material deprivation with a low income (a measure that captures both access to goods and services, and low income) to less than 5% (3) reduce the proportion of children experiencing long periods of relative poverty and (4) reduce the proportion of children living below an income threshold fixed in real terms (often called "absolute poverty") to less than 5%.<sup>11</sup> The UK in focusing on relative poverty follows an EU tradition that is distinct from the US

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<sup>9</sup> This makes this definition close in spirit to that of Sen noted above.

<sup>10</sup> This is a trait which is common amongst the majority of definitions that entail an extension from a purely monetary view of poverty, as shown below.

<sup>11</sup> Absolute low income is defined as an equivalised net income below 60% of an adjusted base amount, with the base year being 2010/11.

where an absolute poverty benchmark set in the 1960s and updated by consumer prices has been most influential.<sup>12</sup>

A definition of poverty which attempts to encompass both the developing and developed country contexts was published in the *Copenhagen Declaration* of the United Nations in 1995. During the summit leading to that declaration, it was agreed that poverty includes "lack of income and productive resources to ensure sustainable livelihoods; hunger and malnutrition; ill health; limited or lack of access to education and other basic services; increased morbidity and mortality from illness; homelessness and inadequate housing; unsafe environments and social discrimination and exclusion. It is also characterised by lack of participation in decision making and in civil, social and cultural life" (United Nations, 1995). The elements of lack of participation and exclusion are thus again emphasised, while the possibility that the status of being poor leads to or results from "discrimination" is also put in the forefront. Furthermore, regarding the global relevance of the concept, in the Declaration it is stated that "...it [poverty] occurs in all countries: as mass poverty in many developing countries, pockets of poverty amid wealth in developed countries, loss of livelihoods as a result of economic recession, sudden poverty as a result of disaster or conflict, the poverty of low-wage workers, and the utter destitution of people who fall outside family support systems, social institutions and safety nets" (United Nations, 1995).

These last remarks describe the different ways in which poverty manifests itself in developing and developed countries and also highlight the main causes of poverty, including the role of social goods as well as an implicit notion of social capital. All these items are covered in the next sections.

## 2.4 Summary

Sections 2.1-2.3 above show a tendency towards a gradual enlargement of the set of dimensions captured by the concept of poverty. Nowadays, it is widely considered that poor individuals cannot be studied in isolation from their socio-economic environment and that the relevant benchmark to which the situation of the poor should be compared is characterized by a broad set of factors that is subject to changes both over time, due to the advancement of societies, as well as across countries. This is especially true in the context of developed countries such as the UK, although not in the UK government's implicit definition from the Child Poverty Act. It is interesting to note that among historical economists this paradigm of poverty corresponds most closely to Marx's view.

All the definitions by the authors and institutions provided above can be placed in some point of the spectrum that ranges from the purely relative to the purely absolute conceptions of poverty, while

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<sup>12</sup> As noted by Nolan and Marx (2009) it has fallen from 49% of median income in 1959 to 28% in 2005 and thus may "lose touch with the everyday understanding of poverty in society".

some of them (e.g. pure monetary approaches) lend themselves more naturally to the adoption of the so-called "poverty lines" than others. We now provide a list of working definitions of these concepts:

- Absolute poverty: "a condition characterised by severe deprivation of basic human needs, including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also on access to services" (United Nations, 1995). Concern for such absolute poverty is naturally greater where there is a risk of destitution than where all have access to means of survival (Laderchi et al 2003).
- Relative poverty: "a standard which is measured in terms of the society in which an individual lives and which therefore differs between countries and over time." An income-related example would be living on less than 60% of median UK household income adjusted for household size and after housing costs (JRF 2013).
- Poverty line: "the minimum level of income deemed adequate in a particular country" (Ravallion, 1992). To aid in cross-country comparisons, in 2008 the World Bank revised its international poverty line to \$1.25/day at 2005-based purchasing-power parity (Ravallion et al., 2009).<sup>13</sup>
- Poverty trap: a state where poverty tends to persist due to "self-reinforcing mechanisms" (Azariadis and Stachurski, 2005). These negative feedbacks are found between poverty and a number of circumstances such as undernourishment, lack of access to insurance, population growth, a degraded environment and even economic growth.

All these concepts will be frequently utilized throughout this paper. In the next sections we make reference to these definitions and put them into context by investigating the underlying assumptions and theoretical approaches behind them.

### 3. REVIEW OF MAIN ECONOMIC THEORIES ON POVERTY - INTRODUCTION

We now turn to the analysis of the main economic theories of poverty, with particular attention given to their relevance for the UK. This analysis is divided into sections describing the broad economic frameworks to which each of the theories belong. We begin with the treatment of poverty by the classical and neoclassical schools, or the so-called "orthodox" approaches, which initiated the

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<sup>13</sup> As noted by Nolan and Marx (2009) poverty lines give rise to a problem of aggregation, since the simple number of people below a poverty line may not adequately capture the extent of poverty. Accordingly, measures such as the Sen-Shorrocks-Thon measure have been derived that also include the depth of poverty (how far individuals are below the poverty line) and the extent of inequality.

formal analysis of poverty in the 19th century. We then proceed to those theories that emerged partially as a reaction to the assumptions, hypotheses and conclusions derived by the classical economists. Within this group of theories, we encounter those that accept and depart from the foundational premises of classical economics, but introduce a number of novelties (namely the theories of the economic liberals such as Keynes), and those that examine the problem from a completely dissimilar perception of the socio-economic system (namely the radical economic theorists, such as the Marxists).

We focus as we proceed on the connection between each one of the theories overviewed and the definition of poverty employed by the JRF and by other individuals and institutions as highlighted in Section 2. Likewise, we also explore the implications they may have for particularly vulnerable groups in the UK, including lone parents, pensioners, the disabled, immigrants, low-income working families, the homeless, women and minority ethnic groups.

The principles and assumptions on which the classical and neoclassical schools of economics rest are nowadays the most strongly affirmed in the economics profession, having gained over time the labels "conventional", "mainstream" or even "orthodox". As might seem unsurprising, the dominance of these currents of thought has permeated the assessments and analyses of poverty performed in general by economists; formal analyses have, by and large, been approached mainly from the classical or neoclassical perspective. Due to this strong pervasiveness of the orthodox approach, other views, notably the Keynesian and Marxian approaches, can be examined in terms of their differences with respect to the classical and neoclassical models.

This ubiquity of the classical paradigms in the field also implies that the sections devoted to the classical and neoclassical views are somewhat lengthier than the other major frameworks. It is nevertheless important to keep in mind that each theory cannot be understood in isolation from the others. Furthermore, the differences between them are often contingent on particular interpretations, rather than reflecting *de facto* radical divergences<sup>14</sup>. The views on the causes and consequences of poverty by the currents of thought presented are not completely compartmentalised; each of them can be understood as part of a continuum.

Before proceeding to the detailed review of the classical and neoclassical views on poverty in the following sections, we first provide a brief discussion of the fundamental differences between the two. The neoclassical model can be regarded as the main branch stemming from a trunk composed

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<sup>14</sup> An illustrative example is that of the liberal-Keynesian school of thought which accepts most of the fundamental premises of the classical framework but departs in other no less important respects from it.

of the basic principles of the classical economic thinkers. Roughly, the main points of dissimilarity between the two are:

- **Utility:** the main difference between classical and neoclassical economics lies in the concept of utility (i.e., showing the perceived value of the good to the consumer, allowing an ordinal representation of consumer preferences). In classical economics, utility is conspicuously absent in theories of value, labour and growth.
- **Value:** in the classical tradition, the value of a good is equivalent to the cost of producing it. In the neoclassical school, the value of a good is a function of the demand for it and the supply of it. Therefore, in classical economics, value is an inherent property; in neoclassical economics, value is a derived property. In classical economics, value is cost; in neoclassical economics, value is utility.
- **Rationality:** Rationality is emphasized in neoclassical economics but not in classical economics. In neoclassical economics, individual agents have rational preferences that guide their purchasing and selling behaviour: Individuals seek to maximize utility over their consumption and labour choices, and firms seek to maximize profits by making marginal calculations of potential gain or loss from varying factors of production, types of consumption etc. In classical economics, no distinction is made between firm and individual; the profits that accrue to firms are the same as wages that accrue to workers, economic benefits brought on by the "invisible hand" of the free market.
- **Equilibrium:** Classical and neoclassical definitions of equilibrium are fundamentally different. In classical economics, equilibrium occurs when (given) savings are equal to investment. Equilibrium is a function of exogenously given levels of wages and interest. In neoclassical economics, equilibrium occurs at the intersection point of the supply and demand curves, which are in turn determined by the rational, optimising behaviour of the agents seeking to maximise utility subject to scarcity and participating in the full set of markets in the economy. The standard neoclassical economic paradigm is the "competitive equilibrium" where given an initial set of asset-endowments for individuals (talents, skills, capital), financial, labour and product markets will, subject to certain conditions, operate to set prices so that all supplies and demands balance, and no one could be made better off without another being worse off ("Pareto optimality").

#### 4. CLASSICAL THEORY

Classical economics, developed mostly during the 18th and 19th centuries, included theories on both value and distribution. The value of a product was thought to depend exclusively on the costs involved in producing that product. The explanation of costs in classical economics served

simultaneously as an explanation of distribution. Expressed in its original agricultural terms, a landlord received rent, workers received wages, and a capitalist tenant farmer received profits on their investment. No exploration was carried out into the driving forces behind the different flows of income accruing to the different actors involved (i.e., on the shape of the distribution of these payments). This approach included the prominent work of Adam Smith and David Ricardo.

Broadly speaking, classical theory typically assumes that the outcomes of the exchanges taking place in the marketplace are efficient, and hence wages faithfully reflect individual productivity. Accordingly, poverty is mainly seen as a consequence of poor individual choices (e.g. the poor lack "self control") that affect productivity negatively, although it is also acknowledged that pure differences in underlying genetic abilities are also potential causes of poverty. As discussed below, the "wrong" choices made by individuals may lead them to find themselves in a "poverty or welfare trap". Beyond a minimum level to prevent destitution, state intervention is generally viewed adversely as a source of economic inefficiency; by generating incentives that are misaligned between poor individuals and society as a whole, welfare programs are perceived as a potential cause for or reinforcement of poverty (through welfare dependence). The government is, at most, justified to intervene whenever poor people need supportive activities or threats to correct for perverse economic incentives. A large majority of the policy prescriptions under this view focus on efforts to raise the productivity of deprived individuals in order for them to join the labour force as soon as possible (although it is acknowledged that some individuals – the young, the sick, the old - cannot participate and will need alternative support).

Given these broad defining characteristics, several different approaches can be distinguished within the classical tradition, each of them underscoring different factors as causes for the incidence of poverty. We discuss each of them in turn.

#### **4.1 Behavioural/decision-based theory:**

As Esping-Andersen (1990) argues in his "three regime" classification of different welfare models currently in use in different developed nations, classical views on poverty correspond for the most part to the market-espousing, *laissez-faire* principle that tends to attribute responsibility for the outcomes of individuals, such as their well-being, to their own economic decisions. Hence, in this view, people are to be held accountable for their experiences of poverty, which are ultimately linked to purely individual deficiencies. Rank et al. (2003) point out that these individual characteristics can range from "the lack of an industrious work ethic or virtuous morality to low levels of education or

competitive market skills", a view which they contend has gained ground since the mid 1970s.<sup>15</sup> This implies that there is virtually no role for the state to intervene, given that the individual traits that cause poverty are either "givens" or determined by market forces. In this context, according to Esping-Andersen (1990), the UK would fall in the category of a liberal state (along with the USA, Australia and Canada), given less generous social benefits and, hence, a smaller set of social rights compared with Continental Europe.

The behavioural view was also pervasive during the 19th century, when it was generally believed that "poverty was necessary because otherwise the labourers would not be motivated to work" (Townsend, 1979). Policy was therefore interwoven with notions of *laissez-faire*, which at the time linked "virtue with work". This stance on poverty was also highly influenced by the prevailing principle of "conditional welfare for the few" as in the Victorian Poor Law. The policy prescriptions derived from this principle focused on keeping public redistributive expenditure low and subject to means testing, while maximizing relief through charity and voluntary effort. Hence, this understanding of the issue of poverty revolves around the belief that the poor self-select into deprivation, which is not the result of market failure, but, rather, the result of shortcomings in their own effort and capabilities (Townsend, 1979). Roughly speaking, the only reason left to support the poor is out of *morality*: help or aid is not conceived of in any other way (such as, for example, as a form of investment in their skills). Given the purely ethical *raison d'être* of poverty alleviation, the preferred method of relief was charity-based assistance.

It is important to reiterate that, in this strand of classical literature, which hypothesises that low productivity and/or non-involvement in markets is the result of conscious choice, it is believed that individuals themselves play an *active* part in influencing their outcomes, with little to no role for the social and/or political environment surrounding them. The crucial underlying premise is thus that, although other options are available, they still make choices that limit their access to economic resources, thereby raising their risk of ending up in poverty<sup>16</sup> (Blank, 2010). This leads the proponents of this approach to oppose the use of subsidies as a measure to alleviate poverty. Kasarda and Ting (1996), among others, suggest the following alternative small-scale measures to welfare transfers in an effort to prevent a "welfare trap" where people lack an incentive to work;

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<sup>15</sup> Rank et al op cit contend that prior to that time, research consistently had demonstrated for decades that a majority of people in the U.S. attributed poverty to structural conditions, such as a lack of opportunity (see Keynesian and liberal theories in Section 6), and not to supposed deficiencies among poor people.

<sup>16</sup> An important caveat made by Blank (2010) is that such choices are not always necessarily viewed disrespectfully; members of religious orders or those who dedicate their life to working with and living among the poor are often viewed with great "moral" admiration. However, behaviourally-linked poverty is generally regarded as an occurrence that is far from being positive; alcohol and substance abuse constitute, for example, the type of disapproved behaviour that is often publicly blamed for poverty among some "deviant" groups of people.

first, decentralize affordable housing and improve transit options, second, cut welfare benefits and increase wages through tax incentives, and third, train social service staff to assist welfare recipients in moving from welfare to work. Even if there is disagreement about the actual size of the incentive misalignment effect, the latter type of policy options have been widely promoted by classical thinkers and adopted in advanced industrial countries such as the UK.

The “negative-decisions” argument is most often invoked when anti-poverty programs are aimed at providing short-term income relief to the poor, rather than long-term development aid which develops capabilities and supplies opportunities in terms of jobs, education and health care. It is contended that behavioural disincentives to escape poverty may prevail as long as subsidies for the poor remain available. In most of the developed world, including the UK, this logic has generated major discussion and concern around “welfare dependence”.

Furthermore, following this logic, subsidies might draw groups of people that are not initially poor into *choosing to become poor* in order to reap the benefits from welfare transfers. For instance, if cash assistance is given disproportionately to particular types of families, such as single mothers with children, then there might be a tendency for single-mother families to form (Blank, 2010). This is the direct result of the basic premise embraced in the classical approach that individuals respond with a great deal of sensitivity to pure market/price incentives<sup>17</sup>. For example Dickens and Elwood (2001) show how a rise in benefits for zero earners in the UK over the 1979-2001 period was accompanied by a rise in joblessness, while in the US the opposite applied.. The immediate reasons behind this difference are, on one hand, that benefits were lower while the financial benefit from working was greater in the US, and, on the other hand, that there was a growing work requirement for benefits in the US that was only partly reflected in the UK.

The policy solution offered by the adherents to this view is the implementation of time-limited aid, tied to work requirements and appropriate support e.g. for child care. Nonetheless, whenever possible, it is argued that authorities should favour *development* policies over mere *alleviation* policies. In this respect, for example, it is believed that it is better to improve education completion rates than to provide wage subsidies to low-skilled individuals (Blank, 2010).

This approach can be criticised from a number of perspectives which are outlined in the rest of the paper, for example that individuals’ decisions may be affected by market failures (neoclassical approach, Section 5) while joblessness may be involuntary due to inadequate aggregate demand (Keynesian, Section 6) or class based oppression (Marxist, Section 7).

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<sup>17</sup> As opposed to other views that highlight the role played by “market imperfections/failures” and “bounded rationality”.

## 4.2 The "sub-culture" of poverty:

Theories of intergenerational poverty claim that behavioural preferences highlighted in classical theories are passed across generations within dynastic families, due either to a genetic component or upbringing. Hence, "poverty begets poverty" as children growing up in dysfunctional families feed from the deviant behaviour of their progenitors, who act as role models (Blank, 2010). Contributions arising from this perspective assert that the intergenerational transmission of attitudes relating to poverty can be perpetuated via a persisting "culture of poverty" may help poor families cope with low economic means<sup>18</sup>.

Among the most prominent figures of the so-called "subculture of poverty" is Oscar Lewis, who suggested that the poorest sections of society tend to form a special sub-group with distinctive traits that are "largely self-perpetuating". He stated that "poverty, in short, is a way of life, remarkably stable and persistent, passed down from generation to generation along family lines" (Lewis 1965, quoted in Townsend, 1979). He enumerated a number of social and psychological characteristics that underpin this sub-culture such as lack of ability to defer gratification, crowded quarters and frequent resort to violence. However, the sub-culture of poverty should not be equated with poverty: "only about 20% of the population below the poverty line in the US could be classified as belonging to a culture of poverty"<sup>19</sup> (Townsend, 1979). It also links to an inability to accumulate private and social assets (Sections 5.2, 6.3, 8.2).

Such theories helped to divert interest in solutions to poverty away from market mechanisms to training and character reform at the individual level, from costly redistributive policies to low-cost social work and community psychiatry. Thus, the sub-culture of poverty (tantamount to the "cycle of deprivation") is a theory where deprivation is treated as being a residual personal or family phenomenon rather than a society-wide structural problem. From this view it follows that the allocative outcomes of a market economy as reflected in the distribution of incomes is not part of the story of poverty. Hence, policy actions that might have far-reaching consequences for wealth and income distribution purposes are not supported, in line with all the theories pertaining to the classical strand of literature (Townsend, 1979).

The main criticisms that this potential explanation of poverty has received are<sup>20</sup>:

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<sup>18</sup> By, for instance, having intrinsically lower expectations on what can be achieved in life (Jung and Smith, 2007).

<sup>19</sup> As an example, he affirms that many people in a country like Cuba may live in (absolute) poverty, but "they do not have a way of life that could be described as a sub-culture of poverty" (Townsend, 1979).

<sup>20</sup> Townsend (1979).

- Bias in interpretation of observed common attitudes and patterns among groups of poor individuals. This is arguably the principal objection made against this view and rests in the argument that many of the criteria normally used to distinguish the culture of poverty are formulated in terms of western, middle-class values (i.e., against middle-class background/prejudices).

- Uncontrolled, individual-orientated research methodology: in empirical studies, the influence upon individuals of values, beliefs and institutions is largely unexamined and even unremarked.

- Inexactness: the boundaries between the *sub-culturally poor* and the rest of the poor are generally not duly specified, let alone quantified.

- Inconsistency: the concept of a sub-culture of poverty cannot be applied when the values and attitudes that are supposed to be inherently possessed by the poor are not accepted by the poor people themselves. By counterargument, the observed attitudes and conditions may well be the result of external causes rather than internal values.

- It is worth noting that empirical evidence to point to attitudes surrounding education and work as the main drivers behind the choice of going on welfare is still scarce. External factors (environmental and structural) are still believed to play a larger role (Jung and Smith, 2007).

Finally, an important policy conclusion that applies to both classical theories of poverty discussed above is that, as Blank (2010) argues, no matter whether poverty is the result of inherent personal weaknesses or the lack of appropriate behaviour that can get imitated (i.e., poor role models), any policy initiative should always aim at generating a *constructive* shift in individuals' behaviour. This may involve either supporting activities, ranging from personal counselling and drug rehabilitation to support groups, or threats, in the form of criminal sanctions and punishments. General poverty alleviation (e.g., cash transfers) is, again, not recommended since it is thought to give rise to incentive problems, thereby encouraging the deleterious habits and dysfunctional behaviour of poor individuals in the first place (Blank, 2010).

## 5. NEOCLASSICAL THEORY

The publication by Alfred Marshall of his "Principles of Economics" in 1890 is considered to be the most important step forward towards the advent of neoclassical economics. Marshall explained price by the intersection of supply and demand curves. The introduction of different market

"periods" was an important innovation of Marshall's<sup>21</sup>. He took supply and demand as stable functions and extended supply and demand explanations of prices to all time horizons. He argued supply was easier to vary over longer time horizons, and thus became a more important determinant of price in the very long run.

Building on the classical tradition, neoclassical theory stresses the role of the unequal initial endowments of talents, skills and capital which determine productivity of an individual in generating poverty, within a market-based competitive economic system. Market failures such as externalities, moral hazard and adverse selection as well as incomplete information are also viewed as aggravators of poverty (Davis, 2007)<sup>22</sup>. Uncertainty may play a major role in causing poverty because the poor are more vulnerable to shocks to their well-being (e.g. recessions, sickness, family breakdown). As in the classical tradition, there is also scepticism about the role of government among neoclassical thinkers, although targeted policies to address market failures may be warranted in some cases. For example, micro-credit or, in the UK, credit unions are seen as potentially valuable from a purely economic point of view. This is because these unions can overcome the risk of moral hazard involved in lending to poor individuals, when they are faced with fluctuations in their income or wish to start a small business. Moral hazard otherwise causes a high social cost and/or limited availability of credit. Finally, poor choices, as criticised by the classical approach, can sometimes be rationalised as information problems which can partly be solved via "small-scale policies" aimed at shifting incentives<sup>23</sup> (Banerjee and Duflo, 2012).

By virtue of the Second Welfare Theorem of welfare theory -- according to which a Pareto-efficient allocation can be attained post-redistribution provided that it is conducted optimally -- redistributive policies aimed at reducing inequality can be efficiency-neutral. However, akin to the classical view, neoclassical economists typically agree that in most practical situations a goal of full income equality, for instance, cannot be attained without incurring too high a cost in efficiency terms. Indeed, current welfare economists abide by the Kaldor-Hicks criterion: "public policy is justified if it produces gains in excess of losses so that it is always possible for winners from the policy to

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<sup>21</sup> The (spot) market, short, long and very long runs.

<sup>22</sup> The definition of each of these market failures is: Externality: a situation where the action of one agent has an unpriced/uncompensated influence on another agent(s)' welfare. Moral hazard: the situation where a set of market prices (or a policy) stimulate individuals to act differently from their underlying needs and preferences to the detriment of the seller or policy maker. Adverse selection: the market process in which undesired results occur when buyers and sellers have asymmetric information (access to different information); the "bad" products or services are more likely to be selected. Incomplete information: a situation where a lack of information for either party or both to a contract/exchange results in a sub-optimal (or unwanted) allocation.

<sup>23</sup> Some of those small-scale policies comprise the correction of market failures through the aforementioned "micro-credit" or through "food for work" arrangements, by which entitlements to food are closely linked to work requirements.

compensate losers (by virtue of the second welfare theorem), even if this compensation does not actually occur" (Jung and Smith, 2007). Indeed, owing to belief that interpersonal comparison of utility was inappropriate and the related Kaldor-Hicks criterion, many in the neoclassical school do not view poverty alleviation as an overriding economic objective, which led to a focus on efficiency at the expense of equality. (Poverty reduction may still be seen as desirable to increase efficiency.) In this it contrasts with classical economists and early neoclassicals such as Marshall (as well as Keynes) who believed that it was valid to compare utility between individuals and that there was diminishing marginal utility across income, meaning an extra unit of income was more valuable to a poor person than a rich one, and thus redistribution raises utility.

We proceed by describing and summarising below the central causes of poverty, and the channels away from it, that have been suggested in the literature pertaining to this view.

### **5.1 The monetary approach:**

At a most basic level, the monetary approach, as suggested *inter alia* by Laderchi et al. (2003) mirrors the fundamental elements of the neoclassical literature rather precisely. It is seen as compatible with the utility maximising behaviour which means welfare can be measured by consumption.

In this view, income and consumption take the centre of the stage by simultaneously constituting the main variables of interest and the main units of measurement to be employed in any analysis of poverty, where as noted the neoclassical approach assumes income depends on marginal productivity. The key assumption in this perspective is that uniform monetary metrics can successfully capture all the relevant heterogeneity across individuals and their situations. Bhalla (2002) argues that income should be the primary consideration in the alleviation of poverty because it enables the poor to gain purchasing power, provides access to resources otherwise unavailable to the poor (thereby addressing the problem of resource inequality) and, enables the poor to purchase or receive free public goods<sup>24</sup>. In their money-based measures, they also use different methods to input the value of non-marketed goods and services. (Laderchi et al., 2003).

For economists following this approach, the main appeal of the monetary measurements of poverty is that welfare can be quantified as the total consumption of individuals, approximated by either expenditure or income data, while poverty is simply defined as a shortfall below some minimum level of resources given by the specific poverty line. As noted before, under the monetary approach,

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<sup>24</sup> This presupposes that a means-tested benefit system is in place so that a certain level of income is necessary to have access to publicly provided goods and services.

indicators expressed in monetary units are believed to identify those who are poor in many fundamental dimensions<sup>25</sup>. It is reflected as noted in Section 2 in the simplest World Bank approach.

The minimum rights approach, pioneered by the seminal work of Rowntree (1901), can be grouped into this monetary view of poverty for it also proposes a certain level of income as the level of material resources everybody should be entitled to. Rowntree calculated the poverty line by estimating the monetary requirements for a nutritionally adequate diet, together with estimated needs for clothing and rent. As noted, those below that line were considered to be in *primary poverty*; those who were regarded as living "in obvious want and squalor", despite being above the poverty line, were classified as being in *secondary poverty*. The most notable features of this conceptualization of poverty by Rowntree are the belief that it is objective, the fact that it was based on an external assessment (i.e., not involving the poor themselves) and the fact that it is an individualistic view of the problem (i.e., it is not driven by factors other than the mere individual circumstances of poor people)<sup>26</sup>.

Some criticisms of the monetary approach include:

- The validity of the approach hinges on a number of *a priori* unknown assumptions, namely, whether utility as expressed in consumption is a reliable definition of well-being, whether money expenditure satisfactorily captures the level of consumption and whether a shortfall in resources encompasses all that can be defined as poverty (Laderchi et al., 2003)
- The volatility as well as the mean of income is important. This in turn depends on diversification of income sources and (in)ability to invest in human and other forms of capital. The poor are vulnerable to shocks such as childbirth, divorce, sickness and recession. Also, there may be a need to measure poverty over time to distinguish the transitorily poor and the persistently poor (Ulimwengu 2008).
- Indeed, assets as well as income are key to poverty (Section 5.2), indeed there are a variety of factors omitted by current income including savings, debt, consumer durables, owner occupied housing, work related expenses such as transport and child care and geographical variation in prices.
- Furthermore, omitting the flow of services stemming from social goods and services, as is typically the case,<sup>27</sup> implies policy prescriptions can be biased towards favouring the generation of private income and against the provision of public goods (in line with Dollar and Kraay's (2004) view

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<sup>25</sup> Not only poor in the sense of lack of purely material resources but also in the sense of other necessities such as nutrition and health (Laderchi et al., 2003).

<sup>26</sup> Laderchi et al. (2003).

<sup>27</sup> This is partly a matter of principle but also reflects the difficulty of measuring non market public goods such as schools, environmental quality and security, as well as outputs of subsistence agriculture.

that "growth is good for the poor"). Indeed, the monetary approach generally predefines poverty as an individual and not a social phenomenon.

- For the most part, nutritional requirements form the basis of the poverty line under this approach. Yet, differing metabolic rates, activities, size, gender and age among individuals mean that dietary adequacy varies among them, implying that a "one-size-fits-all" poverty line is not effective. Similarly, differing tastes and prices affect how much income is needed to secure any level of nutrition in different contexts.
- The theory is focused on individuals but data is usually at the level of the household, within which distribution may be highly uneven (between men and women, adults and children for example).
- Value judgements are performed "externally" without the participation of the poor themselves.

In sum, the monetary approach defines poverty narrowly in terms of consumption derivable from current income, it assumes individuals are identical in terms of needs and preferences and abstracts from the potential benefits of community, social goods and social interaction by taking a purely individualistic standpoint.

The main policy message emerging from this approach is the need to strive for the expansion of GDP so as to increase wages and employment for the poor to cover their necessities. The use of a monetary concept immediately translates into a solution based on the generation of incomes, which is also measured in monetary units. The focus on aspects such as education completion rates as in Section 4 above might be also recommended but only instrumentally as a way of increasing productivity and hence monetary incomes among the poor.

## **5.2 Assets and financial/income risk**

Building from the monetary approach, a neoclassical explanation of poverty and social exclusion that has been extensively cited recently is the incidence of asset scarcity. The general theory underlying this is that households which own an adequate level of assets are less affected by fluctuations in their incomes since asset holdings can be varied. Hence, the risk of becoming poor when they are hit by a negative income shock is lower than for asset-poor households (i.e., they can withstand income risk more easily).

In this context, Ulimwengu (2008) claims that the lack of income diversification resulting from the holding of too few assets affects both the probability of becoming poor and the length of poverty episodes, especially when the principal job is not secure and a family's own internal situation is

prone to instability (a common trait among poor households). He also indicates that it is not only the inability to accumulate private assets but also social assets (such as health and education) that matters in increasing both poverty rates and their persistence. Furthermore, a household's stock of wealth might play a large role in causing and perpetuating poverty for yet another reason: since assets can be transferred from one generation to the next, they might reduce social mobility across time.

These points apply to differing degrees to all types of economically-valuable assets, ranging from cash to human capital. Housing is also a valuable asset although, like life insurance and pension schemes, it is less liquid and thus less effective in ameliorating the impact of income shocks.

The poor are characterised by finding it difficult to save, which means that they are often without bank accounts and, moreover, may face discrimination in financial markets. Accordingly, to reduce asset poverty, one could consider the implementation of the so-called Individual Development Accounts as proposed in the US (i.e., matched savings accounts available to the poor) (Johnson and Mason, 2012). The poor would also benefit from having access to the range of ancillary services that the availability of banking offers, such as lower energy prices with direct debit “Basic” bank accounts are ways in which these benefits might be achieved. Then the poor need facilitation of access to low-cost credit markets, which can protect against income shocks and in the longer term enable them to start a self-reinforcing asset accumulation process that can eventually lead to a sufficient level of wealth so as to counteract the effects of income fluctuations (see also Section 5.3). In this respect, the development of micro credit or credit unions can play an important role.

De Freitas et al. (2009) underscore the importance of the ownership of life insurance or pension schemes for the elderly, an especially vulnerable group in respect of poverty. Long term accumulation of life insurance and pension pots, encouraged by appropriate legislation with government subsidies for the poor might go a large way in preventing poverty among retirees. Indeed, these authors find that the lack of life insurance is a general trait among poor retired households. The immediate policy implication of this is that savings for the future among those individuals with low savings capacities need to be promoted to avoid these risks. Annuities need to be promoted to prevent assets being decumulated too early in retirement, contrary to the UK budget shift announced in 2014. Such an approach also justifies a social security unfunded pension scheme which generates implicit assets for the population without forcing the poor to save and thereby lose out in terms of consumption. Poverty alleviation of such social security schemes is best when they are flat rate providing an income to the retiree regardless of work history as in Denmark, New Zealand and the Netherlands rather than earnings related (Davis (1995), Nolan and Marx (2009)). De Freitas et al (2009) are concerned that reforms which typically cut back unfunded pay-as-

you-go pensions may lead a vulnerable part of the population into old-age poverty. Davis (2004) expressed similar concerns in a UK context. Finally, and overlapping with the Keynesian and liberal approach (Section 6), Sachs (2005) emphasises the role of low levels of capital instead of income in perpetuating poverty particularly in a developing country context. The poor lack capital needed to “get a foot on the ladder of development”. They lack human capital (health, skills and education); business capital (machinery and buildings); infrastructure (transport, power and sanitation); natural capital (viable land); institutional capital (rule of law and security) and knowledge capital (technical know-how needed to raise productivity). All of these also apply in an attenuated form in an advanced country such as the UK.

### **5.3 Incentives, market failures and access to credit markets**

Banerjee and Duflo (2012) provide three reasons why the poor seem to make decisions contrary to their own interests; first, the poor have so few resources that they may have to trade off health for other desirable ends; second, deviations from, for example, the optimal diet, which in an advanced country may entail obesity, may reflect lack of information; and third, there are behavioural constraints such as procrastination, self-control and present-consumption bias, etc. The authors claim the latter argument can be confounded with poor people just being lazy and indulgent, but they argue that richer people are no different, it is just that they do not face these costs in the first place (e.g., they have pension plans that force them to save for old age and postpone consumption, and they have a better quality and more varied diet<sup>28</sup>).

All these factors are symptomatic of market failures in the form of information asymmetries and other constraints giving rise to adverse incentives. These circumstances have in turn been identified as potential causes for inadequate savings (in which effort/transaction costs as well as expensive administrative costs are also involved). What these authors propose are interventions that can marginally improve the life of the poor<sup>29</sup>. They propose a radical rethinking in the sense of a change in focus from deep institutional reforms as proposed by Sachs (2005) (Section 6) to practical, on-the-field direct assistance. This assistance includes small scale transfers, behavioural-change inducing policies and subventions. So for example if the poor believe the returns to education are low at low levels and only high at higher levels, and that it is unlikely they will ever get to the higher levels, they may not want to make the effort to invest in the lower levels and keep their children away from

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<sup>28</sup> We would contend that this argument may apply to advanced as well as developing countries in the sense that cuts in food costs seem to be at the detriment of their quality while the most nutrient dense foods, such as organic foods, remain rather expensive. Accordingly, the price gap between quality and non-quality food might play a rather large role in explaining differences in health outcomes such as obesity, and so this might be a non-negligible factor in determining and/or perpetuating of poverty in developed countries.

<sup>29</sup> "The poor will still be poor, but they can be made better-off" (Banerjee and Duflo, 2012).

school even when it is free. If this is the case, interventions which change information and beliefs can have powerful effects. Other issues addressed include problems in setting up businesses, needs for birth control and incentives to choose good nutrition.

The main criticisms surrounding this "thinking small" approach (Rosenzweig, 2012) include the fact that the gains from tackling these individual-level problems are rather small in absolute compared to relative terms. Furthermore, some suggest that the fact that the poor struggle to start new small businesses means that the focus should be placed on increasing employment opportunities for the poor instead. Owing to costs of information, the cost of implementation of these micro-level policies might paradoxically be higher compared to full-fledged programs designed to combat poverty at the aggregate level. Finding the key constraints that prevent people from escaping poverty and focusing on marginally improving the lives of those who cannot escape it are, nevertheless complementary agendas.

Another source of market-failure-related problems is the mis-match of skills in the labour market (especially for low labour income earners), see Pemberton et al, (2013). They highlight that not only the quantity but also the type of skills matter for avoiding poverty, meaning that having the *wrong* ones can exacerbate poverty. The market dysfunction behind this problem is one of incomplete/asymmetric information in the labour market although it may also link to costs of education and training that the poor cannot afford. Furthermore, Machin (2009) notes that children from disadvantaged backgrounds do worse in terms of attainment and levels of education which aggravates inadequacies in skills; the impact of this on poverty in later life is aggravated by the declining demand for unskilled workers.

Besley and Burgess (2003) discuss the merits of the regulation of labour and product markets as a solution to the type of market failures that may lead to poverty. In their view, the public regulation of markets can be regarded as poverty-relieving insofar as such market failures are a cause of poverty or poverty is regarded as market failure itself. However, excessive regulation, can also represent a hurdle for poverty reduction since it tends to hamper private entrepreneurship and worsen the investment climate, thereby decreasing economic activity and employment generation. As they point out, it has empirically been shown that countries where the transaction costs involved in starting a business are higher are generally the countries whose markets are most heavily regulated; in this case, regulation hurts the public interest and promotes poverty.

Similarly, even though one might think that pro-worker regulation can help protect the rights and income of the lowest earners, it can also be associated with higher poverty if it has a restrictive effect on economic growth, following the typically classical contention that "gains of equality cannot

outweigh the efficiency cost imposed by legislation such as the minimum wage" (Persky, 2004 quoting the classical economist Mill). Thus, attempts to redress the balance of power between capitalists and labourers can damage the poor eventually. Strict regulation can also lead to segmented primary and secondary labour markets where employment in the former is secure and protected by regulation while in the latter employment is precarious and may entail poverty (Spain is an example of this pattern), see also the discussion of dual labour markets in Section 7.

Lack of access to credit markets has also been identified as an additional cause for poverty, given that it prevents individuals with not enough collateral from starting business activities that might lead them out of poverty (Granville and Mallick, 2006). This problem is clearly linked with the problem of a low level of relevant economic assets as well as asymmetric information, moral hazard and adverse selection inherent to credit markets.<sup>30</sup> There can be a "vicious cycle" since the direction of causality between the lack of access to credit and the lack of assets runs both ways and in a perverse manner: permanent constraints (e.g., liquidity and collateral constraints) prevent people from accumulating enough resources/assets to escape poverty, which in turn leads to a lower likelihood of being able to access credits. This feedback process effectively induces a poverty trap (Ulimwengu, 2008).

Besley and Burgess (2003) suggest that the role played by access to credit in making people escape poverty may need to be qualified if it may also be difficult for poorer individuals to exploit these opportunities<sup>31</sup>, due to a lower level of education in basic financial concepts and the sound management of financial instruments. These authors nonetheless argue that these shortcomings do not nullify the advantages of expanding access to credit for the poor, which, as with education, may not only increase the (positive) elasticity between economic growth and the reduction of poverty (by making them more likely to reap the returns to the opportunities that economic growth offers), but also act as a form of redistribution (thereby lowering inequality) in terms of business opportunities and ownership of financial resources. Furthermore, it can be argued that, despite typically lower levels of education, low income households have to be excellent money managers, not least because *every penny counts* when they have no access to flexible and low cost credit lines.

In this context, micro credit is seen as particularly valuable from an economic point of view, as it overcomes the moral hazard problem of lending to the poor. Collateral is not needed as there is peer monitoring of use of the loan by groups of local people (who get a loan in rotation), and lending to women who are usually more responsible than men. The Grameen Bank in Bangladesh is a key example (Bornstein 2005). Credit unions are a related example in advanced countries, although their

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<sup>30</sup> See footnote 28 above.

<sup>31</sup> Banerjee and Newman (1993); Aghion and Bolton (1997).

size and scope remains limited at present in the UK (membership is around 1 million). Government promotion plus a major effort by the voluntary sector is needed to make a major impact on poverty via such institutions (see Church of England, 2014).

Besides starting businesses credit can be seen as a means of consumption smoothing for the poor, whereby access to credit enables shortfalls in income without a collapse in consumption. Indeed, Pemberton et al (2013) suggest that in the UK “debt would appear to be an inevitable feature of life on a low income”. However, where this is feasible it often comes at a high cost as in the case of “payday lenders” in the UK. Credit unions are helpful in this regard also (Davis 2012).

#### **5.4 Human capital theory**

The core of orthodox economic theory relies on the assumptions of perfect competition and market equilibrium entailing a strong relationship between wages and marginal productivity.<sup>32</sup> The demand side of the labour market is thought to be determined by a number of characteristics or skills workers can supply. The importance placed on the set of skills workers are equipped with gave rise to the development and spread of human capital theory (originally due to Becker 1964). One strand of neoclassical economics accordingly focuses on individual choices in relation to education, training and mobility (as determinants of human capital) to explain differences in incomes, albeit still with little to no reference to the role played by other factors such as economic institutions and social norms.

Lydall (1968) argued that it is the variation in the combination of intelligence, environment and education at the individual level that can account for most of the variation in the distribution of personal earnings. This theory, however, cannot be reconciled with the observed large wage wedge between men and women or between whites and blacks. Even though he did mention the possible presence of “social prejudice” in his work, he did not incorporate it into his analysis. Meanwhile, Machin (2009) notes that “poor households in many countries tend to ‘under-invest’ in education”.

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<sup>32</sup>To explain the observed (before tax) income distribution, some of the first classical economists pointed to the distribution of ability as a good predictor/reflection of the former. Whereas the measured distribution of intelligence did not capture the actual income distribution, stochastic process theory started to develop to explain it (Townsend 1979), acknowledging that the income distribution is affected by a myriad of random, unidentifiable factors and hence leaving no room for economic explanations of poverty. Human capital theory is partly a response to this, advocating an analysis of the socio-economic factors that are known to influence the income distribution.

The policy prescription that stems from this human-capital-oriented view on poverty is that, even though individuals' incomes cannot ultimately be fully equalized due to genetic differences in ability, much can be done by increasing spending on the education of the poor to improve the level of ability they can achieve, which to a great extent determines their earnings potential. Adult education may have an important role to play for those whose skills are in low demand and/or have not benefited from normal schooling (Scott et al 2000). As some authors have noted, at times investing in one's own human capital entails a financial and emotional cost which can be too high for individuals to be willing to incur due to leaving stable but low paid jobs and breaking social relationships. On the other hand, not investing in one's own skills risks perpetuating low pay and, thus poverty, which further raises the aforementioned cost of investing in human capital, and thereby reinforcing the vicious cycle (Pemberton et al, 2013). This policy proposal, which effectively calls for the redistribution of a public resource such as education, thereby flattening out of the distribution of skills among the population., can help prevent such vicious cycles.

### **5.5 Ethnic minorities and immigration**

In 2010, it was observed that around two-fifths of people from ethnic minorities in the UK live in low-income households, which is twice the rate for White British people<sup>33</sup>. Poverty among ethnic minorities is widely seen as largely related to discrimination, as discussed in Section 7.3 although cultural aspects and especially attitudes to education, with implications for attainment may also be important (Farkas (1996), Tackey et al (2011)).

A further factor may be immigration status of ethnic minorities. Even though ethnic minorities represent only a subset of the total number of immigrants, this is indicative of the possibility that immigrants may be more susceptible to poverty than natives/nationals. Accordingly, we review some of the proposed explanations for why immigration may or may not act as a source of poverty for both the immigrants themselves and the natives, using a neoclassical perspective.

Blume et al. (2005) look at the specific characteristics that have at least historically made immigrant groups more prone to both being drawn into poverty and remaining in long-term poverty:<sup>34</sup>

- They normally face more hurdles to find employment and to be entitled to welfare and other state benefits compared to natives.
- The number of years of residence in the host country is a central aspect in determining the likelihood of being poor; the longer immigrants have been in the country, the more

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<sup>33</sup> Family Resources Survey, DWP (2010).

<sup>34</sup> See also Dickens and McKnight (2008).

likely it is they are entitled to more welfare benefits and, hence, the less likely it is they will become poor (or, alternatively, the more likely it is they will surpass the poverty threshold if they are below it). Meanwhile, immigrants who have been for a long period in the host country have arguably had enough time to adapt to the country's socioeconomic circumstances<sup>35</sup>.

- There might be a misalignment between the skills demanded in the labour market and those supplied by immigrants following structural shifts in the types of employment (e.g., the transition from a manufacturing to a service-oriented economy). This will hold, for example, whenever the immigrant population is overrepresented in an industrial type of work and where the move in demand is towards communicative and social skills.

- The effect of education on poverty might have a greater impact for immigrants relative to natives in determining success in the labour market if the level of educational attainment of immigrants acts as the best signal available for employers of the *quality* of a potential immigrant employee, part of an otherwise relatively unknown background. Hence, it can be expected that a high educational level provides central information to potential employers and thus reduces the chances of unemployment among the immigrant population<sup>36</sup>.

Raphael and Smolensky (2009) refer to this list of causes of immigrant poverty as the *direct effect*. According to this effect, the higher propensity for immigrant individuals to be classified as poor means that those areas where the percentage of immigrants is higher will, *ceteris paribus*, tend to show higher overall poverty rates. Additionally, these authors suggest the existence of an *indirect effect* of immigration on poverty by which an inflow of immigrants can affect the relative supply of labour at different skill levels, potentially having a negative impact on the wages of native workers. If the *negative externality* in the form of lower wages due to higher labour supply following immigration is strong enough, the poverty rate among natives may increase, thereby increasing overall poverty, the so-called displacement argument.

On the other hand, after empirical examination in the US, they find that none of these two effects of immigration on poverty seems to be substantial; if anything, there is generally significant empirical evidence pointing to a negative link between immigration and poverty<sup>37</sup> (Johnson and Mason, 2012). Immigrant labour might instead be complementary to native labour, in which case the effect of an inflow of migrant workers would actually be in the direction of raising native's wages.

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<sup>35</sup> This adaptation process can take the form of, for example, acquiring the set of skills that are most sought after in the labour market or a degree awarded from a native educational institution. It also enables them to learn the language of the receiving country, a critical factor in being able to participate in the formal labour market all these factors make long-term immigrants better equipped to fully integrate in society and avoid social exclusion (which in itself might lead to poverty).

<sup>36</sup> Note the analogy with an asymmetric information type of market failure.

<sup>37</sup> Albeit the size of the effects is quantitatively small relative to other factors intertwined with poverty.

Equally in the UK, Lisenkova et al. (2013) shed light on the impact of immigration on workers' income in the UK by carrying out an evaluation of the plausible effects that a reduction (instead of an increase) in migration rates would have on the UK's future labour market. One of the main results is that, despite the fact that *gross* wages would increase following a reduction in the flow of immigrants due purely to a labour supply effect, *net* wages would decrease due to the rise in fiscal pressure that would be needed in the absence of the extra government revenue that accrues from the immigrant workforce. Hence, taken as it is, the immediate implication of this result for poverty is that a reduction in immigration might actually lead to an increase in poverty rates due to the loss in the purchasing power of workers that it generates<sup>38</sup>.

Underlying such results is the fact that nowadays immigrants in the UK are on average more educated than the UK-born; especially migrant men tend to have an average hourly wage slightly higher than UK-natives as a reflection of their higher skills and education (see Manacorda et al (2010), Rienzo (2013)). In turn skilled immigration may reduce inequality via a rise in wages of the skilled relative to the unskilled (Kahanec and Zimmermann 2009).

## 5.6 Health and demographics

Health and demographic aspects (chiefly age) are major components of the individuals' stock of human capital and it is through this channel that they indirectly influence the likelihood of the incidence of poverty. The health status of people acts similar to their set of skills in causing poverty in that poor levels of health, like poor levels of skills, imply a lower likelihood of finding work (or being able to work at all) and hence a higher probability of ending up poor (Reinstadler and Ray, 2010). Even if individuals in precarious health conditions manage to participate in the labour market, they are often less likely to gather the abilities required for relatively high paid jobs which makes them suitable only for low-wage opportunities that reflect their relatively lower marginal productivity (Buddelmeyer and Cai, 2009). In turn, income poverty may cause poor health owing to factors such as malnutrition (including reliance on “junk food” leading to obesity) and less access to medical services as well as the possibility that the experience of poverty induces behaviour contrary to health, including smoking, alcoholism, overeating for psychological reasons and drug abuse. Therefore, the feedback effects between ill-health and poverty represent yet another example of a vicious cycle that is conducive to a permanent poverty trap for those of working age (issues for pensioners are noted in Section 5.2 above).

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<sup>38</sup> Caution is needed in interpreting these results given that the effect on inequality and/or the effect on native wages only are not accounted for during the simulation exercise. Thus, these results should not be viewed as conclusive concerning the overall impact of immigration on poverty.

Likewise, age can be a element of poverty if it is an important determinant of the likelihood of being unemployed. Those age groups which are more vulnerable to unemployment are, in turn, more vulnerable to enter or re-enter poverty. This works through the neoclassical labour market argument if age is an important determinant of the marginal productivity of workers. Empirically, older individuals tend to have a lower marginal productivity than younger ones, arguably due to the obsolescence of their stock of "marketable" knowledge/skills or even a shortage of cognitive skills that erodes their human capital stock as well as lower physical strength and dexterity<sup>39</sup>. In turn, a lower marginal productivity is associated with a higher degree of replaceability in the workforce. Age affects the rate of exit from poverty negatively; older individuals are less likely to regain employment for economic reasons ranging from a higher depreciation rate of human capital to shorter employment horizons, entailing lower incentives for employers to invest in their skills (Kyzyma, 2013). Thus, the poor health-poor income vicious cycle applies equally to the trap-like relationship between age and poverty.

Note however that some of these arguments also apply to many young workers, not only for those with low human capital due to poor education but also across the board due to lack of work experience which reduces productivity and increases employer uncertainty about productivity. They are also more likely to be excluded from primary labour markets, owing to employment protection legislation. These factors lead overall to high levels of youth unemployment and consequent poverty.

Lone-parent households are also more vulnerable to poverty simply because only one household member is responsible for the provision of food, clothing, shelter, education and other goods and services to the entire family unit. An immediate consequence is that it is likely that the total generated household revenue falls short of the resources needed to cover all these expenses and, thus, they are more predisposed to fall into poverty. Put another way, single-parent families cannot reap the benefits of the economies of scale that exist at the household level when more than one family member earns income. Single parenthood has risen sharply in recent decades largely for social reasons (in particular the rising rate of parental separation) but probably also relating to economic incentives<sup>40</sup> (see Section 4.1), with the proportion of households in the lower income

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<sup>39</sup> Even though accumulated experience is a positive aspect of older workers that may partly or even fully neutralise the other negative conditions. The age-productivity relation is weaker for services than manufacturing and may not apply strongly in some professional fields (medicine, the legal profession, academia).

<sup>40</sup> There is a lack of strong empirical evidence on the effect of economic incentives on the choice of parenthood, although the decline of teen birth rates in the US in recent decades is correlated with a decline in welfare support (Primus, 2006).

quartile with a single parent rising from 5% in 1979 to 12% in 1999 in the UK (Dickens and Elwood, 2001).

Whereas most contributions in the literature typically understand poverty among women as the result of discrimination (Section 7.3), experiences of poverty among single-mother households and, especially, their persistence over time, can have a well-grounded economic cause as follows: Individuals belonging to this demographic risk group exhibit higher jobless rates on average, also in light of the issues of youth employment noted above. Given that the opportunity cost of fertility is much lower for jobless individuals, and assuming there are social benefits for families in poverty, they have an incentive to rationally decide to have and rear more children, which in turn would reinforce their isolation from the labour market, eventually leading to a poverty trap (see also Section 4). This logic applies in fact to any type of household facing low employment prospects and/or incomes and a low degree of social support. On the other hand, empirical work suggests that this incentive has a minor impact on fertility (Cancian and Reed 2009).

Furthermore, lack of access to inexpensive child-care implies that parents (especially single parents) need to devote time to fulfilling this task which could otherwise be allocated to hours supplied to the labour market. Hence, a lack of affordable child-care services keeps families poor by preventing them from being able to supply their effort and time to the labour market. The straightforward policy answer is to facilitate childcare for poor families in order to free up time for household heads to join the workforce (Dickens and Ellwood, 2001).

An important cautionary note regarding state-provided childcare benefits, however, is that reforms in the structure of this type of aid, even if they entail a rise in the amount of overall childcare, can be detrimental to poverty if entitlement to it is tied to the level of previous earnings. This is because those with short work histories and/or low past labour income profiles can actually suffer from such policy, as opposed to a system based on flat rate transfers (i.e., irrespective of earnings). Means-tested benefits can thus have perverse effects on poverty since they usually raise overall resource inequality. For individuals who are in the poverty borderline, a move in the direction of means-tested rights can push them into the poor status (Kyzyma, 2013).

More generally, from a policy perspective, demographic causes of poverty are difficult to tackle as demographics are typically insensitive to policy. Hence, some authors have argued that only a combination of strategies that dramatically increases employment and increases the pay of low wage parents seem likely to improve the picture of poverty dramatically (Dickens and Ellwood, 2001).

As we conclude Sections 4 and 5, note that neither the classical nor the neoclassical theories on poverty that have been reviewed are applicable to the whole of the current definition of poverty utilised by JRF. This is mainly due to the omission of the social capabilities dimension of poverty, which, even though emphasised by JRF and many contemporary experts on the topic, is ignored in all the working definitions of poverty used by most economists in the prevailing neoclassical tradition, focusing as they do on the individual and monetary compensation.

We explore next how the issue of poverty has been looked into from other theoretical perspectives. Some of these approaches depart from definitions of poverty closer to JRF's notion than do orthodox economists whose thinking is summarised above. We begin by discussing the insights on poverty offered by the Keynesian approach, which still accepts most of the premises of the classical and neoclassical models, and then continue to theories that lie farther away in spirit from the classical and neoclassical paradigms.

## 6. KEYNESIAN/LIBERAL THEORY

Liberal theory revolves around the idea that not only market distortions, but also broad underdevelopment in its multiple facets cause poverty. Meanwhile, Keynesians suggest growth can promote economic development and thus relieve poverty, hence further justifying government intervention at the macroeconomic level (via fiscal and monetary policy), mainly to tackle involuntary unemployment.

### **6.1 Provision of capital and public goods**

In a typical liberal approach (Sachs, 2005) the main signs of underdevelopment in a country or region include: poor levels of human capital (health, skills and education), business capital (machinery and buildings), infrastructure (transport, power and sanitation), natural capital (viable land), public institutional capital (rule of law and security) and knowledge capital (technical know-how needed to raise productivity). Although the role played by most of these deep-rooted structural factors was originally explained for developing nations, similar patterns are transferrable to regions or localities of the UK in many respects. For example, this view involves a focus on the provision of capital goods, in the form of education (to increase human capital) and infrastructure (to increase productive capacity), flowing to the poor, as well as overall development of markets that may be applicable for example to the North-South divide in the UK.

Sachs' approach is innovative in being "clinical" in designing anti-poverty intervention and needing to adapt to circumstances rather than "one size fits all". Economies, like persons, should be seen as

complex systems, where failures in one part (e.g. corruption) lead to failure elsewhere (e.g. market systems), and “diseases” differ (Davis, 2007). Factors to be taken into account include the existence of a poverty trap, the economic policy framework, the fiscal framework and fiscal traps, physical geography, governance patterns and failures, cultural barriers and geopolitics. In this regard, poverty in a given country might be heavily affected by the presence of a very weak institutional environment including corruption, for example, which adversely influences the functioning of markets, whereas in another context the most crucial factor may be geographical isolation, which may impede the import of basic goods and services needed for individuals to attain a certain level of well-being. Hence, under this view, the importance of these wide range of factors at the macro level needs to be weighed in each specific case, and only then can a particular, tailor-made policy agenda be designed to combat poverty. Similar arguments can apply in advanced countries at the level of the locality or region.

Critics (as summarised in Davis, 2007) argue that the Sachs approach resembles the “big push” to get the poor out of a poverty trap by massive aid that was fashionable in the 1950s but shows little evidence of having worked. Perhaps the approach should be more “bottom up” from the poor rather than “top down” to them. Black markets might arise in the capital-good commodities he proposes to distribute. Much more rigorous ways of preventing abuse of aid by governments may need to be devised (as argued earlier by Lal (1995)).

Some of the capital stocks that are considered essential under this approach fit the characteristics of public goods, as defined by Samuelson (1955), namely a product that one individual can consume without reducing its availability to another individual and from which no one is excluded. Economists refer to public goods as “non-rivalrous” and “non-excludable”. Examples are rule of law and security.<sup>41</sup> This acknowledgment by the liberal-Keynesian theory of the importance of this type of public good means that it is partly in line with Sen's capability approach. The idea, stressed under this approach, that it is the *adequacy* of resources rather than their *sufficiency* that matters for “desire fulfilment” (Laderchi et al., 2003) and hence both externalities and public goods are important elements in the overall picture of poverty understood in terms of capabilities.

The most prominent pioneer of liberal economics, J. M. Keynes, believed that market forces can promote economic development, which was in turn perceived to be the single most important tool against poverty. In this regard, the point of departure of the Keynesian model is the same as that of the neoclassical paradigm; economic growth is ultimately regarded as the most effective factor in ending poverty. In fact, Alfred Marshall, commonly regarded as the father of neoclassical economics,

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<sup>41</sup> Other examples are national defence, sewer systems, public parks and free television and radio broadcasts.

greatly influenced the work of Keynes himself and the subsequent new-Keynesian scholars. As discussed in the previous section, Marshall and succeeding neoclassical authors held that education, by raising human capital, allows individuals to become more efficient in the marketplace, reach a higher class of work, make unskilled labour scarcer and consequently also raise the income of the unskilled by a simple supply argument (Jung and Smith, 2007).

## 6.2 A macro perspective

The major shift in perspective with respect to neoclassical theory lies in the greater emphasis placed on the *macro* side in liberal theory in comparison with the more *micro* orientation of preceding models. Hence, Keynes also embraced the significance of education, but the emphasis in the promotion of this crucial aspect of human capital was not so much on the individual decisions leading to its accumulation, but, rather, on the promotion of human capital accumulation through aggregate investment in public education. The role of the government in the economy therefore takes the centre of the stage. It is contended that government intervention against poverty is needed in a wide variety of economic issues, from tackling involuntary unemployment to promoting human capital accumulation and through investment in public education, which can both encourage economic growth via the famous multipliers and tackle poverty through the development of abilities it entails<sup>42</sup>. This is in stark contrast with the classical and neoclassical view that the presence of the government in all spheres of the economy should be limited.

In a Keynesian/liberal perspective, poverty is mainly explained by "the misfortune of certain minorities who fall out of work, cannot work or are not expected to", although they wish to do so. It therefore follows that the state needs to act to "regulate, supplement and exhort, but not impose" (Townsend, 1979). This theory contends that poverty can be a reflection of market failures that under certain circumstances justify redistributive taxation in cash and kind<sup>43</sup>.

From the set of macroeconomic variables that Keynes and the new-Keynesians stress, aggregate investment, with its positive effect in employment, emerges as the key element in generating the type of growth that permits poverty relief. If entrepreneurial investment is low, this in turn raises unemployment and poverty rates among suppliers of labour. It is thus suggested that government revenue, raised via taxes or bond issue, should be funnelled to public investment. This was viewed, in Keynes' own words, as the "socialization of investment" (Jung and Smith, 2007). Entrepreneurs

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<sup>42</sup> This is especially true if disproportionately more educational resources are allocated to the most disadvantaged individuals (e.g., in the form of grants) (Besley and Burgess, 2003).

<sup>43</sup> Even though, as discussed before, market failures are also admitted by neoclassical thinkers, they do not envisage such a large allocation of powers to the state to resolve these problems.

would at the same time be prompted to invest in profitable projects rather than saving if direct taxes were raised.

The focus on public investment to attain the complementary goals of economic growth, employment and poverty reduction is strongest in certain crucial sectors which are considered to be strategic in the sense that they exhibit the highest multiplier effects. These sectors correspond mainly to the infrastructure and human development or educational sectors. By injecting resources into these areas, it is believed that private capital investment follows, further boosting activity and helping alleviate poverty by generating value added. Moreover, if a growing economy manages to stimulate job growth in a way that reduces poverty, then doing so is appealing, for it avoids the need to resort to rises in tax rates to fund antipoverty programs, since tax revenue increases automatically, while the lower poverty count diminishes demands on antipoverty programmes (Jefferson, 2012)<sup>44</sup>.

While growth is likely to reduce absolute poverty, because it will tend to raise the incomes of all members of society, the beneficial effects on relative poverty of the expansion of economic activity will only apply so long as the rise in average income that economic growth permits is accompanied by a reduction in the variance of the income distribution or it is accompanied by an increase in dispersion that does not offset the increase in the average level of income (Granville and Mallick, 2006). As Dickens and Ellwood (2001) indicate, the growth in wages that usually accompanies growth in GDP can cause surges in relative poverty if wage dispersion rises along with it, even if the average wage increases. The effect on absolute poverty is ambiguous provided that the average wage also increases. This hypothesis corresponds to the theory that poverty rates can actually persist and even grow despite economic growth if the deprived are left off the "growth wagon" (Dickens and Ellwood, 2001).

To reduce poverty, growth must be sustainable. It should be if a rise in demand is accompanied by aggregate supply in terms of growth in labour and capital. But often demand accelerates ahead of supply leading to unsustainable booms followed by deep recessions. Such patterns may accompany financial liberalisation. Cline (2002) suggests that there is a disproportionate effect of financial crises on the poor whereby a decline in GDP of 5% as is typical of crises would raise the poverty rate by

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<sup>44</sup> Concerning the existence of these effects in the data, while the link between the unemployment rate and poverty rates is "unmistakable" throughout history (Jefferson, 2012), most of the empirical studies that examine the relationship between economic growth and poverty show mixed results, which are highly dependent on the specific time period/economic cycle analysed. For instance, for the US, while Freeman (2003) finds some evidence of a stronger poverty/growth nexus during the 1993-99 period, Formby et al. (2001, 2004) find that growth during the 1980s and the first half of the 1990s did not have as strong an anti-poverty impact as growth during the 1970s. On balance, over the long term, the empirical investigations undertaken so far imply that economic growth must be accompanied by factors such as rising real wages, declining joblessness and decreasing income inequality to have a major impact on poverty (Jefferson, 2012).

10% in the same year<sup>45</sup>. Arestis and Craner (2004) also contend that financial liberalisation, if poorly designed, can exacerbate poverty, partly by causing unsustainable booms followed by financial crises. On the other hand, In this respect, Dollar and Kraay (2002) suggest that there is a one-to-one relationship between income of the bottom fifth of the income distribution and per capita GDP. Contrary to Cline (2002) they also find no evidence that economic crises affect the income of the poor disproportionately (i.e., to a larger extent than other groups).

In the UK context , as more widely round the world it is well-known that SMEs account for the majority of employment in the country<sup>46</sup>. Hence, in line with the Keynesian focus on the most relevant sectors, freer flow of credit into SMEs can have a large impact in the incorporation of poor individuals into the workforce, thereby alleviating poverty. The policy prescription that follows from this view is then that the financial needs of growth-oriented small entrepreneurs and businesses must be addressed in a way that helps the generation of a more even distribution of credit across borrowing firms, so as to have as largest an impact on poverty as possible (Granville and Mallick, 2006). The main structural issue underlying restrictions on SME lending is lack of collateral leading to credit rationing due to risk perception and opacity, and not the Keynesian cost of capital per se. Constraints vary with institutional and structural development in the economy and financial system (Beck 2013) and can be enhanced by certain policies such as credit guarantees. There are also regulatory factors that are worsening such as high risk weights on SME loans for banks in Basel III and inability to securitise SME loans. Cyclical restrictions on credit to UK SMEs in the wake of the financial crisis are of concern in this regard (Armstrong et al., 2013).

### **6.3 Unemployment and poverty**

The paramount importance assigned to unemployment as a primary source of poverty under the liberal view is based on the logic that if individuals do not receive labour income, they are more likely to be poor. This sensitivity of poverty to unemployment can actually be amplified if poor individuals tend to experience discontinuous, short employment spells throughout the lifetime; if poor people who enrol in a job fail to retain it, no matter their pay, they will likely return to poverty when exiting employment given that the amount of accumulated savings is likely to be insufficient

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<sup>45</sup> Economists conceptualise this as an elasticity of poverty to growth of around -2. Put more positively in the case of growth, if 35 percent of households are below the poverty line, then per capita growth of 1 percent is likely to reduce the number in poverty by 2 percent, or from 35 percent to 34.3 percent of total households. Thus, the World Bank (2004, p. 47) finds that “On average, every additional percentage point of growth in average household consumption reduces that share [of people living on less than \$1 a day] by about 2 percent”.

<sup>46</sup> According to the Federation of Small Businesses, “SMEs accounted for 99.9 per cent of all private sector businesses in the UK, 59.3 per cent of private sector employment and 48.1 per cent of private sector turnover” (FSB, 2013).

for maintaining the standard of living above the poverty line (Aassve et al, 2005). In some pension and social security systems they are also likely to face poverty in retirement due to gaps in entitlements (Pemberton et al 2013).

Hence, the steadiness of employment is a central feature in preventing poverty persistence, not least because it also enables individuals to envisage better career prospects that allow higher expected future income, thereby facilitating borrowing (leading to longer term consumption-saving decisions) and investment in one's own skills and knowledge (human capital) as well as social capital (Ulimwengu, 2008). In terms of Sen (1983, 1999), it influences ability to transform assets into entitlements. It underlines the importance of distinguishing between transitory (short term) and persistent (lifelong) poverty.

In this context we may cite the concept of poverty "hysteresis"; movements in and out of poverty can be markedly harmful since they might entail far-reaching consequences for the individuals most susceptible to poverty<sup>47</sup>. The effects of these dynamics can be seen as having the same features of a "hysteresis" process, whereby current experiences of deprivation can lead to permanent negative "scars" on people's abilities and their resilience against the re-incidence of poverty. The recurrence of poverty spells throughout a lifetime might render individuals unable to acquire any of the assets (notably human capital and liquid saving) that are fundamental for escaping poverty once-and-for-all, due to the presence of many breaks that undermine the smoothness required in any accumulation.

Similarly, Reinstadler and Ray (2010) argue that the regional unemployment rate can have a direct and indirect impact on poverty. The first one is straightforward: a higher aggregate unemployment rate increases the likelihood of individual unemployment. The second effect is an indirect effect through the negative impact of the unemployment rate on the wage bargaining power of the employed, who are at higher risk (since they face higher competition) of being fired or receiving a lower wage when the aggregate regional unemployment rate rises. Importantly, they find that the aggregate factors such as regional employment are significant even after controlling for the main individual characteristics influencing the likelihood of being poor. This gives support to the Keynesian emphasis on factors at the macroeconomic level but partly undermines the efficacy of nationwide fiscal policy, implying a need for regionally focused policies (notably public investment) as well.

Notwithstanding the fact that employment is generally perceived as an anti-poverty tool, in practice employment may conceivably cause poverty under some specific circumstances. For example, this

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<sup>47</sup> Even though not a macroeconomic issue itself, it is included here because of the parallels with the original hysteresis concept, which was applied to unemployment dynamics.

could happen whenever the generation of employment is accomplished via the expansion of part-time, low-paid and temporary jobs (that is, insecure and precarious jobs), which may be linked to drastic supply-side, labour market reforms aimed at bringing flexibility to the labour market<sup>48</sup> albeit also linked to technical changes which are reducing the demand for unskilled labour and hence reducing wages for such work (Machin 2009). Indeed, a process like this took place in Germany during the most recent crisis: despite the reduction in the unemployment rate, poverty has actually increased (Kyzyma, 2013). We also noted at the outset that just over half of the 14 million people in poverty in the UK were from working families. Osterling (2007) also adheres to this view, adding that far-reaching economic restructuring can in some instances become a source of poverty, at least in the short run. Low paid jobs may disincentivise work when there is a sufficient safety net, or if jobs are accepted they may lead to poor health (Pemberton et al 2013).

In the US, Edwards and Foley (1997) noted that trends related to deindustrialization and globalization have transformed the U.S. economy from a manufacturing-based to a service-based economy. This large shift precipitated the widespread closure of manufacturing plants, especially in central city areas. These changes resulted in sizeable losses of living-wage unionized manufacturing jobs for central residents and, hence, in the concentration of poverty within the limits of these urban areas<sup>49</sup>.

#### **6.4 Further macroeconomic factors underlying poverty**

Concluding this section, other macroeconomic factors that have been suggested as potential triggers of poverty include:

Inflation: especially when the nominal wages on which low earners depend stagnate or grow at a lower rate than prices, inflation can depress workers' real income and generate poverty. This will also be more likely the more the prices of basic goods are affected. Agenor (1999) finds that inflation always increases the poverty rate, using a cross-section of 38 countries. Easterly and Fischer (2000) found that the poor tend to rate inflation as a top concern, using survey data on 31,869 households in 38 countries. On the other hand, the often-cited "inflation tax" reducing the purchasing power of monetary assets may not affect those already below the poverty line, since these individuals hold few liquid balances to begin with (Granville and Mallick, 2006).

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<sup>48</sup> These type of measures have been common in the Euro zone during the recession.

<sup>49</sup> In relation with this, there exist several empirical studies on the US showing that growth alone is an "insufficient weapon" to fight poverty for it may not always translate into rising wages, declining joblessness and decreasing income inequality (Johnson and Mason, 2012).

High sovereign debt: this burden can worsen poverty by impeding economic growth and the allocation of public resources to poverty alleviation owing to austerity programmes (Granville and Mallick, 2006).

Asset market bubbles: massive surges in housing prices and related rises in rents may carry with them an enhanced risk of homelessness (Early and Olsen, 2002). This risk is all the higher for those lacking income to pay rent or interest and/or who possess few assets so as to be eligible to apply for mortgages, and where social housing is absent or in short supply. Thus, housing bubbles can be a source of increased poverty by denying the most vulnerable groups the ability to participate in the housing market and hence to satisfy the basic right of shelter. This is in addition to the poverty linked to financial crises that may accompany deflation of such bubbles, as discussed above.

## 7. MARXIST/RADICAL THEORIES

Marxists contend that capitalism and related social and political factors based on class division cause poverty. Adherents to this school of thought advocate that "the market is inherently dysfunctional" (Blank, 2010). According to this view, capitalist societies keep the cost of labour unnaturally lower than its value added through the threat of unemployment (the "reserve army of unemployed"), and therefore poverty in a capitalist economy can only be alleviated via strict regulation of the market (e.g., in the form of minimum wages).<sup>50</sup> A wider range of authors in the political economy field suggest that poverty is predominantly the result of structural factors, including stratified labour markets as well as prejudice and corruption. In both cases, the policy message is that anti-discrimination laws and labour market reforms are essential to overcome structural barriers that impede employment and cause poverty. Links of environment problems to poverty can also be analysed from a radical point of view.

Marx argued that the presence of unemployed workers, which is ultimately caused by the need of capitalists to have surplus labour, artificially lowers wages (by a simple labour supply argument)<sup>51</sup>. This was believed to be an inherent dysfunction of the labour market which only the state, when controlled by the working class, can regulate. One of the central elements of Marxist theory is that

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<sup>50</sup> The more fundamental Marxist prescription is of course the suppression of free markets, nationalisation of all means of production, collectivisation of agriculture etc. as under the experiment of communism in the 20<sup>th</sup> century.

<sup>51</sup> This view is actually shared by some strands of other disciplines, such as sociology. In his study of social inequality, Gans (1973) enumerated a number of "functions" that poverty plays in society, whose usefulness are the primary causes of its permanent character. Among these roles, there are some which serve the vested interests of the more affluent, which helps explain the lack of motivation for these groups to propose and implement measures towards the eradication of poverty. The parallel between these views and the Marxist theses is evident.

the primary aim of this state regulation should be to enhance the working conditions of labourers and promote higher wages among them (Blank, 2010).

### **7.1 Minimum wages**

One of the most extensively proposed measures stemming from this thesis is the need to implement minimum wages to prevent workers on the lowest incomes from falling into poverty due to the *abuses* of capitalism. The basic justification for setting a minimum wage resides in the fact that when former welfare recipients enter low wage job markets, competition increases, thus lowering the wages of all workers, which might result in increased poverty (Jung and Smith, 2007). In addition, permanently low paid work (engendered by the capitalist system) can cause poverty via an indirect channel: low earners are more likely to develop poor health which, in turn, erodes their human capital and hence their possibilities of escaping poverty<sup>52</sup> (Pemberton et al, 2013). Yet another reason why low wages may lead to perpetual poverty is that they prevent individuals from saving, which in turn causes a higher likelihood of falling into poverty upon a negative socio-economic shock (Pemberton et al, 2013).

Minimum wages can help countervail these effects by providing a threshold level below which *equilibrium* wages can never decline. Likewise, unionization is another major instrument in helping fight poverty, since it is believed to empower the working segments of the population and assist them in the protection and preservation of the most basic standards of living for blue-collar workers and other low wage earners (Kyzyma, 2013). On the other hand, this proposal includes no reference to the potential distortionary effects that both minimum wage regulation and unionization may inflict on efficiency. Furthermore, Neumark and Walscher (2002) suggest that increasing the minimum wage may only achieve income redistribution among low-income families, rather than a redistribution of resources from high to low income families. This then does not univocally lead to a more equal aggregate distribution.

### **7.2 Dual Labour Markets**

The existence of long-lasting, low-paid jobs is widely seen as explicable in terms of a "dual market" character of the labour market. Dual market theory is based on the premise that the labour market is stratified into the "primary" and the "secondary" sectors. In contrast with the primary sectors, the "secondary" sectors are distinguished by unstable employment, depressed pay levels and very poor prospects for promotion. According to Rank et al. (2003), these issues reflect a situation where the experience of poverty is the consequence of vulnerabilities inherent in the system rather than in

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<sup>52</sup> Alternatively, it increases the likelihood of falling back into poverty if one already experienced it before.

their personal traits and characteristics<sup>53</sup>. Thus, in explaining poverty, Marxist theory places greater emphasis on the disadvantageous characteristics of the secondary labour market than on the specific individual features of workers (Townsend, 1979).

The most radical current in Marxist tradition, in the sense of being farthest apart in spirit from the neoclassical paradigm, stresses the role played by employers in perpetuating inequality by taking advantage of the abovementioned dual feature of the labour market<sup>54</sup>. (Although as noted above, inappropriate labour market regulations (employment protection) may also underlie dual labour markets.) The concept of social class represents the basic unit of analysis and it is thus a central element of radical theory. Class division and the relative distribution among classes within society are postulated as the ultimate determinants of the distribution of individual income, for members of different classes are believed to have unequal opportunities to access the fundamental precursors of marginal productivity such as complementary capital and social resources. And indeed empirical work in the UK shows social class to be the one of the most significant factors that influence educational performance (Tackey et al 2011).

In this respect, Ayittey (2005) argues that, for poverty to be properly addressed, it should be the lowest classes in society, normally consisting of workers/labourers at the bottom of the resource distribution, that gain control of production and governance. This radical view implicitly contains the idea that it is actually those affected by deprivation who are the ones that can best find a solution for it, without the need of external advice/expertise on the matter, hence including an important *participatory* element in their interpretation of poverty (Morazes and Pintak, 2007).

Jung and Smith (2007) point out that Adam Smith actually assumed that everybody has something valuable to offer to the labour market, no matter the particular circumstances surrounding individuals, thus overlooking critical hurdles such as illness, injury or old age. In contrast, a radical/Marxist view would highlight that, in the investigation of poverty, the focus should be shifted to ensuring the fulfilment of social rights and social justice. Even short of full-blown communism, this involves a recognition of the importance of social and political forces in shaping the outlook on poverty, whose removal is thought to decisively hinge on the achievement of the overarching principle of egalitarianism through the implementation of policies and programs that directly or indirectly affect the rich (Baratz and Grigsby, 1972; Levitas, 2005; Øyen, 2002). These authors claim that measures focusing exclusively on social inclusion and the alleviation of poverty will not be

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<sup>53</sup> A working example of such vulnerabilities being the growing number of jobs, in advanced societies, that pay less than a "living" wage. (Morazes and Pintak, 2006)

<sup>54</sup> By, for instance, separating non-manual from manual strata of workers (Townsend, 1979).

effective if living standards continue to rise and inequality is ignored, since, in this scenario, the poor-rich wedge could widen – as indeed has been the case in the UK in recent years.

### 7.3 Discrimination and class

In this sense, the conventional definition of social inequality views it as "the result of differential access to scarce and valued social resources for some individuals and groups, on the grounds of structural factors beyond their control" (Western and Dwan 2005). The factors that typically condition inequality and the accessibility of resources comprise: ethnic origins, class, gender, age and space (urban-rural differences). These factors inherent to the individual are in turn combined with social phenomena that lie beyond their control (such as crime, education, health, housing and occupation) to finally determine the degree of inequality/lack of access to resources among certain groups in society<sup>55</sup> (Morazes and Pintak, 2007).

All these previous arguments point to the existence of discrimination at both the economic (out of the labour force) and social levels (Jefferson, 2012). According to this perspective, discrimination is viewed as preventing the full participation of individuals affected in the political, societal and economic processes. The economic argument goes that, to the extent that some individuals are involuntarily isolated from the different layers of society, then this can act in favour of the persistence of their exclusion from adequate economic resources as well, so that economic and social discrimination are inevitably interrelated<sup>56</sup>. It is thus unsurprising that anti-discrimination law, along with evenly-distributed economic development, are considered highly effective anti-poverty strategies (Jung and Smith, 2007). In this respect, Elliot and Sims (2001) find that race is one of the strongest predictors of poverty and that pro-growth policies can overlook certain vulnerable sub-groups. Indeed Hoover et al (2004) find that non-white people in the US failed to benefit from economic growth in terms of poverty reduction, for example.

Social status has also been put forward by scholars adhering to these views as an important determinant of inequality, given that the hierarchy in material resources tends to closely follow that of social status. However, there is no common definition of "status" at work among the proponents of the radical theories approaches to inequality. Another problem with this view is that, while it is feasible for a society to achieve total equality in material resources, it is more difficult to conceive of no differences in prestige/authority/status. This criticism also relates to the fact that these theories

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<sup>55</sup> Crime and the subsequent punishment of criminals has been pointed as a primary cause for poverty and, more importantly, for the persistence of it for three main reasons: first, there is a social stigma against former inmates once they are free and, second, their human capital gets eroded while in prison (lower labour market value) and, third, incarceration reduces social capital by breaking social ties that might lead to legal work (Johnson and Mason, 2012).

<sup>56</sup> Johnson and Mason (2012) suggests such factors underlie poverty in the US.

do not rely on quantifiable variables, given that their objects of analysis (i.e., occupational status and power) are not measurable (Townsend, 1979)

Poverty may become institutionalised for political reasons in the sense that social and political norms and systems come to accept it, it becomes legitimised in political discourse and by the political elites while the poorest groups fail to gain political representation (Hickey and Bracking 2005)

As a final note, in the political arena, the faction that draws most from these economic principles and tries to devise practical policy agendas based on them is that of the social democrats, who view welfare assistance as a right of citizenship and who perceive poverty as a systemic concern that originates as a side-effect of market economies. As previously indicated, under this perspective the state is identified as the actor that holds the ultimate responsibility in fighting poverty and, therefore, the one in charge of providing resources to its citizens for its elimination. An important consequence of this is that, in this model, individuals are deemed worthy of government benefits based solely on their membership in society, rather than on proof of need/means-testing. The right to assistance is thus irrespective of the particular circumstances or characteristics of the poor. Thus, the principle of *universality* (as opposed to the classical *selectivity*) of rights strongly shapes the logic behind these views (Morazes and Pintak, 2007).

#### **7.4 Poverty and the environment**

It is widely accepted that economic growth, when it is linked to an unsustainable rate of exploitation of natural resources and/or the harmful by-products of the production process, can have an indirect, detrimental effect on poverty through its negative impact on the natural environment. In particular, in spite of the fact that growth in output generally raises the incomes of all individuals, the possibility remains that the environmental externalities generated as *collateral damage* outweigh the benefits of growth in income, even more so when these externalities are augmented with the plethora of other aspects discussed in previous sections.

The analysis of the poverty-environment nexus has mostly been set in the context of developing nations, but we contend it is also relevant to the UK. Dasgupta et. al, (2005), for example, have assessed the health damage suffered by poor households that are directly exposed to pollution of the air, water and land in least developed countries. These erode in turn the human capital stock of poor individuals, thereby making them more likely to gain poverty levels of income. These considerations fit reasonably well in the context of developed nations too, for it is likely that in countries such as the UK the health of the poor is sensitive to the consequences of environmental

externalities just as well<sup>57</sup>. Likewise, albeit perhaps to a lesser extent, the role that climate change and environmental disasters (and maybe even environment-related conflicts) may play in hurting the lives of the individuals least capable of coping with them can apply to rich countries just as it does to poorer ones<sup>58</sup>.

Even the presence of economic-environment poverty traps at the aggregate level is not limited to developing countries; as Sanchez-Martinez (2012) shows. If countries endowed with initially lower levels of capital and, hence, wealth are more likely to fall into a poverty-environment trap, any country that pollutes the environment to the point of surpassing a certain threshold level of pollution can eventually fall into a low income-low environmental quality equilibrium too.

The most prominent type of negative environmental externality affecting the poorest spheres of the population is the air-polluting activities which radical theory would see as carried out by higher income groups, in general, and heavy industry, in particular (Duraiappah, 1998). A number of studies have shown higher income groups are, to a large extent, able to shield themselves from the adverse impacts of air pollution (Dixon et al., 1995). By contrast, in many instances, polluting factories are located within or close to low-income neighbourhoods. The resulting health consequences arising from outdoor air pollution are thus more prominent among low income individuals. The likely rise in the incidence of respiratory diseases can undermine the productivity levels of blue-collar workers and hence jeopardise the income of these individuals. The ensuing drop in income may result in poverty (Duraiappah, 1998). This is a classic example of how environmental degradation linked to class discrimination can cause poverty.

As pointed out by several authors, institutional factors might play a large role in helping correct for these troublesome market failures. Preference should be given to policy measures geared towards eliminating the problem at its root (i.e., by preventing the harmful environmental externalities normally created by the higher income groups in the first place), whereas ex-post transfer policies that make an attempt at achieving a more even distribution of the environmental burden are generally also needed<sup>59</sup>. A common example is the implementation of pollution taxes for individuals owning polluting durable goods and the regulation of emissions via the imposition of a market for emission rights (i.e., a "cap-and-trade" solution).

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<sup>57</sup> Water and, especially, air pollution are probably the most relevant examples in a developed country framework, although poor housing with damp or mould may also be relevant.

<sup>58</sup> This applies for example to the homeless/"shelterless" and the impacts of flooding or extreme weather/temperature conditions affecting subsistence agriculture.

<sup>59</sup> In fact, all of the social-class-related, redistributive policies to address poverty suggested in other sections (especially under the Marxist views) to tackle some of the failures of market allocations can actually simultaneously serve the purposes of both eradicating the prevalence of poverty and the spread of environmental externalities.

In the UK private rental housing is becoming more common and features aspects of this problem also, in the sense that mould and damp in poorly maintained houses aggravates health problems for the poor who have no alternative to renting such accommodation. Meanwhile wealthier landlords profit from the government's housing benefit scheme (Stephens and Whitehead 2013).

A key aspect of this nexus is the *blame* falling on the richer segments of society in causing negative environmental externalities that may translate into increased poverty; in developed nations, the poor tend to carry the burden and not the blame, as opposed to those higher income groups who might benefit from environmental degradation instead.

We now proceed to discuss the theories of poverty departing from traditional economic theory. These contributions are characterized by an eclectic approach, in which elements from other social sciences, such as sociology and psychology, are added to economic aspects. The first set of theories is closely linked to the concept of social discrimination just discussed in this section.

## 8. SOCIAL EXCLUSION, SOCIAL CAPITAL AND ECLECTIC THEORIES OF POVERTY

This section covers diverse theoretical approaches that can be interpreted as *peripheral*, in the sense of deviating significantly from the *core* theories of the main economic schools of thought reviewed so far, which are grounded on pure economic principles. The main difference between these theories and the previous ones is that they consider a wider spectrum of aspects and ideas arising from several disciplines, notably sociology as well as economics.

We start with an analysis of the role attributed to social exclusion in causing poverty. Even though this concept is part of some of the core paradigms reviewed (especially political economy theories), we include it here because its foundations are heavily based on the work of researchers from other fields of social science.

### **8.1 Social Exclusion**

Continental European analyses of poverty often tend to highlight the role of social exclusion above other factors in explaining destitution. We have seen that the EU defines social exclusion as a process through which individuals or groups are wholly or partially excluded from full participation in the society in which they live<sup>60</sup>. In turn, Hills and Stewart (2005) define social exclusion as "more than the lack of material resources" by reframing poverty as a feature of society at large that can

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<sup>60</sup> European Foundation for the Improvement of Living and Working Conditions (1995).

foster lack of participation. Thus, there is wide consensus among those who focus on exclusion in viewing poverty as non-participation in consumption, production, political engagement and social interaction<sup>61</sup> (Morazes and Pintak, 2007).

The most outstanding characteristics of the analysis of social exclusion are:

- Its intrinsic, rather than complementary, focus on the processes and dynamics which allow deprivation to arise and persist and the agents that cause it (i.e., an in-depth investigation of the real causes of poverty) (Atkinson 1998).
- It lends itself to the study of structural characteristics of society and the situation of certain groups including their socially defined characteristics<sup>62</sup> (e.g., ethnic minorities, aged, handicapped or the landless) which can generate and characterise exclusion.
- It leads to a shift in focus to distributional issues, resolution of which is deemed a *sine qua non* for ending poverty<sup>63</sup>.

It thus follows that inequality is central in the social exclusion paradigm and it is not confined to income inequality alone, but it is also defined in terms of limited opportunities for the poor and in terms of a broader concept of the material resources available in society (Hills and Stewart, 2005). Thus, items such as health and neighbourhood inequality also need to be considered in addition to income inequality, according to this perspective (Nolan and Marx 2009). It is clearly broader than the monetary approach (Section 5.1) and capabilities approach (Section 2.2)/

One of the main critiques cast upon this view is that social exclusion is arguably the least precisely-defined and somewhat the most open to different interpretations of the concepts of deprivation reviewed. Exclusion has to be clearly defined relative to society's "normal activities". It is most applicable to developed countries such as the UK. In developing countries, most people are excluded from the formal employed sector for example without being excluded from normal social patterns and relationships. Furthermore aggregating the different dimensions of exclusion has proved to be problematic (Nolan and Marx 2009). An example is the Human Poverty Index of the UN (2008) focused on developed countries which, inspired by Sen's capabilities approach (Section 2.2) weights together deprivations in the four basic dimensions captured in the human development index — a

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<sup>61</sup> This emphasis on the importance of participation at different layers in society makes these theories very close in spirit to Sen's conceptualization of poverty as lack of capabilities.

<sup>62</sup> See Section 7.3.

<sup>63</sup> The last two aspects are clearly related to the Marxist tradition.

long and healthy life, knowledge and a decent standard of living<sup>64</sup> — and also capturing social exclusion. It has now been superseded by the Human Development Index (for all countries) which weights a variety of additional factors in a similar way (UN 2013).

## 8.2 Social Capital

The concept of social capital was originally proposed by Loury (1977), who contended that it is a complement to the theory of human capital in explaining income disparities between black and white youth in the US. As a matter of fact, this author views the notion of social capital as describing "the consequences of social position in facilitating the acquisition of standard human capital characteristics and, thus, economic status" (Johnson and Mason, 2012). In his initial investigation of race-based differences in outcomes, he argued that whites might be better positioned to build the type of social connections necessary to capitalize on job-market opportunities. Loury further claimed that human capital is inseparable from social context and social origin and, hence, the latter two are crucial conditioning factors in the acquisition of the standard characteristics that lead to the accumulation of this productive stock. The importance given to this type of capital is evident in his statement that "the social context within which individual maturation occurs strongly conditions what otherwise equally competent individuals can achieve" (Osterling, 2007). As a result, Loury's conceptualization of social capital renders it useful in helping explain the dissimilar economic outcomes between, for example, minorities and non-minorities. Given that it can explain these inequalities, the concept of social capital is equally suitable for explaining the occurrence of poverty (Osterling, 2007).

Bourdieu (1985) refined the idea of social capital by expanding its functions to include its role as a tool that facilitates the production of other forms of capital. Therefore, in this authors' mind, this form of capital is valuable because it can increase, for example, access to power and other forms of capital<sup>65</sup> (Osterling, 2007). In turn, Durlauf and Fafchamps (2005) suggest the following definition: "social capital involves network-based processes that generate beneficial (economic) outcomes through norms and trust". These processes are capable of generating society-wide externalities in both negative and positive directions. For instance, individuals with access to social group interactions that promote negative behaviour and negative outcomes will more likely be poor (Jefferson, 2012).

These definitions and views notwithstanding, the most widely-employed definition of social capital was popularized by Putnam (2000), who postulated that "social capital consists of connections

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<sup>64</sup> The four indicators are (1) Probability at birth of not surviving to age 60 (times 100); (2) Adults lacking functional literacy skills; (3) Population below income poverty line (50% of median adjusted household disposable income); and (4) Rate of long-term unemployment (lasting 12 months or more)

<sup>65</sup> By means of "social connections".

among individuals, including the social networks as well as the norms of reciprocity and trustworthiness that arise from them". This notion is centred around the concepts of social networks, trust and norms of reciprocity and is in line with the idea of "civic virtue" associated with civil society. Hence, a lack of civic engagement and participation is indicative of a low level of social capital. Thus, social capital implicitly embeds the previously discussed concept of social exclusion; a large degree of exclusion acts as a sign of a low level of social capital given that it impedes civic engagement. As the level of inclusion is part of the broader notion of social capital enjoyed by a community, it follows that we can express poverty in terms of a lack of sufficient social capital only.

Putnam (2000) further disaggregates social capital into two components: "bridging social capital" and "bonding social capital". The first represents the set of inclusive social networks that connect heterogeneous groups. The relevance of this concept in explaining poverty and, especially, the persistence of poverty, is that: a lack of bridging social capital may exacerbate the social isolation of already poor neighbourhoods, resulting in a lack of contact with positive, pro-social role models, thereby obstructing the escape ways out of poverty. Similarly, weak bridging networks may lead people into poverty if, for instance, they are unable to find a job within their specific area, in particular if it is a highly unemployment-stricken area. The situation of these individuals would greatly improve if they enjoyed a level of bridging social capital high enough to enable them to find a job elsewhere, thanks to a more solid network of contacts (Osterling, 2007).

Additionally, the lack of contact with external, more positive social paradigms may create, in communities suffering from a host of socio-economic problems, "contagion effects" in which maladaptive norms of behaviour are spread more easily -- above all among children and the youth -- mainly through peer influences<sup>66</sup> (see also Section 4.2). Thus, since it is considered to yield opportunities and information otherwise not available within one's own social sphere, a healthy level of bridging social capital is a crucial asset for upward mobility. As a result, an absence of this type of capital within low-income areas is thought to help foster unemployment and accompanying economic distress in these neighbourhoods (Osterling, 2007). As an illustration, Wilson (1987) states that residents of high poverty inner city areas may rarely have contact with people who have steady jobs, higher education or who are not receiving public assistance. Indeed, the author argues that there is some evidence to suggest that these individuals are socially isolated from the mainstream social networks.

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<sup>66</sup> Ulimwengu (2008) hypothesises that a higher density of poor people in a given area can lead to the perpetuation of poverty given that a congregation of individuals that share the same *poverty-prone* attributes entails interactions between them that may favour the maintenance of the state of being poor. This suggests that there may exist economies of scale in the accumulation of this perverse type of social capital stock, characterized by the rapid expansion of negative external effects.

The second component of social capital, bonding social capital, includes exclusive or inward-looking social networks that are characterized by strong cohesion and social support. A lack of this type of capital can be conceived to have a negative impact on the incidence of poverty through two mechanisms: problems related to the communities' social organization and a general absence of trust, reciprocity and social support. These two elements alone can go a long way in determining the thickness of social safety nets which play two fundamental roles: first, they prevent a large deterioration in living standards upon the occurrence of negative shocks (especially through the second mechanism) and, second, they can speed up the process of lifting people out of poverty (notably via the first mechanism) (Osterling, 2007).

In relation to the second element of bonding social capital, a sense of trust within a social network involves the expectation that others in the network are mutually supportive. Reciprocity, in turn, involves a member of the social network acting on behalf of others (even at a personal cost) with the expectation that others will act for her benefit at some point in the future. There exists a large body of research showing that social support is indeed associated with improved mental health and health outcomes (Osterling, 2007), which are in turn intimately related to the likelihood of experiencing poverty as discussed in previous sections.

Putnam (2000) warns that, although low levels of social capital can cause poverty, the opposite may not necessarily hold true. That is, poor communities may not necessarily be endowed with low levels of social capital. In fact, poor people may belong to social groups characterized by high levels of social capital, however, they might lack the basic/essential resources to take advantage/make use of that social capital. Effectively, this means that high enough levels of social capital may be a necessary but not sufficient condition to combat poverty if it is not accompanied by minimal improvements in the material and socioeconomic attributes present in poor communities.

Social capital can have a "dark side" in which dense social networks are used to realise goals that do not contribute to a public good, but, rather, to a "public bad". Good examples where social capital plays the inverse role for this include "mafia" families, prostitution rings and youth gangs. These networks may yield substantial social capital returns to their members, yet they obviously do not contribute to the community's well-being (Putnam, 2000). Social capital in local networks may also disincentivise movement in search of work in that it provides resources to mitigate the impact of low income.

Pemberton et al. (2013) provide a summary of some of the roles of social capital commented so far as well as a concise list of other avenues through which low levels of social capital can channel individuals into poverty and/or keep people impoverished:

- Disconnection from social networks (and, thus, a depreciation of social capital) after long unemployment spells are a cause for persistent poverty since it increases the cost and decreases the likelihood of finding a job.
- Fear of losing social networks prevents individuals from moving elsewhere for work, which reinforces their joblessness.
- The breakdown of family relationships, the onset of chronic health conditions and the experience of crime are some of the factors that cause social exclusion, whose detrimental effect on the incidence of poverty can only be counteracted via the presence of strong social safety nets, which necessitate relatively high levels of social capital
- A lack of social capital can negatively affect poverty through another indirect channel: a low level of social capital in a region might mean that families do not have access to informal (and free) childcare arrangements (e.g., the role played by relatives and friends in taking care of children while at work), thereby having to resort to paid childcare, hence raising the opportunity cost of work which might lead to a vicious unemployment-poverty cycle.

It is worth noting that, thus far, the great difficulties faced when measuring the somewhat elusive lack of social capital and also addressing it by policy means is a reason why its use and further analysis have been neglected in the poverty literature. On the other hand, the concepts of social exclusion and social capital do fill a major gap in the economics literature due to its principal focus on the atomistic individual. Community and social groups matter for poverty outcomes.

## 9. CONCLUDING REMARKS

We conclude with a brief summary of the merits and drawbacks of each of the perspectives reviewed as well as the appropriateness of economic science per se for the study of poverty and recommendations for JRF. Our overall view is that each of the approaches has an important contribution to make to the understanding of poverty but no theory is sufficient in itself, a synthesis is needed. Furthermore, economics by its nature leaves out important aspects of the nature and causes of poverty.

Starting with the classical and neoclassical approaches, it can be argued that their main advantages reside in the employment of units of measurement of poverty (generally monetary) that are quantifiable and that the policy prescriptions deduced from these theories are usually precise, concise and measurable and, hence, easier to put into practice. Among the most salient criticisms of the treatment of poverty by this school, however, are its potential overemphasis on the

individualistic aspect of destitution only and its focus on purely material means/instruments to eradicate it. These two shortcomings stem in turn from the use of the narrowest working definitions of poverty in comparison with most other schools.

Even though the neo-liberal school led by the new-Keynesians departs from the same premises as the classical and neoclassical and also adopts a money-centred, individual stance towards poverty, the importance assigned to the functions of the government allows for a greater focus on public goods and inequality issues, which may affect dimensions of poverty not explicitly acknowledged by orthodox economists<sup>67</sup>. Nevertheless, distributional concerns are still not at the forefront in this approach (Morazes and Pintak, 2007), given that new-Keynesians believe that overall growth in income is the single most effective element in poverty removal (Laderchi et. al, 2003).

By suggesting radical changes in the socio-economic system, Marxist theorists highlight the possibility that economic growth alone may be insufficient to lift poor people out of poverty, for those who belong to certain classes may not reap any of the benefits of overall income growth. This is arguably their most important observation regarding poverty. Similarly, by emphasising the concept of *class* (as opposed to the *individual*), it also provides a drastic shift in perspective in the direction of focusing on group characteristics when examining poverty. In addition, Marxists take the accountability for their status away from the individuals to the exogenous socio-economic environment in which they live. However, the idea of lack of sufficient income as the culprit of poverty is still present under these unorthodox views; regardless of whether it is caused by systemic failures of capitalism leading to the permanent oppression of workers or not, the problem of poverty is ultimately inextricably tied to material well-being.

A further important contribution of Marxist/radical economists is a sense that poverty is a moral as well as a technical issue, a matter of justice and not only efficiency in use of resources. This is often lacking in more mainstream economic frameworks, except when they (as for Sen (1983)) integrate political theory of justice for example in terms of the Rawlesian preference for social organisation people would have behind a "veil of ignorance".

Those who stress the interrelation between social exclusion, social capital and the occurrence of poverty recognise the importance of the structural characteristics of society and the situation of certain groups, and thus are also less individualistic than the mainstream in scope. In contrast with the Marxists, however, they emphasise characteristics of groups or classes (such as gender or race)

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<sup>67</sup> For instance, a more equal income distribution can facilitate the participation of the disfavoured groups of society in the type of activities that are deemed essential under broader notions of poverty not generally used by the *orthodox* schools. This "instrumental" character of monetary measures in enabling non-monetary outcomes has, as we discussed, been emphasised by a number of *orthodox* authors such as Bhalla (2002).

other than their purely economic means, in explaining poverty. Furthermore, social exclusion and social capital theories arguably focus most closely on understanding the intrinsic processes and dynamics which allow deprivation to arise and persist, rather than providing a mere description of the characteristics surrounding poverty that most authors from other viewpoints have conducted (Laderchi et. al, 2003). This means that they provide a clear, consistent effort to propose an integral theory of poverty occurrence. Nevertheless, the wide definition of poverty considered under these theories comes at the cost of being less precisely-defined and more challenging to quantify and address by policy means (Laderchi et. al, 2003).

Townsend (1979) summarised where the most generalized approach to poverty in the economics profession stands and further proposed possible changes and addition to improve its effectiveness. In particular, he claims that excessive attention has been paid to the wage system/labour market outcomes and that other resource systems, such as the political and welfare institutional framework, should be factored in a general theory of poverty. The five main ingredients that a unified theory should incorporate, according to him, are:

1. An analysis of the distribution of resources other than income alone.
2. A description of the production and distribution (i.e., the framework governing the functioning of the systems) channels of these resources.
3. The different styles of living that ownership of different resources gives rise to.
4. An analysis and identification of the social classes that influence relationships between people in each system and which are characterized by distinct styles of living.
5. Special attention to minority groups who tend to be overrepresented among the needy.

These remain largely relevant despite the passage of time since his book was published in 1979. Townsend's view thus calls for adopting an eclectic stance in the analysis of poverty by taking advantage of the strengths and discarding the weaknesses of each of the perspectives investigated in this review.

Undoubtedly, the profession has shifted from an initial focus on too narrow and materialistic assessments of poverty to the consideration of a wide range of factors. Efforts within sub-disciplines such as behavioural economics to, for example, disentangle the effects of bounded rationality on poor people's choices are a growing avenue capable of shedding more light on this topic. Nevertheless, there remains a need in the economic literature on poverty for further assessing factors causing and perpetuating poverty outside the strict realm of monetary conditions.

If we re-examine the definitions of poverty in Section 2.3 we see for example a number of areas that have been neglected in the economics work we have presented, such as:

- Survival with dignity....inadequate physical security, lack of political voice (World Bank, 2004)
- Exclusion from social and cultural activities (European Commission, 2004)
- Lack of participation in decision making and in civil, social and cultural life (UN, 1995).

These point *inter alia* to a broader and richer range of motivations for human behaviour than the key focus of economics on maximising one's own consumption less utility of labour. People also seek autonomy, freedom, status, political influence, fairness, justice, dignity and community, for example, which for the most part are simply excluded from the economic calculus.<sup>68</sup> In this context, the conduct of sociological and qualitative analyses can strongly complement the insights arising from the quantitative analyses typically carried out under in orthodox economics. Other political issues related to poverty, such as, for example, the role of the institutionalization and legitimization of poor individuals in generating political and social support also needs better understanding given the important role they can play in certain contexts (Ulimwengu, 2008).

The need to focus on a context-specific nature of poverty is one of the main conclusions from this review. It would appear that the task of envisaging a generic theory of poverty is losing support among most experts, and that, rather, the profession is moving to context-specific investigations both at the theoretical and empirical levels. Nevertheless, there is still room for normative, political economy ideas around the concept of poverty to be re-evaluated and discussions at the theoretical level can also fruitfully inform applied research and policy.

As regards our recommendations for JRF, we consider that the review should be helpful firstly in identifying the undercurrents in the policy debate, that is, from which theoretical foundations particular policy viewpoints (e.g., "the poor have only themselves to blame") and their counterarguments (e.g., "there are market failures involved") originate.

Second, and more importantly, it provides a menu for intervention in the poverty debate, with, we contend, a need to emphasise the following policy points:

- the key role of capital formation (including human capital through investment in education) in the alleviation of poverty, which will require substantial government expenditure and which must

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<sup>68</sup> In the same vein, Pemberton et al (2013), reviewing the UK literature on qualitative aspects of poverty comment that "the literature details the many relational aspects of poverty and exclusion including stigma, shame, disrespect, humiliation, suspicion, lack of self esteem and powerlessness".

be appropriately designed for the nature of poverty in each locality (following the Keynesian tradition);

- the role of discrimination in poverty inter alia via society's class stratification and the need for legal action and deep market regulation to offset it (as emphasised by Marxists);
- the importance of community development in alleviating poverty rather than a sole focus on the individual (which other social disciplines emphasise);
- the importance of market failures in causing and perpetuating poverty (such as lack of access to affordable credit) and the need to focus on the incentives that may generate poverty (such as failure to invest in appropriate skill formation), which are the key insights from mainstream neoclassical economics

Third, it provides insight into states of the economy which will help alleviate poverty in the UK. This should be a state of high employment that rests on sustainable and inclusive economic growth and that is characterized by the absence of market distortions - such as the housing and credit boom that is currently potentially developing in the UK - that invariably lead to the aggravation of poverty in downturns. Nevertheless, some theories (especially the more laissez-faire oriented) would agree that individual choices (e.g. substance abuse, voluntary unemployment) remain barriers to the absolute removal of poverty. Marxists would also emphasise that the capitalist system inherently necessitates the existence of poor classes for it to prevail and, so, the eradication of discrimination is deemed essential for eliminating poverty. Hence, all theories establish a set of sine qua non conditions needed for poverty to end, therefore allowing for the possibility of the persistence of poverty in case they are not satisfied.

Fourth, the review gives a guide to the key and contrasting emphases of each tradition. Most of the literature focuses on the poor individual in two main aspects (Rank 2003): their participation versus exclusion from typical social life and their accountability versus responsibility for their current situation relative to the status of being poor. The theories correspondingly clash in whether social exclusion and hence community should be the focus of analysis (as emphasised by the social exclusion and social capital theories, and to some degree the Marxists) as opposed to the individual (stressed by mainstream economic theories). In addition, there is the question of whether individuals should be considered actively responsible for their well-being (as in the Classical and Neo-classical schools) or, instead, the passive victims of underlying flaws in the socio-economic system (as in the Keynesian and Marxist traditions). Finally, there are differing views on the role of government, with Marxists and Keynesians favouring, albeit at different levels, the implementation of public policies such as the provision of public goods and the establishment of minimum wages and

anti-discriminatory laws, and with Classicals and Neo Classicals generally seeking to limit the state's role in the correction of incentives and market failures. A similar distinction can be made between the two blocks of economic schools concerning the potential benefits of redistribution, with the Keynesians and Marxists in favour of it and the Classicals and Neo-Classicals opposed to it.

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