



Introduction to the special issue on “Poverty and Economic Decision-Making”

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Poverty is typically defined as being caught in a set of challenging conditions that make it hard to subsist or meet the prevailing standards in society. There is extensive evidence that poverty impacts decision-making through a variety of channels (Bertrand et al., 2004; Duflo, 2006; Mullainathan & Shafir, 2013). In classical economics, poverty can be captured by a tight budget constraint and its effect on the optimal consumption of goods, services, and leisure. The literature on scarcity following Shah et al., (2012) and Mani et al., (2013), on the other hand, stresses cognitive constraints induced by worries about one’s financial situation. This may lead affected people to narrowly focus on the situation at hand, to the detriment of opportunities that may help changing that situation in the longer term. Poverty is also related to inequality and social status, which can aggravate some of these issues, e.g., by inducing social reference points or by systematically eroding self-confidence and thus inducing inaction. Finally, poverty and its underlying causes affect risk exposure and, thereby, decision-making.

This special issue encompasses eight articles that span three broad topics relating to poverty. Influenced by Shah et al., (2012) and Mani et al., (2013), the first and largest set of papers investigates the cognitive effects that scarcity has on decision-making. de Bruijn & Antonides (2021) give a thorough and up-to-date survey of the empirical literature. The reviewed studies confirm that scarcity narrows attention to the most pressing domains, causing decision-makers to neglect other factors such as the long-run implications of over borrowing. Poverty also leads to more consistent choices in agreement with the idea that scarcity forces people to abstract away from irrelevant contextual factors and focus on the real trade-offs when comparing consumption options. The review finds less support for the proposition that scarcity affects cognitive performance and core economic preferences directly through its

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impact on cognitive load. In a closing note, the review points at issues that remain open and suggests promising directions for future research.

González-Arango et al. (2021) provides new evidence on the topic using a sample of high school students. In line with the review by de Bruijn and Antonides, they find no support for the idea that a scarcity framing directly impacts general cognitive performance and economic preferences. The study provides suggestive evidence of heterogeneous reactions to scarcity across socioeconomic groups, with more emphatic responses reported among participants with low socioeconomic status.

The literature on scarcity has focused on individual decision-making. Diekert & Brekke (2021) broaden the perspective by also considering the decisions of groups using a laboratory experiment. While they show that scarcity affects borrowing decisions for groups, their findings reveal that groups are less affected and appear better at countering the tendency of scarcity to distort focus away from long-run interests.

Bos et al., (2021) provide novel evidence on how scarcity affects decision-making outside of the lab. Using exogenous variation in the timing of welfare payments in Sweden, they study how variation in the budget constraint affects credit choices. Prolonged cycles create exogenous variation in the scarcity right before the payday. While high-educated individuals react to such extra scarcity, low-educated individuals do not, which results in higher default risk and higher borrowing costs among the low educated. The proposed mechanism is that high-educated individuals are more sophisticated and foresee that they will become shortsighted during periods of scarcity and therefore commit to repaying by borrowing less. The findings imply that the reaction to temporary increases in scarcity may exacerbate poverty in the long run through excessive borrowing and increased default risks.

Poverty has also been linked with the overconsumption of so-called temptation goods, such as junk food, sugary drinks, or cigarettes. Governments often try to rein in this sort of overconsumption by means of sin-taxes—taxes devised to lower the consumption of goods that may harm the health of the consumer. While in standard economics, the rationale behind such tax instruments is clear, Burlacu et al., (2021) investigate whether the poor react to such taxes in ways that deviate from the predictions of standard economics. They do this in a large online experiment in the UK, in which they experimentally induce financial worries, as well as varying the price of temptation goods relative to regular goods. While they find financial worries per se to decrease the demand for temptation goods, they also find them to decrease the attention paid toward the attributes of goods in general. That is, the demand function of participants in the financial worries condition is much less sensitive to the price manipulation than that of participants without induced financial worries.

Beyond issues pertaining to scarcity in absolute terms, poverty may also impact behavior through the inequality it creates. Bigoni et al., (2021) investigate the effect of differences in socioeconomic background on individual preferences. In an additional twist, they investigate such differences in a university student population within the same city—arguably a harder test, since it controls for educational attainment. They find participants living in more affluent areas of the city to exhibit

higher levels of trust, as well as being more trustworthy in the sense of being more likely to reciprocate trust. They do not find any effects on other preferences, such as generosity, risk preferences, or time preferences. Interestingly, the heightened trust found in participants from more affluent neighborhoods appears to be mostly driven by more optimistic beliefs about trustworthiness.

Finally, there is a question whether poverty may impact preferences directly. Conducting an experiment in rural Uganda, Verschoor & D'Exelle (2020) zoom in on the question how farmers in poor environments may distort probabilities. They use a methodology—called common consequence ladders—which allows them to paint a fine-grained picture of the relative steepness of the probability-distortion function across different segments. They deploy this method with both traditional and non-traditional framers and for both gains and losses, using methods that have been fine-tuned to fit their low-education target population. Whereas they find decisions in the loss domain to largely agree with typical findings from the West—exhibiting pronounced probability distortions—for gains they find evidence that is most consistent with EU maximization. This suggests that decision-makers in developing countries—far from the extremely risk averse picture that has been painted of them in parts of the literature—may actually be rather adept at taking decisions under risk.

Holden and Tilahun (2021), on the other hand, make a methodological point pertaining to the measurement of risk preferences. The tasks used to measure risk preferences in development settings may have affected our view of poor people's risk attitudes, since (a) measured attitudes often depend on the measurement method; and (b) measurement methods used in developed and less developed settings do often differ systematically, to deal with the different education levels prevalent in the different settings. Holden and Tilahun show that this may be particularly problematic in the risky investment game of Gneezy and Potters (1997) when expected utility theory is used to describe the data. The issue arises because the money participants are endowed with generates reference-point effects, which may lead to an overestimation of risk aversion due to loss aversion. In a field experiment in rural Ethiopia, they compare the standard version of the game to a setup in which participants are endowed with a lottery that is equivalent to the full investment of the endowment in the standard version. They find substantially higher investment levels when participants are endowed with the lottery rather than the fixed amount. The finding highlights the dangers arising from the combination of simple elicitation tasks with simplistic decision models, which may result in systematic biases in the estimation of preferences.

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