

# ECONOMIC THEORIES OF POVERTY

This paper reviews the main theories of poverty relevant to the UK. Each approach has a contribution to make to understanding poverty, but no theory is sufficient in itself: an integrated approach is needed.

## Key points

- Different definitions of poverty adopted over time reflect a shift in thinking from monetary aspects to wider issues such as political participation and social exclusion.
- Classical economic traditions contend that individuals are ultimately responsible for poverty, thereby providing a foundation for *laissez-faire* policies. Neoclassical (mainstream) economics is more diverse and provides explanations for poverty that are beyond individuals' control (notably, market failures).
- Both classical and neoclassical approaches overemphasise monetary aspects, the individual as opposed to the group, and a limited role for government.
- Keynesian/neoliberal schools focus on macroeconomic forces and emphasise the role of government in providing economic stabilisation and public goods. Poverty is considered largely as involuntary and caused by unemployment.
- Marxian/radical views consider class and group discrimination as central to poverty and assign a key role to the state in its intervention/regulation of markets. Anti-poverty proposals in this vein include minimum wages and anti-discrimination laws.
- Social exclusion and social capital theories recognise the role of social as well as economic factors. They help in understanding the precursors of poverty and its persistence over time.
- To maximise the relevance of insights into poverty reduction, a selective synthesis of approaches is needed. This should draw on social disciplines such as political theory and sociology to recognise a broader range of motivations for human behaviour beyond material and individualistic aspects.
- Policy recommendations include the need to focus on provision of forms of capital (including education); anti-discriminatory laws; community development; and policies to offset the adverse incentives and market failures that underlie poverty.

## The research

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**JUNE 2015**

# BACKGROUND

With about 24.4 per cent of the UK population in poverty in 2013 according to JRF's latest figures (Monitoring poverty and social exclusion 2014), this social and economic phenomenon represents a major challenge for UK policy.

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Definitions of poverty adopted by pre-20th century economists already distinguished the concepts of relative and absolute poverty. Rowntree, in 1901, was innovative in stressing a 'cycle of poverty'. Among recent economists, Sen is noteworthy in looking beyond narrow monetary-based measures of poverty, while Townsend highlighted the variety of resources needed to escape poverty.

Meanwhile, the World Bank uses not only monetary measures of poverty but also context-specific measures applicable to different countries' conditions. The European Commission (and the UK) links material resources and outcomes to social exclusion (e.g. poverty and social exclusion may preclude the affordable use of energy). The United Nations extends the concept of poverty to include lack of political participation and discrimination.

## Theories of poverty

### Classical and neoclassical

Classical traditions view individuals as largely responsible for their own destiny, choosing in effect to become poor (e.g. by forming lone-parent families). The concept of 'sub-cultures of poverty' implies that deficiencies may continue over time, owing for example to lack of appropriate role models, and that state aid should be limited to changing individual capabilities and attitudes (i.e. the *laissez-faire* tradition).

Neoclassical theories are more wide ranging and recognise reasons for poverty beyond individuals' control. These include lack of social as well as private assets; market failures that exclude the poor from credit markets and cause certain adverse choices to be rational; barriers to education; immigrant status; poor health and advanced age; and barriers to employment for lone-parent families.

Looking at the classical and neoclassical approaches together, their main advantages reside in the use of (quantifiable) monetary units to measure poverty and the readiness with which policy prescriptions can be put into practice. They also highlight the influence of incentives on individual behaviour as well as the relationship between productivity and income.

Criticism of these approaches highlights their overemphasis on the individual (without, for instance, taking into account links with the community) and the focus on purely material means to eradicate poverty.

### Keynsian/neoliberal

Even though the neoliberal school led by the new-Keynesians 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. For instance, a more equal income distribution can facilitate the participation of disadvantaged groups of society in the type of activities that are deemed essential under broader notions of poverty. On the other hand, new-Keynesians are in line with neoclassical economists in their belief that overall growth in income is ultimately the most effective element in poverty removal.

Publicly provided capital (including education) has an important role to play, with physical and human capital believed to be the foundation for economic prosperity. Unlike the classical approach, unemployment, viewed as a major cause of poverty, is largely seen as involuntary and in need of government intervention to combat it. Excessive inflation, high sovereign debt and asset bubbles are other macroeconomic factors, besides weak aggregate demand, believed to cause poverty.

## Marxian/radical

By suggesting radical changes in the socio-economic system, Marxian economists and other radical theorists highlight the possibility that economic growth alone may be insufficient to lift poor people out of (relative) poverty, because those who belong to certain classes may not reap any of the benefits of overall income growth. Similarly, by emphasising the concept of class, it provides a shift in perspective, focusing on group (rather than individual) characteristics, with individuals' status considered dependent on the socio-economic environment in which they live.

Nevertheless, adequacy of income remains a key factor. Within a capitalist system, alleviation of poverty may require minimum wage laws, action to eliminate dual labour markets, and anti-discrimination laws (seen as one of the most effective anti-poverty strategies). The exploitation of the poor by the rich groups in society may also occur via the quality of the environment; for example, the poor tend to suffer most from air pollution (normally generated by the wealthier groups) given their residential location. A further contribution of Marxian/radical economists is the sense that poverty is a moral as well as a technical issue. This is often lacking in more mainstream economic frameworks, except when they (e.g. Sen) integrate political theories of justice in their analytical framework.

## Social exclusion and social capital

Another strand of the literature stresses the interrelation between social exclusion, social capital and the occurrence of poverty and recognises the importance of the structural characteristics of society and the situation of certain groups. Social exclusion and social capital theories are, among all the reviewed approaches, arguably the ones that focus most on understanding the intrinsic processes that allow deprivation to arise and persist. 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.

## A broader understanding of poverty

Townsend claimed 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 taken into account. In line with this review, he calls for an eclectic stance in the analysis of poverty.

Progress is underway in that economics has shifted from focusing on materialistic assessments of poverty to considering other factors. Sub-disciplines such as behavioural economics, for example, attempt to disentangle the effects of bounded rationality on poor people's choices.

Institutional definitions of poverty highlight areas that have been neglected in economic approaches:

- inadequate physical security, lack of political voice (World Bank);
- exclusion from social and cultural activities (European Commission);
- lack of participation in decision making and in civil, social and cultural life (United Nations).

These point to a broader range of motivations for human behaviour than just 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 are often excluded from the economic calculus. These elements can be part of the circumstances that qualify people as poor in broader delineations of poverty. In this context, political, sociological and qualitative analyses can strongly complement insights from quantitative economic analyses. Discussions at the theoretical level can also inform applied research and policy.

## Conclusions and policy recommendations

Each approach has an important contribution to make to our understanding of poverty, but no theory is sufficient in itself. Furthermore, economics by its nature leaves out important aspects of the nature and causes of poverty.

In terms of informing policy, this review should first help to identify the theoretical foundations of particular policy viewpoints (e.g. 'the poor have only themselves to blame' or 'there are market failures involved'). Second, it provides ideas for intervention, based on the following policy points:

- the key role of capital formation (including human capital through education) in the alleviation of poverty, which will require substantial government expenditure and which must be appropriately designed for each locality (following the Keynesian tradition);
- the role of discrimination in poverty, via society's class stratification and the need for legal action and deep market regulation to offset it (as emphasised by Marxian economists);
- the importance of community development in alleviating poverty rather than a sole focus on the individual (which other 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 suggests which state the UK economy needs to achieve to alleviate poverty: a state of high employment that rests on sustainable and inclusive economic growth, without market distortions (such as the housing and credit boom potentially developing in the UK) that invariably lead to the aggravation of poverty in downturns.

Fourth, the review identifies the key and contrasting emphases of each tradition. Most of the literature focuses on the individual in poverty in two main aspects: their participation versus exclusion from social life and their accountability versus responsibility for being poor. The theories clash on whether social exclusion and community should be the focus of analysis (as emphasised by the social exclusion and social capital theories, and to some degree Marxian economists) as opposed to the individual (stressed by mainstream economic theories). There is also the question of whether individuals should be considered actively responsible for their well-being (as in the Classical and Neo-classical schools) or as passive victims of flaws in the socio-economic system (as in the Keynesian and Marxian traditions). Finally, there are differing views on the role of government, redistribution and the implementation of public policies such as providing public goods and establishing minimum wages and anti-discriminatory laws.

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## About the project

This review draws on theoretical work on poverty from the economics literature, much of which relates to absolute poverty in developing countries but has relevance to relative poverty in developed countries. The authors provide recommendations to inform the UK policy debate on poverty.

## FOR FURTHER INFORMATION

This summary is part of JRF's research and development programme. The views are those of the authors and not necessarily those of JRF. The main report, **Economic theories of poverty** by E. Philip Davis and Miguel Sanchez-Martinez, is available as a free download at [www.jrf.org.uk](http://www.jrf.org.uk)

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ISSN 0958-3084

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