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Poverty traps in theory and in practice

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Poverty traps in theory and in practice

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Introduction

In our modern world, poverty remains an urgent and pervasive challenge, hindering societal progress and exacerbating inequalities. Among the many challenges confronted by poor households, the enigmatic "poverty trap" stands out as a particularly stubborn and intricate phenomenon. This trap catches individuals and communities, perpetuating a cycle of deprivation and limited opportunities. It is a complex idea, with interlocking factors contributing to the persistent nature of poverty, making it difficult for those affected to break free from its grip.

Through rigorous literature review, we aim to gain a deeper understanding of the economic mechanisms that contribute to the perpetuation of the poverty trap. Furthermore, understanding the influence of the poverty trap is crucial, both at the micro level, where families struggle to escape its clutches, and at the macro level, where entire countries grapple with its consequences on economic development and social cohesion. As we unravel the intricacies of the poverty trap, we will see to identify targeted intervention programs that have been used to interrupt the cycle and empower those affected.

Chapter 1: General context

Eliminating extreme poverty worldwide is a critical component for achieving Sustainable Development by 2030 (United Nations, 2015). However, despite important progress, poverty remain widespread in part of the world and still capture the attention of economists.

1.1. How can we define poverty?

Poverty is a broad concept that encompasses several dimensions such as health, education, and income, its study requires that it is clearly defined first. Nyasulu (2010) documented a variety of viewpoints (such as social, statistical, or political) on how to define poverty. The World Bank defines poverty as living with less than US $1.90 per day. While this definition offers a pragmatic measurement, its comprehensiveness can still be questioned. Would poverty be solely about a lack of daily income? Amatea and West-Olatunji (2007) argues that poverty extends beyond inadequate income. For Davis (2014) poverty entails a deficiency in active participation within the decision-making processes of civil, social, and cultural affairs. Banerjee and Duflo (2011) show their agreement with the fact that poverty goes beyond income by highlighting in their books "*Poor Economics*" the famous argument of Nobel Prize winner Amartya Sen when he states that poverty encompasses more than a mere lack of financial resources: it also includes the idea that individuals may not be able to achieve their maximum potential as human beings. Indeed, Banerjee and Duflo (2011) demonstrate through their studies that beyond just the lack of financial resources, poverty can impact an individual's ability to reach their full potential by hindering their opportunities for personal growth and development.

However, the complexity of the poverty phenomenon exceeds the social and statistical description, since it impacts the physical and moral health (Wijekoon and al.,2021). Due to disabilities, even the US1$ per day for poverty line is sometimes difficult to reach, and some people called ultra-poor live with less than 50 cents a day (Bowers and al., 2014). For Halder and Mosley (2004) the ultra-poor are the most vulnerable people who, in addition they lack abilities and self-assurance. Barrett and al., (2017) find in their economic study that most of the world's ultra-poor (over 83%) live in sub-Saharan Africa, which is a region where poverty is geographically clustered.

1.2. What is a poverty trap?

Individuals living in poverty often face a range of interconnected challenges that may obstruct their ability to improve their situation, leading to what is commonly referred to as a "poverty trap". According to Azariadis and Stachurski (2005) this poverty trap can be defined as a vicious cycle where current poverty leads to future poverty, creating a negative and continuous cycle. According to Barrett and al., (2017) poverty traps emerge when extreme poverty persists over time, and the poor continue to live with substandard conditions, reinforcing the cycle. For Matsuyama (2010), a poverty trap denotes an innate state where an economy finds itself confined within an unending cycle of continuous underdevelopment, thereby perpetuating a detrimental loop of destitution. In this state, the economy struggles to break free from the grip of poverty, as various factors contribute to its perpetuation, leading to a self-reinforcing cycle of deprivation and limited progress.

1.3. Why should we care about poverty trap?

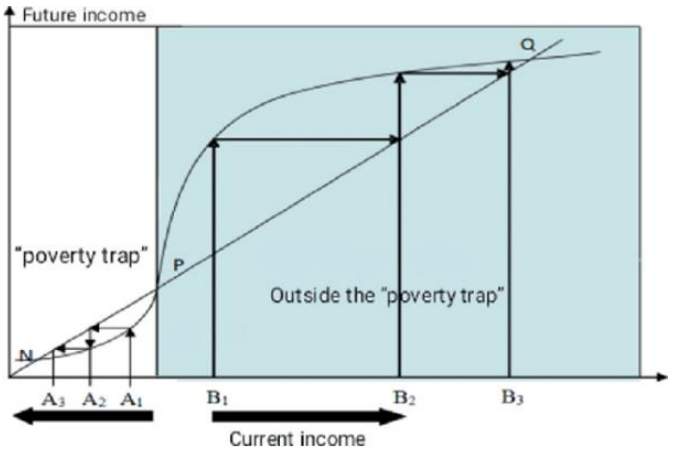
Poverty traps represent a severe form of poverty, characterized not only by individuals being trapped in poverty for extended periods but also by entire regions or areas caught in a cycle of persistent and entrenched poverty due to specific geographic factors or constraints. This phenomenon, referred to as the geographic poverty trap by Jalan and Ravallion (2002) poses significant challenges in formulating effective policies and programs to lift the poor out of poverty without the risk of falling back into it in the short term.

Furthermore, addressing poverty trap is complex, as it requires strategies that not only provide immediate relief but also empower individuals and communities to build resilience and sustainable livelihoods. Research, such as that conducted by Ikegami and al., (2017) has shown that conventional cash transfer programs might not be sufficient in preventing individuals from slipping back into poverty traps over time. These programs, although helpful in meeting immediate needs, may not adequately support asset protection and management, crucial elements in breaking the cycle of poverty.

Chapter 2: What are the economic mechanisms responsible for the emergence of poverty traps?

The poverty trap is a complicated idea that researchers have debated using both theories and real-world evidence. They aim to show how certain factors and conditions make it hard for people to escape poverty. One key concept in the economics of poverty trap is the S-shaped curve, which shows how on the one hand people struggle to escape poverty due to low income and on the other hand how they can escape poverty trap when income increase over time. By studying this curve and analyzing data, scholars gain insights into the challenges individuals face in overcoming poverty. This knowledge helps in creating strategies and policies that can break the cycle of poverty and support long-term progress.

2.1. What is the S-shape curve?



Source: The S-Shape curve and poverty trap (Zhang and al., 2022)

In the field of development economics, scholars have depicted the poverty trap through an S-shaped curve, which showcases the relationship between current income and income tomorrow (Ravallion and al., 2020). The S-shaped curve can be used to explain poverty trap by illustrating how financial constraints limit access to adequate saving, nutrition, leading to poor health and perpetuating the cycle of poverty. The slanted line (45 degree) on the graph assumes that the amount of money people earn now is the same as what they will earn in the future.

The bottom section (first part) of the S-shaped curve illustrates the concept of a poverty trap. This occurs when individuals or households have incomes that fall below a certain level known as "P." If a person or household's income is lower than this "P" threshold, they become trapped in poverty. Their current income is so meager that their future earnings consistently

remain below the line that slopes at a 45-degree angle. This situation arises due to slow income growth or challenging economic circumstances, such as limited opportunities for progress and financial constraints. These factors hinder their ability to save money or raise their income. Additionally, the presence of imperfections in the capital market, as outlined by Ghatak (2015), represents a significant challenge in this scenario of a poverty trap. Specifically, people with low incomes face intertemporal borrowing limitations, which means they can't easily borrow money across different time periods. This lack of access to timely funds for their financial needs affects their ability to keep up with rising living costs, causing a decline in their actual income value. As time goes on, if income growth remains slow or stagnant, individuals may continually experience decreasing income from one period to the next. This gradual decrease leads to a situation where they become progressively poorer over time, encountering increasing difficulties in meeting basic needs. Eventually, they reach a stable but low level of income denoted by the point "N." At this juncture, their struggle to escape the poverty cycle becomes challenging. Nevertheless, the threshold P emerges as a pivotal juncture on the sigmoidal curve, delineating the "lower steady state N" from the "upper steady state Q." It signifies a distinct level of income that functions as a demarcation between these two conditions. If individuals' current income is below the threshold P, they are more likely to be drawn towards the "low steady state N," where their income growth is slow, leading to poverty trap.

On the other hand, if individuals' current income is above the threshold P, they have a better chance of reaching the "high steady state Q," where they experience positive income growth and improve their economic situation over time. Once they accumulate too many assets, there is now a potential to improve education, skills development, access to credit, or supportive policies which may contribute to breaking definitely with poverty trap. But at a certain level, individuals or households reach a certain income level where the potential for additional growth or improvement may become limited.

2.2. Economic mechanisms of poverty trap

2.2.1. Capital Market Frictions and credit Constraint.

Throughout economic history, the S-shaped curve has been a crucial concept in understanding poverty. Fafchamps (2013) was one of the early researchers to recognize its significance. He argued that individuals in poverty often find themselves trapped due to limited financial resources and restricted opportunities, as shown by the S-shaped curve. This curve illustrates the persistent challenges faced by those in poverty, especially when their struggle to

access credit and financial resources. The scarcity of funds and limited opportunities make it difficult for them to improve their economic circumstances. According to Ghatak (2015), capital market imperfection as a form of friction combined with limited access to financial markets, hinder individuals from accumulating wealth and reaching a stable economic state. In the presence of capital market imperfection, poor cannot borrow and invest in activities generating income, which stops them from improving their money situation and keeps them at the bottom when it comes to revenue. But, in a scenario where a well-functioning credit market exists, the poor could secure loans or credit to invest in productive activities that generate income. By doing so, they could surpass the income threshold P and transition to the "high steady state Q," where they experience positive income growth and upward mobility.

Kraay and McKenzie (2014), emphasize the long-standing impact of credit constraints on poor individuals. Economic evidence from them shows that the inability to obtain loans has hindered their ability to invest in productive activities, thus limiting their potential for higher income and perpetuating the cycle of poverty. Additionally, the lack of credit and financial resources restricts poor households' access to education, productive assets, and entrepreneurial endeavors. This further reinforces the challenges they face in improving their economic prospects and escaping the cycle of poverty. These interrelated factors create a complex web that contributes to the persistence of poverty and makes it difficult for individuals to overcome their disadvantaged situation.

Supporting this perspective, Bos and al., (2018) highlight the historical struggles of individuals with credit information, who have found it difficult to secure employment and improve their income and credit standing. This relation between limited access to credit and the perpetuation of poverty further reinforces the necessity to tackle the credit constraints in poverty alleviation efforts.

2.2.2. Saving

In the context of saving behavior, the S-shaped curve provides valuable insights into the relationship between disposable income and saving rates. Because poor households facing intertemporal borrowing constraints their income might be just enough to cover necessities, leaving little or no surplus for savings. This low disposable income restricts their ability to set aside money for future needs or investments. As a result, their saving behavior is limited or even nonexistent, and their savings rate remains low. This can lead to their entrapment in a poverty trap, where the inability to accumulate savings hinders their ability to escape persistent poverty. However, the critical factor is that if individuals anticipate that their future income will

also be low or decline further, they may be even more hesitant to save. When faced with the possibility of a future income decline, individuals prioritize immediate consumption needs to sustain their current living standards. Consequently, saving for the future becomes challenging, and their savings rate might remain stagnant. Individuals will be stuck in the low steady state "N" of income struggle to accumulate wealth, which inhibits their ability to break free from the poverty trap. Supporting this notion, Kraay and McKenzie (2014) argue that while a low savings rate is an important factor, it alone is not sufficient for the occurrence of a poverty trap.

However, when households have access to borrowing, they often resort to using more expensive forms of credit, even when faced with higher interest rates. For instance, in the study conducted by Dean and Sautmann (2021), they examine a scenario involving two households, labeled as Household 1 and Household 2. Household 2, experiencing consistently higher interest rates on their savings compared to Household 1, may be motivated to increase their savings behavior as a result. This upsurge in savings capacity can play a crucial role in helping individuals and households mitigate the risk of falling into poverty or being trapped in it. In line with this, Banerjee and al., (2015) emphasize that an increase in households' wealth leads to higher capital savings, enhancing their ability to cope with unexpected economic shocks.

High saving rate plays a crucial role in fostering economic prosperity at the country level (Ribaj and Mexhuani, 2021). By accumulating capital, individuals gain the capacity to invest in various opportunities that can contribute to a nation's development. These investments have the potential to elevate a country's income level and ultimately alleviate poverty. As a country generates more wealth, it can allocate funds to vital sectors such as education, healthcare, infrastructure, and job creation. This allocation of resources provides people with improved access to essential services and better employment prospects, enabling them to escape the cycle of poverty and enhance their quality of life. The underlying concept is that once a country surpasses a certain income threshold, it can break free from the trap of poverty and continue on a path of sustained growth.

2.2.3. Scarcity-driven

The concept of the poverty trap within the S-shaped curve provides valuable insights into the challenges faced by individuals in poverty. Scarcity, particularly resulting from low income, creates a significant barrier for the poor in accessing borrowing and engaging in productive activities, especially when borrowing is expensive for them (de Bruijn and Antonides, 2022). With low levels of income, individuals may exhibit distinct behaviors in terms of saving or leaving bequests, even when their deep preference parameters are the same and there are no

external frictions. Such behavior referred to as scarcity-driven according to Ghatak (2015), can further solidify their low-income situation, establishing a self-reinforcing mechanism that perpetuates the cycle of poverty. In other words, scarcity not only limits their access to resources but also influences their behavior in ways that entrench their poverty even further.

Moreover, Ghatak (2015) highlights the significant influence of both capital market imperfections and scarcity in generating a poverty trap, especially considering the fundamentally different attitudes towards risk below and above the threshold P. Individuals below the threshold (between steady state N and threshold P), who face significant scarcity of resources and limited access to capital, tend to be highly risk averse. They prioritize avoiding losses and opt for low-risk projects, even if they offer lower returns. This cautious approach is driven by the fear of further impoverishment, as they lack the financial cushion to recover from potential losses. In contrast, individuals above the threshold (between steady state Q and threshold P), who have more access to resources and financial stability, tend to be less risk averse. They are more comfortable with taking on higher-risk ventures, as they have the means to withstand potential losses and recover from setbacks. This scarcity-driven difference in risk attitudes creates a challenging cycle for those in poverty trap. Their risk-averse behavior limits their potential for significant income growth, making it difficult to escape poverty and break free from the poverty trap. Meanwhile, those above the threshold have more opportunities for higher-income growth and economic advancement, leading to further disparities between the two groups.

Furthermore, it is important to notify that the scarce resource here is not only related to money but also related to time or attention spent by parents in children's education.

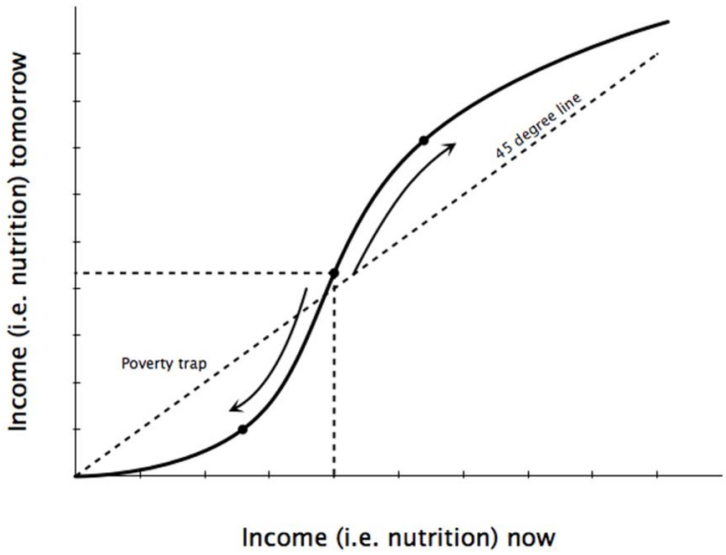
2.2.4. Assets return

The dynamics of poverty traps can be better understood by examining the relationship between asset returns and the non-linear nature of the S-shaped curve. The non-linear shape of the S-shaped curve reflects the challenges faced by individuals in poverty when it comes to accessing higher return-generating assets. In fact, limited financial resources and restricted lending opportunities are key factors that hinder poor ability to invest in assets that could potentially generate significant returns. Carter and Barrett (2006) argue that families with limited financial resources and restricted access to lending opportunities, may struggle to invest in lucrative assets that generate substantial profits. Consequently, these households often need to rely on self-reliance and saving strategies to overcome the poverty trap, improving their

financial situation, and achieving economic stability. In contrast, wealthier households, despite experiencing low marginal returns on assets, can choose to save and accumulate wealth, ultimately reaching a long-term equilibrium in asset stocks. Giesbert and Schindler (2012) also conducted a study on poverty trap, focusing analysis on the educational level of the household head. As result, they find that better-educated households who imply risk, investment and higher returns are awaited to reach better welfare levels than households with average asset endowments. But when they consider the initial asset endowments, they conclude a no evidence for a poverty trap that discriminates against households.

Moreover, when households start to get access to financial resources so investment opportunities, and potentially higher returns which in turn enables further investment and asset accumulation. This positive cycle allows individuals to build wealth, increase their financial stability, and gradually escape the poverty trap.

2.2.5. Nutrition



Source: The S-Shape curve, poverty trap and nutrition (Barto, 2017)

Beyond facing different rates of returns to physical assets, the poor may also experience a non-linear return to current income due to undernourishment. This means that the impact of an increase in income on their well-being and productivity might not follow a linear relationship. Since poor don't have money and cannot borrow to compensate, they have limited income. Therefore, they often struggle to afford healthy and nutritious food options, relying instead on cheaper, less nutritious alternatives. Kraay and McKenzie (2014), suggests that bad nutrition is a key factor in explaining self-reinforcing poverty. Because, poor are undernourished, they have

limited physical and cognitive abilities, making it difficult for them to work effectively and earn enough income to meet their basic needs, including proper nutrition. This creates a vicious cycle such as undernourishment limits their income-generating capacity, which, in turn, restricts their ability to access sufficient and nutritious food in the future. As a result, breaking out of this cycle becomes extremely challenging without addressing the issue of undernourishment.

However, when income increases, individuals can purchase a greater variety and quality of food, leading to improved nutrition (more calories). As Banerjee and Duflo (2011) argue, a household with limited financial resources, which experiences a 10% increase in income, tends to allocate approximately 7% of their additional income towards food expenses. This allocation of 7% of the income increase to food expenses indicates that food is a critical item in their consumption basket. With a best quality of food individuals will experience a significant improvement in their nutritional status which will have a positive impact on physical well-being, health, and energy levels. Adequate nutrition provides the necessary nutrients for optimal bodily functions, including cognitive abilities, physical strength, and overall productivity. As shown on the curve, when nutrition improves, there is a proportional increase in individuals' productivity so they can work more and earn more money which will allow them to escape the poverty trap.

Furthermore, beyond a certain threshold, the marginal benefits of improved nutrition on productivity may diminish because individuals reach the saturation point.

2.2.6. Decision-making

Kraay and McKenzie (2014) find that the way that poverty affects the decisions made by households can create a situation where poverty becomes self-perpetuating. Further support for the impact of poverty on decision-making and behavior comes from Mullainathan and Shafir, (2013). They argue that poverty inherently triggers a mindset characterized by limited resources, influencing individuals experiencing poverty. For instance, due to financial constraints, poor households are often compelled to prioritize present needs at the expense of the future (Sheehy-Skeffington and Rea, 2017). As a result, their limited financial resources lead them to engage in counterproductive actions that further entrench the cycle of poverty (De Bruijn and Antonides, 2022).

2.3. Behavioral and Psychological poverty trap

When considering the behavioral poverty trap, it can be observed that individuals living in poverty experience cognitive effects that influence their decision-making patterns. These effects have a significant impact on their risk preference, delay discounting, and loss aversion (Xu and al., 2020). For instance, the cognitive effects of poverty may make individuals more risk-averse, as they are likely to perceive potential losses as even more detrimental to their already disadvantaged situation.

Kraay and McKenzie (2014), argue that the way decision-making is influenced by poverty can lead to its self-reinforcing dynamics. It means that, any distortions in thinking may lead to unfair or inaccurate judgments which can are bias that contribute to poverty trap. For instance, Shah and al., (2012) argue that due to resource scarcity the poor decision-making processes is altering and they often prioritizes immediate needs over long-term considerations, hindering efforts to break free from poverty. This short-term focus, combined with risk aversion and sensitivity to losses, can create a behavioral pattern that makes it difficult for individuals to break free from the constraints of poverty. By consistently prioritizing immediate needs and avoiding risks, individuals may miss out on opportunities for education, skill development, or entrepreneurship that could potentially improve their economic situation in the long run. As a result, the self-reinforcing dynamics of poverty are fueled by the way decision-making is influenced by poverty itself.

Furthermore, Dasgupta (2022) and Xu et al., (2020) argues that biases such as perceptions regarding one's own effectiveness and hope contribute to the expansion of the poverty cycle. In fact, biases can lead to the internalization of negative beliefs about one's worth and abilities, causing individuals to doubt their capacity to escape poverty or achieve upward mobility. This can result in a decreased sense of self-efficacy, hope, motivation, and a lack of confidence in their ability to overcome challenges or take action to seek out opportunities. This lack of motivation can lead further to decreased efforts in pursuing education, acquiring skills, or accessing available support systems, thereby perpetuating the poverty trap.

Moreover, the combination of internalized biases, such as perceptions or beliefs that influence decision-making, and external limitations, such as borrowing constraints, lower income, and savings, as well as scarcity and poor nutrition, can create a vicious cycle. Biases influence decision-making, leading to suboptimal choices and limited actions to escape poverty. Meanwhile, external limitations reinforce and perpetuate the cycle by restricting opportunities and resources available to individuals.

Haushofer (2019) proposes a link between the mental well-being of individuals and their income, indicating an interconnected relationship. Changes in poor income can affect psychological well-being by giving stress and depression, and in turn, psychological well-being can influence income. According to the author, this relationship plays a role in determining whether a strict poverty trap exists, where individuals cannot escape poverty without significant intervention.

Chapter 3: Consequences of the poverty trap

Poverty when is self-reinforcing may have huge consequences such as deteriorative human health and intensely weakened social life of people (Sapkota and al., 2021). This chapter focuses on some of the effects of the poverty trap, exploring how it can lead to long-lasting problems for individuals and communities. These consequences include having the same low income for a long time and passing poverty from one generation to the next. Understanding these effects is important so we can find ways to break free from poverty and create better opportunities for everyone.

3.1. Stagnant income

- **At the individuals or household's level**

Benson and Shekar (2006) state that having stagnant incomes means there is no opportunity to obtain more food needed for a healthy diet. In fact, poor nutrition can negatively impact cognitive abilities, including memory, attention, and problem-solving skills. Individuals facing malnutrition may have difficulties acquiring new knowledge, learning new skills, and performing effectively in the workforce. Specially for children, if they lack good nutrition they will suffer from delayed mental and intellectual development and no develop their full potential (Hassfurter, 2022). This can limit their ability to secure higher-paying jobs or advance in their careers, resulting in stagnant income.

The inability of households to invest in the future, such as building assets for long-term financial security or investing in children's education and skill development, is another impact of stagnant income. It can also affect the household's access to healthcare, the ability to afford healthy food, and the living environment, leading to long-term impacts on the health and well-being of household members.

- **At the country level**

Kraay and McKenzie (2014), discovered that low productivity levels, possibly caused by factors such as bad nutrition or limited access to the financial market, can lead to self-reinforcing poverty and a stagnant economy. When productivity is low, individuals or households are less efficient in their production processes, resulting in lower levels of output or income generation, contributing to economic stagnation or slow growth rates.

Barrett and al., (2017), highlight that countries trapped in stagnant income levels for long periods may struggle to stimulate economic growth and break the poverty cycle unless fundamental aspects of the economy, such as technological advancements, are addressed.

However, households still retain the potential to escape low-income situations, even in countries facing stagnant income levels (Barrett and al., 2017).

3.2. Intergenerational Poverty trap

The first argument to explain intergenerational transmission of poverty trap is limited access to financial market developed by Araujo and al., (2017). They demonstrated that the lack of credit or other economic market factors could lead to a continuation of poverty in adulthood for children born into a poor household. For them, the lack of access to credit, which is often a result of low income and limited assets, can severely hinder the ability of individuals from poor households to invest in income-generating activities and seize economic opportunities. Without access to credit, individuals may struggle to start or expand businesses, invest, or access essential resources and tools needed for economic advancement. This lack of economic market factors, including credit, exacerbates the challenges faced by individuals born into poverty. They may find themselves trapped in a cycle where limited financial resources limit their ability to escape poverty and improve their socioeconomic status. As a result, the disadvantages experienced in childhood can persist into adulthood, perpetuating intergenerational poverty.

Another argument is limited access to quality education by Barham and al., (1995). For them, children from poor families find themselves trapped in a cycle of poverty due to the lack of financial resources to finance their education. In fact, access to quality education is crucial for upward mobility and escaping the poverty trap. However, children from poorer families often face significant barriers in accessing educational opportunities. They may be unable to afford school fees, books, uniforms, or transportation costs, hindering their enrollment and attendance in school.

Moreover, the impact of bad nutrition can be extended beyond the individual experiencing it. If poor parents face malnutrition, their children are more likely to inherit the cycle of poor nutrition and poverty. This intergenerational transmission can create a persistent poverty trap, where inadequate nutrition perpetuates low-income levels across generations.

- **Impacts on the household's level**

For households caught in the poverty trap, the scarcity of resources makes it challenging for families to invest in education, healthcare, nutrition, and other essential needs. This can perpetuate a cycle of poverty, as children growing up in these households face similar disadvantages and are more likely to experience poverty themselves as adults.

Because of the lack of good education, these children may lack the necessary skills and knowledge to pursue higher-paying employment opportunities in the future. This perpetuates the cycle of poverty as they struggle to secure stable and well-paying jobs, thus limiting their ability to improve their socioeconomic status. These factors can further exacerbate social inequalities, deepening the divide between the rich and the poor within a society.

- **Impacts on the country level**

At the country level, the intergenerational poverty trap poses significant challenges for social and economic development. When a substantial portion of the population remains trapped in poverty across generations, it affects the overall productivity and growth potential of the nation. According to Kraay and McKenzie (2014), when a country cannot reach a certain level of income per person, it gets stuck in poverty.

Persistent poverty limits human capital development, hindering the country's ability to cultivate a skilled and educated workforce. This, in turn, can impede economic progress and innovation, as individuals who lack access to quality education and training struggle to contribute meaningfully to the workforce.

Chapter 4: Policies and programs used to break the Poverty Trap and their impacts

Poverty trap remains an enduring challenge caused by economic mechanisms such as capital market frictions and credit constraints, low saving rates, scarcity-driven conditions, low asset returns, poor nutrition, and suboptimal decision-making processes. By confronting societies worldwide, it necessitates the implementation of diverse policies and interventions to address this multifaceted issue. Though government policies and programs almost never point at poverty trap as the issue they want to tackle, many interventions to influence the mechanism behind it can be analyzed as an attempt to address and alleviate poverty trap.

Thus, this chapter aims to examine the effectiveness and limitations of key policies in combatting different economics mechanisms that leads to poverty trap. These interventions can be grouped into three categories, each addressing a different aspect and mechanism of the poverty trap. Government transfer payments serve as a safety net, offering vital support and essential services. Simultaneously, microfinance interventions foster financial inclusion, while graduation programs provide a comprehensive framework to help individuals overcome poverty trap.

However, it is essential to acknowledge that the implementation of these policies can differ across countries and contexts, with their efficacy influenced by factors such as targeted implementation, supportive regulatory frameworks, and robust evaluation mechanisms to ensure sustained impact.

4.1. Government transfer payments

Government Transfer Payments (GTPs) involve the regular provision of monetary assistance by the government (Dancey, 2013) to impoverished individuals. The underlying aim is to alleviate both persistent and shock-induced poverty, thereby enhancing economic resilience among eligible beneficiaries. This policy's execution involves the delineation of specific criteria by the government or relevant organizations to identify target groups. Subsequently, direct monetary aid is extended to these groups as a means of social support and poverty alleviation, often entailing specific conditions (Conditional Cash Transfers) or lacking any stringent prerequisites (Unconditional Cash Transfers). Such conditions frequently imply sending children to school or attending healthcare check-ups (De Britto, 2008).

Daidone and al., (2019) emphasize that UCTs hold the potential to address limited access to credit and formal financial institutions which is the one of the prominent challenges faced by impoverished households. In regions characterized by market imperfections that restrict borrowing options, these cash transfers offer a pivotal source of capital. This capital infusion,

in turn, can be channeled into income-generating activities or invested in productive assets, such as initiating small businesses or pursuing education and skills development. As these enterprises take root, households tend to become more appealing to formal financial institutions, leading to enhanced access to formal credit (Gazeaud and al., 2023). Additionally, this financial stability enables households to commence saving and accumulating capital, facilitating further investment in education and skill enhancement. These endeavors are crucial in augmenting employability and expanding opportunities for higher-paying employment, thereby reducing susceptibility to relapsing into a cycle of poverty.

Furthermore, Marinescu (2018) highlights the potential of UCTs to significantly enhance health outcomes. An increase in financial resources enables families to afford better dietary options, ensuring improved nutrition for their members. This, in turn, contributes to better health outcomes and reduced vulnerability to illnesses.

Ghatak (2015) studies the pivotal role of decision-making in poverty reduction. For him, UCTs exemplify this approach by empowering recipients to judiciously allocate funds according to their unique circumstances. This recognition of individuals' agencies underlines their capacity to discern the most effective use of resources.

Beyond their economic implications, CCTs and UCTs yield noteworthy psychological benefits. Haushofer and Shapiro (2013), Zimmerman and al. (2021) and Roelen (2014) underscore that regular cash disbursements contribute to enhanced mental well-being. By providing recipients with a reliable source of income, the government reduces worries about meeting basic needs. This financial stability can lead to a reduction in stress levels and an improved mental health outcomes and sense of well-being. Still in the psychological argument of UCT benefit, Malhi (2020) demonstrated that even if the size of unconditional cash transfers may not be sufficient to break the poverty cycle, it can positively influence individuals' aspirations and their desire to achieve something. When individuals receive unconditional cash transfers, it can positively influence their aspirations and increase their belief in their own agency and ability to create change. This newfound confidence can lead to a shift in mindset, where individuals begin to see possibilities beyond their current circumstances. They may be more inclined to invest in their own development, seek out opportunities, and take steps towards achieving their goals. These changes in aspirations and motivation can have a lasting impact on individuals' trajectory out of poverty. With increased motivation and a sense of possibility, individuals are more likely to engage in activities that enhance their skills, pursue education, or explore entrepreneurial endeavors. This can contribute to breaking the poverty cycle by creating pathways to higher-paying jobs, increased income, and improved economic prospects.

However, despite the potential benefits of CCT and UCTs, there is limited available evidence regarding their effects. Firstly, according to Ghatak (2015), a more effective approach to addressing poverty is to go beyond just addressing poverty traps. Instead, he suggests implementing direct interventions that improve access to markets, provide substantial cash grants, invest in infrastructure, and promote migration to regions with better economic conditions. Moreover, the absence of conditions in UCTs may raise concerns about responsible fund utilization and productive investments, as noted by Haushofer and al., (2013). Compared to conditional cash transfers (CCTs), which involve monitoring and follow-up, UCTs are more cost-effective to administer. However, the absence of conditions may potentially lead to a reduced inclination among individuals to utilize the funds responsibly or for productive investments.

Secondly, for CCT programs some recipients of financial transfers did not receive the required forms to track their children's school attendance (de Brauw and Hoddinott, 2011). So even with this condition the human capital may increase but the outcome may not be good and at the end doesn't contribute to long term poverty trap reduction. Furthermore, in a context where resources are limited and not readily available, the introduction of conditions to social welfare programs not only hinders their capacity to break the cycle of poverty across generations but can also result in significant negative consequences concerning child protection (Roelen, 2014). For instance, when services (school or hospital) are far, bad, or unavailable for household to allow them to comply easily with requirement.

4.2. Microfinance interventions

Despite the significant financial resources allocated by governments to households, they may not always achieve the desired poverty reduction outcomes. In such cases, microfinance initiatives are recognized as a powerful and innovative tool for poverty reduction (Miled and al., 2022). While cash transfer and microfinance initiatives aim to alleviate poverty and empower individuals economically, they differ in their approach. UCTs provide direct financial assistance without conditions, while microfinance provides access to financial services, particularly small loans. According to Nasir (2013), microfinance encompasses the provision of modest savings, credit, and insurance services to individuals from socially and economically marginalized sections of the community.

Moro Visconti (2011) argues that microfinance stands as a successful financial innovation aimed at addressing credit exclusion, a significant poverty trap that hinders billions of

underserved individuals, particularly women, from breaking free from entrenched hardships. This credit exclusion severely limits their ability to access capital and invest in income-generating activities, perpetuating the cycle of poverty and economic vulnerability. By providing small loans, savings accounts, and other financial services to individuals who are otherwise excluded from traditional banking due to capital market imperfections, microfinance initiatives empower them to engage in productive economic activities and establish small businesses. This access to credit enables underserved individuals, especially women, to break free from the entrenched hardships of poverty and improve their economic prospects.

Furthermore, microfinance programs go beyond addressing immediate consumption needs by encouraging individuals to save and invest for the long term. According to Khandker and al. (2016), microcredit has a positive impact on poverty reduction as it enhances consumption levels and reduces both moderate and extreme poverty. Ishfaq and al., (2015) argue that microfinance has evolved into an industry that assists the most impoverished individuals in breaking free from the cycle of extreme poverty. Through savings accounts and financial literacy programs offered by microfinance institutions, individuals can develop a habit of saving and build financial resilience. This focus on asset accumulation contributes to the development of lasting assets, such as productive equipment, housing improvements, or education for themselves and their children.

Kraay and McKenzie (2014) argue that microfinance programs, through their provision of financial services to individuals living in poverty, can indirectly contribute to improvements in nutrition. By accessing credit and financial resources, individuals may have the means to invest in income-generating activities related to food production. They can purchase tools, or livestock, which can enhance their ability to produce nutritious food for themselves and their families. Increased income from microfinance activities can improve individuals' purchasing power, enabling them to afford a more diverse and nutritious diet.

Additionally, microfinance programs have demonstrated benefits for women, highlighting their potential in promoting gender empowerment and addressing gender-based inequalities (Khandker and al., 2016). Firstly, microfinance programs enable women to engage in income-generating activities, start their own businesses, or expand existing ventures. This access to credit allows women to overcome financial barriers and take control of their economic destinies. As a result, they can contribute to household income, increase their financial independence, and exert greater decision-making power within their families. Secondly, microfinance programs often provide financial literacy training and support services that equip women with essential financial management skills. This financial education enhances their ability to effectively

manage resources, make informed financial decisions, and improve their overall financial well-being. D'espallier and al., (2013) argue that in the context of poverty reduction, providing a dollar loan to a woman has a more significant developmental impact compared to allocating the same amount to a man since she invests income in her family well-being.

However, it is essential to acknowledge that the effectiveness of microfinance programs can vary depending on household circumstances and capabilities (Barrett and al., 2017). By providing access to short-term credit, microfinance can act as a catalyst for talented but poor entrepreneurs, facilitating their escape from the poverty trap (Banerjee and al., 2019). By accessing short-term credit through microfinance, individuals with entrepreneurial aspirations can invest in their business ideas, purchase necessary equipment or materials, and cover initial operating expenses. This injection of capital empowers them to pursue income-generating activities and embark on a path of economic self-sufficiency. For Kraay and McKenzie (2014), irrespective of the available financial resources, individuals who lack adequate skills and face various constraints may struggle to generate output beyond subsistence levels. Recognizing this potential limitation, several policy interventions have aimed to integrate assets with intensive skills training and the promotion of savings.

Nevertheless, Stewart and al. (2010) suggests that microfinance programs, particularly for micro-credit recipients, can lead to a decline in their financial status rather than improvement. This can be attributed to factors such as a tendency to prioritize immediate consumption over prospects, insufficient profitability of businesses to cover high interest rates, and inadequate allocation of resources towards long-term investments that could yield substantial returns. For Banerjee and Jackson (2017), microfinance programs have resulted in increased levels of indebtedness among communities already living in poverty. This has led to the exacerbation of economic, social, and environmental vulnerabilities.

4.3. Graduation program

Widely recognized as a highly effective approach in poverty alleviation, the Ultra-Poor Graduation (UPG) program is not intended to replace or rectify all previous poverty reduction policies. Instead, it serves as an innovative and complementary strategy that specifically targets the unique needs of ultra-poor households. Defines by Ikegami and al., (2017) as a new generation of program which is combination of monetary grants, instruction on financial literacy, enhancement of self-assurance and guidance and ultimately lead to the transfer of assets. The UPG program is designed to address the multifaceted challenges faced by ultra-poor

households, aiming to provide them with the necessary tools and resources to escape extreme poverty sustainably.

Balboni and al., (2022) argue that the primary objective of this policy is to address both credit constraint and skill limitations simultaneously, with a specific focus on establishing a sustainable income stream for impoverished individuals, particularly women. This is achieved through the implementation of a single distribution of productive assets. By addressing credit constraint and skill limitations in tandem, the policy creates a sustainable income stream for individuals in poverty. As they develop their businesses, poor households can become more financially stable and capable to generating a steady stream of income. This, in turn, reduces their dependency on external aid and allows them to build a pathway out of poverty trap.

Barrett and al., (2017b) emphasize the successful outcomes achieved through a comprehensive approach in graduate programs, which includes a combination of asset transfers, skill-building, social connections, and emotional support. This holistic strategy has proven to be highly effective in addressing poverty traps and empowering individuals to improve their economic and social well-being. In fact, emotional support is a crucial aspect often overlooked in poverty alleviation efforts. Graduation programs recognize the importance of emotional well-being and offer counseling or support services to help participants deal with stress, anxiety, or other emotional challenges. Emotional well-being is fundamental in empowering individuals to make informed decisions and persist in their pursuit of better economic opportunities. Banerjee and al., (2021) find a substantial and positive treatment effects of the graduation program on the economic well-being of impoverished households. This includes notable improvements in measures of income and health for the program participants. An improvement of health measures suggest that the graduation program can facilitated better access to healthcare services, nutrition, or living conditions, thereby increasing the overall well-being of the participants and their families. Additionally, a notable increase in poor income levels indicates that the program effectively empowered them to engage in income-generating activities or access economic opportunities they previously lacked. Gollin and al., (2023) support this finding by demonstrating that programs like the Ultra-Poor Graduation program provide essential support to the poor by granting them access to crucial services such as healthcare and education which are vital for their survival and well-being. By equipping them with the necessary skills and financial knowledge, these programs help the poor effectively manage their activities and finances, leading to improved outcomes. Consequently, all these outcomes will underscore the effectiveness and potential impact of the graduation program in breaking the cycle of poverty.

Conclusion

This work on the poverty trap has provided valuable insights into the intricate interplay of economic mechanisms that perpetuate the vicious cycle of poverty. The poverty trap can be defined as a self-perpetuating cycle in which individuals and communities become trapped in persistent poverty due to a combination of economic factors that reinforce one another. By analyzing both theoretical frameworks and real-world evidence from literature review we identified economic mechanisms such as capital market frictions, credit constraints, low saving rates, scarcity-driven conditions, low asset returns, poor nutrition, and suboptimal decision-making processes that contribute to the entrapment of individuals and communities in poverty trap. These interconnected factors create a web of challenges that make it difficult for individuals to break free from poverty.

However, the multi-dimensional consequences of the poverty trap extend far beyond the immediate hardships faced by those trapped within it. Stagnant income and intergenerational poverty traps not only hinder individual progress but also pose significant challenges for the sustainable development of entire nations, entrenching inequality and hindering economic growth. To combat the poverty trap, various intervention programs that directly address its underlying mechanisms have been set up. Firstly, Government transfer payments which provide crucial financial support to vulnerable households, easing their immediate burden and helping them access essential resources. Secondly, Microfinance initiatives that offer an avenue for individuals to overcome credit constraints, empowering them to invest in income-generating activities and create sustainable livelihoods. Finally, the graduation program, closely linked to the main mechanism of credit constraint, represents a holistic approach. By combining financial assistance with skill development, education, and social support, this program equips individuals with the tools and resources needed to escape the poverty trap permanently.

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