Poverty Measurement and Consumption Smoothing

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Abstract

The practice of poverty measurement provides simple metrics to gauge deprivation based on yearly data, built on strong assumptions about consumption smoothing during the year. Decades of research on household finance, however, show that people with very low yearly incomes also tend to face instability and have limited ability to smooth consumption. As a result, income and expenditures can vary substantially by month or quarter. We propose an approach to measuring poverty that allows for varying within-year experiences of poverty. We use five years of monthly household survey data from rural India to show: (1) The number of households that experience poverty is far greater than the number counted as poor by annual aggregates. (2) The average poverty level across months is systematically larger than the poverty level based on average income or consumption. (3) The most vulnerable households see the largest increase in measured poverty when accounting for within-year variation. (4) Exiting poverty rarely means immediately leaving poverty behind. We describe challenges for income and expenditure measurement and implications for public action.