

Symposium on Consumption Smoothing in Developing Countries

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Roughly 75 percent of the 1.5 billion workers in low-income countries are employed in agriculture. Incomes of these farmers are volatile, determined in large part by weather conditions and international crop prices. These factors are beyond the control of individual farmers, which leaves their households exposed to risk. In the poor countries of the world, where per capita GDP may be only a few hundred dollars, it is a very small step from a bad growing season to malnutrition, disease, and even starvation. These farm households need ways to protect themselves against the risk of a bad year. For them, finding ways to smooth out their consumption between good years and bad can mean the difference between life and death.

However, in many parts of the developing world, farm households also lack access to formal insurance and credit markets. This symposium explores ways in which households in low-income countries, even without access to formal credit and insurance markets, find ways to smooth their consumption in the face of large shocks to their income. This general area of risk sharing and consumption smoothing has received a great deal of attention from development economists in the last five years or so.

Robert Townsend begins the symposium with a theoretical framework and procedures to test the extent of consumption smoothing. He examines the extent to which household consumption in low-income countries moves with household income and the extent to which household consumption moves with village income. To the extent that household consumption is linked to village

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income, there is evidence that villages are acting as institutions for sharing risk.

Jonathan Morduch examines the ways in which farm households may self-insure, with a particular emphasis on the idea that farm households may seek to smooth their consumption by altering their methods of production. In this way, Morduch points out, low-income farm households may choose a somewhat lower level of expected income in exchange for reducing the risk of devastating swings in income. Morduch finds that in certain areas where credit markets are especially poor, households are more likely to choose lower mean, lower variance production methods.

Timothy Besley presents evidence on nonmarket institutions that have developed in many areas to deal with risk and provide forms of credit. These include credit cooperatives, informal credit and insurance arrangements, rotating savings and credit associations, and certain interlinkages observed in agricultural contracts.

All three papers highlight the extent to which theoretical work in mechanism design, contract theory, and information economics has informed recent work in development economics. In addition, these papers underscore the ways in which large, detailed, household level data sets have recently been applied in developing country research. The phenomena of consumption smoothing and risk sharing in developing countries have provided fertile opportunities for testing predictions of theoretical models, and continue to serve as a source of facts that will generate future analysis.