Shocks, Income Diversification and Welfare in Developing and Transition Countries

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Rural life in developing and transition countries is prone to risks. In the absence of functioning formal insurance and credit markets, unanticipated shocks such as droughts, fluctuating prices or diseases frequently push rural households into poverty. This dissertation takes a welfare perspective to analyze how rural households manage risks ex-ante and cope with shocks ex-post.

The first part looks at risk-coping strategies and analyzes the socio-economic consequences of AIDS-related mortality in rural sub-Saharan Africa. Chapter 2 shows that households in rural Zambia are able to stabilize their per-capita incomes after the death of a prime-age member. Adjustments of income-generating activities as well as household size and composition are likely to explain this finding. Yet, risk-sharing arrangements appear to spread the burden beyond directly afflicted households. Despite its limited impact on monetary welfare, the death of an adult member could still affect other dimensions of household welfare. Chapter 3 demonstrates for North-Western Tanzania that the age at parental bereavement has important consequences for children's long-term capital accumulation in terms of both health and education. These effects, however, depend on the gender of the deceased parent. Preferences of the surviving parent partly protect same-sex children from the detrimental effects of orphanhood, suggesting that risks are not shared equally within households.

The second part of the dissertation explores risk-management strategies and investigates the income diversification patterns of farm households in sub-Saharan Africa. Chapter 4 analyzes the dichotomy of the non-agricultural sector in Western Kenya and the resulting poverty and inequality implications. The results show that only rich households are able to overcome the entry barriers into high-return activities. Low-return activities, however, are not concentrated among the poor. They are pursued by households across the entire income distribution, possibly reflecting the high risks associated with high-return activities. The chapter also provides evidence that high-return non-agricultural activities are associated with increased agricultural productivity. Apparently, they play an important role in triggering positive interactions between different income strategies and may hence contribute to sustainable livelihood success. Chapter 5 examines the determinants of diversification in Burkina Faso between 1994 and 2003. Diversification into non-agricultural activities appears to be motivated by insurance motives. During the severe drought in 1997/1998 households earned increased incomes from migration and local non-agricultural activities. The poorest households were hit particularly hard, often being forced to sell their livestock. Yet, the patterns of diversification also reflect structural change offering better opportunities in the non-farm sector.

The final part of the dissertation concentrates on Eastern Europe and looks at the welfare implications of international migration for those who stay behind and the migrants themselves. Chapter 6 examines the reasons for reduced labor supply of migrant-sending households in Moldova. The findings do not support the common view that decreased labor market activity is the result of remittances-driven leisure consumption. Instead, the departure of a migrant appears to raise remaining members' productivity in home production. In addition, young adults in migrant families are substantially more likely to pursue higher education. This effect may be due to remittances relieving credit constraints or migration-induced incentives for additional investments in human capital. Chapter 7 takes into account that migration itself is a very risky activity. It investigates the economic drivers of human trafficking, which refers to a situation in which a migrant has been recruited by false promises and is forced to work for no or little pay by means of coercion. Based on a household survey on human trafficking from Belarus, Bulgaria, Moldova, Romania and Ukraine, the analysis finds that the individual risk of falling victim to human trafficking is closely related to the size of regional migration flows. The reasons are lower recruitment costs for traffickers and, to a lesser extent, negative self-selection into migration.

Together, these findings illustrate that rural households in the developing world have developed various informal strategies to cope with shocks and reduce their exposure to risks. While these strategies help households to temporarily smooth income or consumption, they are likely to perpetuate poverty and reduce economic growth in the longer run. Consequently, measures that protect households from risks, e.g. microinsurance schemes, should play a prominent role in rural development strategies.