Consultation Draft
Not for Quotation
January 17, 2000

World Development Report 2000/1

Attacking Poverty

WDR 2000/1 is currently under preparation. This is a consultation draft. The draft will be revised in April and May of 2000 in light of comments received during the Consultation. The draft can be downloaded from the WDR Website: www.worldbank.org/poverty/wdrpoverty.

Consultation Draft
Not for Quotation
January 17, 2000

World Development Report 2000/1

AttackingPoverty

Contents

Consultation Draft
Not for Quotation
January 17, 2000

World Development Report 2000/1

Attacking Poverty

Chapter Summaries

WDR 2000/1 is currently under preparation. This is a consultation draft. The draft will be revised in April and May of 2000 in light of comments received during the Consultation. The draft can be downloaded from the WDR Website: www.worldbank.org/poverty/wdrpoverty.

World Development Report 2000/1

Attacking Poverty

Chapter Summaries

"Don't ask me what poverty is because you have met it outside my house. Look at the house and count the number of holes. Look at the utensils and the clothes I am wearing. Look at everything and write what you see. What you see is poverty."

— Kenya, 1997

Certainly our farming is little; all the products, things bought from stores, are expensive; it is hard to live, we work and earn little money, buy few things or products; products are scarce, there is no money and we feel poor. If there were money….

— Ecuador, 1999

"We face a calamity when my husband falls ill. Our life comes to a halt until he recovers and goes back to work."

— Egypt, 1999

"Poverty is humiliation, the sense of being dependent on them, and of being forced to accept rudeness, insults and indifference when we seek help."

— Latvia, 1998

"At first I was afraid of everyone and everything; my husband, the village sarpanch, the police. Today I fear no one. I have my own bank account, I am the leader of my village's savings group…I tell my sisters about our movement. And we have a 40,000 strong union in the district."

— India, 1997

S.1 This Report is about actions to attack poverty in the first decades of the twenty-first century.

S.2 Poverty is about people, the human beings behind the statistics. The voices of the poor tell us that poverty is low income and low human development, but that it is more than this. It is vulnerability. And it is powerlessness. The voices of the poor also reveal what can be achieved when policies and interventions work together to increase material well being and human development, to reduce vulnerability and to increase accountability to the poor. As Bashiranbibi, an agricultural laborer and member of the Self Employed Women's Association in India says, "Today, I fear no one."

S.3 Poverty amidst plenty is an affront to universal values. There are many dimensions to poverty, but unacceptably low levels of living are widespread. The world has the wherewithal to attack poverty vigorously. This report proposes a framework for poverty reduction based on recent development experience and the prospects for the coming decades. The experience of poverty reduction in the last fifteen years has been remarkably diverse. Spectacular successes and failures are found side by side. This diversity allows us to draw useful lessons, but it also warns us against simplistic universal policies and interventions. At the same time, while current global trends present opportunities for poverty reduction, they also pose risks of growing inequalities and the marginalization of large numbers. Accessing opportunities for poverty reduction, while managing the risks, will be the policy challenge of the coming decades.

S.4 Based on an assessment of the recent experience of poverty reduction, the Report conceptualizes a framework of action to attack poverty based on three pillars:

- Empowerment: Making state institutions pro-poor and removing social barriers to poverty reduction.
- Security: Helping the poor to manage the risks they face in their everyday lives, and managing national downturns to minimize their impact on the poor.
- Opportunity: Expanding economic opportunity for the poor by building up their assets and increasing the returns on these assets, through a combination of market-oriented and nonmarket actions.

S.5 This implies neither compartmentalization nor hierarchy. Actions for attacking poverty must move broadly on all three fronts. The Report proposes no blueprint to cover all circumstances. Rather, it proposes the empowerment-security-opportunity framework as a way to view country specific policy and intervention packages for attacking poverty. The international community can contribute significantly to this task through financial and non-financial resources for international public goods (such as environmental preservation or research on health vaccines) and through debt relief and targeted development assistance to help countries implement actions to attack poverty.

Part I. A Framework

S.6 This Report is about actions to attack poverty. But what actions? By whom? Over what time frame? Our consultations for the Report uncovered a range of sincerely held but very different views on the best way to fight poverty:

- Accountability of state institutions to the poor is needed, including advancement of electoral democracy.
- Gender equity is the *sine qua non* of a poverty reduction strategy.

- Global-level actions such as research in health or management of capital volatility are crucial.
- Rapid economic growth, brought about by macroeconomic stability and minimal government interference in markets and international trade, is at the core of poverty reduction.
- Labor-intensive growth and investment in basic social services provide the strategy for poverty reduction.
- Rapid integration into world markets is good neither for growth nor for poverty reduction.
- Rich countries need to moderate their economic growth and consumption, to minimize environmental damage affecting the poor.

S.7 How do such widely different views arise, when the common objective is poverty reduction? The answer is that people differ in their understanding of poverty and its causes. The Report begins, therefore, by setting out our conception of poverty, and our understanding of what explains the evolution of poverty.

Chapter 1 The Nature and Evolution of Poverty

S.8 Poverty is unacceptable human deprivation. But what is deprivation, and what is unacceptable? This Report takes as a starting point the now traditional conception of poverty as encompassing both low levels of income and consumption and low levels of achievement in education, health and nutrition status. But it also draws on other traditions to go beyond these dimensions to include vulnerability and powerlessness. This broader conceptualization of poverty is supported by the voices of the poor themselves and by philosophical arguments by Amartya Sen and others for viewing poverty as a deprivation of basic capabilities rather than merely as low incomes. And driving this effort is the prospect of finding new lines of inquiry that will add further to our understanding of the causal mechanisms generating poverty and identify more effective actions for fighting poverty.

S.9 A broadening of the dimensions from income and consumption to education and health led to a broader causal framework and to a broader policy framework. World Development Report 1990, which defined poverty in these terms, famously put forward a two-part strategy based on income growth and public spending on basic social services. The broadening we propose will lead to a corresponding broadening of the causal framework and greater analytical and policy insight. It brings to center stage the policy issues of security and safety nets, which was only partially handled in World Development Report 1990, and it brings to prominence actions in the social and institutional arena.

S.10 What has happened to poverty in the last decade? Global trends are not particularly encouraging. But the real story is that there has been tremendous diversity in outcomes: across dimensions, regions, communities, households and individuals. This differentiation theme is central to the Report.

- For income poverty, global totals have not changed much in the last decade—there are still around 1.2 billion people surviving on under a dollar a day. But there is considerable regional variation. In East Asia there was a spectacular fall in poverty, largely due to China. But income poverty rose in all other regions of the world except the Middle East.

- And within regions there are large variations across countries Thus, for example, for the eight African countries for which we have data for the 1990s, poverty increased in five, matching the regional trend, and decreased in three. Other regions experienced similar differentiation.

- Within a country, poverty in different areas can and does move in different directions. For example, in Mexico during 1989-1994, the poverty incidence in Mexico city fell by two thirds while in the Southeast it rose by 10 percent. Similar patterns are found in other countries and other regions.

- Disaggregating further, panel data show a pattern of tremendous volatility over time at the household level. When households in seven countries are classified as “always poor,” “sometimes poor,” and “never poor,” the “sometimes poor” group is generally much larger than the “always poor” group. For example, in Pakistan 55.3 percent of the households fell below the poverty line at some point between 1986 and 1991—only 3 percent were “always poor.”

- Nonincome dimensions of poverty show the same pattern of differentiation in the evolution of poverty across regions, countries within regions, areas within countries, and households within areas. For example, the 10 best performers on infant mortality rates all had a better than 5 percent rate of annual decline; the 10 worst performers actually had increases in infant mortality rates in the 1990s (for some, this was the result of the AIDS epidemic).

- Gender disaggregation reveals further variations in performance along different dimensions. In Sub-Saharan Africa, life expectancy has been improving much faster for men than for women. In Europe and Central Asia the ratio of female to male life expectancy rose but only because male life expectancy fell dramatically in the 1990s. Statistics on income poverty, and standard education and health indicators, do not capture such microlevel realities of poor women’s lives as domestic violence. These dimensions of poverty are revealed through more participatory approaches to poverty assessment.

S.11 Thus our basic message is that the patterns of poverty evolution are enormously varied, especially at the disaggregated level. One should not expect, therefore, a simple causal explanation of these changes, and even less so a uniform set of policy prescriptions. Differentiated patterns of outcomes indicate differentiated causes and thus differentiated policy responses.

Chapter 2 The Causes of Poverty and a Framework for Action

S.12 The previous chapter showed the highly varied patterns of poverty reduction in the last decade. What are the causes of poverty reduction? Through all the complexities of these patterns, there is a strong association between national economic growth and national level poverty indicators. This is true for income poverty measures and for nonincome poverty measures. This is the sense in which economic growth is the engine of poverty reduction. But there is a wide variation across countries in the extent to which economic growth reduces poverty. For income poverty, one study calculated that for a one percent increase in per capita consumption the range of reduction in the incidence of poverty could vary from 1 percent to 5 percent. There is also a large variation in the impact of economic growth on nonincome indicators of poverty such as infant mortality rates.

S.13 Whether growth translates into significant reductions in poverty depends on a number of factors. The degree of inequality in society matters. Studies find that the responsiveness of income poverty to growth increases significantly as inequality is lower. Initial levels of inequality in assets (land and education) also determine the poverty impact of growth, as do gender and ethnic inequalities. Addressing these structural inequalities thus become a crucial component of a poverty reduction strategy.

S.14 For a long time there was a concern that greater equality in different dimensions would come at the expense of lower growth. More recently, however, empirical studies have tended to show that more equal societies can actually grow faster. This is true of assets inequality and gender inequality, for example. Thus greater equity in these dimensions has a double impact on poverty reduction—because the impact of any given growth rate on poverty reduction is greater, and because the growth rate will be higher as well.

S.15 The stability of the growth path matters. There is evidence for some countries of asymmetric patterns of poverty responses to booms and recessions, and there is growing evidence that short-term shocks in nonincome dimensions such as education and health can have long-term consequences.

S.16 Improvements in national poverty aggregates which accompany growth can nevertheless hide considerable worsening for a significant number at the disaggregated level. For example, data for Ghana show an overall fall in poverty incidence between 1989 and 1992, but this is composed of a fall in poverty in rural areas and an increase in urban area. And it is cold comfort to the urban poor to be told that the national incidence of poverty has gone down.

S.17 The fundamental causal processes underlying growth and its distribution include social and political forces that lead to certain policies (public expenditures skewed away from primary education, for example) and to the persistence of certain social practices (such as gender discrimination). Governance is closely connected to poverty outcomes at any given rate of growth, and it also determines the rate of growth.

S.18 Global factors matter over and above their impact on growth. The costs of global environmental degradation are often visited upon the poor. Advances in health technologies have led to long-term improvements in mortality rates which are not explained by income growth alone. Agricultural productivity growth depends as much on international scientific advances as on country policies. And development assistance, if delivered effectively can also help poverty reduction.

S.19 Is there a conceptual framework that broadly captures the differentiated poverty outcomes described in chapter 1, and the causal issues raised by the discussion of the role of national economic growth in poverty reduction? Various approaches to understanding poverty can be structured around the concept of assets and returns to assets. Well-being is determined by the level of assets and the level and volatility of returns to these assets. This framework can accommodate a wide range of assets. The most obvious are physical and human assets, including in the former land, machinery and financial capital, and in the latter education and skill and health. Geographic location, physical infrastructure and natural assets also fall into this category.

S.20 A key feature of our framework is that individuals interact with each other not just through markets but also through institutions, norms and values. For example, social networks based on reciprocity generate claims (enforced through norms and values) that can be called on in times of distress. Institutions such as the legal system can powerfully affect the prospects for growth and poverty reduction. Such arrangements are sometimes described as assets. But norms, values, and institutions can also act as social barriers to poverty reduction. Whatever the terminology, it is important to grasp that the returns on physical, human and natural assets, and the volatility in these returns, are determined in part by a range of nonmarket factors.

S.21 Given this broader conception of poverty and the broader framework for understanding poverty, as well as the global context for poverty reduction, we propose a framework of actions to attack poverty built on three pillars—empowerment, security, opportunity.

S.22 Under empowerment we consider actions to make state institutions pro-poor (chapter 3) and actions to remove social barriers to poverty reduction (chapter 4). In making state institutions pro-poor, the nature of formal democratic processes is an important component. As important are more detailed processes of accountability, especially legal processes. Actions to build up the social institutions of the poor and to bring down social barriers against particular groups include building up assets of poor women (also discussed in chapter 7), and stopping their exclusion from the market place and increasing their voice through legal and other steps.

S.23 Under security we consider actions to protect the poor against negative shocks, and to manage national-level economic and other shocks. For both, broad coverage of safety nets is crucial. Chapter 5 discusses these and argues that while there should be a vision of a safety net for all, implementation should take a modular approach—with different schemes for different types of risk for different sections of the population. Chapter 6 takes up macroeconomic shocks and develops specific guidelines for pro-poor macroeconomic policy in response to global volatility.

S.24 Under opportunity we consider a range of direct actions to increase the poor's access to physical and human capital, and to increase the rates of return to these assets. Chapter 7 discusses the key role of land reform and investment in rural infrastructure in poverty reduction, and looks as well at physical infrastructure issues in urban areas. Lessons from investment in education and health are also reviewed in this chapter. Chapter 8 takes up the hotly debated question of market liberalization and the poor. For each type of liberalization, the chapter develops guidelines that emphasize the need for country and case specificity.

S.25 Actions to better channel global forces towards poverty reduction are discussed in chapters 9 and 10. Actions to promote key global public goods with benefits for the poorest—like health vaccines and agricultural technology research—are proposed and discussed in chapter 9. The role of development assistance in poverty reduction is discussed in chapter 10, and specific actions are proposed to better orient aid delivery mechanisms to poverty reduction.

Part II. Empowerment

S.26 Poverty is not the outcome of economic processes alone. It is also the outcome of social and political processes and their interactions with each other and with economic forces. These interactions are mediated through a range of institutions that are key to understanding poverty and to formulating strategies to reduce it.

S.27 In the words of Douglass North, institutions are "the humanly devised constraints that structure political, economic and social interactions." Institutions in this sense encompass a wide range of phenomena—social networks governed by reciprocity norms, customary gender roles, the legal system, the state more generally. Moreover, these institutions interact with each other. While recognizing the interrelationships, we start the discussion of empowerment by focusing on state institutions in chapter 3. Chapter 4 takes up a range of phenomena more closely linked to nonstate institutions.

Chapter 3 Making State Institutions Pro-Poor

S.28 Any poverty reduction strategy must ensure that state institutions work well, and that they work well for the poor. This is assumed implicitly, for example, in any strategy that includes the provision of basic health and education services through the state. There is growing consensus that at any level of per capita income, the nature of governance strongly influences the nature of poverty outcomes, where governance includes such notions as voice and accountability and corruption. Evidence shows that corruption directly affects poor people's lives in myriad ways. Poor governance also reduces the prospects for growth.

S.29 A sense of voicelessness and powerlessness is a key dimension of poverty. There are many aspects of this dimension, but one that has received special attention is voice selecting national governments—formal democracy, in other words. Formal democracy is also one component of more general "voice and accountability" measures at the national level, which in turn form components of governance indicators.

S.30 Democracy is valuable in its own right. Crosscountry evidence also suggests that, on average, political rights, civil liberties, and press freedom are associated with higher rates of growth, lower corruption and better performance on poverty reduction. Democracies are also better at responding rapidly to famines. However, there are large variations around this average. A more interesting question is why there is such variation, and how democracies could more systematically deliver for the poor.

S.31 The chapter argues that how well states take on the interests of the poor depends on the participation of the poor in political processes and on the quality and orientation of organizations in political and civil society, especially the extent to which they mediate the voice of the poor to the state. Empowerment of the poor with respect to institutions of the state is thus both a good in itself and instrumentally, as a way of ensuring that state institutions do indeed become pro-poor.

S.32 One aspect of governance with a tremendous impact on poor people's lives is the rule of law. This can be both the result of inherently inequitable laws (such as women's property rights in some countries) and the result of inequitable and capricious application and enforcement of the law. Police brutality and violence is often mentioned by the poor. Making the legal system more pro-poor will mean changing of laws, speeding legal and other dispute resolution proceedings, and reducing the financial cost of these proceedings. The chapter looks, in particular, at legal services organizations that work with the poor and argues for actions to support them.

S.33 If state institutions are too remote from the daily realities of poor people's lives, can bringing them closer to these realities make them more pro-poor? The chapter considers the question of the decentralization of government and argues for caution in "a premature celebration of the local." It shows that decentralization works for the poor only when key technocratic and political conditions are met. A focus on these is at least as important for a pro-poor decentralization strategy.

S.34 If success in the fight against poverty requires that state institutions become pro-poor, what are the interests of the non-poor, especially the elite, in making that happen? The chapter argues that factors from self interest to moral imperatives may drive the elites to greater concern about the poor. This means a wide scope for pro-poor alliances in the fight against poverty at the national and the international level.

Chapter 4 Building Social Institutions and Removing Social Barriers

S.35 Making state institutions at the national and local levels pro-poor in their operation should improve poverty outcomes. However, social interactions between individuals and communities also influence poverty. The chapter focuses on the opportunities and constraints that social institutions present to development generally, and to poverty reduction in particular.

S.36 Recognition is growing that differences in traditional inputs such as land, labor and physical capital cannot fully explain differences in economic outcomes. Studies of social capital are uncovering its role in household wellbeing and in the development of communities and nations. An emerging theme is that reaping the full benefits of investments in human capital and physical infrastructure requires complementary forms of institutional development at the local and national levels. A well functioning parent-teacher association may be a necessary complement to building schools and training teachers. Irrigation programs may need to be accompanied by the promotion of social cohesion among farmers.

S.37 Consensus is growing on a definition of social capital as the ability of individuals and households to secure benefits by virtue of membership in social networks or other social structures. This definition is broad enough to go from the micro level of household and community interactions to the macro level of state institutions discussed in the last chapter. Strong ties between family members and close friends can be referred to as “bonding” social capital, through civic organizations and business associates as “bridging” social capital, and ties between the poor and those in positions of influence in formal state organizations as “linking” social capital.

S.38 Research on different types of social capital confirms its importance. For example, Using comparable data on household participation in associational life, studies on Bolivia, Burkina Faso, and Indonesia found—as with other forms of capital—that the poor tend to have less of it, not more. However, the returns to this social capital were found to be systematically higher for the poor. This is the sense in which social capital is the capital of the poor, and policy should promote a diversified portfolio of social assets.

S.39 The state’s role is vital in shaping the general context and climate within which organizations of civil society operate, but in some cases the state can also create social capital. A key lesson of experience is to draw on existing forms of social capital in poor communities as a basis for scaling up. At the very least, the state needs to be wary of destroying forms of social capital that are beneficial to the poor—as happens when common property resource management arrangements are dismantled and nationalized in the name of environmental protection.

S.40 A consistent lesson from the social capital literature is that households, communities, and societies which are low in bridging and linking social capital are greatly constrained in pursuing effective development strategies. Societies that are highly stratified along ethnic, gender, and economic lines face a difficult task in forging the broader sense of cohesion needed to embrace new opportunities and weather crises. Values, norms, and social institutions can lead to persistent inequalities between groups, the most well-known examples being the caste system in India and the old apartheid system in South Africa. Discrimination against indigenous and African-origin groups in the Americas are also leading examples of this phenomenon, as is persistent gender discrimination. These social divisions can become the basis for severe deprivation.

S.41 Ethnicity is a major factor explaining poverty and inequality in many countries. In Latin America, poverty is pervasive among indigenous groups. In China, illiteracy is higher for minorities than for the Han majority. In the rural north region of Vietnam, the incidence of poverty is 80 percent for minorities and 60 percent for the majority; 12 percent of minority households are illiterate, or four times the rate for majority households. To the extent that such disparities are due to discrimination—whether in the marketplace or in access to public services such as health and schooling—economic growth alone may not help much. Indeed, the benefits of any growth may flow to the privileged group. What is needed is purposive action to eliminate discrimination in access to markets and public services.

S.42 Ethnic divisions are bad for the group discriminated against. But evidence is accumulating that they are also bad for overall growth and development—and thus for poverty reduction among privileged ethnic groups. Thus policies to combat ethnic exclusion will benefit all.

S.43 Gender discrimination is a major causal factor in poverty and inequality. One study calculated that the world has roughly 100 million fewer women than it would if gender relations were more equitable. Discrimination against women occurs through formal and informal institutions. In some countries, women have no independent right to own or manage property—and no right to transfer anything as an inheritance. Widespread reform is needed in the area of property rights, but also in education and access to credit. Again, such reforms are good not only for poor women, but for society overall. Evidence shows that greater gender equity is associated with better national growth—a double impact on poverty reduction.

Part III. Security

S.44 Poverty is more than inadequate consumption or inadequate education and health. The voices of the poor make abundantly clear that poverty is also fear for the future—knowing that crises may occur, but not knowing how one will be able to cope. As a poor woman in Egypt said, “We face a calamity when my husband gets ill. Our life comes to a halt until he recovers and goes back to work.”

S.45 As traditionally defined and measured, poverty is static. But vulnerability and insecurity are dynamic. Insecurity is exposure to risk and vulnerability is the resulting possibility of decline in well-being. The event triggering a decline is often referred to as a “shock.” Shocks can affect individuals (illness, death), the community, region, or nation at large (natural disasters, macroeconomic crises). Chapter 5, considers risks at the micro level. Chapter 6 focuses on economic crises and natural disasters.

Chapter 5 Protecting the Poor

S.46 Vulnerability affects everyone. But it is a greater concern for the poor because downward fluctuations in income can push them below destitution levels. In China, 40 percent of an income shock is passed on as lower consumption for the poorest 10 percent of households while just 10 percent is for the richest third of households, which are better able to insure against many risks. Only 12 percent of households in a survey of South Indian villages had never fallen below the poverty line over a period of nine years.

S.47 At the micro level, shocks that affect specific individuals or households are referred to as "idiosyncratic." At the meso level, shocks affect a group of households, a community, or village and so are common (or "covariant") to all households in the group. Many shocks have both idiosyncratic and covariant parts. A study of crop damage in 15 Ethiopian communities found that 23 percent of rainfall shocks are idiosyncratic, and that 65-87 percent of shocks from other sources (such as pests) are idiosyncratic. Shocks with large common components are more difficult to insure because risk pooling outside the affected group is needed.

S.48 The poor face a range of exposures to risk, including illness and injury, violence, harvest failure, labor market risk and price variations. Several of these risks tend to occur together: harvest failures may coincide with increases in the price of food and be followed by epidemics. Poor households and communities have developed a range of responses to risk. Risk reduction aims at lowering the probability of a negative shock. A single person or household is rarely in a position to take such action (reduce risk of flooding through dam construction, for example). Risk mitigation aims at decreasing the potential impact of a negative shock through diversification of activities and insurance. Risk coping strategies aim to alleviate the impact of the shock on consumption after its occurs—by running down assets, borrowing, or calling on networks for support.

S.49 Many studies have documented that households across the developing world diversify their income sources. But the net effect of these efforts is limited. Evidence from Burkina Faso, Ethiopia, India, Kenya, and Tanzania indicates that poor households tend to be less diversified than rich ones, and remain exposed to greater variability in their incomes, in part because of entry constraints on many activities. Insurance markets are not well developed in the poorest parts of the world, so households engage in self-insurance—they accumulate assets in good times to draw down in bad times. But asset values and income are often covariant—"fire sales" of assets by the poor all at the same time can push down their price. Households prefer not to sell assets under these circumstances, and so cut consumption even further, as happened in the 1984-85 Ethiopian famine. Households also engage in informal and group insurance, relying on transfers from their networks to tide them over. Evidence shows that in most countries transfers are strongly concentrated among the poor households—it is not uncommon for transfers to add a third to a half to a household's pre-transfer income.

S.50 Risk mitigation and risk coping are rational responses to vulnerability, but because of the constraints under which they operate, poor households' short term responses can translate into long-term poverty traps. Diversification into safer but low-return activities is one example. Another is pulling children out of school sending them to work to supplement household income at times of stress—there may be no short term alternative, but the long term cost may be severe.

S.51 Enhancing the security of the poorest households has to be a key part of a poverty reduction strategy—not only because negative shocks worsen household poverty, but because household behavioral responses to risk perpetuate their poverty and impede long-run growth and development. The chapter presents a vision of comprehensive assistance for protection of the poor—but not through a single, uniform safety net. Rather, it takes a modular approach and argues for a system of specific risk management and assistance and safety nets for specific risks and specific sections of the population. It considers, in particular, seven instruments—pensions and old age assistance, unemployment insurance and assistance, workfare schemes, health insurance, social funds, microfinance, and cash transfers. For each, it reviews experiences and draws lessons.

S.52 The balance needs to shift from policies for coping to policies for reducing and mitigating risk—providing health insurance, managing labor market risk better (especially child labor), and providing better access to credit and financial assets. The chapter outlines the conditions under which the state could step in and market- or government provided mechanisms are likely to be more cost-effective than informal mechanisms. For example, studies have shown that the poor are generally able to insure themselves adequately against minor illnesses but not against catastrophic illnesses or disabling injuries. Public provision of insurance against major health shocks could thus improve the welfare of poor households. Evidence suggests that premiums for such insurance are likely to be well below households' willingness to pay. Unemployment assistance, social funds, and workfare programs are tools that can effectively alleviate labor market risk for the poor. Microfinance programs have helped moderately poor households smooth consumption, but loan size and repayment schedules need to be made more flexible for such programs to also reach the poorest households. As also mentioned in Chapters 6 and 8, cash transfers, welfare programs, social funds, and school scholarships can be used as effective safety nets in the face of economywide crises and to cope with the short-term costs of economic reforms.

Chapter 6 Managing National Shocks: Economic Crises and Natural Disasters

S.53 Economic crises and natural disasters are among the most important causes of sharp increases in poverty. These phenomena have occurred throughout history and many will continue to occur. Still, much can be done to avoid economic crises and prevent natural disasters—essential parts of the poverty reduction agenda. Responses to such crises should give priority to protecting the poor from drastic cuts in living standards and deterioration in their human and physical assets.

S.54 There is a strong link between macroeconomic downturns and rising poverty. In Latin America, it is estimated that each one percent decline in per capita income during a recession episode reversed the reduction in poverty achieved by an increase of 3.7 percent in income per head for urban areas, and 2 percent for rural areas during the 1970s. Also, crises ratchet up inequality, so that later growth tends not to eliminate the higher level of inequality generated during a downturn. The impact on nonincome indicators is also striking. In Indonesia, the dropout rate for children ages 7-12 in the lowest income quartile increased from 1.3 percent in 1997 to 7.5 percent in 1998. For 13-19 year olds the drop out rate rose from 14.2 percent before the crisis to 22.5 percent after. Economic crises can thus have persistent effects through their impact on the human capital of the poor.

S.55 Clearly, crises are to be avoided. The 1990s have seen a different type of crisis from those of earlier periods. Irresponsible fiscal or monetary policy seems not to have been widespread. Rather, the most important cause of these recent crises was weak banking systems and weak financial regulation in a world of large and volatile international capital flows. The direct policy responses are thus to improve prudential regulation and implement bankruptcy reform.

S.56 One example of an area of controversy in policy is the choice of exchange rate regime—flexible or hard peg? A flexible exchange rate regime allows smoother adjustment given an exogenous shock. The argument for the hard peg is that it reduces the likelihood of a home-made crisis through irresponsible fiscal or monetary policy. Under hard pegs labor markets are more likely to adjust to a shock through changes in unemployment, while under flexible exchange rate regimes real wages are more likely to adjust. The impact on poverty depends on whether the poor are primarily unemployed or whether they are employed but in low and flexible wage sectors. This will vary from country to country.

S.57 Once a crisis is under way despite the best efforts to avoid it, responses to the crisis can be more, or less, pro-poor. A poverty-sensitive response should: help the poor maintain adequate consumption levels and access to basic social services, avoid permanent reversals in the accumulation of human and physical capital; and prevent the development of self-defeating behavior such as criminal activities or abusive child labor. The evidence shows that protecting the poor from sharp, short-term drops in income through appropriate macroeconomic responses and well-functioning safety nets not only enhances equity but can also result in better growth outcomes.

S.58 A socially responsible approach to macroeconomic crises should, above all, avoid overkill—monetary and fiscal policy responses that result in a larger recession than needed to restore macroeconomic balance. Such overshooting is particularly damaging to the poor. Fiscal adjustment during crises should also be pro-poor. Programs that are particularly important to the poor—basic education, preventive health care, water and sanitation, rural infrastructure, and slum upgrading—should be protected from budget cuts. For example, Peru has recently introduced a “Fiscal Prudence and Transparency Law,” one component of which is prioritization of targeted poverty alleviation programs in the event of austerity measures. Safety nets for the poor should not be an afterthought in a crises. As discussed in chapter 5, a comprehensive system of tailored interventions for different needs and groups should be in place to protect the poor from the effects of policy responses to the crises.

S.59 Between 1988 and 1997, natural disasters claimed around 50,000 lives and caused damages of more than US$60 billion a year. Dramatic as these costs are, they underestimate true costs since they tally only the direct physical impacts on fixed capital and inventory. The human costs include injury and disability, destruction of social networks, and psychological trauma.

S.60 Natural disasters have increased over the last ten years, and developing countries suffer the brunt of their destructiveness. In 1990-98, 94 percent of the world's major disasters struck developing countries, which also suffered more than 97 percent of disaster-related deaths. In poor countries, the poorest are the least able to bear the burden of natural disasters. In Ecuador, the economic and social costs of El Nino during 1997-98 were substantial for the most vulnerable groups with an impact on equivalent to an increase in the poverty incidence of 10 percentage points.

S.61 Experience with natural disasters points to the need for a major shift in policy—from response to preparation and from the mobilization of resources after disaster strikes programs of risk reduction and risk mitigation. Reducing physical vulnerability requires better information (and better access to it), improved land and water use management, better protection of critical infrastructure, protecting critical infrastructure, and a sturdy institutional framework for disaster preparedness. Financial risk management instruments at the national level include catastrophe insurance or issuing financial instruments such as catastrophe bonds. For risks that cannot be absorbed in this way, the government should consider calamity funds—for financing safety nets and social assistance for disaster victims who are poor. The reconstruction period following a natural disaster provides a further opportunity for reducing vulnerability. Evidence suggests that community participation in decision making and implementing reconstruction delivers much better results during this phase.

Part IV. Opportunity

S.62 As discussed in chapter 2, the well-being of the poor can be seen as a product of their assets and the level and variability of returns to these assets. Improving their well-being can thus take place by building up these (economic and noneconomic) assets, increasing the return, and reducing the variability of returns. A wide range of assets matter for the poor—human, natural, physical, financial and social. Social assets encompass a range of reciprocal norms and obligations that can be drawn on in times of need, or that facilitate and enforce collective action. These assets are discussed in chapters 3 and 4. Chapters 5 and 6 have focused on volatility and variability in returns on assets of different types. The next two chapters will focus on market and nonmarket mechanisms for building up the assets of the poor and increasing the returns on these assets.

Chapter 7 Building Up Assets

S.63 That assets—human, natural, physical and financial—matter to the poor and to poverty reduction is not in dispute. The capacity for labor is a basic human asset. This capacity can be enhanced by improving skills through training and education and by maintaining and enhancing health. Natural assets can be privately owned, such as farmland, or owned and operated as common property resources, such as wood lots. Physical assets include infrastructure like roads or telecommunications, which can be privately owned or publicly supplied. Financial assets include savings and credit instruments of different types.

S.64 The premise of this chapter is that actions to build up the lowest levels of assets are central to poverty reduction. But the assets positions of the poor are highly varied. For a start, geographical position makes a difference. Natural assets are more important to the rural poor than to the urban poor. Infrastructure is important to both, but in different ways. And, there are significant crosslinkages between assets, and so between strategies to build them up. Roads to schools and health clinics, clean water and health, education and returns to farming, are all examples of such interlinkages.

S.65 Actions for building up assets of the poor will thus have to be specific to the particular situation of the poor find themselves, in particular areas of particular countries. However, a general framework can help in thinking through the specific issues involved. Actions to build up assets have typically been thought of on the supply side—schools, roads, telecommunications, rural banks—and these supply side actions have typically been thought of as being undertaken wholly or mainly by the state. But there is a demand side to the story as well. Schools can be built but parents may not send their children because of costs or social norms. A health clinic may be too far away for sick farmers to walk to. Public action to build up the poor's assets should therefore be seen as operating simultaneously on the supply side and the demand side. When demand for asset build up is weak, supply side measures will lead to unused and therefore wasted assets unless measures are also taken to strengthen demand. Where demand already exists, undersupply of assets will lead to frustration of demand and missed opportunities for poverty reduction. A balanced expansion of supply and demand is thus called for. This requires more than state action alone. What is needed is a partnership of the state, the private sector and the poor.

S.66 While there can be no blueprint, the lessons of experience suggest five closely related guiding principles:

- Take national actions for a more equitable distribution of assets. This means supporting land reform, building on recent successful experiences. It also means making patterns of public spending more pro-poor. Many countries spend more on the military than on public health and within health and education, spending is skewed away from sectors which benefit the poor. Within health and education., expenditures are skewed away from sectors that benefit the poor. The same is true of infrastructure. A study of five Latin American countries found ratios of public subsidies of the richest to the poorest quintiles ranging from 2.8 to 1.3.

- Focus on building mechanisms that hold state institutions accountable to the poor. There is ample evidence, for example, of newly built health clinics with staff who fail to show up or who mistreat poor people. There are also cases where local control of health and education has improved service delivery significantly. In infrastructure, decentralizing responsibility to subnational levels and involving local beneficiaries has led to improvement in provision and maintenance.

- Pay attention to the demand side of the equation. Studies have consistently found that cost (financial and time) and quality affects the demand for health services. Cost recovery needs to be analyzed with care and introduced with caution—and only if appropriate exemptions for the poor can be administratively managed. On the other hand, municipal water to the rich is subsidized, while the poor pay over the top for water in the market. In this case, charging the rich to finance connections to the poor is surely the pro-poor strategy.

- Seek partnerships of government, private sector, civil society and the poor. If the private sector can run telecommunications more efficiently, then a state-private partnership with adequate safeguards for services to the rural areas, is surely better than the wholly state-run systems in some countries. Joint government-community management of environmental resources is working better than the previous system of total control by the state. NGOs, working with community groups, have transformed the operation of credit markets in some countries.

- Build on synergies between assets. Building up one asset can affect other assets negatively or positively. Studies in Belize, Brazil, Mexico, Cameroon and Zaire have shown that new roads in forested areas can lead to deforestation corridors several kilometers wide. Methods and techniques exist to minimize the negative consequences. By contrast, in slum upgrading projects experience suggest significant payoffs to addressing the needs of the poorest groups through an integrated approach—combining roads, water and sanitation, flood prevention, public telephones, and other services.

Chapter 8 Making Markets Work for the Poor

S.67 Markets have a profound impact on the well-being of the poor. Poor workers sell their labor to landlords or factory owners. Poor farmers sell their produce to traders. Informal sector markets are particularly important to women, who sell their labor or the output of small-scale activities. The demand for labor depends, in turn, on domestic and international markets for commodities. Access to credit markets determines the ability to invest—of the poor and of the nonpoor who hire the poor as workers.

S.68 The role of markets and state interventions in markets is a major issue in developing poverty reduction strategies. Over the past 20 years, there has been a tendency for national governments to reduce state intervention in markets, replace public ownership with private ownership, and to replace protection with competition from foreign producers and investors. For example, in Latin America average tariff rates were reduced from 50 percent in 1985 to 10 percent in 1996 and maximum tariffs fell from an average of 83.7 percent to 41 percent. What effect have these changes had on the poor? What lessons have been learned from experience?

S.69 Market-oriented reforms of the type described above affect poverty through the rate of economic growth and the pattern of growth. The experience of the last two decades has been highly differentiated across countries and across categories of reforms. Easy generalizations are not possible. Several studies find that on average reforms have been associated with the resumption of economic growth—not sufficient, however, to meet the poverty reduction targets. But there are large variations around this average. One set of reforms which have been found to cause serious disruptions to growth are related to financial sector liberalizations. The combination of open capital accounts, weak regulation of the financial sector, and the volatility of short term capital flows lie behind the major macroeconomic crises in the 1990s.

S.70 For poverty reduction, as important as the rate of growth is the pattern of growth. The view that removing trade barriers would result in low-skilled labor-intensive growth, which was put forward a decade or more ago, is based on standard predictions of the theory of trade. Since developing countries have a comparative advantage in producing goods that depend on low-skilled labor, trade reform should make the production of goods that use low-skilled labor more profitable, increasing the demand for (and hence wages of) low-skilled labor.

S.71 In fact, the evidence shows that in the past 15 years the relative returns to skills have risen, not fallen. While skill-biased technical change explains a large portion of this widening gap, studies show that trade liberalization has played a role as well.. For example, a study for Mexico found that reductions in tariffs and the elimination of import license requirements accounted for about one fourth of the increase in the relative wages of skilled labor over the period studied. Another study, based on cross-country regression analysis, found that an indicator of openness is negatively correlated with income growth among the poorest 40 percent of the population but positively correlated with income growth among the higher income groups.

S.72 In so far as they contributed to higher—albeit only modest—growth rates, market oriented reforms appear to have been good for poverty reduction. However, this positive effect is dampened by the fact that the impact of reforms on income distribution might have been unequalizing. Furthermore, grouping all poor people together conceals important differences in poverty outcomes within countries. It also conceals the fact that reforms can have very important short term costs for the poor. For example, a study of six African countries showed that poverty was more likely to decline with improving macroeconomic policy. However, in three countries—Kenya, Nigeria and Tanzania—the standard of living of the very poorest segment declined, even though the incidence of poverty fell. Paying insufficient attention to the fact that important segments of the poor can be absolutely or relatively worse off as a result of reforms could jeopardize social cohesion, poverty reduction, and the sustainability and further progress of reforms. As argued in chapters 5 and 6, short term shocks to living standards—including the short term costs of reforms—can have irreversible effects on poor people's assets, particularly the human assets of their children.

S.73 The evidence strongly suggests that market-oriented reforms have different effects on different groups within an economy. There are winners and losers, even among the poor. What is to be done of a reform will increase growth and reduce poverty in the medium term but will hurt large numbers of poor people in the short term? One answer is to provide safety nets that minimize the short term burden on the poor. Another answer, particularly if compensatory measures do not exist, is to regulate the pace of reform.

S.74 Much of the discussion—and much of the controversy—has centered on market-oriented reforms at the macro level. But markets, and state regulation of markets, affect poor people's lives at the micro level as well. This chapter presents evidence that micro-level deregulation—such as lifting the heavy hand of local bureaucracies on small-scale trading activities—can be greatly beneficial to the poor as they work to pull themselves out of poverty. In the coming decade, such reforms should receive more attention than they have in the past.

Part V. International Dimensions

S.75 The well-being of the poor depends increasingly on forces originating outside country borders. Progress in developing malaria and AIDS vaccines in rich countries can determine life and death chances for the poor in poor countries. Commodity price fluctuations generated on world markets can feed through to cocoa farmers in Africa. Common standards set in international agreements can affect working conditions for the poorest in developing countries. Global warming can change the climate and increase the frequency of natural disasters that affect the poorest countries. International development assistance, financial and nonfinancial, properly used, can help in the fight against poverty, while heavy debt burdens reduce the resources available for poverty reduction. This part of the Report takes up some of these international dimensions of attacking poverty. Chapter 9 focuses on international public goods, and chapter 10 takes up development assistance.

Chapter 9 International Public Goods

S.76 International public goods are commodities, services or resources with benefits that cross borders and therefore benefit entire regions of the world or even the entire world. Examples include international economic stability, global health research, and global or regional environmental improvement. These goods are important for every country. But they are essential for developing countries. Take, for example, global health research. The 20th century saw enormous improvements in health indicators. But, for example, income and education improvements explain, on average, only about half of the gains in mortality reduction between 1960 and 1990. The rest is likely to have been caused by the generation and use of new knowledge—an international public good. Nor is this an isolated example. International cooperation to fight river blindness in 11

African countries is another international public good that has had a direct and measurable impact on the lives of the poor. The Green Revolution was the result of international research on high-yielding seed varieties.

S.77 Like public goods at the national level, the production of international public goods suffers because their benefits spill over to others, so every actor underestimates the global benefits of supplying it—leading to a global undersupply. Some form of international cooperation is therefore needed. What kind of cooperation depends on the nature of the public good in question, and the chapter considers a taxonomy and illustrates with examples.

S.78 Labor and environmental standards are international public goods for which demand is higher in rich than in poor countries. The controversy over labor standards, and whether rich countries should use trade sanctions to raise these standards in poor countries, illustrates the different incentives and interests in play. In the environmental arena, the Montreal Protocol on ozone-depleting gases is an example of an international agreement which succeeded despite major differences in interests across participants. It was based on clear scientific evidence of the costs of ozone depletion as well as an understanding that many developing countries would have trouble meeting the costs of joining the agreement. Flexibility was therefore incorporated into the design of regulations for developing countries. The chapter concludes that while provision of international public goods is enormously complicated when incentives differ for countries, a flexible use of a wide range of policy instruments (including development assistance as a compensatory device) will help spur cooperation.

S.79 Tropical health and agricultural research are examples of international public goods for which there is restricted demand in developing countries because of low income and low capacity. While rich countries have the capacity to carry out this research, their private sectors lack incentive to carry it out because of perceived low demand. Yet these goods are essential to growth and poverty reduction prospects in poor countries. Innovative international partnerships are needed to overcome the undersupply of such international public goods. One example is the recent proposal for a vaccine purchase fund. Another is the proposal for an international partnership to develop market-based commodity price insurance mechanisms for developing countries.

Chapter 10 Development Assistance

S.80 Poverty reduction emerged as the central focus of international development cooperation in the 1990s. But development assistance, after peaking in 1992, decline through the rest of the decade. Donors often cited their own fiscal problems as a large part of the reason. Yet even after fiscal deficits in donor countries improved (falling from an average of 4.3 percent in 1993 to 1.3 percent in 1997), official development assistance still fell by 14 percent. The hope at the beginning of the decade that the end of the cold war would lead to a peace dividend for development assistance was clearly not realized.

S.81 The reasons for the decline are manyfold. One that must receive close attention is the growing evidence that development assistance has not, in fact, been fully effective in bringing about poverty reduction and growth. Studies have shown that aid flowed to countries which do not have a conducive framework for poverty reduction and growth. One such calculation estimates that if all aid were allocated with this criterion in mind, it would lift 30 million people out of poverty every year, rather than the 16 million a year in its current allocation.

S.82 Allocation of aid across countries is only one part of the problem. The detailed mechanisms of aid delivery, at any overall level of financial allocation, have also come under scrutiny. Studies find, especially in the poorest countries, large numbers of donors with multiple projects cutting across each other, with donor each requiring separate accounting procedures. This lack of donor coordination, and lack of ownership of the development assistance agenda, is a major cause of the ineffectiveness of aid in fighting poverty. A true partnership is needed in which donors support, in a nonintrusive way, a poverty reduction agenda agreed within the country. Donors should consider moving away from planting their flags on specific projects toward supporting a country's overall development program through a common pool of resources. Experiments under way to take development cooperation in this direction should be strongly encouraged.

S.83 The chapter recognizes that the debt burden of the heavily indebted poorest countries is unsustainable and a major obstacle to poverty reduction and growth. It argues for debt reduction initiatives as part of an overall strategy for making development more effective in attacking poverty.

S.84 The chapter ends with a list of principles and actions derived from the findings of this Report for use in guiding international development cooperation:

- *Actions to address inequalities—of assets, across gender and ethnic groups, and so on—that impede poverty reduction and growth.* Examples: support in some countries for market-based land reform programs, such as the one in Northeast Brazil, to address asset inequalities in perpetuating poverty and impeding growth; a global program of removing gender bias in legislation and the operation of legal systems; accelerating the process of skill acquisition by the poor with demand- and supply-side interventions.

- *Support for making institutions of the state (both local and national) pro-poor and accountable to the poor.* Examples: ensuring the poor's access to legal services; providing training to local-level officials on treatment of poor women.

- *Support for capacity building for membership-based organizations that engage the poor in the formulation and implementation of policies and interventions.* Examples: scaling up the organizational impact of community-based organizations by supporting links among organizations (such as cooperative federations); a program to look at what kind of legal, regulatory, and institutional environments are most enabling for the poor.

- *Recognition of the importance of risk and vulnerability in the lives of the poor and the encouragement of further analysis of its impacts on poverty, efficiency, and growth.* Examples: a global program of research to develop local- and household-level knowledge on the nature of risks and how the poor cope with them; a major initiative to generate qualitative and quantitative information on the lives of the poor, in real time.

- *Development of a modular approach to protecting the poor against shocks, with different interventions—community, market and state—to address different risks and serve different segments of the population.* Examples: micro-insurance programs to complement micro-credit programs for poor women, built around their organizations; institutionalizing labor-based public works schemes, so that they are ready to roll out in response to negative shocks to the economy or a locality.

- *Stronger support for national and international efforts to prevent and respond to macro shocks (financial, natural, and other).* Examples: setting up "calamity funds" for dealing with natural shocks, as is being done in Mexico; support for new technology and training for better risk assessment and disaster communications systems; in financial shocks, avoiding policies that result in excessive contractions of real output and minimizing the impact of crises on the poor through macroeconomic instruments.

- *A clear recognition that universal prescriptions for economic policy reform (including trade and capital account liberalization, financial market liberalization, and privatization) are unlikely to succeed, that local realities matter, and that the success of liberalization in reducing poverty is contingent on institution building.* Examples: support for "micro-level" deregulation to increase the poor's access to markets at the local level; support for building adequate and accountable institutions and mechanisms before privatization.

- *For sectoral strategies, a recognition of strong cross-sectoral linkages; of cross-cutting impacts on empowerment, security, and opportunity; and of the importance of holding service delivery accountable to the poor.* Examples: explicitly exploiting cross-sectoral linkages— for example, between education and health, schools and roads, roads and health clinics, or girls' education and child-care facilities; improving the efficiency of education and health facilities through better monitoring and accountability.

- *Support for the provision of international public goods that benefit the poorest, and for participation by poor countries in discussions of global arrangements.* Examples: countering the current neglect by medical research of the problems of the poorest and supporting innovative solutions—such as vaccine purchase funds—to bridge the gap between private incentives for research and the needs of the poorest; support for the provision of global commodity price insurance instruments to address key price volatility problems of developing countries.

- *Debt relief and development assistance that support broad-based consensus on a poverty reduction strategy.* Examples: accelerated implementation of the enhanced HIPC Initiative and consideration of special measures for post-conflict countries; holding all Consultative Groups and Roundtable meetings in client countries, increasing the role of civil society and the private sector in such deliberations, and turning leadership of these meetings over to the recipient country as soon as possible.