Chapter 9. Poverty Reduction Policies

Summary

Given a description and analysis of poverty, what policies may be invoked to reduce poverty?

There is a very strong link between economic growth and poverty reduction; Dollar and Kraay find, based on a study of 236 “episodes” worldwide that a 1% increase in per capita income is associated with a 1% increase in the incomes of the poor. The relationship is robust and has not changed over time. Greater economic openness, the rule of law, and fiscal discipline all boost growth; democracy, and greater public spending on health and education, have no measurable effect on the incomes of the poor.

The World Bank classifies its anti-poverty activities into three groups:

a. **Fostering opportunity** – through well-functioning and internationally open markets, and investments in infrastructure and education.

b. **Facilitating empowerment**, which amounts to including people in the decision-making process. This requires government accountability, a strong media, local organizational capacity, and mechanisms for participation in making decisions.

c. **Addressing income security**, which tackles the problem of vulnerability. This calls for insurance programs, disaster relief procedures, and a solid public health infrastructure.

The chapter concludes with brief sketches of poverty reduction policies in India and Tanzania.

Learning Objectives

After completing the module on poverty lines, you should be able to:

1. Explain the methodology used by Dollar and Kraay to reach the conclusion that growth is good for the poor.
2. Evaluate the importance of other influences – including government spending, openness to trade, democracy, fiscal discipline, and the rule of law – on the growth of the incomes of the poor.
3. Describe what is meant by “pro-poor growth.”
4. For each of the three groups of anti-poverty activities identified by the World Bank, i.e.
   - promoting opportunity
   - facilitating empowerment, and
   - enhancing income security
   justify the importance of each broad activity and identify specific policies within each of these activities that are likely to work to reduce poverty.
Previous chapters have discussed the concept of poverty and well-being, the various indicators used to measure poverty, the idea of poverty profiles, and the factors that determine poverty. In this section, we consider poverty reduction strategies, as well as touch upon certain policy implications.

### 9.1 Is growth good for the poor?

Few economists doubt that economic growth is necessary for the long-term reduction of poverty. But how close is the link between the two?

If the incomes of the poor rise closely in line with incomes overall, then the key to poverty reduction is rapid economic growth; on the other hand if the relationship is weak, then other policies, such as targeted subsidies, are likely to be important and the concept of "pro-poor growth" might have some relevance.

David Dollar and Aart Kraay address the problem directly, in a paper entitled "Growth is Good for the Poor" that appeared in March 2000 (see [www.worldbank.org/research](http://www.worldbank.org/research)). They gathered information on the per capita income of the poor (the bottom quintile of the income distribution) and on overall per capita income. The data come from 80 countries over four decades, and Dollar and Kraay were able to piece together 236 "episodes," - periods during which it was possible to measure changes in the income of the poor and of the country overall.

They first regressed the log of per capita income of the poor (ln(poor)) on overall per capita income (ln(inc)) and got

\[
\ln(\text{poor}) = 1.07 \ln(\text{inc}) - 1.78. \quad R^2=0.87. \quad (1)
\]

This relationship, and the underlying data, are reproduced in Figure 9.1 (Figure 1a from Dollar and Kraay) below. Two points are worth noting: First, the relatively high value of $R^2$, which says that 87% of the variation in the log of per capita income of the poor is associated with changes in the log of per capita income overall. Second, the coefficient on the $\ln(\text{inc})$ term is 1.07, which means that if average incomes were to rise by 10%, the incomes of the poor would rise by about 10.7%. This coefficient is not significantly different from 1, so perhaps it would be wiser to conclude that the incomes of the poor tend to rise in line with those of the country as a whole.

As an alternative, Dollar and Kraay regressed the change in ln(poor) on the change in ln(inc). In this case they found (see Figure 9.2, which reproduces Figure 1b from Dollar and Kraay)
\[ \Delta \ln(\text{poor}) = 1.17 \ln(\text{inc}) - 0.00. \quad R^2 = 0.52. \]
The fit is weaker in this equation, with only about half of the variation in the change in the log of incomes of the poorest quintile being attributable to changes in the log of overall income. The elasticity (i.e. 1.17) is still close to unity.

In order to test the robustness of this finding, Dollar and Kraay estimate a number of variations on the original equation - for different time periods, for countries that are growing and countries that are shrinking, for low- and high-growth countries, for poor countries and rich. The details are summarized in their Figure 2 (reproduced below), and show that the elasticity of poor incomes with respect to overall incomes is close to 1 in every case. They also address the issues of measurement error (it washes out), omitted variable bias (the use of instruments gives similar results) and endogeneity (systems estimators also give similar results). And when they include additional variables, the key elasticity remains close to 1, as Table 9.1 (their Table 5, reproduced below) shows.

There are several important conclusions:

1. The per capita income of the poorest quintile grew in line with overall per capita GDP for the 80 countries in the same over the four decades covered. In short, growth matters.
2. The relationship in equation (1) has not changed over time, and applies both in rich and poor countries. In short, growth still matters.
3. The incomes of the poor do not fall disproportionately during an economic crisis.
4. Greater economic openness, the rule of law, fiscal discipline, and low inflation all contribute to (or are at least associated with) faster economic growth, and in this manner help the poor.
5. Democracy, and higher public spending on health and education, do not have a measurable effect, one way or another, on the incomes of the poor.
Figure 1: Growth and the Poor

Levels

\[ y = 1.07x - 1.78 \]
\[ R^2 = 0.87 \]

Growth Rates

\[ y = 1.17x - 0.00 \]
\[ R^2 = 0.52 \]
Figure 2: Variants on Basic Regression

- 1980s and 1990s
- 1960s and 1970s
- Negative Growth
- Positive Growth
- Low Growth
- High Growth
- Low Income
- High Income
- Basic

Elasticity of Income of the Poor with Respect to Mean Income
Other researchers have also found that poverty trends tracked growth trends very closely in 1980s and 1990s. According to Chen and Ravallion (2000), on average, growth in the consumption of poorest fifth of the population tracked economic growth one-for-one over this period. In the vast majority of countries that they study, growth led to rising consumption in the poorest fifth of the population, while economic decline led to falling consumption. So pro-growth policies in most cases actually are also pro-poor.

### 9.2 Pro-poor growth

If the incomes of the poor are closely tied to overall economic growth, how much room remains for a poverty reduction policy per se? Put another way, is there any substance in calls for “pro-poor” growth?

In a recent controversial paper, Aart Kraay (2004) argues that “in the medium run, most of the variation in changes in poverty is due to growth, suggesting that policies and institutions that promote broad-based

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Notes: This table reports the results of adding the indicated control variables to the system estimator of Equations (2) and (2'). The row labelled P-OID reports the P-value associated with the test of overidentifying restrictions. Standard errors are corrected for heteroskedasticity and for the first-order autocorrelation induced by first differencing using a standard Newey-West procedure.
growth should be central to pro-poor growth.” He goes on to argue, “most of the remainder is due to poverty-reducing patterns of growth in relative incomes,” but “cross-country evidence provides little guidance on policies and institutions that promote these other sources of pro-poor growth.” In other words, we do not know enough about what drives pro-poor growth – roughly, growth accompanied by a reduction in inequality – to be in a position to design viable pro-poor policies.

That has not stopped the World Bank and others from trying! The World Bank (2000) separates its anti-poverty – as distinct from pro-growth – activities into three groups: promoting opportunity, facilitating empowerment, and enhancing (income) security. We now consider each in some more detail.

### 9.2.1 Opportunity

As argued in chapter 8, the lack of material opportunities such as jobs, credit, and public services, including schools and health services, is a direct cause of poverty.

Well-functioning markets are important in generating sustainable growth and expanding opportunity for poor people because poor people rely on formal and informal markets to sell their labor and products, to finance their investments, and to insure against risks. For example, recent studies have examined the impact of market-friendly policies – such as openness to international trade, low inflation, a moderate-size government, and strong rule of law – on the incomes of poor people in a large cross-country sample. The findings: these policies on average benefit poor people more than others. Case studies of Chile, China, Ghana, Uganda and Vietnam show that agricultural reforms have helped raise producer prices for small farmers by eliminating marketing boards, changing real exchange rates through broader economic reforms, lowering tariffs and eliminating quotas (e.g. Haughton and Kinh 2003).

The human, physical, natural, financial and social assets that poor people possess – or have access to – affect their prospects for escaping poverty because these assets can enable poor people to take advantage of opportunities. Expanding the assets of poor people can strengthen their position and their control over their lives. A recent study of irrigation in Vietnam (van de Walle 2000a) has uncovered important complementarities between education and gains from irrigation. Households with higher education levels received higher returns to irrigation.
Policies to Enhance Opportunity

The World Bank argues that creating more opportunities involves complementary actions to stimulate overall growth, make markets work for poor people, and build their assets, including addressing inequalities in the distribution of endowments such as education. More specifically:

- Encouraging effective private investment is essential because investment and technological innovation are the main drivers of growth in jobs and labor incomes. Fostering private investment requires reducing risk for private investors—through stable fiscal and monetary policy, stable investment regimes, sound financial systems, and a transparent business environment. Certainly, the rule of law and anti-corruption measures are also important. Special measures are frequently required to ensure that micro enterprises and small businesses can participate effectively in markets that are more vulnerable, yet employ a large number of poor people. For example, ensuring access to credit, lowering transaction costs of reaching export markets, and reducing restrictions on the informal sector will all help creating a sound business environment for poor households and small firms. Public investment in expanding infrastructure and communications, and upgrading the skills of the labor force have to complement private investment to enhance competitiveness and create new market opportunities.

- Opening to international markets offers an important opportunity for income growth as long as countries have the infrastructure and institutions to stimulate a strong supply response (e.g. call centers in Ghana, garment factories in Vietnam). Therefore, the opening needs to be well designed with special attention to bottlenecks.

- Building human, physical, natural and financial assets that poor people own or can use requires actions on at least two fronts. First, sufficient public spending on basic social and economic services such as primary education. Second, reform public delivery or privatize those services in order to ensure good quality service delivery.

- Addressing asset inequalities across gender, ethnic, racial and social divides. Special action is required to tackle socially-based inequality such as concentrated farm land ownership in rural communities, under-schooling of girls relative to boys, and the limited independence of women due to lack of access to productive means. Ethnic inequalities can easily flare up into violence, which in turn can set back economic development for a generation.

- Getting infrastructure and knowledge to poor areas. Special action is also needed in order to improve the social and economic infrastructure in poor and remote areas, which to a great extent also contribute the poverty problem. Similarly, basic urban services should be provided to city slums so that urban poor people may have chance to participate more actively in over growth.
9.2.2 Empowerment

The premise underlying an emphasis on empowerment is that a lack of representation in the process of policy-making, due to social and institutional barriers, has impeded poor people’s access to market opportunities and to public sector services. It follows that empowerment – defined succinctly as “including people, who were previously excluded, in the decision making process” – should help. Unfortunately, there is very little empirical evidence, to date, on how well empowerment policies along the lines discussed below contribute to reducing poverty.

Broadly, empowerment refers to being able to make informed decisions and choices effectively. But there is some disagreement about the true content of empowerment. Mahatma Gandhi emphasized self-reliance; Paolo Freire stressed the need for conscientization, for helping the poor to learn about and perceive “social, political and economic contradictions” and then to stir to act against “the oppressive elements of society.” E.F. Schumacher, author of Small is Beautiful, argues that empowerment follows when one makes up deficiencies in education, organization and discipline. The World Bank finesses these differences by defining empowerment as “the expansion of assets and capabilities of poor people to participate in, negotiate with, influence, control, and hold accountable institutions that affect their lives.” It sees the four major elements of empowerment as (i) access to information, (ii) inclusion/participation, (iii) accountability, and (iv) local organizational capacity.

State institutions must be responsive and accountable to poor people. In nearly every country the public sector often pursues activities that are biased against poor people, and poor people have trouble getting prompt, efficient service from the public administration. Accountability is helped when there is good access to information.

**Example:** The Public Expenditure Tracking Survey (PETS) conducted in 1996 in Uganda found that only 22% of the central government funds intended to support schools run at the local level were reaching their intended destination. By 1999-2000, after the government made the budgetary transfers public via the media and required schools to share financial information, 80-90% of the funds began to reach the schools for which they were intended.

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8 The material in this section is derived from a survey paper entitled Employment, by Zeynep Orhun.
Amartya Sen sees poverty as consisting of a “deprivation of capabilities,” so that the poor have inadequate resources (financial, informational, etc.) to participate fully in society; in short, they are socially excluded. It follows that inclusion, which encompasses economic and political participation, is inherently part of the solution to poverty. The process of including the poor is likely to require the development of their social capital, the “features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated actions.” Social capital takes time to build, but contributes to stronger local organizational capacity.

Good social institutions — kinship, community organizations, and informal networks—can play an important role in poverty reduction. For example, many development programs succeed because they mobilize local groups of project beneficiaries in program design and implementation. On the other hand, when social institutions are week, fissures such as ethnic cleavages can explode into open conflict; most of the world’s poorest countries have experienced civil war within the past generation.

Some social norms and practices help generate and perpetuate poverty. Discrimination on the basis of gender, ethnicity, race, religion, or social status can lead to social exclusion and create barriers to upward mobility, constraining people’s ability to participate in economic opportunities and to benefit from and contribute to economic growth. For example, one cross-country study (Klasen, 1999) indicates that countries that invest in girls’ education have higher rates of economic growth.

It is difficult to empower the poor if decision-making is concentrated in a far-away capital city. Hence the conclusion that a major component of empowering the poor is the need to decentralize power, particularly through delegating it to sub-national levels of government, and privatizing some activities (e.g. grain marketing). Decentralization is not, however, a panacea; when done badly, power may be captured by local elites, who may be even less concerned about the poor than the central government. In India, for instance, the state of Kerala has used its powers to spread development widely, while in the state of Bihar local decision-making has not been particularly beneficial to the poor.

Empowerment is difficult to measure. The UNDP’s Gender Empowerment Measure (GEM) includes indicators such as male and female shares of parliamentary seats, managerial positions, and earned income, but also has serious limitations in that it does not include information on the informal sector, or on such items as the right to vote. By design, the GEM focuses on gender empowerment, and not on the empowerment of the poor per se.


Policies to enhance empowerment

To empower poor people, policies need to facilitate active collaboration among poor and other groups in society include strengthening the participation of poor people in political processes and local decision-making; making changes in governance that make public administration, legal institutions, and public service delivery more efficient and accountable to all citizens; and removing the social barriers that result from distinctions of gender, ethnicity, race and social status. Worthy as this sounds, it is not at all obvious how to achieve such changes, but here are some policies that have been suggested:

- To improve access to **information**, encourage the development of the media. For instance, Besley and Burgess show that there is a robust link between media development and government responsiveness in India; states with higher newspaper circulation also undertake more extensive relief efforts in the wake of natural disasters.
- To increase **participation and inclusion**, it helps to institutionalize transparent, democratic and participatory mechanisms for making decisions and monitoring implementation. In this context, it may also be useful to provide legal assistance to poor people who usually have limited access to the legal system.
- **Accountability** is increased by strengthening the mechanisms used to monitor the performance of public administrations and by providing access to budgetary information and participatory mechanisms. There are many possible ways to do this, including:
  - Publish complete and timely budgetary information. Vietnam does not do this, for instance, so it is impossible to hold the government to account for how it spends its money.
  - Institutional and Governance Reviews (IGR), which use surveys and other quantitative measures to analyze the functioning of public institutions.
  - Citizen Report Cards, which allow citizens to express their opinions on the performance and quality of government services.
  - World Bank Corruption Surveys, which are designed to extract information on corruption from households, the private sector, and public officials. Based on such a survey, for instance, Albania requested an anti-corruption program to undermine patronage in judicial and civil service appointments.
  - Public Expenditure Tracking Surveys (PETS), which have helped ensure that budgeted funds get to their intended recipients in places such as Ghana and Uganda.
  - Private Enterprise Surveys of the Business Environment, and Investor Roadmaps. These indicate the problems and costs faced by entrepreneurs.
- Participatory Poverty Assessments (PPA). Using focus groups, in-depth interviews and other measures, these complement survey data to help build a more detailed picture of the nature and roots of poverty; they have been influential in Vietnam, for instance.

- To increase **local organizational capacity**, it helps to
  - Promote decentralization and community development to enhance the control that poor people and their communities have over the services to which they are entitled. Decentralization needs to be combined with effective participation and monitoring mechanisms.
  - Promote gender equality by promoting women’s representation in decision-making and providing special assistance for women’s productive activities.
  - Tackle social structures and institutions that are obstacles to the upward mobility of poor people by fostering debate over exclusionary practices and supporting the socially excluded participating into political processes.
  - Support poor people’s social capital by assisting networks of poor people to engage with market and non-market institutions so as to strengthen their influence over policy.

### 9.2.3 Income security

Poor people are exposed to a wide array of risks that make them vulnerable to income shocks and losses of well-being. Reducing poor people’s **vulnerability** to ill health, economic shocks, natural disasters, and violence enhances well-being on its own and encourages investment in human capital and in higher-risk, higher-return activities as well.

Households and communities respond to their risk exposure through diversification of assets and sources of income and various types of self-insurance and networks of mutual insurance mechanisms. For instance, some family members may travel to the cities to seek work, sending remittances home; if they cannot find work, then return home. Or farmers may store grain from one season to the next, in case the crops fail. In some very poor countries, such as Mali, some very poor rural women wear large gold ornaments – in effect carrying their savings, which could be sold if necessary to tide the household over a bad year.

Mechanisms such as these help to reduce the risk or soften the impact, but the effect may be limited. To counter the incentive and information problems that exclude poor people from many market-based insurance mechanisms, the state has a special role in providing or regulating insurance and setting up
safety nets. Health, environmental, labor market, and macroeconomic policies can all reduce and mitigate risk.

Large adverse shocks – economic crises and natural disasters – cause poor people to suffer not only in the short run. They undercut the ability of the poor to move out of poverty in the long run as well, by depleting their human and physical assets, which may be irreversible. So it is crucial to prevent economic crises and natural disasters, as well to protect poor people when they occur.

**Policies to enhance security and reduce vulnerability**

National programs to manage economy-wide shocks and effective mechanisms to reduce the risks faced by poor people, as well as helping them cope with adverse shocks when they occur, are useful. Appropriate measures might include:

- Formulating programs to helping poor people manage risk. Microinsurance programs, public works programs and food transfer programs may be mixed with other mechanisms to deliver more effective risk management.
- Developing national programs to prevent and respond to macro shocks—financial or natural.
- Supporting minority rights and providing the institutional basis for peaceful conflict resolution, to help prevent civil conflict and mobilize more resource into productive activities.
- Tackling health problems including widespread illnesses such as malaria and tuberculosis, as well as moderately common but serious conditions such as HIV/AIDS.

There is no simple, universal blueprint for implementing this strategy. Each developing country needs to prepare its own mix of policies to reduce poverty, reflecting national priorities and local realities. Given the important complementarities among these three dimensions, an effective poverty reduction strategy will require action on all three fronts, by all stakeholders in society—government, civil society, the private sector and poor people themselves.

### 9.3 Practice and good examples

Any good poverty reduction plan has to be based on a comprehensive poverty analysis that identifies the nature and evolution of poverty, the profile of poor people, and all contributing factors of poverty. Building on an accurate understanding of poverty, the strategy for poverty reduction has to prioritize the
poverty reduction goals and take into account complementarities and compatibilities of various policy tools. Then specific implementation modules including resource allocation and monitoring mechanisms have to be designed. The participation of poor people at the last two stages is essential since overall they are the main actors in the fight against poverty. We finish this chapter with brief sketches of two interesting examples of poverty reduction strategies.

9.3.1 India

India suffers severe deprivations in education and health—especially in the North, where caste, class, and gender inequities are particularly strong. In studies in Bihar and Uttar Pradesh, poor women and men emphasized their extreme vulnerability and the ineffectiveness of state institutions, from schools to police.

In the past, poverty reduction in India lagged behind that of East Asia because of slower growth and significantly less progress in promoting mass education and basic health. More recently, however, growth has accelerated and there is a growing consensus that poverty has fallen substantially.

There are also marked differences within India—with the South, particularly the state of Kerala, having sharply better education and health. Kerala has life expectancies greater than those in Washington, D.C., despite vastly lower income levels. The effectiveness of public action in Kerala has been attributed to its strong tradition of political and social mobilization.

What are the priorities for action in India? Accelerated poverty reduction requires continued solid economic growth, which in turn demands further liberalization, especially in agriculture, and better provision of infrastructure, sorely lacking in most of India. In areas with deep deprivation in health and education, the development of social infrastructure is critical. Expanding education and health services requires that state governments reverse the deterioration in their fiscal positions, as subsidies to the loss-making power sector crowd out spending in the social sectors. The higher spending needs to be matched by better service provision. This requires deep improvements in governance, often weakest in India’s poorest regions, and in combating teacher absenteeism. Also needed is more equitable service provision, which requires empowering women and members of lower castes.
9.3.2 Tanzania

Since independence, the government has been focused on three development problems: ignorance, disease and poverty. National efforts to tackle these problems were initially channeled through centrally directed, medium-term and long-term development plans; despite high levels of foreign aid, these efforts were a complete failure, and poverty was higher in 1990 than at the time of independence. Despite sustained effort over the past decade, and an acceleration in economic growth, half of the population today is considered basically poor, and approximately one third lives in extreme poverty.

The current poverty reduction strategy takes a decentralized approach, based on broad consultation with all stakeholders. The Zonal Workshops, which included a large number of representatives of the poor at the village level, identified priority concerns and requirements for poverty reduction. Through an assessment of the poverty profiles and trends using 6 household surveys of various purposes during the past two decades, the key findings include: a very high incidence of poverty (48% in 1991/92); poverty is more widespread in rural areas than in urban centers; the poor are concentrated in subsistence agriculture; urban poverty is also acute in urban areas other than Dar es Salaam, and poor people are mostly in the informal sector; youth, the old and large households are more likely to be poor; the incidence of poverty declined between 1983-1991 and 1991-1993, but rose during 1993-1998; infant mortality rate remains to be high and AIDS is the leading killer of youths in Dar es Salaam and several other sampled districts; malnutrition continues to be severe; access to clean drinking water is still limited and the majority of poor people have no access to piped water and, as a result, have much higher exposure to cholera and waterborne diseases; the judiciary system has corruption problems.

Two participatory poverty assessment studies have suggested the following causes of poverty and obstacles to development: insecure land tenure, lack of access to agricultural inputs, credit, technology, transportation, markets, and quality health services, vulnerability to shocks, gender inequality. These factors were reiterated in the Zonal Workshops. The information then was summarized for each dimension of poverty and further discussed with other stakeholders.

The poverty reduction strategy aims at (1) reducing income poverty; (2) improving human capabilities, survival and social well-being; and (3) containing the extreme vulnerability among the poor. The key instrument is high and equitable growth. Specifically the strategy aimed (optimistically) to raise, within three years, the annual GDP growth rate from 5.2% to 6%. Agriculture was expected to increase by 5% annually on average, compared to 3.6% during 1990-1998. The growth of the industrial and service
sectors was expected to be higher than that of agriculture. At these growth rates, the incidence of poverty is expected to drop to 42% by 2003 and 24% by 2010. In pursuit of the above poverty reduction objectives, reforms aimed at bolstering market efficiency and factor productivity will be implemented. Besides maintaining low inflation and a small fiscal imbalance, special budgetary attention is to be given to rural, export, and private sectors development programs.

Specific goals were also identified for other dimensions of poverty such as education and health, and especially HIV/AIDS related issues. Twenty seven indicators for the monitoring and evaluation of the poverty reduction strategy have been selected and at least two observations will be made during the next three years. These key welfare indicators will be at the heart of further discussion and assessment of the poverty reduction strategy.

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