MALAYSIA:

CASE STUDIES ON POVERTY EXIT

A Case Study from the 2006 Special Evaluation Study on Pathways Out of Poverty and the Effectiveness of Poverty Targeting

December 2006

Qiaolun Ye

Operations Evaluation Department

Asian Development Bank
Abbreviations

ADB  Asian Development Bank
ha  hectare
OEM  Operations Evaluation Mission
SES  special evaluation study

Note

In this report, “$” refers to US dollars.
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I. Introduction

1. Selection of the Projects for Case Study

1. The Sabah Land Development Project (the Land Project) and two township development projects, the Terengganu Tengah Township Development Project and the Second Terengganu Tengah Development Project (the Township Projects), were selected as case studies for this special evaluation study (SES) in view of their expected roles in promoting rural development and reducing poverty. The Land Project, which was rated generally successful by the Asian Development Bank (ADB), aimed to develop land for palm oil production in Sabah, one of the poorest of Malaysia’s 13 states. The two Township Projects were located in the same district in the state of Terengganu. The first project constructed five new towns, and the second expanded them and established the sixth town. ADB rated both projects partly successful.

2. Fieldwork of the Operations Evaluation Mission

2. The ADB evaluation reports of the three projects above were used as supplementary information in preparing this SES. In addition, an Operations Evaluation Mission (OEM) visited Malaysia from 24 November to 14 December 2004 and conducted fieldwork in Sabah and Terengganu. During this period, the OEM held individual interviews with 29 government officers involved in implementing government policies, programs, or projects, including those working in federal, state, and village governments. Meanwhile, the OEM visited three of the six townships constructed under the two Township Projects and eight villages located in five land settlement schemes, interviewing 64 rural households, 6 managers of palm oil and wood processing industries, and 4 government employees at the grassroots: 4 teachers, 1 doctor, and 1 nurse. The table below provides a list of villages and projects visited.

List of Villages and Projects Visited

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II. Results of Poverty Exit

1. Poverty Reduced

3. While considering the official poverty line,¹ the OEM measured poverty in the villages visited using the local people’s definition of poverty. According to interviewees, this has changed over time. Three decades ago, being poor meant not having enough food to eat. Today, it means a family lacking a stable income. In all areas visited, the OEM observed dramatic reductions in rural poverty, including almost an absence of poverty in many villages. The OEM made a point of finding for interviews a few poor households, which included some with many children and some with very low human capital. This observation seemed to be consistent with official data, which reported rural poverty in Malaysia falling from 58.7% in 1970 to 12.4% in 1999, including only 2.4% in hardcore poverty, which was defined as people living on income equal to half of the official poverty line.² Living standards had improved significantly in the households interviewed, with many farmers owning large, comfortable houses, cars, trucks, motorcycles, televisions, and other appliances. Many interviewees said that they or their parents had been poor 2 or 3 decades earlier, with limited literacy and little land. Most of them had risen from poverty by receiving 6–10 acres (2.4–4.0 hectares [ha]) of land per family from government settlement programs.

2. Sustainability of Poverty Exit

4. The sustainability of poverty reduction was highly likely in the areas visited, with several contributing factors. First, most households had regular and reliable incomes. Almost all households interviewed had farmland that generated stable annual income for them. The government settlement programs had provided participants with modest houses as well as farmland under young rubber or oil palm trees. The land, trees, and houses were provided to participants as long-term loans at low interest, to be repaid by the participants over 20–25 years through deductions from payments for rubber or palm oil. The settlement programs also established processing plants that provided permanent jobs for low-skilled workers who migrated from poor areas 2–3 decades ago. In addition to farming, many rural households engaged in off-farm activities in transportation, construction, small shops, restaurants, or other services, available through the abundant job market in Peninsular Malaysia. Finally, plantation jobs were readily available in both Terengganu and Sabah, which seemed unattractive to locals, especially the young generation, who considered the pay too low and the work too hard. Many plantations, both large and small, used foreign labor from neighboring countries to fill the labor shortage.

5. Second, continued economic growth in Malaysia over the past 3 decades has created significant employment in cities, and most rural youth have received education largely free of charge. After graduating from secondary schools, most left villages to work in industry or services in urban areas. Their departure reduced population pressure on farmland for the remaining rural population, enabling them to make a decent living from agriculture.

¹ The official poverty line in 1999 was RM510 per household per month in Peninsular Malaysia and RM685 in Sabah, assuming two adults and three kids per family (ADB. 2004. Poverty and Development Indicators Database. Manila).
6. Third, household vulnerability was low as generous government policies provided free or highly subsidized medical care for all citizens of Malaysia. This policy originated in colonial times with a narrow focus on urban centers but was expanded to cover all rural areas after independence. Fourth, as continued economic growth strengthened the financial capacity of the Government, and as rural poverty fell to a minimum, the Government was able to provide generous subsidies to the remaining hardcore poor, which accounted for only 2.4% of rural residents. The OEM interviewed some of the hardcore poor, who lived in big houses provided by the Government free of charge and received free medical services, free education for their children, and a monthly allowance for each child in school. Finally, since most rural youths now work outside agriculture, low population densities in rural areas put little pressure on natural resources, which seemed to be well protected.

III. Poverty Exit Strategies

7. Agricultural intensification and diversification did not seem to be an important strategy for escaping poverty adopted by the households interviewed in Malaysia. The OEM observed four types of poor households with different poverty-exit strategies and results. Those from the first type were smart, hard-working, highly motivated, aggressive, and business-oriented, some having accumulated savings and purchased farmland for their children. This group found multiple jobs, including in particular employment outside agriculture. Without participating in government settlement programs, farmers in this group took advantage of (i) economic growth and jobs created by the private sector and (ii) education and training opportunities provided by the federal and local governments. The OEM interviewed some of these households in Terengganu, who took advantage of growth in the gas and oil industries in that state and worked part-time in construction in nearby towns, in addition to tending their oil palms or working in oil mills. In Sabah, some settlers bought trucks and transported oil palm products for others, in addition to tending their own small plantations.

8. Farmers in the second group were weaker, including laborers with fewer skills and less aggression. These people rose from poverty by participating in government land settlement programs or being employed by the palm oil mills set up by subsidiary companies owned by government agencies. The farmland and permanent jobs they received from the government programs provided them with a reliable source of regular income.

9. The third group included second generation settlers, who might have become poor if they had remained in villages, since there was no more land for distribution to the rising generation in most areas visited. This group rose from poverty by migrating to cities and finding employment in manufacturing or services. Their secondary education was provided by the Government largely free of charge, and they obtained better-paid jobs in the private sector, including in particular factories established by foreign investors. Rapid industrialization in Malaysia since the 1970s had brought large-scale rural–urban migration, and the rural population fell from 56.7% of the national total in 1980 to 38.2% in 2000.

10. The trend toward migration, however, was slow in Sabah, where potential migrants faced more difficulties and higher costs than did those in Terengganu.
high costs of energy and transportation in that state, so off-farm jobs were not plentiful. While jobs were abundant in Peninsular Malaysia, migration from Sabah was relatively expensive. In Sabah, the OEM found that young people carefully calculated migration costs and risks before leaving their villages. The factors they considered included transportation costs, the risks and expenses of job hunting including housing and food for the first days in the city, wages, the urban cost of living relative to rural, and the possibility of unexpected difficulties. Finally, they considered the government subsidies that they might receive if they remained in poverty, which probably provided a sort of incentive for staying in villages.

11. The last group, the weakest, remained in poverty despite favorable conditions. This group included the disabled who relied on welfare assistance, young school dropouts with many children, and those of very weak character with low human capital, lack of motivation, and ease of contentment. The choices of strategies for rising from poverty were limited for people in this group. Migration to cities and employment in manufacturing and services were difficult for them because they had few social connections outside their villages. They could not get high-paying jobs for lack of qualifications, and they were not interested in low-paying jobs considering the higher cost of living in cities, as well as the perceived uncertainties of job hunting in an unfamiliar city. They did not like plantation jobs that were readily available in their villages because of the low wages and difficult working conditions compared with factory jobs in cities. Finally, these people could as a last resort obtain free government subsidies, which were limited but seemed to be sufficient to support a low standard of living.

IV. Household Resources

12. Household resources include physical, natural, financial, human, and social assets. In the cases studied, the rural poor had few resources other than their family labor. Initially, these poor had no land or only small parcels insufficient to support their families. By participating in government settlement programs, many of them received farmland as long-term loans repayable with income from future harvests. By providing the poor with a stable annual income, the farmland facilitated their sustainable rise from poverty.

13. Meanwhile, participants in settlement programs received from the Government basic houses as another loan repayable over a long period. The OEM found that inadequate housing, equipment, and other physical assets were the results of poverty instead of its causes. After rising from poverty, most interviewed families improved the houses they had originally received through government programs and purchased furniture, televisions and other electronic goods, cars, trucks, and motorcycles.

14. In the cases studied, most of the poor had few savings or other financial assets for as long as they were poor. However, most accumulated savings after rising from poverty with stable income from their oil palm estates or wage jobs.

15. The largest variations observed among the poor related to their human and social capital. Initially, most of the poor had little education. Many of the first generation settlers had
only elementary schooling, and some were even illiterate. In spite of this disadvantage, some poor had good human capital unrelated to schooling, such as the capacity to be self-taught, hard-working, devoted to their families, willing to take risks, highly motivated, and, finally, business-oriented. Some interviewees endeavored to accumulate savings and purchased additional farmland when available, which laid a solid foundation for their permanent rise from poverty—for themselves and their children as well. Some of the poor were, though little educated, particularly good at making social connections, which facilitated establishing their own businesses or finding jobs in cities.

16. The OEM made a point of interviewing households that remained in poverty and had limited household resources, such as families with little or no land. Some young couples inherited small parcels of land from their settler parents, which were insufficient to provide a decent living from agriculture. Some settlers sold the farmland received from the government programs. These poor had few savings or other financial assets for lack of an income stable and sufficient enough to support large families. Most of the remaining interviewed poor had low human capital. Some went to school for years without learning much, and others dropped out for lack of interest in studying. Many had few if any social connections, which discouraged them from migrating to unfamiliar cities. These people were typically risk averse, less willing to try new jobs, or lacking motivation to work hard for a better living.

V. Context and Conditions

17. The context and conditions in which the rural poor lived influenced the options available to them to escape poverty, their selection and implementation of them, and the results. In the areas visited, the following factors seemed to be most critical to poor people’s rise from poverty.

1. History

18. Malaysia’s history has strongly influenced politics and government policies, which shaped the context and conditions faced by the rural poor. During British colonial rule, much of the economy was controlled by British capital invested in rubber plantations, tin mining, and timber production, most of the products of which were exported. Most of the labor in these activities were migrants from China or India who came to Malaya in the 19th and early 20th centuries. The rest of the economy consisted of subsistence farming and fishing carried out by Malays, who represented the great majority of the rural population at that time. In the urban areas, small processing industries and services were largely controlled by Chinese.

19. Malaysia was thus a multiracial and multiethnic society at independence, with more than half of the population being Malay, 37% Chinese, and 12% Indian. Most of the Malays lived in rural areas, as did tribal groups, who were the poorest in the country. The Chinese concentrated in urban areas and had substantially higher incomes. The Indians also concentrated in the urban areas, running small businesses or working as unskilled wage laborers.
2. Politics and Government Policies

20. The ethnic conflict that took place in 1969 had a dramatic impact on the design and implementation of government policies in the last 3 decades. One of the most important results was a new economic policy that defined social unity as the sole goal of national development policies. With a two-pronged strategy to achieve national unity, the Government was strongly committed to poverty eradication and righting economic imbalances among racial groups. In this political context, a set of government policies and projects were designed to reduce poverty and improve income distribution, including the provision of free or highly subsidized education and health services to all citizens and highly subsidized housing for low-income families together with supplies of water, electricity, and other basic services. Other programs distributed government-owned land to the landless poor and provided long-term, subsidized financial support for developing it. Price controls on rice and other essential foodstuffs were implemented, stabilizing prices for both rice farmers and consumers, and so dramatically reducing the potential distress price fluctuations could cause on poor and near-poor families. Finally, policies were implemented to reduce income inequalities between Bumiputeras (Malays) and other ethnicities, including preferential treatment for Bumiputeras in public sector employment, efforts to increased Bumiputeras’ presence in private businesses, and greater access for them to education and training through fellowships.

21. Meanwhile, the country has been governed since the 1970s by a political coalition with strong leadership that provided continuity to the application of national strategies. Policies were implemented through national plans that ensured an active and direct role in the economy for the Government. This stable political context created a favorable environment that encouraged private investment and supported government priorities in terms of poverty reduction and equitable income distribution.

3. Economic Growth

22. Economic growth in Malaysia was led by the private sector. However, the Government played a key role in fostering an attractive environment for private investment. First, the sole goal of national unity and appropriate macroeconomic management have helped the country experience long-term stability over the past 3–4 decades, compared with some other Asian countries that suffered periodic turmoil. Political stability, social harmony, and continuity in government policies played a critical role in attracting foreign direct investment to Malaysia. Second, the Government invested heavily in highways, electric power, telecommunications, and other basic infrastructure, which reduced transportation and energy costs and encouraged foreign companies to invest in the country. Third, with the explicit goal of attracting foreign direct investment, the Government created free trade zones and offered tax breaks for foreign investors. Finally, the Government ensured all citizens’ easy access to education, which was provided free or highly subsidized. For the hardcore poor, an education allowance was provided to the parents to cover school-related expenses such as transportation. Many foreign companies were attracted by the low cost of educated labor in Malaysia, considering their good skills and training potential.

23. As a result, Malaysia experienced outstanding economic growth that reached an annual average of 6.7% during 1971–1990 and 7.0% during 1991–2000. The manufacturing sector led, dominated by textile processing in the 1970s and 1980s, and by electronics and high-tech
industries since the 1990s. The boom of these industries provoked major changes in the labor market, which went from high unemployment to full employment and, more recently, labor shortages, especially in Peninsular Malaysia. In Sabah, however, unemployment remained a problem in some areas visited, where access to off-farm employment was not readily available, primarily because industries grew relatively slowly in Sabah, and migrating from Sabah to Peninsular Malaysia was expensive.

24. Rapid economic growth contributed significantly to poverty reduction in Malaysia. First, growth brought substantial tax revenues, with which the Government implemented a wide range of programs for poverty reduction. Second, private investment in manufacturing and services created employment for both urban and rural residents, and the resulting labor shortage fueled a slow but steady rise in wages. Industrial growth concentrated on the west side of Peninsular Malaysia, attracting Malaysian migrants from other states, including Terengganu and Sabah. In the past 2 decades, Terengganu also developed oil and gas industries, which attracted people from rural areas to work in them and related construction projects. However, industrial growth was slow in Sabah, due largely to high energy and transportation costs there. Nevertheless, this state shifted from relying mainly on timber to developing oil palm plantations, with some growth in palm oil processing as well as tourism-related services.

4. Rural Institution

25. The OEM did not find active informal organizations in the villages visited in Terengganu or Sabah. Instead, government agencies played key roles in the rural areas, especially in areas with land settlement schemes. These agencies provided farmland, low-cost housing, and farm inputs to settlers at the beginning of the settlement programs. After 20–25 years, they also financed the investment costs of replanting oil palm or rubber trees. The land and land development, houses, farm inputs, and replanting financing were provided to settlers as long-term loans with subsidized interest charges. A new government program allowed aged settlers who did not want to continue managing their farms to turn over their farmland to government agencies, which directly managed the plantation operations, with participants receiving land dividends. The participants also had the option of working in the plantations as wage earners. Finally, the palm oil processing factories owned by subsidiary companies of the government agencies provided employment to workers, together with low-cost housing and insurance benefits.

26. At the grassroots, village heads played a major role. They received a government allowance and were mandated to arbitrate conflicts among villagers. In some settlement schemes, cooperatives were organized with assistance from government agencies and engaged primarily in transporting harvests and transferring marketing revenues to members.

5. Government Projects

27. Government projects were commonly used as instruments to reduce rural poverty. The Government invested in basic infrastructure to attract private investment, which indirectly generated substantial employment and contributed to full employment in the country. Meanwhile, the universal provision of education and training opportunities enabled many young people to find high-paying jobs. Access to free or highly subsidized medical services for all citizens, both urban and rural, substantially reduced individual families’ sickness-related risks. Government settlement schemes directly provided avenues out of poverty by distributing land. Among the many projects financed by ADB, the Operations Evaluation Department examined the Land Project in Sabah and the two Township Projects in Terengganu.
28. The Land Project was implemented from 1975 to 1982 and financed by a $14 million loan from ADB. It was a part of a large government investment program in Sabah, which developed 125,000 ha of land for rubber and oil palm production. The project was implemented by the Sabah Land Development Board, which developed around 4,300 ha of land under it. Targeting the landless poor, the Land Project provided farmland and houses to participants as long-term loans, repayable from revenues generated through palm oil production. In addition, palm oil processing factories generated employment, albeit on a relatively small scale.

29. The OEM visited the settlement scheme in Klias village of Sabah’s Beaufort District, which was created in 1977 under the Land Project. At the time of the visit in late 2004, the village had 227 families farming 996 ha of land. Under the scheme, each family received 10 acres (4 ha) of land already planted with oil palms, together with a small wooden house with a living room, kitchen, bathroom, and two bedrooms. These assets were provided to participants as loans to be repaid over 20–25 years through deductions from palm oil payments to participants, who submitted their harvest to government marketing agencies.

30. While confirming the positive impact of the Land Project on poverty reduction, the OEM observed some weaknesses in it. First, the project design overestimated participant interest, with the actual participation of 681 families at the end of 1981 substantially below the target set at appraisal of 4,314 families. Due to the shortage of eligible candidates, some non-poor also participated in the settlement schemes and benefited from the generous government subsidies, as observed by the OEM and reported by earlier reports from ADB. Second, 10 acres of oil palms is sufficient to lift a poor family out of poverty but too small to be economically efficient. The OEM observed low yields in the small estates run by settlers compared with the high yields achieved in large plantations run by commercial companies. Third, oil palms need replacing every 20–25 years, and most visited settlers could not finance the high cost of replanting. Moreover, as many of the first generation of the settlers grew old, and their children did not want to work in plantations, farm management deteriorated. To address these issues, the government agencies concerned initiated the new program to allow individual farmers to turn their land over to the government plantations and work for wages, if they so wished, while receiving regular dividends.

31. The two Township Projects were financed by two ADB loans of $16 million and $30.2 million as part of a master plan for developing the state of Terengganu. The first project was implemented from 1979 to 1984, and the second from 1983 to 1990, by the Terengganu Tengah Development Authority, a federal government agency for regional development established in 1973 with a mandate in township development and maintenance. Both projects were located in Dungun District, an area dominated by rubber and oil plantations. The projects financed town development works, regional water supply, low-income housing, and feeder roads.

32. ADB post-evaluation studies rated the two projects partly successful. Among the many problems identified, the primary one was oversupply of infrastructure, especially in terms of water. With an anticipated population of 75,750, the six towns created by the projects reached an actual population of 35,109 by 1994, about 4 years after the second project ended, or less than half of the appraisal target. One major cause of the problem was the difficulty of selecting an appropriate site for township development, which demands accurate forecasts of future economic and population growth. These towns were created in the rural areas, but the rapid growth of oil and gas industries along the coast of Terengganu attracted young people from

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rural areas, beating out the small towns created by the projects in attracting wage workers. By the time of the OEM visit in 2004, the towns’ population had increased significantly over figures reported by ADB in 1994. However, many town residents did not work there, living in the towns to take advantage of low-cost housing and commuting in their own vehicles to oil and gas jobs on the coast.

VI. Issues for Discussions

1. Poverty Exit and Underlying Factors

33. Agricultural intensification and diversification—two policies promoted by governments in many developing counties—were not important strategies for rising from poverty adopted by the households interviewed in Malaysia. While many of the first generation to rise from poverty did so by obtaining farmland from government settlement programs, most of the second generation migrated to find employment outside agriculture. Many of the second generation might have become poor if they had remained in villages and relied on agriculture, as there was no more land to distribute to them. Today, agriculture remains critically important to Malaysia for food security and export earnings. Its role in providing avenues out of poverty, however, seemed to be limited. While higher crop yields increased farm income, government interventions to promote agricultural development helped mainly those with farmland instead of the landless poor, because the higher crop yields did not generate significant employment. It is interesting that even in a country initially with relatively abundant land resources such as Malaysia, manufacturing and services were the sectors that provided employment for most of the second generation of rural residents, with jobs in agriculture sharply reduced in the past 3 decades. While many of the remaining poor lived in rural areas and relied on agriculture, it seemed that land-based agriculture could not provide them with avenues out of poverty because these poor had little land. Future efforts to eradicate the remaining poverty may have to focus on job creation outside agriculture.

34. Government interventions in Malaysia strongly shaped the context and conditions faced by the rural poor, influencing household strategies selected for escaping poverty and their results. To the surprise of the OEM, rural institutions, especially informal ones, did not seem to critically influence household strategies. The underlying factor seemed to be strong government interventions that provided the poor with farmland, housing, and investment financing, as well as taking measures, such as highly subsidized education and health services, to mitigate shocks. In terms of household resources, the most significant variations were found in human capital factors unassociated with schooling, as well as in social connections, which strongly influenced household decisions on migration, the most common strategy. A possible explanation is that initially all poor households had little physical or financial capital or formal education. Yet variations in social and human capital unrelated to schooling became important determinants in households’ selection of strategies to escape poverty. This was so in Malaysia probably because migration to work outside agriculture played the most critical role in poverty reduction, fueled by continued economic growth and the availability of many jobs in cities, where employment depended heavily on personal characteristics and social connections.
35. Some of the avenues out of poverty were provided directly by government projects such as settlement schemes that gave farmland to participants, or the palm oil processing facilities that employed unskilled migrants from rural areas. By providing long-term employment, these projects effectively reduced poverty but apparently only for the first generation of the settlers, as no more state-owned land existed for distribution to the second generation of rural residents, especially in the Peninsular Malaysia. Moreover, the Government, increasingly concerned about inefficiency and the need to restore budgetary equilibrium, substantially constrained the creation of agro-processing facilities for unskilled laborers in rural areas.

2. Trade-Off Between Short-Term Inefficiencies and Long-Term Stability

36. Efficiency was not a stated objective of government policies in Malaysia. The OEM noted that strong government interventions to reduce social and economic imbalances among ethnic groups, and to curb income inequality, might have caused, to some extent, inefficiencies in the short run. However, racial harmony and social stability achieved through the principle of growth with equity encouraged foreign direct investment, created jobs, ensured continued economic growth, and resulted in greater efficiency in the long run. In addition, government provision of free or highly subsidized medical services—though at the cost of a certain degree of inefficiency and placing a financial burden on the Government—prevented shocks such as serious illness of family members that might otherwise have drawn some weak individuals and the near-poor down into poverty. Over time, the costs of universally providing free or highly subsidized medical services seemed to have fallen to an extent, as some of the non-poor used private clinics instead of public hospitals, leaving public hospitals to low-income groups.

3. Eradication of the Remaining Hardcore Poverty

37. Despite the favorable context and conditions in Malaysia, including continued economic growth and easy access to education and health services, about 5% of the population remained poor in 2004, including the 2.4% of hardcore poor. Interviews with some of the remaining poor found that they faced less favorable conditions and had fewer household resources. First, their villages were located in remote areas with high transportation and communication costs, leaving them relatively isolated from the dynamics of the national economy. Second, they had little human capital, some having spent years in school without learning much, and some dropping out. Third, they had few or no social connections outside their villages and were discouraged from migrating to cities to search for work. Fourth, they seemed to be less aggressive and easily contented, more risk averse and less willing to face the unfamiliar world, and generally lacking motivation to work hard for a better living.

38. While public investment in education facilitated the rise of most of the poor, especially the young generation, out of poverty, formal education and schooling did not seem to be effective or sufficient for this weakest group, who might suffer learning difficulties or whose parents did not value education. It seemed that additional efforts were needed to help this group build human capital unassociated with schooling, such as character, and social capital such as connections in cities. One suggestion is to link this group to the more dynamic segments of the society through mentor programs run with financial incentives given to some aggressive non-poor, who would be encouraged to help the poor in their villages by assisting them in job
hunting or coaching them in self-employment. With appropriate incentives, the non-poor may effectively contribute to reducing poverty in their communities.