

ALLEVIATING POVERTY THROUGH MICRO FINANCE: NIGERIA'S EXPERIENCE



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ABSTRACT

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Poverty is a global phenomenon, especially in the less developed countries like Nigeria and it has aroused the concern of people all over the world, including individuals, Non-Governmental Organizations (NGO's), Multilateral Institutions such as the World Bank and the United Nations Development Programme (UNDP), as well as national governments. Microfinance is still a relatively new phenomenon in Nigeria as it was just employed as a strategy for poverty reduction in December 2005. The first Microfinance Bank can be traced back to 1976, when Muhammad Yunus set up the Grameen Bank, as an experiment, on the outskirts of Chittangong University campus in the village of Jobra, Bangladesh. Since the Microfinance policy was put in place in December 2005, the effect has rarely been felt; it hasn't had the adequate trickle-down effect on the Nigerian citizenry because the gap between the rich and the poor is still on the increase. Poverty is a critical phenomenon that calls for an urgent attention and solution all over the world, especially in the underdeveloped nations of the world where it has eaten deep into the lives of many. The need to alleviate poverty arises in order to enhance the quality of life through the creation of favorable standards of living by effective production and distribution of consumer goods and services. This study seeks to determine the effect that Microfinance Institutions have had on reduction, or alleviation of poverty in Nigeria.

Contribution/ Originality: The Paper's contribution is finding out that what distinguishes a developed country from a less developed one is not prevalence of informal finance over a long period of time, but legal recognition given to informal finance and protection of the institutions through prudential regulation and effective supervision of such institutions.

1. INTRODUCTION

The problem of poverty alleviation actually starts with the proper identifications of the poor. Over the years the issue of poverty has assumed a global status both in dimension and efforts to reduce it. According to The World Bank (2010) the number of people living below the \$1.25 a day poverty line declined from 1.94 billion (52% of the population of the developing world) in 1981 to 1.29 billion (22%) in 2008, a 33.5% drop. The World Bank estimates that just less than half of the population of sub-Saharan Africa lives below \$1.25/day (World Bank, 2010). According to the Report, Poverty is more prominent in Sub-Saharan African countries than anywhere else in the World.

In a report on Poverty and Human Development in Africa, released by the UNDP (2011) Nigeria is ranked 32nd among the 42 poorest nations of the world. In a similar development, the World Bank study on poverty in Nigeria in 1995 identified that poverty in rural communities are related to poor facilities, food insecurity, obsolete agricultural facilities, poor nutrient values, little access to savings and credit and general inability to meet basic needs.

The findings of the studies and surveys conducted in Nigeria correlate with those of the international bodies. If poverty is characterized by hunger, ill health, inadequate or poor housing, illiteracy, malnutrition and unemployment, then there is no doubt that majority of Nigerians are living below the poverty line as set out by the World Bank in 1990 (World Bank, 1990).

2. LITERATURE REVIEW

2.1 *The Concept of Poverty*

Poverty is defined as lack of command over basic consumption needs, that is, a situation of inadequate level of consumption; giving rise to insufficient food, clothing and shelter (Ravillion and Bodani, 1994).

The phenomenon of poverty may also be defined as lack of certain capabilities, such as being able to participate with dignity in societal endeavors (Aluko, 1975). Poverty is as old and as rife as humankind. A majority of the human race has always suffered intermittent hunger. What is not old is the fact that people all over the world are beginning to demand a betterment of their economic lot. It is this 'revolution in expectations' that is creating such ferment in the underdeveloped world. And these new attitudes are a political force that cannot be ignored (Enke, 2007). According to the World Bank Organization, the most commonly used way to measure poverty is based on incomes. If a person's income level falls below a minimum level required to meet his basic needs, the person is considered poor. This minimum level is usually called the "poverty line".

Essentially, three common definitions of poverty exist: absolute poverty, relative poverty and social exclusion.

Absolute poverty can be defined as a condition of severe lack of basic human needs, such as safe drinking water, food, health, shelter, sanitation facilities, information and education. Absolute poverty is a function of not only income but also of access to services (United Nations, 1995).

Relative poverty is defined as the condition characterized by lack of the minimum amount of income necessary to sustain an average standard of living. Social exclusion, a complex multi-dimensional process, is the lack/denial of goods and services resources, rights and ability to partake in normal relationships and activities accessible to the majority in the society, whether in political, social, economic or cultural arenas (Levitas, 2007).

2.2 *The Concept of Microfinance*

Microfinance can be defined as a type of financial development mainly dedicated to poverty reduction via provision of financial services to the poor. The Canadian International Development Agency (2002) defined microfinance as, the provision of a wide spectrum of financial services to the low-income households and micro-enterprises who usually lack access to formal financial institutions. Though it is narrowly believed that microfinance is all about micro-credit (i.e. lending small amounts of money to the poor), microfinance is beyond that: it has a far-reaching perspective, which include transactional services, insurance, and most importantly, savings.

2.3 *Microfinance and Poverty Alleviation*

There is a debate about whether impact assessment of microfinance projects is necessary or not. The argument is if the market gives sufficient proxies for impact, such that customers are pleased to pay for a service, then assessments are a waste of resources. However, this is too simplistic a rationale as market proxies mask the range of client responses and benefits to the MFIs. Therefore, impact assessment of microfinance interventions is necessary,

not just to demonstrate to donors that their interventions are having a positive impact, but to allow for learning with MFIs so that they can improve their services and the impact of their projects (Mayoux and Simanowitz, 2001).

Poverty is beyond a lack of income. Wright and Rowe (1999) drew attention to the shortcomings of seeing increased income as the sole measure of the effect of microfinance on poverty. He argues that a significant difference exist between increased income and poverty alleviation. He argues further that by growing the incomes of the poor, microfinance institutions are not necessarily alleviating poverty. It is all a function of what these low-income people do with the money: often it is spent on gambling or on alcohol. Thus focusing merely on growing incomes is not adequate. The focus needs to be on helping the poor to have a particular quantum of well-being (Wright and Rowe, 1999) by offering them a variety of financial services tailored to their needs so that their net wealth and income security can be improved. Dichter (1999) states that microfinance is a tool for poverty reduction and while arguing that the record of MFIs in microfinance is “generally well below expectation” he does concede that some positive impact do take place. After a study of a number of microfinance institutions, the findings show that redistribution of wealth and consumption smoothing effects within the household are the commonest impacts of microfinance.

Hulme and Paul (1996) in a broad survey of the usage of microfinance to fight poverty, showed that ingenious microfinance programmes can enhance the incomes of the poor and can lift them out of poverty. They argued that clear evidence exists that the effect of a loan on a borrower’s income is correlated with his level of income, as people with greater incomes have a wider spectrum of investment opportunities and so microfinance schemes are much more likely to be advantageous to the middle and upper poo” (Hulme and Paul, 1996). However, they also show that when MFIs such as the Grameen Bank and Bangladesh Rural Advancement Committee (BRAC) provided credit to very poor households, those households were able to raise their incomes and their assets.

Hulme and Paul (1996) found that when loans are correlated with rise in assets, when borrowers are motivated to participate in low-risk income-generating activities and when the extremely poor are motivated to save; the susceptibility of the extremely poor is drastically reduced and their poverty subsides.

Johnson and Rogaly (1997) highlight examples where savings and credit met the needs of the poor. They argued that microfinance experts have begun to see increase in economic security, rather than increased income as the first step in the alleviation of poverty as this lessens recipients’ overall vulnerability.

Thus, while the debate still rages on about the effect of microfinance schemes on poverty, it is established that when microfinance institutions recognize the needs of the poor and meet those needs, microfinance schemes can have positive impacts on alleviating the susceptibility, not just for the poor, but also for the poorest in the society.

2.4. Microfinance in Nigeria

The importance of microcredit to the growth of any economy can never be overemphasized, as it is the solution to helping the poor. Micro-enterprises or small businesses are important in situations where economic and social environments have had a disappointing effect on the people, so that the poor can survive under micro-financing. Yet these small businesses play a great role in providing jobs thereby contributing positively to the GNP. Despite this, the enabling environment is still lacking in Africa to make this function well.

The weakness of the enabling environment has caused untold hardship on the people. Lack of infrastructural facilities has stood on the way of small business owners.

Part of the fallouts of the implications of SAP in Nigeria was that it caused varying degrees of hardship to different vulnerable groups of the population. Therefore, to give relief, improve earnings opportunities, alleviate poverty and ignorance among the poverty stricken, Better Life Programme (BLP) was launched in 1987 but later changed to Family Support Programme (FS P)/Family Economic Advancement Programme (FEAP) under Abacha in 1993. To benefit from microcredit scheme of BLP/FSP/FEAP, individuals must be members of cooperative societies.

Since 1987, the efficacy of microcredit through the cooperative regime to alleviate poverty has come under a paucity of loanable funds, absence of support institutions in the sector, unwillingness of conventional banks to support micro enterprises, weak internal control, poor credit administration and asset quality, low management capacity and unavailability of clients. This is an important test since poverty alleviation has turned out to be a key policy debate in recent development literature and Nigerian Government is fully committed to alleviating poverty among its citizens. The Nigerian economy is full of attempts at alleviating poverty especially among vulnerable groups based on cooperative ideals with large degrees of failure. According to the World Bank (1995) the Peoples Bank and Community Bank failed in achieving their goals and objectives. The failure experienced through these approaches (i.e. Peoples Bank and Community Bank) were as a result of the wrong perception by members of the unique framework of cooperatives due to poor financial management by some cooperatives, lack of understanding of the status of cooperatives by a large number of beneficiaries, among others. The view of these authors is that micro credit through cooperative does not automatically guarantee poverty alleviation. They maintained that for success to be achieved by such cooperatives they need to depend largely on loan administration, efficient cooperative management, and on whether the organized cooperative is routed on felt needs of the citizenry rather than on undue emphasis on business orientation and profitability. In the case of Nigeria, over 80 million people (65% of the active population) remain unserved by the formal financial institutions (Central Bank of Nigeria (CBN), 2006). Hence there is a need for MFIs to reach the unreached and serve the unserved.

3. MODEL SPECIFICATION

Taking inference from the empirical findings and theories, which have been derived from the theoretical exposition of poverty alleviation and microfinance, then making HDI central to the equation, the model to estimate the impact of the microfinance on poverty alleviation has been considered in the following form:

$$HDI = f(UNEMP, INF, CRDT, ER, IR) \tag{1}$$

$$HDI = \alpha_0 + \alpha_1 \ln CRDT + \alpha_2 \ln UNEMP + \alpha_3 INF + \alpha_4 ER + \alpha_5 IR + \mu \tag{2}$$

Where,

- HDI = Human Development Index
- UNEMP = Unemployment Rate
- INF = Inflation rate
- CRDT = Credit to small scale Enterprises
- ER = Exchange rate
- IR = Interest rate
- α_0 = the constant term or the Intercept
- α_1 = coefficient of credit to small scale enterprises
- α_2 = coefficient of unemployment rate
- α_3 = coefficient of inflation rate
- α_4 = coefficient of exchange rate
- α_5 = coefficient of interest rate

μ = Error term

HDI is a proxy for poverty alleviation. The choice of these variables is supported by development literature. The a priori expectations are: Unemployment Rate, Inflation rate, Exchange rate and Interest rate have negative relationship with poverty alleviation while Credit to small scale Enterprises is positive. Therefore, it is expected that credit to the poor through microfinance will reduce poverty in the country.

Rewriting the model above as an error correction model, we obtain:

$$\Delta HDI_i = a + \sum_{i=1}^p b \Delta HDI_{i-1} + \sum_{i=1}^p c \Delta UNEMP_{i-1} + \sum_{i=1}^p d \Delta INF_{i-1} + \sum_{i=1}^p e \Delta CRDT_{i-1} + \sum_{i=1}^p f \Delta ER_{i-1} + \sum_{i=1}^p g \Delta IR_{i-1} + e ECM_{i-1} + \xi_i \tag{3}$$

This study empirically investigates the linear relationship between poverty alleviation and micro credit to small scale enterprises in Nigeria for the period 1980 - 2014, using co-integration and error correction techniques. An error correction model (ECM), a multiple time series model, directly estimates the speed of adjustment of a dependent variable to equilibrium subsequent to a change in the explanatory variable. The ECM is appropriate for this study because it is capable of estimating both short and long run effects of one time series on another. Moreover, ECM, as a dynamic process, has the advantage that the deviation of the current state from its long run connection can be fed into its short-run dynamics (Engle and Granger, 1987). Data were obtained from the Central Bank of Nigeria Statistical Bulletin and the Human Development Index for the period 2005Q1 to 2014Q4. The start date of the sample period was dictated by data availability with respect to HDI, which were only published from 2005.

4. EMPIRICAL ANALYSIS

4.1. Unit Root Tests

It is necessary to examine the unit root properties of time series data before estimation so as to preclude the problem of spurious regression. Ordinary least squares (OLS) estimation of regressions in the presence of non-stationary variables gives rise to spurious regressions if the variables are not co-integrated (Granger and Newbold, 1974). The results of the ADF unit root tests are presented in Table 1. The results in the Table show that all the variables are stationary in their first differences.

Table-1. Unit Root Tests

| Variable | ADF Test Statistical Value | Critical Value at 1% | Critical Value at 5% | Critical Value at 10% | Order of Integration |
|----------|----------------------------|----------------------|----------------------|-----------------------|----------------------|
| CRDT | -6.023883* | -3.615588 | -2.941145 | -2.609066 | I(1) |
| EXCH | -6.016343* | -3.615588 | -2.941145 | -2.609066 | I(1) |
| HDI | -6.752777* | -3.615588 | -2.941145 | -2.609066 | I(1) |
| INF | -6.013354** | -3.615588 | -2.941145 | -2.609066 | I(1) |
| IR | -6.069291* | -3.615588 | -2.941145 | -2.609066 | I(1) |
| UNEMP | -6.471413* | -3.615588 | -2.941145 | -2.609066 | I(1) |

Note: * and ** are significant at 1 and 5 percent levels respectively.

Source: Author's Computation

This result is particularly important in that it confirms the use of ECM approach as the most appropriate procedure in the context of this study.

4.2. Co-Integration Test

This study uses the reduced rank procedure developed by Johansen (1988) and Johansen and Juselius (1990) two tests to determine the number of co-integration vectors: the Maximum Eigenvalue test and the Trace test. The Maximum Eigenvalue statistic tests the null hypothesis of r co-integrating relations against the alternative of $r+1$ co-integrating relations for $r = 0, 1, 2, \dots, n-1$. Whenever the results of Trace and Maximum Eigenvalue statistics are different results, the result of trace test is always preferred.

The co-integration test results are reported in Table 2 below.

As shown in Table 2, the dependent variable HDI is co-integrated with CRDT, UNEMP, INF, ER and IR. The trace test statistics strongly rejects the null hypothesis of no co-integration in favour of one co-integrating equation between the variables. Hence, the results show that the dependent and independent variables are both co-integrated and have long run relationship with one another.

Table-2. Johansen Co-integration Test

| Unrestricted Co-integration Rank Test (Trace) | | | | |
|---|------------|-----------|----------------|---------|
| Hypothesized | | Trace | 0.05 | |
| No. of CE(s) | Eigenvalue | Statistic | Critical Value | Prob.** |
| None * | 0.820437 | 56.66864 | 40.07757 | 0.0003 |
| At most 1 | 0.516570 | 23.98601 | 33.87687 | 0.4566 |
| At most 2 | 0.507633 | 23.38150 | 27.58434 | 0.1578 |
| At most 3 | 0.354448 | 14.44241 | 21.13162 | 0.3298 |
| At most 4 | 0.261621 | 10.00885 | 14.26460 | 0.2113 |
| At most 5 | 0.001322 | 0.043650 | 3.841466 | 0.8345 |

Trace test indicates 1 co-integration(s) at the 0.05 level.

* denotes rejection of the hypothesis at the 0.05 level.

**Mackinnon *et al.* (1999) p-values

4.3. Error Correction Model

Since the variables are found to be co-integrated, we can go ahead to estimate the error correction model. The result of parsimonious error correction model is reported in Table 4.3.

Table-3. ECM Model Results

| Dependent Variable: D(HDI) | | | | |
|----------------------------|-------------|------------|-------------|--------|
| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
| D(CRDT(-1)) | 0.000400 | 0.001125 | 0.355829 | 0.5248 |
| D(UNEMP(-1)) | -0.000626 | 0.001620 | 0.386275 | 0.0024 |
| D(INF(-1)) | -0.000058 | 0.000039 | -1.494947 | 0.0470 |
| D(ER(-1)) | -0.000020 | 0.000008 | -2.580348 | 0.0159 |
| D(IR(-1)) | -0.000055 | 0.000050 | 1.099961 | 0.0214 |
| ECM(-1) | 0.031610 | 0.012036 | 2.626217 | 0.0143 |
| C | -0.016897 | 0.007366 | -2.294031 | 0.0301 |
| Adjusted R-squared | 0.736971 | | | |
| Durbin-Watson stat | 2.006046 | | | |
| F-statistic | 18.46452 | | | |
| Prob(F-statistic) | 0.008900 | | | |

Source: Author's Computation

The main variable of interest, the Credit to small scale Enterprises, has positive but non-significant effect on HDI in Nigeria. In other words, an increase in Credit to small scale Enterprises can reduce poverty in Nigeria, but at present, the magnitude is too insignificant to do so. The coefficients of Unemployment Rate, Inflation rate, Exchange rate and Interest rate have negative and statistically significant effect on HDI. The coefficient of the error-correction term is correctly negatively signed and statistically significant. Thus, the ECM is able to correct any deviations in the relationship between HDI and the explanatory variables.

The adjusted R² is 74 percent, showing that over 74 per cent of the variations in HDI can be explained by the explanatory variables. The remaining 26 per cent variation is attributable to other variables not captured by our model. The Durbin-Watson statistics of 2.006046 rules out auto-correlation. The F-statistics of 18.46452 show that the explanatory variables are important determinants of HDI in Nigeria.

These results explain the role of microfinance in poverty alleviation in Nigeria and corroborate the findings of Hulme and Paul (1996) which indicated that the use of microfinance to fight poverty (i.e. well-designed microfinance schemes) can improve the lots of the poor and can lift them out of poverty. Now, there is clear evidence that the provision of credit to the very poor households and businesses raises their standard of living.

5. SUMMARY OF FINDINGS

Microfinance has become an increasingly popular tool for poverty alleviation in developing countries for the past two decades, this is not surprising because it is a well known fact that micro-finance holds enormous potential for national economic growth and development by supporting the economic activities of the poor who are essentially the majority.

In Nigeria, as around the World, most micro-financing can be grouped in three areas: financial services (loans, deposits, leasing, etc.), non-financial services (classes on literacy, numeracy, health, nutrition, etc.) and business development.

In the course of this study, it has been learnt that what distinguishes as a developed country, say Germany, and a less developed one like Nigeria is not the prevalence of informal finance and self-help over a longer period of time; because Nigerian history suggests such institutions date back to the 15th and 16th century where Nigerians were carried as slaves to the Caribbean as part of their Social Capital where both the Institution and the original Yoruba term 'esusu' are still found today, but the major difference seems to be the legal recognition given to informal finance and the protection of the institutions through prudential regulation and effective supervision of such institutions.

Undoubtedly Micro-Financing has had positive impacts on the World War over, however, the findings of this study suggests otherwise for the Nigerian case. The data analysis shows that there exists a negative correlation between the Human Development Index and the Credit to Small Scale Enterprises which goes against all a priori expectations.

Due to numerous unexpected variables and because of their relevance, it is extremely difficult to pinpoint the exact cause of the in-efficiencies and excesses of micro-financing on the poverty level of the country. It is most probably a combination of two or more of the different variables listed below:

- i. Gross Fraud and mismanagement of micro-finance Banks.
- ii. Costly Fines and Litigation.
- iii. Attracting Clients but not retaining them.
- iv. Improper funding and investment from Commercial Banks.
- v. Less developed countries like Nigeria are characterized by dualistic economies which favour Large Scale Enterprises to the neglect of the Small Scale Enterprises.

6. RECOMMENDATIONS

The following recommendations are made with regards to the study:

MFIs should be situated more in the rural areas because they are most in need of their services.

There is immediate need for the Nigerian government to launch intensive awareness for the creation and the existence of poverty alleviation schemes via village meetings, village/town criers, radio and television jingles (especially, in local dialect).

Policy makers should de-emphasize the issues of top-down flow of information: it has the worrisome demerit of dipping interaction between the rural dwellers and policy makers as well as involvement. Community driven development approach should rather be embraced as it provides the rural people the opportunity to be actively involved in the entire process of conception, identification, and execution of any poverty alleviation programme that will benefit them.

Government needs to adopt price-support policies to keep the prices of commodities down to a minimal level. Such policies will increase the real incomes of the rural producers.

Institutions that engage in giving out of credit to the poor should also endeavour to invest in training them and provide useful information to such customers as to how to improve the efficiency of their businesses.

Seeing that being employed doesn't necessarily mean that a person is living above the poverty line calls for a general savings culture in the lifestyle of Nigerians as a whole. The Nigerian Government could achieve this by increasing Money supply to boost aggregate demand in the economy which will lead to increased productivity and hence reduce unemployment and increase income which in the long-run would increase savings and reduce consumption.

MFIs should be properly checked and regulated by the proper authorities to safeguard against corruption and mismanagement.

Beneficiaries of credits should be provided with adequate facilities to express their satisfaction or otherwise of the performance of the respective MFIs which they patronize.

7. CONCLUSION

Microfinance schemes are seen as a means for poor households to gain access to much needed credit services that are appropriate for their needs. More specifically, the development objective of microfinance for poor, small scale farming and fish farming, rural and urban communities is to enable them to increase their income, smoothen consumption, develop micro-enterprises, manage risks better and enhance their earning capacities, thus reducing their social and economic vulnerabilities.

Poverty is a critical phenomenon that calls for an urgent attention and solution all over the world, especially in the underdeveloped nations of the world where it has eaten deep into the lives of many. The need to alleviate poverty arises in order to enhance the quality of life through the creation of favorable standards of living by effective production and distribution of consumer goods and services. In the case of Nigeria, over 80 million people (65% of the active population) remain unserved by the formal financial institutions, hence, the need for MFIs to reach the unreached and serve the unserved.

This study has shown that credit to small scale enterprises has positive but non-significant effect on the human development variable, HDI, in Nigeria. In other words, an increase in credit to small scale enterprises can reduce poverty in Nigeria, but at present, the magnitude is too insignificant to do so. The findings correlate with those of the international bodies. If poverty is characterized by hunger, ill health, inadequate or poor housing, illiteracy, malnutrition and unemployment, then there is no doubt that majority of Nigerians are living below the poverty line as set out by the World Bank in 1990.

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