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## Concept Paper

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Project Number: 52018-001  
April 2018

# Proposed Policy-Based Loan Republic of Palau: Disaster Resilience Program

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**Asian Development Bank**

## CURRENCY EQUIVALENTS

The currency unit of Palau is the United States dollar.

## ABBREVIATIONS

ADB	–	Asian Development Bank
DRM	–	disaster risk management
GDP	–	gross domestic product
GFR	–	General Fund Reserve
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
NDRMF	–	National Disaster and Risk Management Framework
NEMO	–	National Emergency Management Office
PBL	–	policy-based loan

## NOTES

- (i) The fiscal year (FY) of the Government of Palau and its agencies ends on 30 September. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2018 ends on 30 September 2018.
- (ii) In this report, "\$" refers to United States dollars.

<b>Vice-President</b>	Stephen Groff, Operations 2
<b>Director General</b>	Ma. Carmela D. Locsin, Pacific Department (PARD)
<b>Director</b>	Emma Veve, Pacific Urban, Social Development and Public Sector Management Division, PARD
<b>Team leader</b>	Ananya Basu, Principal Economist, PARD
<b>Team members</b>	Charlotte Benson, Principal Disaster Risk Management Specialist, Sustainable Development and Climate Change Department (SDCC) Jesusa Dela Cruz, Operations Assistant, PARD Asghar Ali Syed, Senior Counsel, Office of the General Counsel Hanna Uusimaa, Climate Change Specialist, PARD
<b>Peer reviewer</b>	Arghya Sinha Roy, Senior Disaster Risk Management Specialist (Climate Change Adaptation), SDCC

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## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 52018-001</b>	
<b>Project Name</b>	Disaster Resilience Program	<b>Department/Division</b>	PARD/PAUS
<b>Country</b>	Palau, Republic of	<b>Executing Agency</b>	Ministry of Finance
<b>Borrower</b>	Government of Palau		
<b>2. Sector</b>		<b>ADB Financing (\$ million)</b>	
✓ <b>Public sector management</b>	Public expenditure and fiscal management		15.00
		<b>Total</b>	<b>15.00</b>
<b>3. Strategic Agenda</b>		<b>Climate Change Information</b>	
<b>Subcomponents</b>			
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Adaptation (\$ million)	15.00
Environmentally sustainable growth (ESG)	Disaster risk management Global and regional transboundary environmental concerns	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>		<b>Gender Equity and Mainstreaming</b>	
<b>Components</b>			
Governance and capacity development (GCD)	Institutional development Public financial governance	Some gender elements (SGE)	✓
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
<b>Subcomponents</b>			
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG13		
<b>6. Risk Categorization:</b>		Low	
<b>7. Safeguard Categorization</b>		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>15.00</b>	
Sovereign Program (Regular Loan): Ordinary capital resources		15.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>15.00</b>	

## I. THE PROPOSAL

1. The Government of Palau has requested financial assistance from the Asian Development Bank (ADB) for the Disaster Resilience Program to help manage the fiscal risk arising from disasters triggered by all types of natural hazards.<sup>1</sup> A single-tranche stand-alone policy-based loan (PBL) from regular ordinary capital resources is proposed to provide Palau with a source of contingent financing for timely disaster response, early recovery, and reconstruction.<sup>2</sup> Eligibility to access the financing will be established by the government's ongoing reforms to improve disaster and climate resilience. Actual withdrawal will be deferred until the occurrence of a disaster that leads to the declaration of a state of emergency in Palau.

## II. PROGRAM AND RATIONALE

### A. Background and Development Constraints

2. **Development context.** Palau comprises approximately 340 islands covering 466 square kilometers, with an estimated population of about 21,500 (in 2016). The economy is narrowly based, with tourism receipts contributing 45%–55% of Palau's gross domestic product (GDP). Palau experiences frequent natural hazards (mainly typhoons, droughts, and tidal surges), which can disrupt economic activity, lead to loss of livelihoods, divert fiscal resources, and undermine development priorities. Palau is also vulnerable climate change, which will affect disaster risks as more extreme weather events are likely to increase in the future.<sup>3</sup>

3. **Estimated losses.** Analysis undertaken under the Pacific Catastrophe Risk Assessment and Financing Initiative indicates that Palau faces an average annual loss of \$2.7 million (0.9% of GDP in FY2016) from typhoons, earthquakes, and tsunamis, with probable maximum losses of \$16.8 million from a 1-in-50-year event, \$46.7 million from a 1-in-100-year event, and \$146.0 million from a 1-in-250-year event.<sup>4</sup> This excludes losses from droughts, which are common.

4. **Recent emergencies.** There have been three states of emergency related to natural hazards declared since 2012. In 2012, Typhoon Bopha caused about \$6.3 million in initial damages (2.9% of GDP). In 2013, initial damage from Typhoon Haiyan was estimated to be \$8.5 million (3.7% of GDP). In 2016, severe drought associated with El Niño weather conditions led to water shortages across Palau, and generated significant sanitation and hygiene risks. The drought also led to closure of Jellyfish Lake, a major tourist attraction. Consequently, GDP growth is estimated to have fallen to –0.5% in FY2017 as tourist arrivals declined.

5. **Emergency response.** Immediate response to the emergencies was funded by budget reallocations and emergency appropriations approved by the Palau National Congress, and coordinated through the National Emergency Management Office (NEMO). Palau also received support from development partners for humanitarian relief and reconstruction measures following the typhoons. However, immediate response was constrained by weak emergency response systems (including capacity, equipment, institutions, and funds). Delays in immediate

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<sup>1</sup> The proposed program is included in ADB. *Country Operations Business Plan: Palau, 2017–2019*. Manila. It is also aligned with the Pacific Approach, 2016–2020, which serves as the country partnership strategy for Palau. ADB. *Pacific Approach, 2016–2020*. Manila. An initial draft of the design and monitoring framework is in Appendix 1.

<sup>2</sup> A PBL modality was selected as it is the only instrument available to ADB that enables financing to be put in place before a disaster. The program design is based on the World Bank's catastrophe deferred drawdown option.

<sup>3</sup> Australian Bureau of Meteorology; and Commonwealth Scientific and Industrial Research Organisation. 2011. *Climate Change in the Pacific: Scientific Assessment and New Research. Volume 2: Country Reports*. Canberra.

<sup>4</sup> Pacific Catastrophe Risk Assessment and Financing Initiative. 2011. *Country Risk Profile: Palau*. <http://pcrafi.spc.int/documents/46/download>.

response exacerbated the indirect economic and social costs of disasters, increasing their ultimate impact. Inadequate government-led donor coordination mechanisms impeded recovery.

## **B. Policy Reform and ADB's Value Addition**

6. **Government vision.** The government has taken important steps to improve the country's resilience to disasters. A National Disaster and Risk Management Framework (NDRMF), initially published in 2010, set out a vision of "safe, resilient and prepared communities in Palau."<sup>5</sup> Following the experiences of typhoons Bopha and Haiyan (para. 4), the NDRMF was amended in 2016 to (i) improve risk management structures, (ii) enhance emergency preparedness, response, and recovery, and (iii) integrate disaster risk management (DRM) considerations into national development planning and budgeting processes. It draws special attention to women in livelihoods recovery measures and to DRM strengthening for local communities. The NEMO (with six staff) is expected to coordinate NDRMF implementation.

7. In addition, the Palau Climate Change Policy 2015 to strengthen climate and disaster resilient development outlines a multisector 5-year action plan (with timelines and responsibilities) estimated to cost \$500 million.<sup>6</sup> A key objective is to improve Palau's ability to manage unexpected disasters, and the action plan accordingly prioritizes a number of measures to enhance disaster preparedness and minimize disaster risks. Inadequate institutional capacity and funding has impeded implementation of both the NDRMF and the Palau Climate Change Policy 2015 action plan, but the government remains committed to improving DRM.

8. **Financial arrangements.** Palau has no dedicated financing available for immediate disaster response. In view of the experience of the recent typhoons (para. 4), the General Fund Reserve (GFR)<sup>7</sup> was established in 2015, drawing annually from the budget surplus (if any) in the previous year. The GFR may be tapped after a disaster in the absence of alternative financing, but is not exclusive for disaster response and may also be accessed for other purposes. The government sees a further need to build resources for immediate disaster response needs, instead of relying on budget reallocations which can take time to secure (partly due to government approval procedures) and redirect funds away from development priorities.

9. The government recognizes that contingent financing can be effective in addressing risks from events that would exhaust funds available for disaster response under the GFR, but are too frequent to be covered cost effectively through insurance.<sup>8</sup> The Palau Climate Change Policy 2015 envisions the establishment of a \$25 million disaster contingency fund to respond in times of emergency. However, this measure is not yet in place, and the government continues to rely on the GFR and budget reallocations to deal with disasters. The proposed PBL will address this critical gap in available financing. The government has also requested that ADB's contingent financing be made available in 2018, in view of frequent emergencies (para. 4).

10. **Reform areas.** The PBL is aligned with the following overarching development objective: safety, resilience and preparedness of communities in Palau enhanced (footnote 5). To establish eligibility to access the contingent financing under the PBL, the government will undertake prior actions that (i) strengthen policies and institutions for disaster and climate

<sup>5</sup> Government of Palau. 2016. *National Disaster and Risk Management Framework 2010 (Amended 2016)*. Koror.

<sup>6</sup> Government of Palau. 2015. *Palau Climate Change Policy 2015*. Koror.

<sup>7</sup> Until 2024, the GFR may be drawn down when a state of emergency is declared, if other funds are unavailable. The GFR can also be accessed if local revenues drop by more than 5% in a year, or to finance budget deficits.

<sup>8</sup> The government is also considering insurance from the Pacific Catastrophe Risk Insurance Company for low-frequency, high-impact events, but this is still under discussion internally.

resilience, (ii) improve climate risk management and DRM capacity and infrastructure, and (iii) expand financing for climate risk management and DRM. The indicative prior actions are based on the government's ongoing reforms, based on the priority measures in the Palau Climate Change Policy 2015 action plan and/or the amended NDRMF, and targeted for completion by July 2018 to enable timely approval of the PBL. These actions are part of broader efforts to strengthen DRM, and indicates government commitment. A post-program monitoring framework (to be elaborated in the Report and Recommendation of the President) will also be developed as a basis for ADB's continued engagement with Palau, to support longer-term DRM reforms.

11. The indicative prior actions for the proposed PBL are as follows:

- (i) **Strengthening policies and institutions for disaster and climate resilience.** A midterm review of the Palau Climate Change Policy 2015 action plan (footnote 6) will be completed to identify lagging actions and strengthen the policy itself. Community-level DRM plans will be prepared in one community in each of Palau's 16 states to strengthen disaster resilience, with special considerations for the vulnerability of women. Institutional arrangements for coordinated mass rescue operational responses to large-scale disasters are being improved.
- (ii) **Improving climate risk management and DRM capacity and infrastructure.** A new weather station will be commissioned, with upgraded technological capacity.<sup>9</sup> A proposal to improve the early warning system is being developed.<sup>10</sup> Public schools are updating their emergency management plans to improve community-level disaster preparedness.<sup>11</sup> Climate change and DRM have been integrated into the school science curriculum for grades VI–VIII in 2017–2018. Several public schools that serve as emergency evacuation shelters are upgrading their water filtration systems to provide clean water in case of emergencies. Geographic information system mapping of housing and farms are being undertaken to support location-specific vulnerability assessments and community-level DRM planning. Training manuals for livestock and horticulture farming, with climate and disaster resilience measures (particularly to address drought), and gender considerations, are being completed and will be adopted.
- (iii) **Expanding financing for climate risk management and DRM.** For FY2018, \$1.265 million has been appropriated for the GFR (para. 8). The government has introduced a \$100 per person Pristine Paradise Environmental Fee on tourists, replacing the \$50 per person green fee. This fee will help finance conservation efforts in marine protected areas and the Protected Areas Network, including community adaptation and DRM priorities in Protected Areas Network sites.

12. **ADB's value addition and lessons learned.** Although ADB has instruments for post-disaster response,<sup>12</sup> emergency assistance loans can take 3 months or more to process, while reconstruction loans processed under normal lending modalities can take longer.<sup>13</sup> The proposed PBL will enable financing to be in place before a disaster, thus providing Palau with immediate access to resources for timely disaster response, early recovery, and reconstruction

<sup>9</sup> Much of the equipment currently in use dates back several decades. This measure will be reflected in the final policy matrix only upon confirmation during fact-finding that the weather station (which is already constructed) is located on government-owned and/or leased land, without any legacy or outstanding issues.

<sup>10</sup> The current system relies largely on the public broadcasting system, which is unable to broadcast in frequencies that reach many of the remote outer islands.

<sup>11</sup> It is expected that 15 of 18 schools will update their plans by July 2018. The remaining three schools are in the outer islands, and have fewer than 30 students each, and will update their plans later in the year.

<sup>12</sup> ADB provided Palau \$200,000 from the Asia Pacific Disaster Response Facility in 2013 after Typhoon Haiyan.

<sup>13</sup> ADB provides dedicated funding to its concessional assistance-only countries through the Asian Development Fund 12 Disaster Response Facility. Palau is not eligible since it has access to ordinary capital resources.

in the event of a qualifying disaster. ADB has piloted similar contingent financing in the Cook Islands in 2016 through a stand-alone single-tranche PBL to support timely disaster response.<sup>14</sup> This approach is also reflected in the 2017 regional program, which supports DRM in Samoa, Tonga, and Tuvalu.<sup>15</sup> Following extensive damage caused by Cyclone Gita in Tonga in February 2018, funds from the regional program were released by ADB within 24 hours of the receipt of Tonga's request, demonstrating the benefits of this approach. The PBL, which marks ADB's initial engagement on DRM in Palau, will also pave the way for more systematic support to longer-term DRM reforms through the post-program monitoring framework (para. 10).

### **C. Impacts of the Reform**

13. It will only be possible to quantify the full economic impact of the program after a disaster, as the benefits (or costs avoided) will be determined by the scale and nature of the specific event. The PBL funds will provide the government with enhanced resources to finance short-term post-disaster needs in a timely and cost-effective manner, and reduce the opportunity cost associated with budget or aid program reallocations. Direct economic benefits include faster restoration of essential services. In addition, the prior actions to establish eligibility to access the contingent financing will incentivize reforms that result in (i) reduced loss of lives, (ii) reduced damage to property, and (iii) better coordinated and targeted humanitarian response.

### **D. Development Financing Needs and Budget Support**

14. The government has requested a loan of \$15 million from ADB's regular ordinary capital resources to help meet its vision of a disaster contingency fund (para. 9). The loan will have a 15-year term, including a grace period of 3 years, with repayments calculated based on a disbursement-linked amortization schedule, an annual interest rate determined in accordance with ADB's London interbank offered rate-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions to be set forth in the draft loan agreement.

15. Post-disaster financing needs are determined based on the likely fiscal impact of medium- to high-impact disasters, taking into account the resources likely available from domestic and international sources, and the need to ensure that Palau maintains a sustainable level of debt. As the proposed loan funds are for contingent financing to support additional public spending associated with short-term post-disaster financing needs, the loan amount is not directly correlated with the cost of policy reforms.

### **E. Implementation Arrangements**

16. The Ministry of Finance (MOF) will be the executing agency, responsible for coordinating and monitoring program implementation. The implementing agencies will include ministries and offices responsible for reforms to be presented in the policy matrix. The program period will be from approval to 31 December 2021. Eligibility to withdraw from the loan will be based on achievement of the identified prior actions. Actual withdrawal will be deferred until the occurrence of a disaster event triggered by a natural hazard that results in the declaration of a state of emergency in Palau within the program period. In the event of a qualifying disaster, the government can withdraw the loan proceeds partially or entirely, depending on the government's assessment of the disaster's severity and resultant need, and after the

<sup>14</sup> ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan to the Cook Islands for the Disaster Resilience Program*. Manila.

<sup>15</sup> ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loans, Policy-Based Grants, and Technical Assistance Grant for the Pacific Disaster Resilience Program*. Manila.



government and ADB have agreed on the withdrawal amount. Funds will be spent through national budget processes. During loan effectivity, ADB will monitor the implementation of reforms according to the post-program monitoring framework (para. 10).

### III. DUE DILIGENCE REQUIRED

17. Due diligence for the program will include a sector assessment, a risk assessment, and a summary poverty reduction and social strategy. An International Monetary Fund assessment letter will be requested. The program is proposed as category C for the environment, involuntary resettlement, and indigenous people. No physical or economic displacement is anticipated from prior actions. The program is proposed as having some gender elements. The community-level DRM plans (para. 10) will recognize the special needs of women. The training manuals for livestock and horticulture will benefit women, who make up the bulk of farmers in Palau.

### IV. PROCESSING PLAN

#### A. Risk Categorization

18. The program is categorized low risk because (i) the amount of the PBL (\$15 million) does not exceed \$50 million; (ii) the MOF has experience executing externally financed operations (including ADB public sector management operations);<sup>16</sup> (iii) the proposed safeguard categorization is other than A; and (iv) there is no significant integrity concern, climate risk, waiver of applicable policy, or high-level technology. Since ADB has processed two similar policy-based contingent credit lines to build disaster resilience in the Pacific since 2016 (para. 11), there does not appear to be a need for special Management scrutiny.

#### B. Resource Requirements

19. About 5 person-months of ADB staff inputs are required to complete program processing.

#### C. Processing Schedule

##### Proposed Processing Schedule

Milestones	Expected Completion Date
Concept approval	21 April 2018
Loan fact-finding	5–8 June 2018
Management review meeting	6 August 2018
Loan negotiations	20 August 2018
Board consideration (no-objection procedure)	27 September 2018
Loan effectiveness	10 October 2018

Source: Asian Development Bank.

### V. KEY ISSUES

20. Country consultations will focus on progressing/updating prior actions and finalizing the post-program monitoring framework (para. 10). Under the post-program monitoring framework ADB will provide targeted support from regional technical assistance funds,<sup>17</sup> based on government requests and available partner support.

<sup>16</sup> The MOF's financial management systems for externally financed projects are considered adequate. Palau's 2016 score on the Quality of Budgetary and Financial Management component of ADB's Country Performance Assessment is 3.5, among the higher ones in the Pacific.

<sup>17</sup> ADB. 2015. *Technical Assistance for Strengthening Climate and Disaster Resilience of Investments in the Pacific*. Manila (TA 8961-REG).

**DESIGN AND MONITORING FRAMEWORK**  
(Initial Draft)

<b>Country's Overarching Development Objective</b>			
Safety, resilience, and preparedness of communities in Palau enhanced (National Disaster and Risk Management Framework 2010 [Amended 2016]) <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines</b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Effect of the Reform</b>  Disaster risk management strengthened	By 2021:  Available dedicated pre-disaster contingent financing increased to at least 5% of gross domestic product (2017 baseline: 0%)	MOF annual budget documents	Repeated or major external shocks (e.g., disasters or economic downturns) affect the economy adversely.
<b>Reform Areas</b>	<b>Indicative Policy Actions<sup>b</sup></b>		
1. Policies and institutions for disaster and climate resilience	By July 2018:  1.1 Midterm review of the Palau Climate Change Policy 2015 action plan submitted to the Office of the President (2017 baseline: not applicable)  1.2 Community-level DRM plans (based on gender-sensitive community-based disaster risk reduction toolkit) prepared in one community in each of 16 states <sup>c</sup> (2017 baseline: 0 states)  1.3 Mass rescue operations plan approved (2017 baseline: not applicable)	1.1 Midterm review document from MOF (Office of Climate Change)  1.2 Community-level DRM plan documents from National Emergency Management Office  1.3 Approved plan document from National Emergency Management Office	Staff constraints or shifting priorities delay the strategic planning and/or implementation of DRM actions.
2. Climate risk management and DRM capacity and infrastructure	2.1 School emergency management plans updated for 15 (of 18) public schools for school year 2017–2018 (2017 baseline: 0 schools)  2.2 Training manuals for livestock and horticulture, including climate and disaster resilience measures and gender considerations, adopted (2017 baseline: not applicable)  2.3 Rainwater harvesting and filtration systems upgraded in 6 (of 10) schools serving as emergency shelters (2017 baseline: 0 schools)	2.1 School emergency management plan documents from Ministry of Education  2.2 Training manuals and verification from Ministry of Agriculture  2.3 Ministry of Education annual reports	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
3. Financing for climate risk management and DRM	2.4 New weather station commissioned (2017 baseline: not applicable)	2.4 Government verification	
	2.5 Proposal for early warning system prepared (2017 baseline: not applicable)	2.5 Proposal from MOF (Office of Climate Change)	
	2.6 GIS mapping of housing (based on infrastructure survey) and farms (based on agriculture survey) completed (2017 baseline: not applicable)	2.6 GIS maps from MOF (Palau Automated Land and Resource Information System)	
	3.1 \$1.265 million appropriated for GFR in FY2018 (2017 baseline: 0)	3.1 MOF annual budget documents	
	3.2 Pristine Paradise Environmental Fee of \$100 per tourist implemented (2017 baseline: green fee of \$50 per tourist)	3.2 MOF annual budget documents	

#### Budget Support

Asian Development Bank: \$15 million (regular ordinary capital resources loan)

DRM = disaster risk management, FY = fiscal year, GFR = General Fund Reserve, GIS = geographic information system, MOF = Ministry of Finance.

Note: The FY of the Government of Palau and its agencies ends on 30 September. "FY" before a calendar year denotes the year in which the fiscal year ends, e.g., FY2018 ends on 30 September 2018.

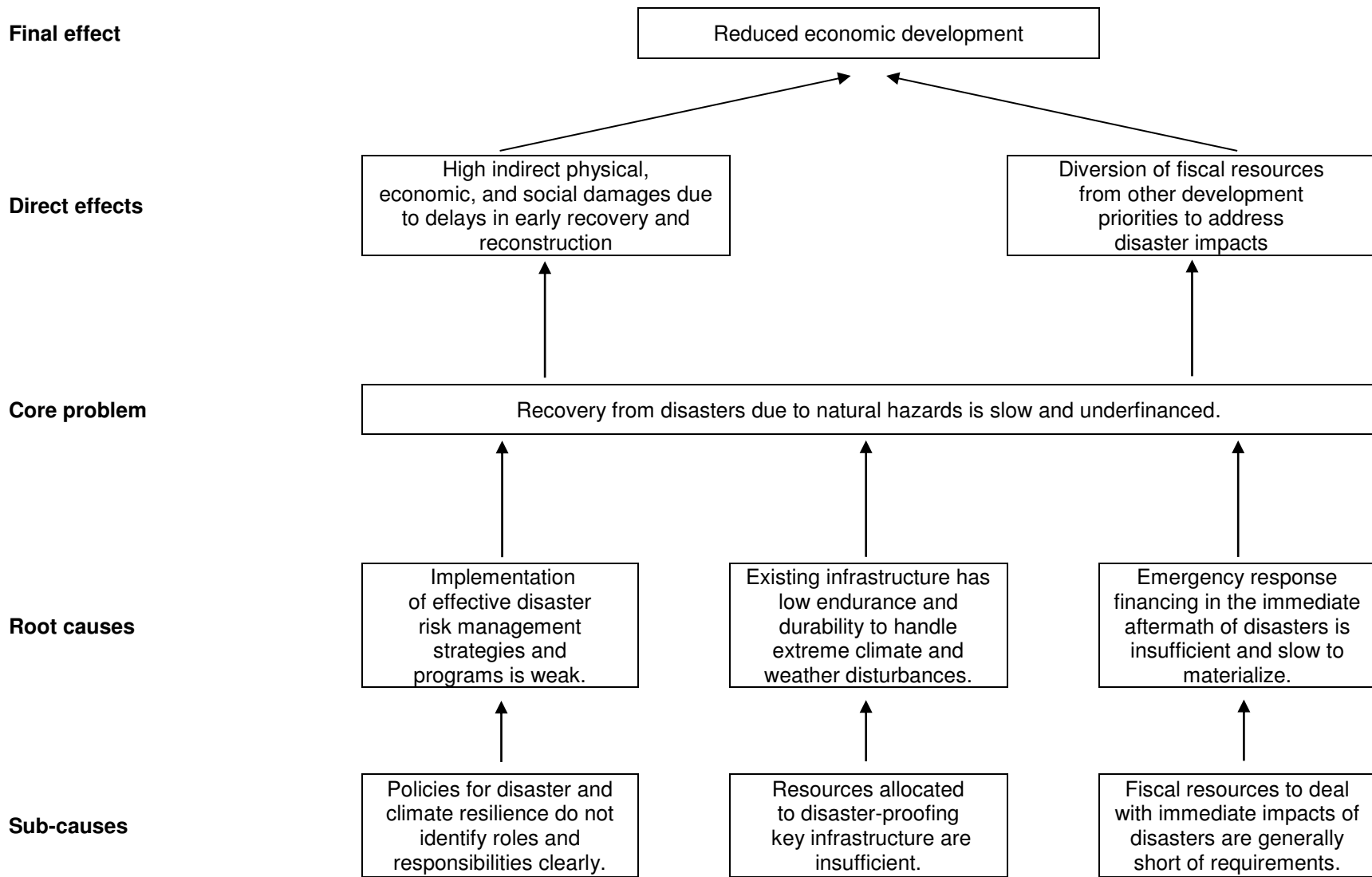
<sup>a</sup> Government of Palau. 2016. *National Disaster and Risk Management Framework 2010 (Amended 2016)*. Koror.

<sup>b</sup> The policy actions (and the data sources and reporting mechanisms) listed are indicative, and will be further refined and/or revised during program appraisal. The actual data presented will also be cross-checked.

<sup>c</sup> The National Emergency Management Office developed the community-based disaster risk reduction toolkit in 2016 to provide clear guidance to communities in their efforts to reduce disaster risks and create effective response and recovery systems. The toolkit recognizes the special needs of women, and the importance of involving women's groups in local DRM planning.

Source: Asian Development Bank.

### PROBLEM TREE



Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=52018-001-ConceptPaper>

1. Initial Poverty and Social Analysis