

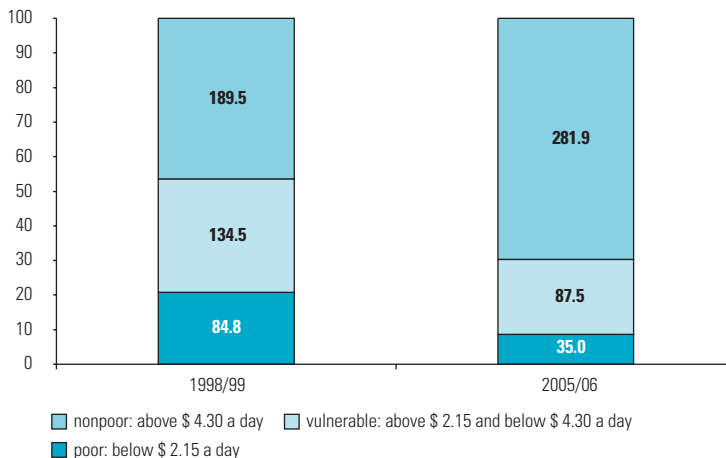
Poverty

Economic growth since the Russian Federation's financial crisis of 1998 has lifted many boats. It has moved 50 million people in the transition countries out of absolute poverty, defined as those with an income less than \$2.15 a day in purchasing power parities (figure 5.1). While nearly one in five people—or 85 million—lived in poverty around 1998/99, only one in twelve—or 35 million—did so around 2005/06. As a result, the poverty headcount—the proportion of the absolute poor in the population—ranged from 1.6 percent in the EU8, 2.9 percent in the middle income CIS, 5.8 percent in Southeastern Europe (SEE), and 38.6 percent in the low income CIS, using a poverty line of \$2.15 a day in purchasing power parities.¹

Most poverty reduction since 1998 has occurred in the middle income countries of the CIS, such as the Russian Federation and Ukraine, where growth has been particularly rapid. Inequality has fallen in the region as a whole, driven in part in the CIS by a reduction in wage arrears, which had been regressive in their incidence. The Gini coefficient of consumption inequality for the transition countries as a whole was 0.35 in 2006, considerably lower than in other middle income country regions such as East Asia and Latin America. While the groups at highest risk of poverty are the young, rural or secondary city dwellers, the unemployed, and the poorly educated, the majority of the poor are

This chapter is based on World Bank (2005a).

FIGURE 5.1
Poverty in Transition Countries, 1998/99–2005/06



Source: World Bank staff estimates based on ECA Household Surveys.

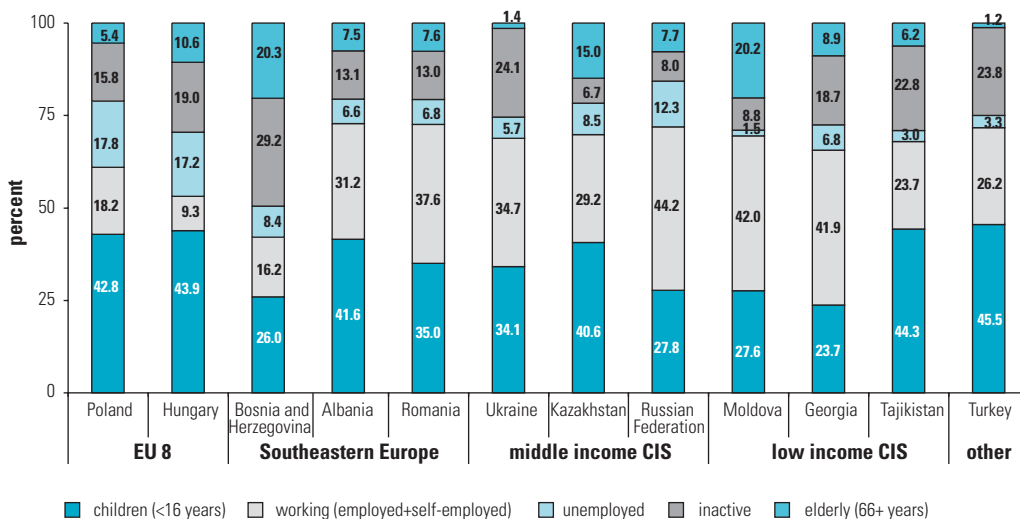
Note: In million persons and in percent to population. Poverty lines converted to local currencies using 2000 PPP.

made up of working adults, whether employed for wages or self-employed, together with children, often the children of working parents (figure 5.2).

Profile of the Poor

There are three main channels through which growth affects the

FIGURE 5.2
Composition of Poor Population, Selected Transition Countries: 2005/2006



Source: World Bank staff estimates using ECA Household Surveys Archive.

poor. The unemployed poor benefit directly from increased employment resulting from growing demand for their labor. The working poor gain from rising real wages or increased productivity of their self-employment. And growth can trickle down to the economically inactive poor through increased public and private transfers.

The labor market profiles of the poor, defined by employment status of the household head in four transition countries, one each from the four country groups—Poland (EU8), Romania (Southeastern Europe), the Russian Federation (middle income CIS), and Moldova (low income CIS)—show the following characteristics (table 5.1).

Labor force status. While the working poor are the majority of the poor everywhere, the poverty rate of the employed (the proportion of the employed that are poor) is below that of the unemployed (the proportion of the unemployed that are poor).² While the unemployed poor make up a small proportion of the poor, the poverty rate among the unemployed is not only above that of the employed but usually also above that of the inactive (those not in the labor force). The inactive poor are however a significant proportion of the poor in many countries.

Sector of employment. The poverty rate is the highest in agriculture and usually the lowest in services. Hence, the growth of the service sector can be expected to have different consequences depending on whether it is translated into an increase in employment or a rise in earnings. The former contributes strongly to poverty reduction. The latter, however, would have a minimal effect on poverty, since workers in the sector are typically above the poverty line. The poverty rate is lower in the public sector than in the private. But many more of the working poor are in the private sector.

Wages, Employment, and Distribution

The rapid increase in real wages and the comparatively muted gains in employment between 1998/99 and 2005/06 affected the income distribution in different degrees, with four main patterns.

First, real wages grew strongly during the post-1998 recovery and outpaced the growth of aggregate labor productivity (figure 5.3). This development needs to be seen, however, against the background of the prolonged decline in real wages during the transitional recession, particularly in the CIS. Looking ahead, the trend raises questions about sustainability. But the rise in average real wages did reduce poverty. The link between growth in real wages and poverty reduction is the strongest in the middle income CIS countries, where many of the poor are employed for wages. The link is weaker in the other

TABLE 5.1

**Poverty Profile by Sector and Type of Employment of the Household Head,
Selected Transition Countries, 2005/06**

Household head employment	Poland (2005)		Romania (2006)		Russian Federation (2006)		Moldova (2005)	
	Poverty rate	Share of poor	Poverty rate	Share of poor	Poverty rate	Share of poor	Poverty rate	Share of poor
Total	21.1	100.0	6.2	100.0	2.7	100.0	44.0	100.0
Labor force status								
Employed	21.3	71.1	6.1	56.5	2.4	80.1	44.5	71.8
Unemployed	54.7	5.9	17.7	9.4	10.9	3.9	52.3	0.3
Not in labor force	17.8	23.0	5.5	34.1	4.4	16.0	43.0	27.8
Public/private sector								
Public employee			1.5	13.6	2.4	13.8	32.9	16.2
Private employee			2.6	42.9	2.5	66.3	43.9	55.6
Employment type								
Employee	19.9	50.2	2.2	12.7	2.5	78.6	40.8	42.6
Self-employed/entrepreneur	25.7	21.0	12.2	43.9	1.2	1.5	51.3	29.3
Sector of employment								
Agriculture	35.3	19.7	12.2	37.8	5.4	12.0	55.9	42.1
Industry	23.2	17.7	3.2	9.8	1.3	8.4	36.2	10.9
Services	16.8	33.8	2.8	8.9	2.5	59.7	33.6	18.8

Source: World Bank staff estimates using data from ECA Household Surveys Archive.

Note: In Poland \$4.30 a day, at 2000 U.S. dollars in purchasing power parities, is used as a poverty line, for other countries in this table \$2.15, also at 2000 U.S. dollars in purchasing power parities, is used.

country regions—either because the working poor make up a smaller majority of the poor, as is to some extent true in the EU8 and South-eastern Europe, or because more of the working poor are self-employed, as in the lower income CIS countries.

Second, the growth of real wages was broad based, occurring across the income distribution in many countries. But there were differences in degree. In Poland mainly the well-off benefited. In the Russian Federation all groups benefited but the well-off did so disproportionately. In Moldova and Romania the gains were more proportionately distributed (figure 5.4).

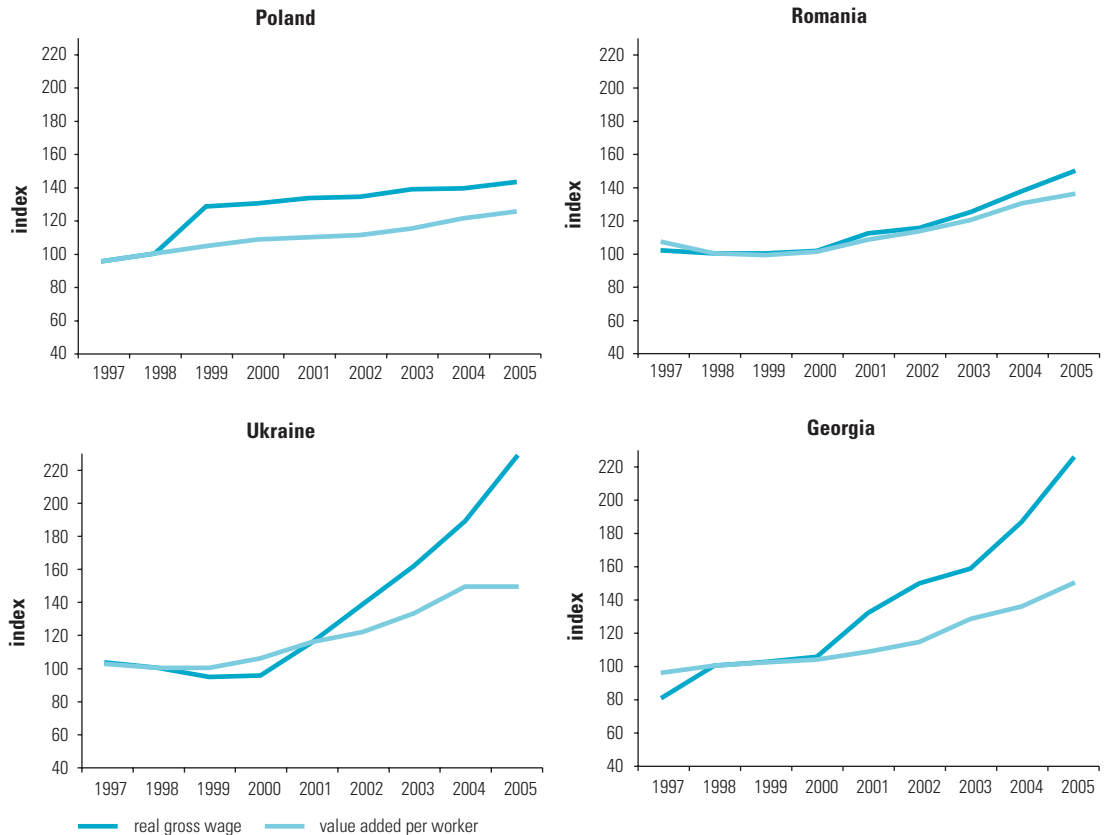
Third, stagnation in employment is evident, and growth in real wages outpaced that of employment (figure 5.5).

Fourth, the growth in employment has been uneven across the income distribution (figure 5.6). In Poland, where employment fell, all groups lost but the poor suffered disproportionately. In Romania there was virtually no change in any part of the income distribution, and the employment rate for the poor remained well below that of the rich. Employment increased noticeably in Moldova and the Russian Federation.³ All income groups benefited in the Russian Federation, with the poor gaining about as much as wealthier households. In Moldova, however, the employment rate rose considerably for the lowest deciles of the population and fell for the top deciles.

FIGURE 5.3

Wage Increases and Productivity Gains during the Economic Recovery

(Real wages and value added per worker in manufacturing in selected countries)

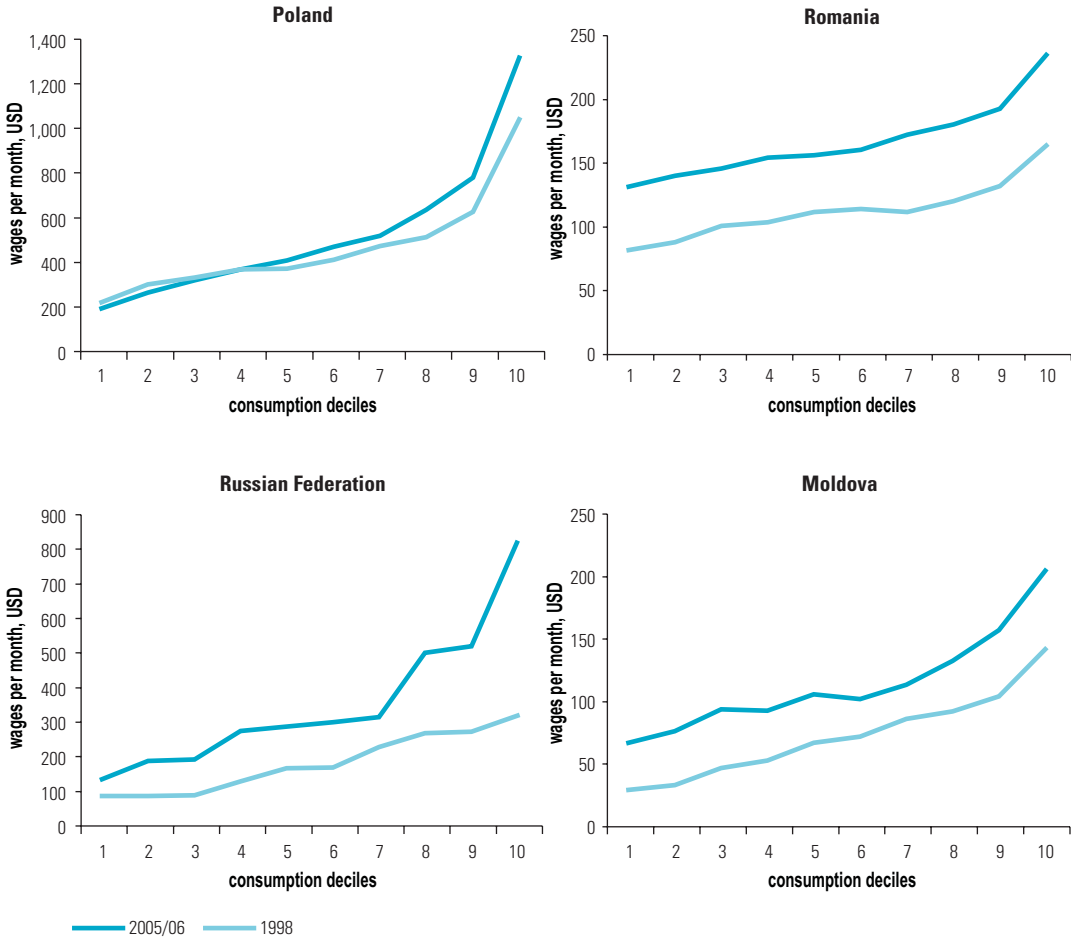


Source: World Bank staff estimates using data from ECA Household Survey Archives.

Even with broad-based increases in real wages since 1998, working adults, whether employed for wages or self-employed, and children, often the children of working parents, make up the majority of the poor (figure 5.2). Work therefore does not always protect people from poverty. This is because much employment, particularly in the region's poorest countries, is in low productivity occupations such as subsistence agriculture. Indeed, in 2002 nearly half of the poor in Moldova were employed in agriculture. For this reason, productivity growth will remain a dominant concern for policy makers. The observation applies especially to productivity growth in agriculture, discussed in Chapter 2, which is important for poverty reduction in the low income CIS countries.

The risk of becoming poor is substantially higher for the unemployed than for the employed. But the unemployed poor are a modest proportion of the poor, ranging from less than 0.3 percent in

FIGURE 5.4
Real Wage Gains in Southeastern Europe and the CIS



Source: World Bank staff estimates using data from ECA Household Survey Archives.

Note: Average monthly wages are in 2002 U.S. dollars, in purchasing power parities. For Russian Federation data are from 2006 income module Household Budget Survey, and the 2002 Russian Longitudinal Monitoring Survey.

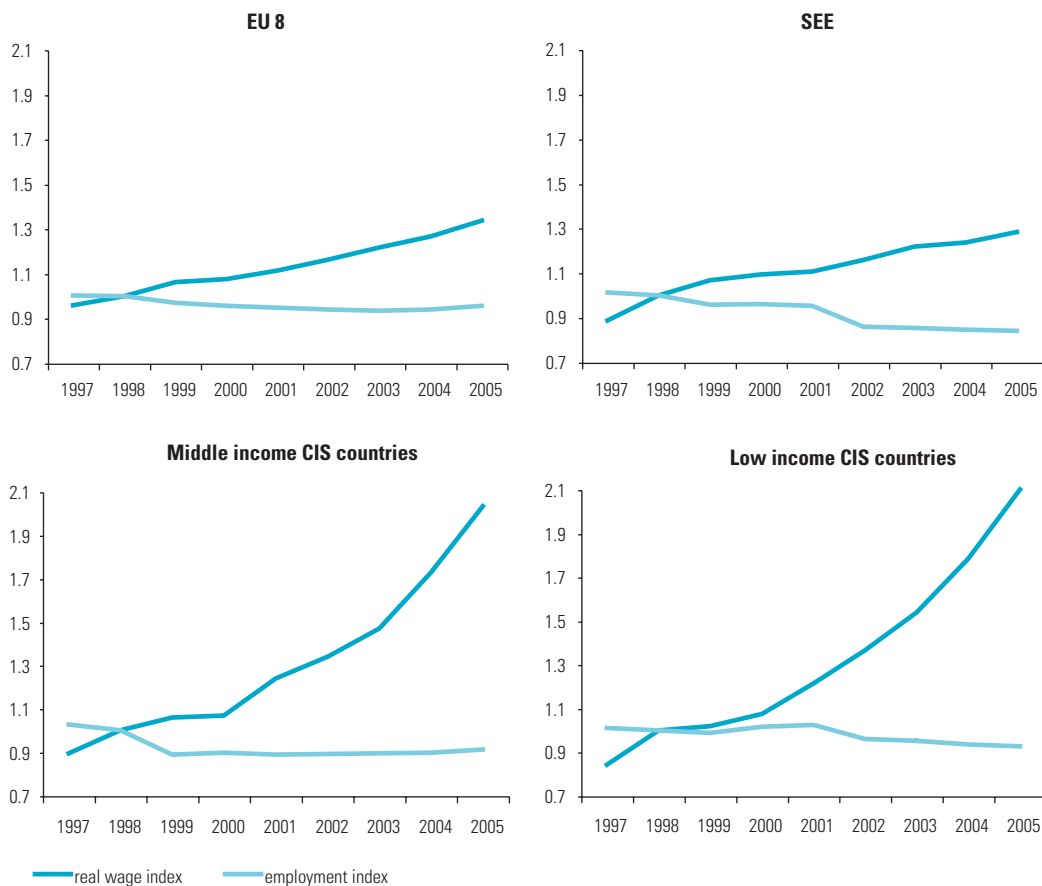
Moldova to 9.4 percent in Romania. And this is despite the fact that in low income CIS countries such as Armenia and the Kyrgyz Republic, where social safety nets are less generous, the proportion of the unemployed without a job for at least a year was 40 percent or more. This suggests that the unemployed retain an informal attachment to the labor market and have benefited from the bounce-back in real wages.

The inactive poor, i.e., those not in the labor force, make up an increasingly significant proportion of the poor in many countries, ranging from 16 percent in the Russian Federation to 34.1 percent in Romania. Furthermore, labor force participation rates are considerably lower than in the EU15 in all transition country groups except

FIGURE 5.5

Real Wage and Net Employment Growth in Transition Countries, 1997–2005

(Indexes, 1998 = 100)



Source: World Bank staff estimates using data from ECA Household Survey Archives.

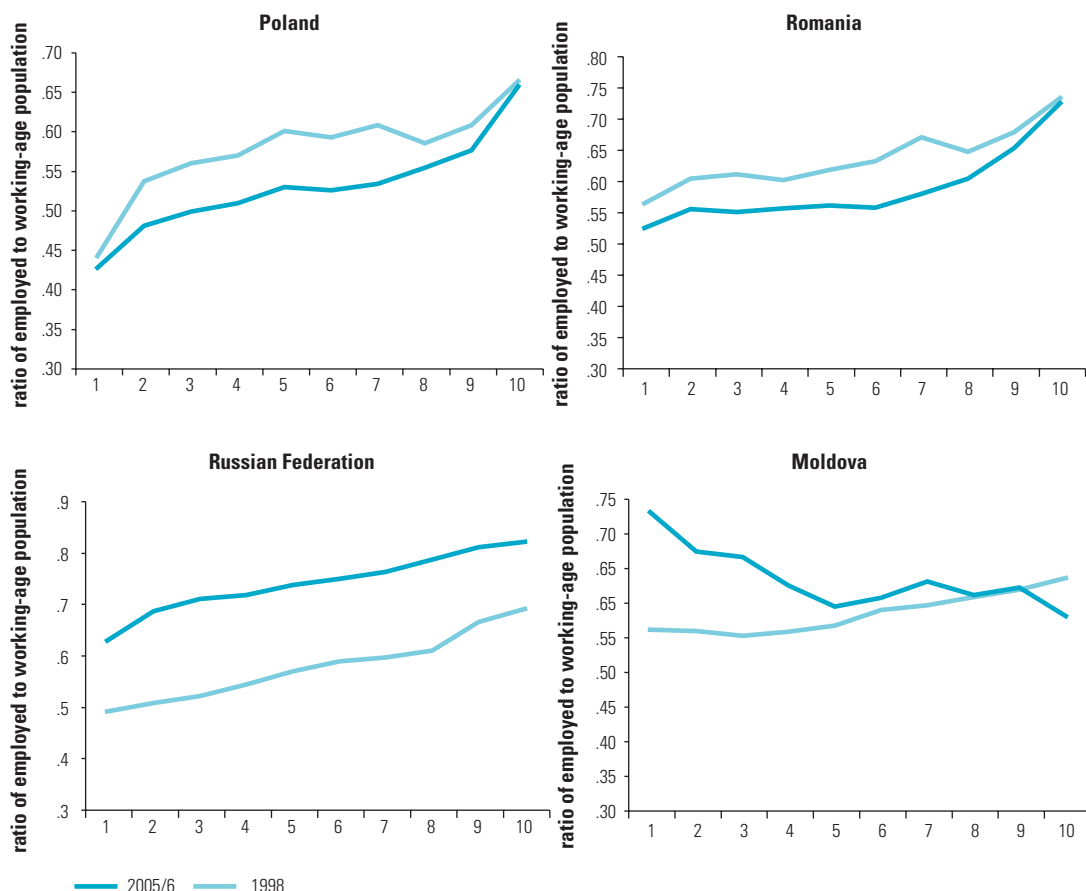
the middle income CIS.⁴ Together, these factors point to the emergence of an underclass dependent on public transfers.

Public Transfers

But the effects of growth on poverty reduction were not confined to the labor market. Social protection transfers to households increased in real per capita terms during 1998–2003, in line with the growth in fiscal revenues. These transfers, together with a reduction in pensions and other arrears, reduced poverty. Given the predominance of pensions in social protection benefits, poverty would have been significantly higher without those benefits, especially outside the low income CIS.

FIGURE 5.6

Changes in Employment Rate, 1998–2005/06, Selected Transition Countries



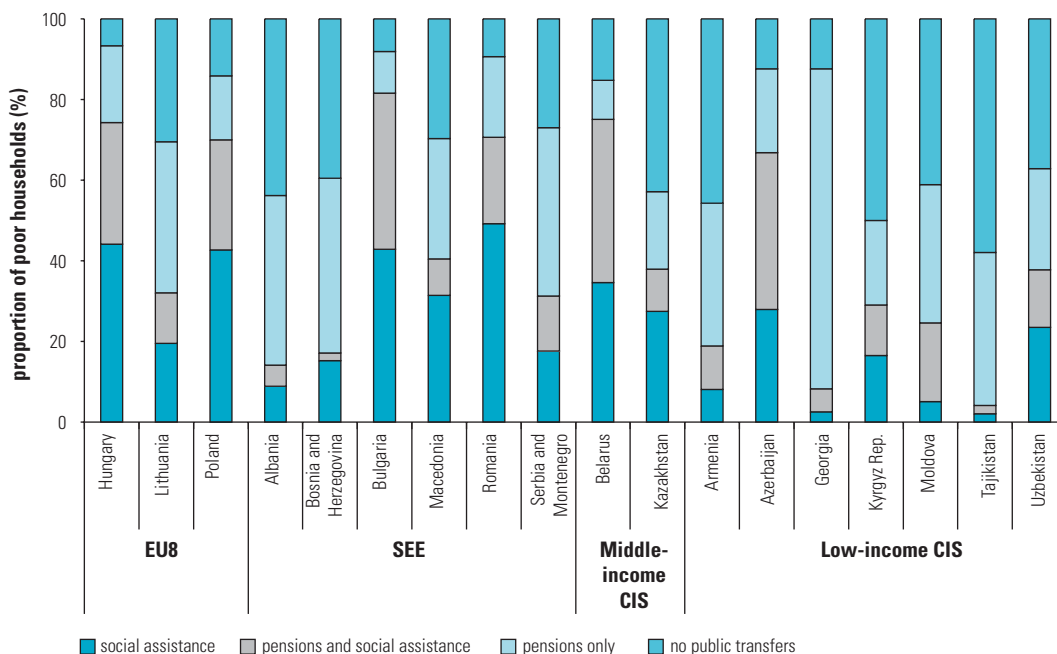
Source: World Bank staff estimates using data from ECA Household Survey Archives.

Social transfers, which include pensions and social assistance, cover the poor quite well. Almost all the poor (based on consumption before transfers) receive some form of social transfer in countries as diverse as Hungary, Belarus, Bulgaria, Georgia, Azerbaijan, and Romania. Coverage rates exceed 50 percent even in the poorest CIS countries, except Tajikistan, where the rate is 40 percent (figure 5.7). But there are differences across countries in the coverage of social assistance programs targeting the poor. These programs reach close to 80 percent of the EU8 and Southeastern Europe, but the coverage rate in the low income CIS countries (except Azerbaijan and Uzbekistan) is around 20 percent.

Private transfers also reduced poverty with remittances playing a prominent role. The European Union (75 percent) and the resource-rich CIS countries (10 percent) are the main sources of remittances

FIGURE 5.7

Coverage of Social Protection by Country Groups, around 2003



Source: World Bank staff estimates using data from ECA Household Surveys Archive; World Bank 2005a.

for Eastern Europe, the CIS, and Turkey. Moldova and Tajikistan have among the largest shares of remittances in GDP (more than 35 percent,) followed by Armenia, Bosnia, and Albania (more than 15 percent).⁵ Indeed, remittances are the second most important source of external financing after foreign direct investment for many countries in the region. They have on average contributed more than 20 percent of the disposable income of the region's poorest households.⁶

Continuing reductions in poverty are possible even without a significant increase in employment. Experience since 1998 shows that productivity growth has been the main driver of poverty reduction, both directly through the labor market and indirectly by making possible more generous safety nets, which help those unable to benefit directly from growth.

Caveats

Despite rapid growth and reduction in income poverty, not all is well. In addition to the 35 million people in absolute poverty, nearly 88 million in 2005-2006 lived on an income of \$2.15-\$4.30 a day in pur-

chasing power parities and, while not absolutely poor, are vulnerable to downturns in economic activity (figure 5.1). Although consumption inequality declined in the region, with the Gini coefficient standing at 0.35 in 2006, it increased in Tajikistan, the poorest country in the region, and in several countries in Southeastern Europe, such as Macedonia, Serbia, and Romania between 1998-99 and 2005-2006.

On the nonincome dimensions of poverty, while male life expectancy and child and maternal mortality are moving in the right direction, progress in reducing mortality has been very slow. There are concerns about the delivery and quality of critical medical services. Some low income CIS countries have been unable to stem the decline in public spending on health or to stabilize it at very low levels. Although the erosion of almost universal primary education that occurred in the 1990s has been reversed and enrollments in secondary education have increased, trends in the quality of education are less sanguine. Despite increases in education spending per capita in many countries, only in the EU8, Bulgaria, Croatia, and Romania were scores in science and mathematics at or higher than the OECD in the Program for International Student Assessment (PISA), which tests 15-year-old students' mastery of higher order skills.⁷

Well-Being in Transition

The recent EBRD-World Bank Life in Transition Survey, which was conducted in 27 transition countries in 2006, shows that satisfaction with life, although well correlated with household expenditure, depends on a number of subjective factors as well. These are self-reported health status, self-assessment of relative economic standing, relative economic status compared to peers, personal perception of improvement in economic status over time and the level of trust in people. Work status is important: the employed are about 16 percent more likely to be satisfied with life than the unemployed. This may be compared with an additional 13 percent of life satisfaction for those with twice the average per capita expenditures, compared to those with half the average per capita expenditure. Hence, the high unemployment and low participation that prevail in many transition countries are taking a toll on individual well-being. This implies that while reduction of income poverty without improved employment prospects is possible, building inclusive societies by directly addressing constraints to higher labor force use, such as skills in the new member states of the European Union, should be an important priority.⁸

Social capital is important as well: those who trust other people are significantly more likely to be satisfied with their lives than those who do not, controlling for other determinants of satisfaction with life. Hence, the erosion of trust associated with the loss of social capital during the transition has affected satisfaction rates adversely in Eastern Europe and the former Soviet Union.

Endnotes

1. The \$4.30 PPP a day standard is however more consistent with national poverty lines in the EU8 countries. A fuller discussion is contained in World Bank (2005a). Use of the higher poverty line leads to a poverty headcount of 15.4 percent in the EU8 countries.
2. The definition of the working poor is based on the work intensity of the household as a whole. If no member of a household with work-capable members worked for even a single day in the reference period, such a household is classified as “jobless”; all other households with employed work-capable members are classified as “working.”
3. Labor force survey data, from which figures 1.1 and 1.2 are constructed, showed total employment in Moldova to be stable between 1999 and 2002, at around 1.5 million, dropping to 1.3 million in 2003. Household survey data, on which Figure 4.6 is based, show however an increase in total employment from 1.5 million in 1998 to 1.6 million in 2003. The likely reason is a more restrictive definition of informal sector unemployment in the labor force survey.
4. Male labor force participation rates are EU8 (72.7%), Southern Europe (71.7%), Middle Income CIS (75.6%), Low Income (73.3%), EU15 (78%). Female labor force participation rates are EU8 (63.1%), South-eastern Europe (56.2%), Middle Income CIS (67.2%), Low Income CIS (58.1%), EU15 (65%).
5. These figures do not take into account the substantial flow of unrecorded remittances. For example, unrecorded remittances in Albania, Bosnia, Moldova, Serbia, and Montenegro more than offset the large current account deficits of those countries.
6. A detailed analysis of migration and remittances is in World Bank (2006b).
7. Some aspects of access to and quality of education, health care, safe water, and heating in the transition countries are discussed in World Bank (2005a).
8. See also EBRD (2007) for a detailed description of the survey as well as a summary of its main findings. The comparisons on work status and trust in people are developed in Alam, Mitra and Zaidi (2008).