

Coping with the Crisis

A. Introduction

The resilience of households to macroeconomic shocks ultimately depends upon the economy's institutional readiness, the flexibility of the economic policy regime, and the ability of the population to adjust. Policy and institutional preparedness is essential so that countries can manage the adverse social impacts of macroeconomic shocks. This requires ex ante analysis of risks, a good understanding of their possible transmission channels if triggered, and their possible impacts on households; approaches that ensure that the state does not intervene excessively in terms of detrimental longer-term distortions to incentives or fiscal sustainability; and a comprehensive social safety net system that provides for countercyclical and scalable interventions.

This chapter looks at how the impact of the various shocks arising from the crisis on household welfare may be offset by households' own coping strategies and by social safety net systems. It will also assess some key constraints

in the policy response to the crisis, drawing from some recent analyses of fiscal space and the availability of fiscal resources and a recent assessment of the performance of social protection programs in ECA countries. Finally, it will provide examples of possible policy responses to mitigate the impact of the crisis, by type of shock to households. The options for policy responses covered here are by no means exhaustive. They are discussed below mainly for illustrative purposes.

B. Household Responses: Lessons from the ECA Experience

Over the transition period, a growing literature has documented patterns of self-insurance, informal insurance, and informal risk pooling in ECA. They have also chronicled household strategies for coping with economic shocks, including borrowing, migration, substitution of consumption toward less expensive goods, and engaging in risky or illegal activities. Such

strategies and risk mitigation mechanisms may be disproportionately concentrated among certain groups of households, depending on their region of residence, income, and social capital.

Households in ECA have employed a variety of coping strategies to smooth consumption during previous crisis periods. Some of these strategies correspond to what is referred to in the literature as “risk management.”⁶³ These include household members holding jobs with uncorrelated risks, either domestically or through migration of family members to foreign countries. Other strategies, such as dissaving, including asset liquidation, and borrowing where possible, smooth consumption over time and still other strategies share risks across households (inter-household private transfers). Generally, the empirical literature rejects the existence of full consumption insurance, whereby temporary income fluctuations have no effect on consumption, but does provide some support to partial consumption smoothing, whereby consumption changes are smaller than income changes. This implies that, in general, households in the region were successful, albeit only partially, in protecting their welfare through crisis times by relying on a variety of coping strategies as described in more detail below.⁶⁴

Labor supply adjustments. In response to falling income due to the effects of a macroeconomic shock, a household can increase its involvement in the labor market. Those already employed can increase their hours worked, or find secondary employment. Other members of the household can transition out of inactivity in order to supplement household income. Existing studies of Bulgaria, Russia, and Turkey indicate that, in general, labor supply adjustments have not allowed households in the ECA region to preserve their pre-crisis welfare levels. The proportion of households that found secondary employment is small and the earnings were generally insufficient to compensate for the loss of income from primary jobs.

Migration. As local employment opportunities decline, one option would be to relocate to a region with better labor market conditions. Labor migration can be internal or international, and it can involve either the whole household or only some of its working-age members. The necessary conditions for the effectiveness of this coping strategy are labor market flexibility and the ability and willingness of workers to move to locations with jobs plus a host region likely to provide sufficient labor income gains to offset migration costs. In the years following the Russian crisis, for example, many Moldovans migrated abroad in search of employment opportunities and better living conditions. Studies of household behavior during the early transition period in Kazakhstan also found that migration responded almost immediately to movements in relative exchange rates and to systemic crises, such as the 1998 Russian financial crisis. However, wage differentials and differences in construction activity have been found to take a longer time in influencing migration patterns. A recent study of Turkey found that rural-to-urban migration has been the most important informal coping strategy, leading to increased urbanization in all regions of Turkey. The broad-based nature of the ongoing downturn, affecting both traditional host and source countries, is clearly an important determinant of the effectiveness of this coping strategy in the current economic environment.

Subsistence Farming. Households that have access to private land plots can use them to supplement their income by selling the home-produced goods or to augment their own consumption with such home production. Studies of household behavior in Bulgaria, Russia, and Turkey during previous crises observe that subsistence farming has often been employed by households to supplement their food consumption. However, it has also been found to be an ineffective coping strategy to address vulnerabilities in non-food consumption, or in lifting households out of poverty.

Dissaving/Borrowing and Asset Liquidation. By saving a portion of its income flow in good times and dissaving (or borrowing) in bad times, a household can minimize consumption variability in the presence of income fluctuations. The same principle applies to the accumulation of assets (such as housing, durables, production equipment) in good times and the sale of such assets in bad times. Of course, the usefulness of this strategy depends on households' access to credit markets and their ability to dispose of their assets after a macroeconomic shock. For example, many households in Turkey turned to selling their assets during the 2001 crisis. About 20 percent of households reported selling assets and valuables. However, it has also been suggested that proceeds from such asset sales were meager due to insufficient demand for assets held by the poor. This is similar to the phenomenon of asset "fire-sales" in financial markets potentially yielding prices below fundamental values (and a wealth redistribution from net sellers to buyers). In addition, as highlighted in the discussion of household indebtedness, household gross asset positions may be associated with financial liabilities such as mortgages, thus limiting the potential net gains from such sales (or even leading to potential net losses as in the case of negative mortgage equity).

Private transfers. Besides turning to the government for assistance, households suffering from the impacts of an economic shock can turn for help to friends and family. If the shock does not affect households equally—that is, more technically, if the idiosyncratic component of the economic shock is large compared to the covariate component—then households can reduce consumption volatility through inter-household transfers, flowing from less affected households to more affected households. In ECA, private transfers have been found to be an important buffer against household income and consumption volatility. However, macroeconomic crises decrease the likelihood that a

household will be able to use this strategy effectively, since a widespread shock would, by definition, affect most people in that household's social network. Moreover, some marginalized groups, such as ethnic minorities, are often excluded from the informal support networks available to other households.

Compared to previous crises, the scope for households to engage in their traditional coping strategies may be more limited. During previous crises, households found secondary employment, relied on transfers from friends and families, or left for work abroad to augment family income. Because of the global nature of the crisis, and because macroeconomic shocks are hitting households on multiple fronts, these coping strategies may no longer be feasible.

For the poorest households, subsistence farming may be a viable strategy, though evidence from the recent food price shock suggests that many of the poorest households do not have access to agricultural assets and inputs. For some, transitions into informal sector employment may be possible though, for many households, earnings from informal sector activity will likely be insufficient to offset the poverty impact of the crisis.

C. Context: Policy Response, Government Resources, and Constraints

Overall Fiscal Envelope

The ability of many governments in ECA to respond to the crisis—such as by increasing social transfers—is generally constrained by rising government deficits. Between 2007 and 2009, on average, deficits in percent of GDP are projected to rise by about 3 percentage points. There are marked variations across countries, with Estonia, Montenegro, and Russia at the higher end of this distribution, while Belarus, Hungary, and Georgia are at the lower end of the distribution. Nonetheless, for many countries, fiscal policy responses to the crisis will likely be

mented by rising deficits that have become much more difficult to finance. It would be essential to first determine the overall fiscal adjustment warranted for macroeconomic stability and debt sustainability, taking into account initial conditions and the likely impact of the crisis on public finances.⁶⁵ Economies that experienced strong initial fiscal and external positions are likely to have more room for expansionary fiscal policy and can afford a fiscal stimulus package, while those with weaker initial positions may require substantial fiscal adjustment. Other features of a country's macroeconomic policies are also important. For example, countries with fixed exchange rates will have to depend more on fiscal policy, rather than monetary policy, for adjustment.

A recent analysis in fact suggests that there are likely large shortfalls in education and health spending worldwide due to the growth slowdown.⁶⁶ ECA countries, as a group, will require the largest outlays, compared with other regions, to protect their planned expenditures in education and health services. With

regard to relative fiscal constraints, ECA is in a better position. However, there is still potentially a large shortfall in education and health spending among countries with little fiscal capacity and it is not likely to be financed by donor resources.

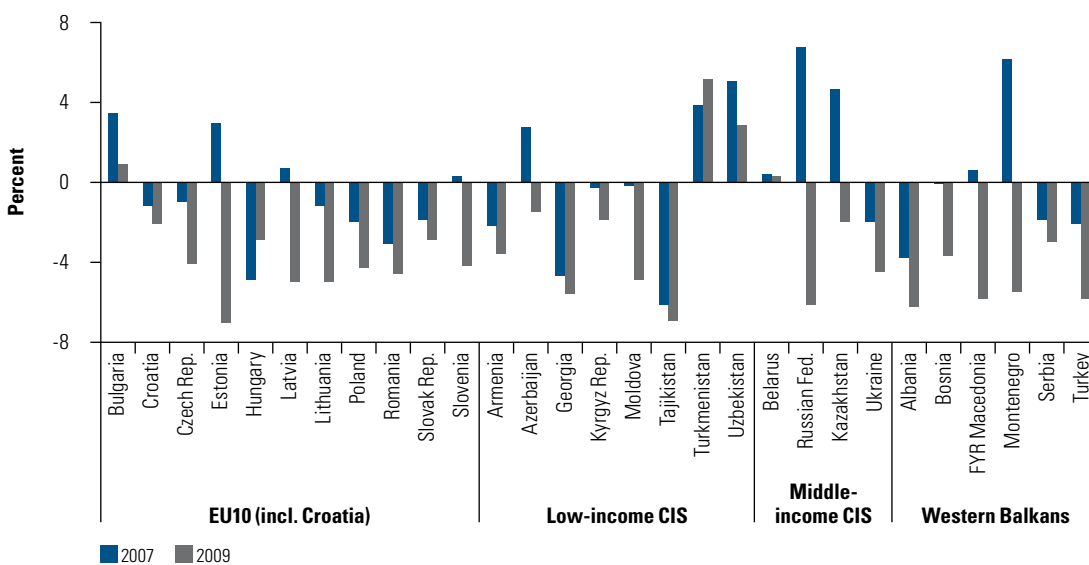
Where there are no new official or alternative sources of financing, or where there is little scope to mobilize revenues, some countries may resort to across-the-board cuts in public spending.⁶⁷ Although social safety nets will be among those items likely to be cut as revenues fall, protecting these programs—and possibly expanding some of them, where some reallocation of resources is possible—will be an important element in the response to the crisis.

The prioritization of labor-using investment expenditures—either from countries' own budgets or from resources provided by donors—could be one option for addressing the labor market consequences of the crisis while accounting for constrained fiscal resources. Such investments could include rural roads projects or irrigation systems rehabilitation

FIGURE 3.1

General Government Balances in ECA, 2007 and 2009

In percent of GDP



Source: IMF WEO database (April 2009).

projects that can create short-term employment opportunities while creating the conditions for longer-term growth. Improving the efficiency of public spending may also create some additional fiscal space.

Existing Social Protection Systems⁶⁸

Countries in the region operate a combination of safety net programs. The programs are typically in the form of cash transfers with an emphasis on family allowances (such as child allowances), social pensions, heating and housing allowances, and targeted anti-poverty programs. Some countries in ECA have yet to reform a range of categorical benefits and subsidies left over from the pre-transition period. Across countries, multiple programs exist, leading to the fragmentation and duplication of benefits.

The region's social protection systems currently vary in size and targeting performance across countries. The results of comparing the targeting performance of selected social assistance benefits across countries suggest that Lithuania, Ukraine, and Turkey are among the countries with the bulk of social benefits reaching the poorest households. At the lower end are countries where only 40 percent of the social benefits reach the poorest quintile. However, most countries in the region have at least one targeted safety net program that can possibly be scaled-up in response to the crisis. Expanding such programs can take place either by increasing the value of benefits they provide or by expanding their coverage to reach those households still currently outside the system. However, in some countries, including Belarus, Bosnia, Hungary, Kazakhstan, Moldova, and Russia, the targeting performance of existing programs remains weak.

Depending on a country's initial conditions, the response to the crisis in terms of social assistance may involve expanding some well-performing programs, reforming relatively less effective interventions, or, alternatively,

introducing new programs as appropriate. The experiences of other countries suggest that programs such as conditional cash transfers (CCTs),⁶⁹ workfare schemes, and public works programs can be effective instruments for protecting the vulnerable from immediate as well as longer-term (second-round) consequences of transitory shocks on nonincome dimensions of welfare, including human capital accumulation.

D. Immediate Policy Responses: Some Illustrations

This section provides illustrations of potential policy responses and instruments for mitigating the poverty and social impact of the crisis. The examples are organized by type of shock to households. The treatment of the topic is not comprehensive and the options listed are by no means exhaustive. The options are instead discussed below for illustrative purposes.

Across various policy instruments and social protection programs, there are a number of important considerations. The primary consideration would of course be the appropriate role for the government—whether the government responds to the crisis through expenditure policy, tax policy, or regulatory policy. Another important consideration would be the fiscal cost of a program, the administrative ease with which it can be implemented, and the incentives it creates. It will also be important to consider whether a program should have universal coverage, or whether it should be narrowly targeted or self-targeted. As explained below, country-specific resources and institutions will drive the relative merits of these instruments.

Credit Market Shocks

In countries where households are experiencing rising debt service burdens, governments may have to consider facilitating the restructuring

of household debt in default.⁷⁰ In many ECA countries where banks currently have limited capital buffers, bank responses to rising non-performing loans have focused on extending grace periods. However, without the certainty of a rapid economic recovery, these restructuring strategies effectively postpone problems into the near future. This creates substantial risks of under-provisioning and inadequate recognition of losses and thus of over-estimating bank solvency.

There is a role for governments to provide incentives for proper debt restructuring. Defining the right framework is challenging as it requires balancing competing pressures on banks, households, and the government in a way that is fiscally affordable, creates minimal market disruption, is socially acceptable, and allows banks to remain solvent and able to resume lending in the medium term.

A template for government-assisted household debt restructuring has been proposed recently.⁷¹ The authors advocate a restructuring program that reflects some essential features including simplicity and limited scope, as well as participation on a voluntary basis, among other features. They consider two general approaches, one involving the creation of a legal and institutional framework that can underpin case-by-case debt restructuring. The other approach is based on some form of financial assistance by the government.

The estimated cost of providing financial assistance to indebted households at risk of default is relatively modest, on average, though with variations across countries. Simple calculations can be made for the cost of compensating indebted households who are subjected to an interest rate shock in Estonia, Hungary, and Lithuania and an exchange rate shock in Hungary and Ukraine. This is based on the assumption that *all* households are fully compensated for the increase in the debt service burden resulting from the shock. In Estonia, Hungary, and Lithuania, the implied costs of

an interest rate shock are 0.44, 0.19, and 0.17 percent of GDP, respectively, equivalent to about 29 percent, 6 percent, and 12 percent of the social assistance budget, respectively. In Hungary and Ukraine, the compensation for an exchange rate shock is 0.04 and 0.22 percent of GDP, respectively, equivalent to about 2 and 15 percent of the social assistance budget, respectively.⁷² In general, these are relatively small sums, except in Estonia. The share of indebted households in these countries that is still not as large as those in more advanced economies likely drives this.

On the other hand, the fiscal cost of assisting severely indebted households may be an underestimate for a number of reasons. First, the SILC-based calculations (Estonia, Hungary, and Lithuania) include mortgage interest payments only, because SILC data allows us only to assess the rising cost of mortgage debt service. Taking all of household debt service costs together may then yield a much bigger sum. Second, the risk exposure varies by type of household debt. In Hungary, in particular, we know from central bank data that the exchange rate exposure of consumer loans is much larger than the exchange rate exposure of housing loans (60 percent versus 84 percent at the end of 2008). The SILC and Ukraine data are for 2007 and our calculations are based on households reporting themselves as indebted. Between 2007 and 2008, the pool of indebted households may have expanded further.

External Price Shocks

Increases in the domestic prices of energy and food pose both short- and long-term challenges for policymakers.⁷³ In the current environment, the short-run inflationary pass-through of higher imported food and energy prices, including those due to exchange rate effects, may be offset by falling domestic demand as economic activity weakens. However, managing inflation using appropriate policy instruments remains important. The full pass-through of

price increases to consumers avoids introducing distortions into productive incentives, with support for vulnerable households to be provided by appropriate, well-targeted social assistance within the constraints imposed by a country's fiscal space. A country may also opt for a gradual phase-in of energy tariff adjustments, where the price increases required by adjustment toward full cost recovery may be too steep.

The ECA region's previous experience with energy tariff adjustments suggests that direct transfers or tariff-based subsidies can play an important role in protecting poor households.⁷⁴ There is ongoing debate on the comparative merits of direct transfers and tariff-based subsidies, such as a lifeline tariff or charging a lower tariff for an initial minimum level of energy consumption. Opponents of lifeline tariffs suggest that they are expensive and, for at least the initial block of, for example, electricity consumption, such lifeline tariffs subsidize both poor and nonpoor consumers alike. However, supporters of lifeline tariffs argue that where poverty is prevalent, where there is close to universal access to network energy, and where social transfers are not well targeted, there is a case to be made for tariff-based subsidies.

It is also important that policy responses do not conflict with the key longer-term reform agenda. For example, authorities should guard against reversal of efforts to lower quasi-fiscal deficits in the energy sector, which is an ongoing challenge in many ECA countries. It will also be critical to maintain an open and transparent trading regime. Although some countries within ECA adopted restrictive trade and price controls in response to the food price increases in 2007, many of them have now been reversed. For example, Ukraine eliminated its export quotas in June 2008 and Kazakhstan lifted its export ban in September 2008. At the same time, work needs to continue toward medium- to longer-term goals for improving the policy environment for agricultural productivity growth,

improving energy efficiency, and strengthening social safety nets and other risk mitigation systems. Finally, communication to the public of the policy choices adopted to address the impact of higher energy and food prices, and the various trade-offs which are involved, may help build broader constituencies in support of the adopted policies.

Income and Employment Shocks

The unemployment insurance system, the main tool for addressing rising unemployment, may not be sufficient to mitigate the impact of the crisis. In fact, the unemployment insurance system itself may suffer from several limitations, including weak incentives for reducing welfare dependency or for job search. Benefit durations are long and can be expensive. Moreover, none of the existing programs are available for returning migrant workers, for example due to a lack of work history necessary for unemployment insurance or a lack of permanent residence required for social assistance. This suggests that it may be worthwhile to consider alternative approaches to social protection.

More generally, the global crisis will probably create "the new poor," or households that may be among those in higher income quintiles in the pre-crisis period but made poor by shocks to their income flows, liabilities, or consumption. These households will likely not be reached immediately by existing social protection programs.

Public works programs were an important component of the overall safety net package in Argentina, Mexico, Korea, and Thailand during the so-called Tequila Crisis of 1995 and the 1997 East Asian crisis. Public workfare programs generally played an important role in mitigating the negative effects of the macroeconomic crises in these countries, though its relative role varied depending on the effects of the crisis on the labor market. With the exception of Mexico, income gains from public workfare programs were significant in these cases. For

example, in Korea the main reason for launching a workfare program was the very sharp increase in unemployment, in both formal and informal sectors, because of the crisis. The rate of unemployment increased from about 2 percent prior to the crisis to 9.3 percent barely six months into the crisis. Not surprisingly, public works in Korea played a dominant role in providing immediate short-term employment opportunities at low wages. In contrast, in Mexico the labor market impact of the crisis was a dramatic fall in the real incomes of workers, with relatively more limited job losses. A cash income support program (*Progres*a) played a major role in social protection, with public works playing only a subsidiary role.

The ECA region's experience with workfare has been relatively limited. To date, simple, non-randomized evaluations are available for only four countries: Bulgaria, the Slovak Republic, Slovenia, and Poland.⁷⁵ These countries' experiences with workfare are summarized in Box 4.

A broader use of workfare in the region faces a number of constraints. First, workers in most countries in the region have access to unemployment insurance. Second, unemployment rates are quite high in some countries even during non-crisis periods. Third, most unemployed are long-term unemployed, with some looking for jobs for over two years, in contrast to many developing countries. Fourth, a uniform application of any policy across the region is not feasible given tremendous diversity within the region in terms of income, degree of urbanization, dependence on agriculture or manufacturing, and so on. Fifth, in many countries over a long period, there has been substantial emphasis on workers' rights, trade unions have been strong and influential, and the attitude toward a downward adjustment of wages has been generally hostile. By contrast, in more decentralized countries such as Argentina (and South Africa) there was less resistance to low wages, particularly

when communities are fully informed about program goals. Sixth, the term "public works" is often mistakenly associated with "forced labor." Indeed, in some countries the two terms have been used synonymously for years. Not surprisingly, workfare programs are not viewed favorably in the region. Finally, at the implementation level, it is common practice to use contractors. This creates its own problems, and requires careful attention to the tendering process and even greater attention to monitoring.

Given these constraints, what role can public works program play in ECA? With respect to the low-income countries in the region, public works program may have considerable merit. These countries have significant seasonal shortfalls in employment (during agricultural slack seasons). In addition, given very low yields of main agricultural crops, productivity-enhancing works, including the construction of rural infrastructure, have a role to play to promote agriculture productivity. Moreover, the design features of public works programs can be modified and adjusted relatively easily to suit this class of countries.

In contrast, the introduction of public works programs in the lower-middle- and upper-middle-income countries of the region requires more careful design and adjustment. For example, the central design feature of programs—the wage rate—needs to be set carefully, so that the level is higher than the unemployment benefit but lower than the prevailing market wage rate. In order for the program to be attractive to skilled and semi-skilled labor, projects need to be carefully selected to accommodate labor of varying skills, as was done, for example, in Korea.

The use of contractors to execute public works programs may pose a challenge, but there are suitable alternatives. In general, countries have followed two approaches: One option is to avoid using contractors at all (such as in Korea and Argentina) and let local governments and

communities implement the program instead. Alternatively, a program can use contractors under a regulatory framework, which has taken several forms. For example, governments could fix the share of labor in each specific contract (say 30 percent wage cost in a road repair project) in the tendering process, and enforce it. Another option would be to provide a list of laborers in each locality that contractors could hire for any specific activity. Contractors provide a weekly report to the government on the number and names of persons working on a specific project, and the government will then transfer wages direct into the bank accounts of laborers. A third approach is to provide appropriate incentives in the tendering process: ask contractors to specify the share of labor cost in each project that they plan to execute, with the proviso that this would be one of the selection criteria. The chosen bid can then be the one that promises to meet quality standards and promises to use the highest labor share in total cost. This needs to be enforced and monitored on a weekly or monthly basis. In all of the above approaches, the government fixes the level of the wage and contractors have to follow accordingly. Clearly, in any of the above scenarios, contractors do not have the freedom to offer a wage that is different from the one fixed by the government.

Another difficulty could be market wages that are below the statutory minimum wage. Because governments cannot offer a wage less than the statutory minimum wage, this becomes a challenge. Argentina stated in its program document that what is provided is not a wage, technically, but compensation. However, contractors may refuse to offer a wage less than the minimum wage, even if the minimum wage were higher than the prevailing market wage.

Finally, contractors may bring in their own labor gangs to work on a project, instead of using local labor. To avoid this scenario, the appropriate requirements need to be specified clearly in the tender. In a depressed region with

a high unemployment rate, contractors have to use available local labor, and only if such local labor is unavailable are contractors legally allowed to bring in labor from outside a region. This is not easy and tendering bids may be slower than otherwise. Clearly, if contractors are used, “self-selection” as a method of targeting may not be feasible and so other approaches to targeting need to be explored.

In sum, the following sequential decisions need to be taken: (i) Decide on whether a public works program is the right option. If so, what is the balance between public works and other programs already in place? (ii) When public works is chosen, decide on the specific design aspects critical for success for the chosen country. (iii) Decide on the implementation modalities. (iv) Finally, institute a credible monitoring and evaluation system. Regardless of which program is chosen, post-crisis settings require that full attention be paid to selecting the right targeting instrument to reach the intended groups, exploring possibilities for quickly scaling up the program throughout the country without compromising on the quality, and considering exit strategies upfront before launching any program.

E. Longer-Term Policy Responses

Over the longer term, there are various measures for limiting the risks borne by households as financial markets deepen. These include measures affecting both the demand- and supply-side of household financial products. In terms of the demand-side, promoting financial literacy may help households to understand the risks they expose themselves to because of their consumption, employment, borrowing, and asset portfolio choices. Addressing the supply-side dimension potentially incorporates a whole host of macro-financial policy measures.

Detailed examination of such measures is not within the scope of this report, but in its discussion of the generic policy implications of

BOX 4**Public Works Programs in ECA**

Bulgaria. Bulgaria launched its public works program in 2002 in response to high long-term unemployment and a perceived heavy dependence of government beneficiaries on social assistance. The program aimed to promote a more “active” approach to social assistance. The benefit comprised a minimum monthly salary plus social insurance plus health insurance, but not unemployment insurance. Wages were set around 125 Leva (around \$60) when the minimum wage was 110 Leva, but those employed had to give up social assistance benefits (40 Leva, on average, in 2002). The net wage cost of the program to the government was about 80 Leva per participant. Projects executed under the public works program included community infrastructure (construction and renovation), afforestation, and other environmentally useful tasks. Tripartite labor councils at the local and regional level selected project proposals based on bidding procedures. A training component was included, but few workers chose to participate. The long-term unemployed were given priority, and refusal to participate in workfare meant being dropped out of the social assistance beneficiary list. Several ministries are involved in its implementation. In 2003, 117,800 temporary jobs were created, and 79,400 persons were absorbed.

The program was recently evaluated⁷⁶ and several findings emerged. First, the program reduced unemployment spells among the long-term unemployed, thus preventing further deterioration of skills and work ethics. Second, by far the largest positive gain observed was with respect to self-confidence and job-search motivation. Third, completed projects and services were found to be of use to communities. One reason for the attractiveness of the program was that (eligible) participants received pensions, and all participants were covered by health insurance. At the same time, the program also suffered from many weaknesses. For example, only 8 percent of participants managed to get a job quickly in the private sector, mainly because of a lack of attention to training. Employers preferred those who underwent on-the-job training (only about 8 percent underwent such training). In addition, private firms and nongovernmental organizations (NGOs) that implemented public works were found to have trained their workers more compared to municipalities.

The **Slovak Republic** introduced public works in 1992, known as “socially purposeful jobs” (SPJ) and “publicly useful jobs” (PUJ). The two programs continued with some modifications through 1997–98. In the beginning, there was no emphasis on training but in 1997, both programs were reformed. Retraining was emphasized, and more attention was paid to targeting specific groups such as the disabled, long-term unemployed, young workers, and school leavers. SPJ and PUJ were then formally combined into a single program. Jobs were provided for workers of all skill levels. An assessment⁷⁷ of this program found that the vast majority of workers (90 percent of the total) had a higher transition rate to a regular job after participation in the program, although a few workers (10 percent of the total) had a lower transition rate. In general, female, lower educated, and older unemployed workers have had much greater difficulty in accessing regular jobs. The exit rate from PUJ jobs was quite high, mainly due to the positive effect of the retraining provided.

BOX 4 (continued)

Public Works Programs in ECA

Slovenia also introduced public works during 1992–96, in response to rising unemployment in the early 1990s. There was heavy reliance on public works, partly because of the limited success of other programs. The program consisted of creating jobs for the unemployed under the auspices of a public or a non-profit (NGO) organization. Projects were required to provide useful services or build infrastructure of use to communities. Jobs were for a period of one year. The objectives were to help workers maintain their workforce attachment and prevent the erosion of their human capital. The contractors (selected via a tendering process) organized and carried out public works as well as provided mentoring and training as needed. In comparison with programs in Hungary and Poland, Slovenian public works attracted significantly more educated participants and younger workers, and the program was more innovative. An assessment⁷⁸ concluded that Slovenian public works participants immediately found a job upon completing the program.

Poland implemented active labor market programs (ALMP) consisting of training and retraining and programs to enhance human capital, along with public works. A systematic evaluation of Polish ALMP showed training and retraining performed well, with the post-treatment employment rates of both female and male participants observed to be higher than those who did not participate in the program. By contrast, the public works program suffered from major distortions, mainly because of “benefit churning” and lack of attention to proper calibration of various benefits (unemployment compensation) and wage levels. In addition, program officials felt male heads of households deserved sustained income support, which in turn adversely affected the functioning of the public works program.⁷⁹

Some important lessons emerge from the Polish experience. First, greater emphasis should have been given to the training of the long-term unemployed while they were employed in public works. Second, the careful monitoring of employer behavior should have been incorporated into the program, to curb abuses of hiring cheap labor under the program. Third, distortions in the functioning of programs should have been minimized by carefully calibrating program benefits (wage levels) with other benefits such as unemployment compensation.

household credit growth in emerging market countries, the IMF highlighted five key policy areas that can help to limit related financial stability risks.⁸⁰ These include prudent macro-economic management to minimize the potential future likelihood of interest rate, exchange rate, and income shocks to households. The second set of measures relates to the usage of macro-prudential norms, such as on loan-to-value or debt-service-to-income ratios. The third area concerns improvements to the overall legal environment and infrastructure, such

as in sharing credit information and effective enforcement of collateral. The fourth area relates to enhanced data availability on the risks in household credit portfolios both in aggregate and individually. Finally, as highlighted in the various trade-offs discussed throughout this report, authorities should recognize the potential impact on households of traditional economic management policy measures, such as exchange rate and interest rate adjustments.

Many of these generic policy messages have clear resonance for countries within

ECA. For example, while a number of countries within the EU10 have taken measures to limit the extent of foreign currency borrowing by households, a recent analysis found that they might have had only limited effects.⁸¹ In particular, the analysis finds that while such measures appeared to influence the extent of foreign currency credit channeled through the domestic financial system, they may have had the effect of shifting borrowing toward non-resident financial institutions. This highlights the need to adopt a combination of policies, at both the macro-financial and household levels, to help mitigate the potential risks associated with increased household credit growth, for example relating to foreign currency or variable interest rate loans. The exact combination of policy measures that is appropriate to allow for the benefits of household credit growth while limiting the potential associated risks will depend on country circumstances.

Diversified sources of economic growth will also be critical in helping dampen ECA countries' vulnerability to macroeconomic shocks. In some ECA countries, recent growth performance has been underpinned by economic activity concentrated in a few sectors, such as the housing sector, or income flows from some dominant source, such as migrant labor.

Monitoring systems are important. Guaranteeing that statistical monitoring systems are in place and that relevant household data are collected regularly and made available for analyses are important measures for ensuring that household vulnerabilities are understood in a timely manner. Such monitoring systems can also help identify households at risk and ensure that they can be reached by a country's social protection system. The monitoring of vulnerabilities could include risks in household credit portfolios, as discussed previously.