Chapter 9

Providing Greater Security[1]

Equity and income security were the cornerstones of the socialist system. These objectives were achieved through an equitable wage structure, guaranteed employment, and wide-ranging subsidies on basic consumer goods and enterprise-provided services. Explicit social protection programs were essentially limited to public pension systems that provided generous benefits to the retired and social assistance programs that helped those with special needs, such as the disabled and orphans. Extensive privileges were also available to particular groups as a reward for their contribution to society (for example, veterans and teachers) or because of the hardship or danger imposed by their occupation (for example, miners).

With the transition to market, the guaranteed employment, retirement security, and consumer subsidies promised by the socialist system diminished substantially at the same time that the real incomes of households fell. By and large, Central and Eastern European countries used cash assistance programs to provide income support to the growing number of poor, and they relied on early retirement and unemployment insurance programs to facilitate the layoff of a large number of workers (Garibaldi and Brixiova 1997). In the Commonwealth of Independent States (CIS), however, the state continued to protect employment by not imposing hard budget constraints on enterprises, and it adjusted subsidies for housing and utilities in response to rising prices. Cash assistance programs and unemployment insurance programs have been less important.

Despite expansion, existing social programs have only had varied success in reaching the poor. Central and Eastern European countries have spent a larger share of their gross domestic product on social programs, but many of these programs—with the exception of pensions—have had a limited impact on poverty. In the CIS, and in some countries in Central and South Eastern Europe and the Baltics (CSB), high rates of inflation have eroded the value of benefits provided by most programs, and the few benefits that exist on paper are often provided in arrears or sometimes not at all. Across the region utility and housing subsidies have primarily gone to the nonpoor. They impose a heavy burden on the budget but are politically difficult to remove. In virtually all countries, groups dependent on institutionalized care live in miserable conditions made worse by dwindling levels of public support.

What are the key objectives for social protection programs in the future? Most societies would like to help the most destitute and ensure that children's mental and physical development is not impaired. This ought to be the overriding objective of social protection programs. Indeed, for very poor countries this may be all that they can afford. Substantial reforms of social protection systems will be required to achieve this objective. As the level of income increases, countries may be able to afford to do more. The state can play an important role in insuring individuals against the loss of income from unemployment through unemployment insurance programs and in helping individuals smooth income over the life cycle through pension schemes.

An Overview of the Most Important Social Protection Programs

The main types of cash assistance provided by transition countries are child allowances and (means-tested) social assistance.[2] *Family and child benefits* were the most common form of cash benefits before the transition. As poverty worsened in transition countries, child allowances became a key instrument used by the government to reduce the impoverishment of the population. Some countries (Romania and Estonia) have introduced universal child allowances. Others have targeted previously universal benefits (Poland, Belarus, Russia) or introduced new targeted benefits (Czech Republic, Lithuania). Still others, under fiscal pressure, have sharply reduced real benefits (the former Yugoslav Republic of Macedonia) or eliminated child allowances altogether (Armenia, Georgia). In Romania child benefits are now conditional on participation in school. The design of benefits has varied as well. Often benefits are differentiated according to the number and age of children (Romania), the presence of a single mother, and location.

In the early 1990s many countries began to introduce or broaden *poverty cash benefit programs* to supplement child allowance programs. Poverty cash benefit programs were intended to address the needs of the newly emerging groups of poor who did not qualify for help under the existing pension and child allowance programs or under newly created unemployment insurance programs—namely, the long-term unemployed and those who had exhausted other benefits, the elderly poor with very low pensions or none at all, and families without children. Poland, Hungary, and the Czech and Slovak Republics passed new legislation on social assistance in the early 1990s that built upon existing programs. FYR Macedonia, Estonia, and Latvia introduced new means-tested social assistance programs in the early 1990s, and in 1995 the Kyrgyz Republic was the first country in the former Soviet Union (FSU) to adopt a national poverty benefit.[3] Recently, Armenia and Georgia replaced child allowances with a single cash poverty benefit.

Many countries also introduced a variety of *utility price subsidization mechanisms* to help consumers cope with rising utility prices during the 1990s. Gas, electricity, and heat prices were set particularly low during the socialist era. But by the mid-1990s these low household utility tariffs became unsustainable: the budgets of many countries in Europe and Central Asia lacked the resources to cover the costs of price subsidies, and the utilities found it increasingly difficult to shoulder the losses associated with low residential tariffs. Most countries have adjusted prices slowly, often at the expense of making needed investments in infrastructure to keep the utility services running smoothly and efficiently. To protect the poor, governments used other policies as well. "No disconnection" policies are quite usual in South Eastern Europe and in the former Soviet Union, although they are less common in Central and Eastern European countries. Most countries in Central and Eastern Europe have abandoned across-the-board utility and housing subsidies, but these remain popular in the CIS countries. The CIS countries also retain energy-related subsidies— "privileges"—for particular groups, such as the police, judges, and individuals with birth defects. These privileges have proved difficult to reorient toward the poor (box 9.1).

Spurred on by the ever-increasing number of unemployed and the need to facilitate layoffs and promote restructuring, many countries created *unemployment insurance programs* similar to those in member countries of the Organisation for Economic Co-operation and Development (OECD). Unlike such programs in most OECD countries, these programs did not require individuals to "contribute" for a minimum time in order to qualify for insurance payments. In the first few years of the transition, unemploy-

Box 9.1 Rationalizing Privileges in the Kyrgyz Republic and Moldova

Privileges represent special benefits (cash, in-kind payments, and/or price subsidies) for categories of individuals. They are a mix between entitlements for status (for example, for World War II participants), remuneration for public sector employment (for example, police, judges), and category-based targeting of social assistance (for example, fourth children). Some privileges exist only on paper, since they have never been financed by government budgets. Some are funded by utility and service providers that are obliged to provide free or reduced-price services to privileged individuals. In many cases these service providers receive indirect subsidies or support from the state (for example, assumption by the state of energy arrears of utilities to foreign suppliers). Other privileges are funded (at least partially) through government budgets.

Many privileges were introduced in the Soviet era. They were aimed at providing benefits to those deserving special merit because of their service to the state. Since then various new privileges have been introduced. These tend to be more category-based assistance. Privileges range from discounts on utility prices (energy, telephone, water, sewage), public transportation, housing rental, and medicine to free cars and sanatorium treatments to actual cash grants.

In the Kyrgyz Republic privileges are granted to about 10 percent of the population and are targeted to 26 categories of people. In 2000 the total cost of the privileges that were functioning is estimated at 452 million som (US$9.5 million) or less than 1 percent of GDP, of which 340 million som (US$7 million) were actually budgeted and the remainder were “implicit.” About half the total cost of privileges is on energy tariff discounts. The government has gradually been extending privileges—mainly for energy tariff discounts—as a form of social protection. In 1998–99 energy privileges were extended to some categories of poor families: single nonworking pensioners with pensions under 400 soms, families receiving pensions because of the loss of the income-earning head of the household, Unified Monthly Benefit recipients, and families with invalid children. In 2000 a new income-tested category—families with a per capita monthly cash income of 200 soms ($4.20) or less—was added.

ment insurance programs were quite generous; privileges were equivalent to OECD norms—especially in CSB countries.[4] For example, new entrants to the labor force were eligible for benefits (Romania); duration of benefits was long (24 months in FYR Macedonia), or it was open ended (Poland). But as growth in unemployment and layoffs reduced the ratio of contributors to beneficiaries, the financial costs of financing generous schemes rose sharply and countries reduced benefits.

During the socialist period, countries developed comprehensive defined-benefit PAYG (pay-as-you-go) schemes providing *old-age, disability, and survivor pensions*, as well as other insurance-based benefits and short-term benefits for sickness and maternity leave. As in Western countries, pension systems in Eastern Europe evolved out of growing concerns about old-age poverty in the wake of industrialization, and later they were used to help the prewar generation share in the fruits of the postwar economic boom.[5] The pension systems covered a large share of the labor force because of the formalized nature of employment under the socialist system.

Box 9.1 *(continued)*

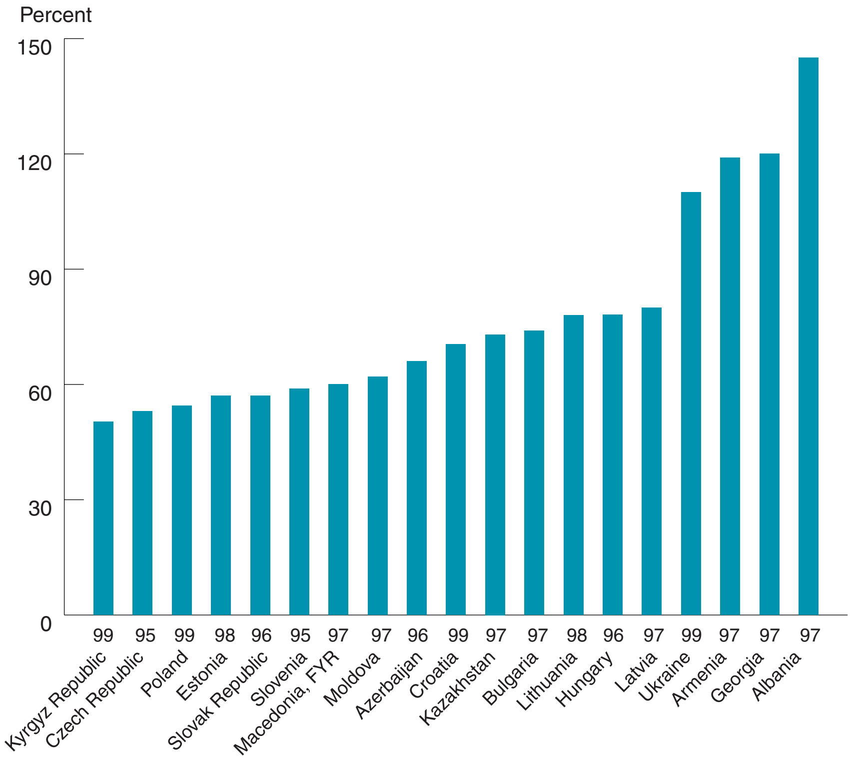
Using categorical and income-testing approaches, the government of the Kyrgyz Republic is taking steps to reduce the overall budgetary cost of privileges and to reorient social protection benefits toward those families in greatest need. In 2000 it submitted a draft law to Parliament that would reduce the number of broad categories from eleven to seven categories better targeted to needy sectors of the population. The proposed legislation also would reduce benefit levels significantly in many of the remaining categories. If enacted, the changes would reduce the total cost of the functioning entitlements by 40 percent, to 276 million som (US$5.8 million or 0.5 percent of GDP), and reorient the privileges to the neediest, increasing their share from less than 40 percent to 70 percent of the total cost.

In Moldova privileges were granted to 447,540 recipients (or about 12 percent of the population) in 37 categories, as of January 2000. The total cost of privileges functioning in 2000 is estimated at 367.5 million lei (US$30 million or about 3 percent of GDP), of which only 207 million lei (US$17 million) are budgeted. Recognizing that the system was unsustainable, the government and Parliament attempted to rationalize it. After several failed efforts, the Parliament in April 2000 approved a targeted compensation scheme that abolishes energy-related privileges issued in the past by law or government decree. In its place is a category-based energy subsidy scheme intended to cover poor and vulnerable sectors of the population via direct payments to consumers for partial energy discounts. Because of difficulties in applying means-testing, the new program covers nine categories of the population that are presumed to be the poorest and most vulnerable segment of the population. The new program became effective on June 22, 2000. The total cost of privileges is estimated to fall from $30 million to $25.5 million in 2000. Although the cost savings are not large, the new system is much better targeted to the poor than the old one was. In addition, significant savings have been achieved by completely eliminating energy compensations. Almost 1 million Moldovans were entitled to these subsidies, and the cost of the system was estimated at 270 million lei (or US$21 million) in 1999.

Eligibility criteria for old-age, disability (box 9.2 on Poland), and survivor pensions were generous. High dependency ratios—the ratio of workers to pensioners—in the region, like in Western Europe, led to a demographic profile in the postwar era that supported low retirement ages, commonly 60 for men and 55 for women.[6] In addition, various occupational groups, such as miners and teachers, were eligible to retire even earlier. Benefit levels were quite generous, with system replacement rates as high as 80 percent in Poland, Yugoslavia, and for some groups of pensioners in Russia. The weak link between contributions and benefits led to considerable internal redistribution between classes of workers.

Growing unemployment, layoffs, poor tax compliance from the informal economy, and early retirement policies increased the ratio of pensioners to contributors and created financial problems for most pension systems in transition economies (figure 9.1). Although many systems began the transition with three contributors financing each pensioner, now there are fewer than two contributors for each pensioner. The inherited gener-

Figure 9.1 The Dependency Ratio of Pension Systems in Selected Countries in Europe and Central Asia, Various Years



Note: The dependency ratio is the number of pensioners to the number of contributors to the pension system.
Source: World Bank (2000b).

osity of public pension systems further reduced the fiscal viability of pension systems. As a result, some pension systems—particularly those in the CIS—found it increasingly difficult to pay beneficiaries.

The tendency of transition countries to spend most of their social protection budget on pension programs reflects their historical legacy of well-developed pension schemes. Spending on social insurance programs averages more than 10 percent of GDP in CSB countries compared with about half that in CIS countries. Budgets for cash social assistance and child allowance programs typically range between 0.5 and 2 percent of GDP across the region, with CSB countries spending more than CIS countries. A few countries spend 13 percent or more of GDP on pensions—notably Croatia, Poland, Slovenia, and Slovakia. CIS countries in the

Caucasus and in Tajikistan spend less than 4 percent of GDP on pensions and very little on social assistance, with the exception of Armenia, which spent more than 2 percent of GDP on its targeted means-tested poverty benefit in 1999. In 1998 Georgia spent less than 3 percent of GDP on pensions—and less than 0.1 percent of GDP on family benefits. In 1999 Tajikistan—the poorest country in the region—spent 1.8 percent of GDP

Box 9.2 Poland's Disability Pension System

Disability is a costly problem in Poland. Disability pensions total more than 3.3 percent of GDP, and they require a payroll tax of more than 7 percent of the wage bill.

The high cost of Poland's disability pension system can be attributed to its large number of beneficiaries relative to other ECA countries and to its relatively generous benefits. More than 15 percent of the working-age population in Poland is disabled, compared with 10 percent in Hungary and Latvia (countries with disability systems similar to Poland's prior to the transition), less than 7 percent in Germany, and only 4 percent in Switzerland. Health problems and injuries do not account for Poland's high share of disabled. Program design and implementation seem to have encouraged an extraordinary number of people to apply for, and qualify for, disability pensions. In a household survey conducted in 1996, one-third of the people who said that they had qualified for benefits answered questions about their well-being in a way that revealed that they did not meet International Classification of Impairments, Disabilities and Handicaps (ICIDH) criteria for disability. They were legally but not physiologically disabled.

Persons with the least serious kinds of disabilities have been generously treated. Until 1997 individuals suffering from a long-term medical problem could qualify for the weakest category even if work capacity was unimpaired. In 1997 a law mapped the old three categories into three new degrees of disability, and the critical element became loss of work capacity rather than just health problems. Even so, people with a "slight" degree of disability remain eligible for disability insurance benefits, and they continue to count in the quota and Sheltered Work Establishment systems (see box 10.2 in chapter 10).

Eligibility criteria have not been strictly enforced. This was especially true in the early 1990s when applications for certificates of disability jumped. It appears that people substitute disability benefits for unemployment benefits because they are easier to qualify for and they do not expire automatically. This helps to explain why the number of beneficiaries grew so rapidly in the early 1990s. There is even evidence that moral hazard has led to corruption involving workers, certifying physicians, and sometimes employers. A qualitative study on informal payments in the health sector found that some people reported "purchasing" sick leave, a disability certificate, or exemption from military service (Shahriari, Belli, and Lewis 2000). People reported that a disability certificate could cost as much as 3000 zlotys (about US$750).

In response to the rapid growth of disability beneficiaries and the high cost of benefits, the government modified Poland's disability pension system significantly in terms of administrative procedures and eligibility criteria. In 1998 the number of new disability beneficiaries declined by 10 percent compared with the number of new disability beneficiaries in 1997, the first decline ever. Unfortunately, the numbers are likely to resume growing because of continued economic restructuring and the aging of the population.

Source: Andrews and Hoopengardner (1999).

on pensions and only 0.2 percent on poverty benefits; the monthly poverty benefit was sufficient to cover only the cost of two loaves of bread (World Bank 2000f).

Sizable amounts, especially in CIS countries, are spent subsidizing the consumption of utilities. In many cases the subsidy is borne by the utility, rather than the budget, so the amount is difficult to ascertain. The spending gap between CIS countries and CSB countries would narrow if compensation for utility prices were factored in. CIS countries have been much slower than CSB countries to price energy and other utilities at world prices.

Thus, the challenge facing transition countries is not so much to increase the overall envelope allocated to social protection as it is to ensure that the money is used effectively to address the most acute manifestations of poverty. In what follows, we look at the impact of social protection programs on poverty and explore how they might be reformed to be more effective.

Social Assistance Programs and the Poor

The poverty impact of social assistance programs is often evaluated using three common measures—coverage, targeting, and effectiveness. *Coverage* is the share of the poor who receive the benefit; *targeting* is the share of expenditures from the benefit that is received by the poor; and *effectiveness* is the share of the benefit relative to average household expenditure. There are tradeoffs between these various objectives. To include as many poor households as possible, policymakers may make the eligibility criteria very broad. In such circumstances, targeting efficiency is likely to be low since some of the benefits will go to nonpoor households. Tradeoffs also are made between coverage and effectiveness: the more broadly social assistance expenditures are distributed across households, the smaller the amount going to any one household is likely to be. In a world of imperfect information, limited funds, and electoral demands, policymakers face difficult choices in trying to reach as many poor households as possible with a meaningful level of assistance. The evidence discussed below suggests that the coverage of the poor provided by social assistance programs is quite low. Child allowances are somewhat better targeted than means-tested cash benefits, but both programs end up benefiting many nonpoor. Program effectiveness is generally not very high.

The Performace of Cash Benefit Schemes

Despite growing poverty in Europe and Central Asia, cash benefit schemes in the first half of the 1990s performed poorly. In some countries the coverage of the population measured as the proportion of all households receiving the poverty benefit was quite low, to the point many schemes were termed "irrelevant" (Milanovic 1998). More than 20 percent of households in Hungary received social assistance, but the receipt rate was only 13 percent for Russia, and a negligible 4 percent for Bulgaria, Estonia, and Poland. The coverage of poor households receiving social assistance also was low across the region; only Hungary reported high coverage of the poorest households (table 9.1).

Evaluations of the performance of programs in the second half of the decade show that many programs continue to have limited coverage of the poor (tables 9.2 and 9.3). In Romania and Latvia, coverage is particularly low. Croatia is an exception: half of the poor are covered by the social assistance program. The poverty line in Croatia, however, is very low, so that only 2 percent of households fall below it.

Why do social assistance programs do an inadequate job of reaching the poor? There are many reasons. Poor people often lack information regarding poverty programs. Even those who are eligible for benefits may not apply for the programs because they have difficulty obtaining and understanding the numerous documents required. Some may feel there is a stigma attached to claiming resources. For pregnant women and women with small children, and for others, the long wait in line to receive benefits can be discouraging. Some poor people cannot afford transport fees or under-the-counter fees to obtain documents. In addition, the means-testing formulas applied in many programs may inaccurately assess the household's income status.

The *targeting efficiency* of social assistance to the poor varies considerably. For programs evaluated in the first half of the 1990s, poverty benefits are not particularly well targeted. In every country except Russia, the bottom decile received some 20 to 35 percent of total expenditure on the benefit. In Russia the bottom decile received less than its share in the total population (table 9.1). A number of programs also performed poorly in the second half of the decade. In Kazakhstan, as in Russia, where the payment of social assistance out of block grants is left to the discretion of regional authorities, social assistance programs fared particularly poorly. But there are some good examples of targeting, such as Romania and to a lesser extent Hungary. Interestingly, some of the lower income countries—

Table 9.1 Coverage, Targeting Efficiency, and Effectiveness of Benefits in Selected ECA Countries, 1993–95

Indicator	*Poland*	*Hungary*	*Bulgaria*	*Russian Federation*	*Estonia*
Percentage of households below national poverty line	38	8	2	36	3
Coverage					
Percentage of households	4	24	3	13	3
Percentage of poor	6	43	10	13	10
Inclusion errors[a]	36	86	92	84	65
Exclusion errors[b]	94	57	90	87	90
Targeting efficiency[c]	21	27	22	8	35
Effectiveness[d]	22	5	4	4	15
Type of benefit	MT	NMT	NMT	NMT	MT

MT = means tested; NMT = not means tested.
Note: Poverty line is the national poverty line for each country.
a. Share of the nonpoor who receive social assistance.
b. Share of the poor who do not receive social assistance.
c. Share of total transfer expenditures to bottom decile.
d. Social assistance as a share of expenditures of recipients.
Source: Braithwaite, Grootaert, and Milanovic (1998).

Table 9.2 Coverage, Targeting Efficiency, and Effectiveness of Benefits in Croatia and Latvia, Various Years

Indicator	*Croatia, 1998*	*Latvia, 1997–98*
Percentage of households below national poverty line	2	15
Coverage		
Percentage of poor	50	2
Inclusion errors[a]	77	77
Exclusion errors[b]	50	98
Targeting efficiency[c]	30	15
Effectiveness[d]	12	20

Note: Poverty line is the national poverty line for each country.
a. Share of the nonpoor who receive social assistance.
b. Share of the poor who do not receive social assistance.
c. Share of total transfer expenditures to bottom decile.
d. Social assistance as a share of expenditures of recipients.
Source: World Bank (2000a, 2000e).

Table 9.3 Share of Poor Households Receiving Transfers in Bulgaria, Romania, and Kazakhstan, Various Years
(percent)

Cash benefit	*Bulgaria (1997)`*	*Romania (1997)*	*Kazakhstan (1996)*
Social assistance	17	8	—
Child allowances	30 and above	60 and above	6

— Not available.
Note: The poor are defined as follows: Bulgaria, 36 percent; 31 percent; Romania, 31 percent; and Kazakhstan, 35 percent. Bulgaria has diverse programs of social assistance with no means test. The child allowances in Bulgaria and Romania are universal; in Kazakhstan they are means tested.
Source: World Bank (1998, 1999a); Tesliuc and Pop (2000).

FYR Macedonia and Albania, for example—do as well or better than higher income countries in targeting their social assistance (table 9.4).

Targeting can be assessed by an evaluation of inclusion and exclusion errors in the social assistance system. *Exclusion errors*—the share of poor households excluded from assistance—are very high in the region. Evidence from the first half of the 1990s (table 9.1) showed that (with the exception of Hungary) close to 90 percent of the eligible poor were excluded from receiving benefits in most countries! Inclusion errors, or the share of nonpoor receiving assistance, were also quite high, with the exception of Poland. In more recent years comparable evidence from Latvia and Croatia shows that exclusion and inclusion errors remained high: inclusion errors were 77 percent in both countries, while exclusion errors were 50 percent in Croatia and an astonishing 98 percent in Latvia (based on national poverty lines). Programs need not have both high inclusion and high exclusion errors. In the FYR Macedonia, for example, exclusion errors were low, but there was considerable leakage of social assistance benefits to the nonpoor.

How *effective* are cash transfers in alleviating poverty? Programs evaluated in the first half of the 1990s show that social assistance represented a relatively small share of recipients' household expenditures, although in Poland they amounted to 22 percent. Latvia performed almost as well as Poland in the second half of the decade. Additional evidence is available from recent poverty assessments on transfer effectiveness for the bottom quintile or, in the case of Bulgaria, of the poor as defined by the country-specific poverty line (table 9.5). Social assistance comprises about 10 to 20 percent of household expenditures of poor households in Bulgaria, Romania, and FYR Macedonia, but it covers only 1 percent of total expenditures of the poor in Kazakhstan. Are programs adequate in alleviat-

Table 9.4 The Share of Total Cash Transfer Expenditures Received by the Bottom Quintile in Selected ECA Countries, Various Years

	Cash benefit	
Country and year	*Social assistance*	*Child/family allowances*
Latvia 1998	20	29
Croatia 1998	25	28
Romania 1997	79	51
Macedonia, FYR 1997	47	5
Albania 1996	47	—
Kazakhstan 1996	6	24
Uzbekistan 1999	23	—
Hungary 1997	46	20
Estonia 1995	44	40
Armenia 1996	—	25

— Not available.
Note: For all countries the "poor" are defined as the bottom quintile except Romania (bottom 31 percent) and Estonia (bottom 30 percent). The type of poverty cash benefit for Croatia, Romania, FYR Macedonia, Uzbekistan, Albania, Hungary, and Estonia is means-tested social assistance. Bulgaria and Kazakhstan have diverse social assistance programs; no means test. Latvia has a poverty benefit based on minimum subsistence. Child allowances in Armenia, Bulgaria, Romania, and Estonia are universal but targeted by age; in Kazakhstan, FYR Macedonia, Uzbekistan, and Croatia, they are means tested. Latvia has diverse family-benefit programs.
Source: World Bank (1998, 1999b, 1999d, 2000a, 2000c, 2000e); Tesliuc and Pop (2000); Rashid, Dorabawila, and Adams (1999); Coudouel and Marnie (1999).

ing poverty? Evidence from FYR Macedonia and Bulgaria indicates that social assistance and child allowance programs do have some impact on poverty reduction, but the impact is very small (in relation to pensions, for example) and not sufficient to move most households out of poverty.

Table 9.5 Cash Transfers as a Percentage of Household Expenditures of Poor in Selected ECA Countries, Various Years

	Cash benefit	
Country and year	*Social assistance*	*Child/family allowances*
Bulgaria 1997	15	5
Romania 1997	22	11
Macedonia, FYR 1997	12	0.3
Kazakhstan 1996	2.3	2.2

Note: The "poor" are defined as follows: Macedonia and Kazakhstan, bottom 20 percent; Romania, bottom 31 percent; Bulgaria, bottom 36 percent. The type of poverty cash benefit is as follows: Croatia, Romania, and FYR Macedonia, means-tested social assistance; Bulgaria and Kazakhstan, diverse social assistance programs with no means test. Child allowances: Bulgaria, Romania (universal); Kazakhstan, FYR Macedonia (means tested).
Source: World Bank (1998, 1999a, 1999b); Tesliuc and Pop (2000).

The evidence presented above highlights the tension between coverage, targeting, and adequacy. For example, in Romania the social assistance system is better targeted and more adequate than in Croatia, but limited resources mean that the coverage is lower. Coverage is also very low in Latvia, but the benefit adequacy is better. In contrast, in Croatia the coverage is relatively much higher (for a much more restricted number of poor). In most countries, social assistance programs do not do a particularly good job of reaching the poor, concentrating their expenditures on the poor, and lifting the poor out of poverty.

The Performance of Child Allowance Programs

Evidence on the *coverage* of child allowance programs is more limited than on the coverage of cash benefit programs, but it appears to vary considerably as well. In the few countries where data on both types of coverage are available, the coverage of child allowances is much higher than for social assistance. This may be because child allowances, by targeting children rather than income or other characteristics, reach a large share of the poor.

There is considerable variation in the *targeting efficiency* of child allowances. The efficiency of targeting does not appear to be related to the nature of the benefit—means tested or universal. In Croatia means-tested child allowances are relatively well targeted, but means-tested child allowances perform much worse in FYR Macedonia. Universal child allowances are reasonably well targeted to the poor in Romania, reflecting the strong correlation between family size and poverty status.

Therefore, using child allowance programs to target the poor, at least from this sample, does not appear to be superior to using social assistance. In Croatia and Kazakhstan means-tested child allowances are relatively better targeted than means-tested social assistance. However, the opposite is true in FYR Macedonia. In Estonia universal child allowances do no better than means-tested social assistance, while in Romania they do much worse than means-tested social assistance programs. In other cases, despite disparate methods of targeting (Estonia, Croatia), both programs do about the same.

The *effectiveness* of child allowances is minimal, and (except for Romania) these allowances cover less than 5 percent of household expenditures for the poor. This is largely because these programs receive a minimal amount of funding. Although the coverage of child allowance programs is better than social assistance coverage, even where child allowance programs are well targeted, limited funding makes them a very weak tool for poverty alleviation.

Options for Reform

Social assistance and child allowance schemes are reaching the poor with limited success, although some do better than others. The key reason for social assistance reform in most countries is the need to channel scarce resources in the most efficient way to provide basic needs—food, shelter, clothing—for the most destitute, while avoiding the creation of "poverty traps" or a culture of benefit dependency.

To achieve this objective, transition countries must address these fundamental questions: What type of protection (cash or in kind, broad-based or categorical) will be provided? Is there a need for a variety of programs to cater to different groups of poor? How can programs be administered effectively? Who will finance and deliver the social assistance? A country's income level often influences program design.

High-income and upper-middle-income transition countries. These countries have lower absolute poverty rates, more fiscal resources, and in general greater administrative capacity than lower-middle- and low-income countries have. As a result, they should be able to help not only the truly destitute but also a broader group of poor. The high-income and upper-middle-income countries—especially in Central Europe—tend to have a high concentration of child poverty as well as rural poverty; long-term unemployment also is a problem. Meeting the needs of these disparate groups of poor is not easy.

In principle, a broad poverty benefit based on means and asset testing would be the choice social assistance mechanism. This would ensure that "holes" in targeting that are prevalent in category-based benefits can be plugged. In higher income countries where the informal economy is limited, and where administrative capacity and record keeping and registration of assets are fairly advanced, means testing of income and assets to target the cash benefit to the poor is more feasible. While means testing does not always work, some means-tested systems do perform well (box 9.3). Further analysis is needed to identify which, if any, aspects of the means-testing criteria leads to better targeting efficiency.

Given that means testing is never perfect, child allowances may ensure that families with children, who appear to have the highest risk of poverty in many transition countries, obtain some cash assistance if means tests fail. In countries where child poverty is a particular concern and means-

Box 9.3 The Social Assistance Program in the Former Yugoslav Republic of Macedonia

The social assistance program in FYR Macedonia guarantees households a certain minimum income level that varies by household size. Households claiming the benefit are subject to a combined income and asset test, implemented and monitored by the local welfare offices. The social assistance program provides a cash transfer if the household income falls below the minimum.

Social assistance benefits appear to be relatively well targeted from several perspectives. Data from 1997 show that the bottom two deciles receive almost half of all public spending on social assistance. Without this income support, the severity of poverty would double in rural areas (World Bank 1999b). Social assistance benefits are largely received by the unemployed and by households headed by uneducated or less educated individuals. According to the review of the government in 1999, benefits also reached certain ethnic groups where poverty incidence is high (the Albanian population and Roma). For example, 12.7 percent of the social assistance beneficiaries were Roma, although, as an ethnic group, Roma account for only about 2.2 percent of the total population.

Whether social assistance programs can reach and provide effective assistance to the needy depends on the policy and institutional capacity. In terms of policy, the Macedonian government has been able to define income- and asset-testing criteria that allow the system to capture the most vulnerable groups. In terms of administration of the program, Macedonia has inherited from the former Yugoslav system a relatively developed local-welfare-office structure that collects a significant amount of information on households. A set of stringent reporting and screening requirements is enforced. Macedonia's relatively strong legal infrastructure has largely held the administration accountable for program delivery. A grievance mechanism is used by households that do not agree with the judgment of the social assistance office.

The number of beneficiaries and nominal expenditure on social assistance increased steadily in recent years, and the average benefit duration is long. This is partly attributable to continuing difficulty in monitoring and verifying claims. There is significant inclusion error, and the welfare offices are short of staff to adequately monitor the change-of-asset status of households. Coordination with other social programs and government agencies has not been very efficient in terms of information access and benefit payment. The government is committed to improving program efficiency by developing tighter eligibility criteria and improving the quality of service.

tested poverty benefits cover a limited number of the poor, the benefits could be supplemented (or replaced if they were performing particularly poorly) by universal or indictor-targeted child allowances. In cases where countries provide both cash assistance and child allowances, child allowances (universal or categorically targeted), should be added to the income of recipient households to avoid double counting. Another vulnerable group, elderly nonpensioners, might also be targeted in this way. Where the social assistance system is performing well in reaching the poor, including those with children, child allowances could be merged with the social assistance system. In such cases, the social assistance benefit scale is set so as to increase the threshold level of benefit per child.[7]

Work incentives will be an important issue if cash benefit programs provide a reasonable level of benefit, and income thresholds (means tests) are used for determining program eligibility. Keeping the level of benefit low (relative to the average or minimum wage) will create fewer work disincentives, but will be less effective in pushing households out of poverty. Incorporating work incentives into cash benefit programs entails fiscal and administrative costs that must be carefully considered. More sophisticated incentives should be developed if there are large stagnant pools of beneficiaries in the system—probably the case of the long-term unemployed in many CSB countries. A key question is whether benefits should be of unlimited duration, particularly for working-age adults.

To address this problem, social assistance programs in transition countries have incorporated labor market incentives in different ways. In Bulgaria 30 percent of wage income is disregarded in the calculation of eligibility for benefits. Some countries require beneficiaries to be registered with labor offices, limit the duration of social assistance benefits, or keep benefit levels low. In Estonia nonworking household members of working age are not included in benefit calculations. In FYR Macedonia income thresholds were reduced, and benefit duration was limited to reduce the adverse effects of incentives. Before this reform, the maximum benefit for a four-member family was equivalent to the average wage. (The average wage for unskilled labor in the country was about 30 percent of the average wage.) Now the maximum threshold for a similar family is 40 percent of the average wage.

In many other Central and Eastern European countries, work incentives are weak or nonexistent. Where benefit levels are high and close to the reservation wage, there are no incentives for individuals to seek work or report their true unemployment status instead of claiming benefits. There has been little systematic evaluation of the experience on implementation, efficiency, and effectiveness of work incentives in transition countries. This information would be useful in ascertaining which incentive effects are best at reducing welfare dependency.

Lower-middle-income countries. In lower-middle-income countries a meaningful level of means-tested poverty benefit for all poor may not be possible to finance or administer. Social assistance may be able to protect only some groups of poor. This is an extremely difficult choice for policymakers. The poverty profiles may provide useful guidance in such cases. For example, groups in deepest poverty or those that cannot work might be targeted. If resources are severely limited, children may be targeted in preference to the elderly to avoid irreversible impacts on the human capital development of children.

If it is difficult to verify incomes—the case when there is a high degree of informality in the economy, means testing will probably not work very well. Under such circumstances it is usually preferable to have categorically targeted benefits. Child allowances or demogrants (cash transfers based on age) for nonpensioned elderly might be easily targeted benefits to alleviate poverty. Child allowances would protect the most vulnerable households with unemployed members, but they would do little to protect young unemployed workers without families. Where budget constraints are particularly severe, child allowances may do the best job of protecting those at greatest risk.

Targeting of categorical or in-kind benefits can be universal or based on indicators that are correlated with the characteristics of the poor. *Universal targeting* has greater acceptability and political appeal.[8] But it runs the risk of transferring small amounts of benefit to many recipients, doing little to help the truly destitute. In lieu of universal targeting, countries can deliver child allowances by *indicator targeting*. For example, child allowances can be targeted to families with two or more children and limited by age of child. In countries where the poor with many children are an ethnic minority, indicator targeting may not be politically acceptable. If the nominal value of child allowances is capped, economic growth will reduce the percentage of families receiving allowances automatically in the future, even if initially the allowances were received by the majority of the population. In that way the allocation of social assistance expenditures can gradually be targeted to the residual poverty population once economic growth resumes.

Where categorical targeting is too expensive or has high errors of inclusion or exclusion, governments may want to use a *proxy means test* to target the poor. This type of means test uses several indicators (with appropriate weights) rather than simply income to target the poor. Armenia and Russia are experimenting with these mechanisms for targeting a broad-based poverty benefit. It is not yet clear, however, that this mechanism performs better than indicator targeting or a means test.

Low-income countries. Countries (mainly in the former Soviet Union) with very low incomes have few resources for social assistance benefits and limited administrative capacity. Their key challenge is to identify a few cash and in-kind benefits or services that are administratively easy to target and deliver to the very poorest groups or regions in the country. Social assistance might be limited to addressing the most serious manifestations of malnutrition or hunger, or lack of school attendance linked to poverty among particular population groups. Where possible, benefits or services might be designed to serve two purposes. In addition to alleviating household cash constraints, they might keep children in school or reduce malnutrition.

Several targeting mechanisms may be particularly appropriate for very poor countries. For example, poor countries may want to use *geographical targeting*, especially if resources are limited, and the poor are concentrated in certain areas of the country. In many countries there are pockets with extremely high poverty rates (chapter 2). Like categorical targeting, geographic targeting is, by definition, inequitable, since there may be pockets of poor in nontargeted regions. But if there are identifiable pockets of severe poverty, geographical targeting may be a reasonably efficient way of addressing problems of acute malnutrition or low school attendance.

Self-targeting is perhaps the most simple way of targeting the poor in low-income countries. It means that a subsidized good or service is available to all, but designed in such a way that only the poor will choose to use it. Work fare programs, where the wage is set very low, are self-targeting.[9] Two successful workfare programs are the Maharashtra Employment Guarantee Scheme in India and the Trabajar program in Argentina. Both concentrate on infrastructure projects that are labor intensive, benefit the local community, and target poor areas. The Trabajar program was expanded in the mid-1990s to cope with rising unemployment, which reached 18 percent in 1996–97 and was concentrated among the poor (World Bank 2000g). Public works programs are best viewed as a means of targeting income support to the poor rather than as a way of getting the unemployed back into the labor market (World Bank 2000b).

Self-targeting provides a gradual exit criteria: once individuals or families are back on their feet after a crisis, they will opt out of self-targeted programs. However, program design is key. In Albania and FYR Macedonia, where workfare programs were used, wages were not set low enough to attract only the poorest workers. Perhaps because there is considerable income from the informal sector, people in FYR Macedonia did not wish to join public works programs even though the benefit was set at the average wage. A few other countries in the region have experimented with public works programs, but to date there has been no systematic evaluation of their effectiveness.

Given the limited role of the state in delivering benefits, some countries, namely Albania and Uzbekistan, have used *community targeting* to deliver benefits (box 9.4). As noted earlier, communities may know more about the poor in their area than central or regional officials do, and they will have more information about how to reach the poor and ensure that they receive benefits. In community targeting, some local authority or committee is empowered to make decisions about who should receive program benefits.

Given the success of intracommunity targeting evidenced in these programs, a generalized poverty benefit administered by local communities for low-income countries based on some means-testing criteria cannot be dismissed out of hand and may work in particular institutional settings (Coudouel, Marnie, and Micklewright 1998; Alderman 1999). But community-targeted systems have several drawbacks. Benefits may be captured by local elites, allowing a few individuals to determine who receives assistance. Another problem, emerging from evidence on Albania, is that community targeting does not necessarily facilitate equitable targeting across regions.

Issues that Cut across Country Income Groups

Institutional and financing arrangements for social assistance differ across countries. Although in some countries assistance is centrally funded and administered, in others (such as Bulgaria, Romania, Latvia, and Kazakhstan) responsibility for financing social assistance has been transferred to local governments, with some support through central budget transfers.

Decentralization. A lack of earmarking of budget transfers for social assistance means that funds are often not used for this purpose. Local governments frequently have few resources to finance social assistance. In Hungary, however, the administration and financing of social assistance programs are completely decentralized. Decentralization can give rise to inequities across jurisdictions or to low levels of financing. In Kazakhstan, for example, Almaty city spends roughly 8 times more per poor person on social assistance than do some of the poorest oblasts (World Bank 2000d).[10]

Poor regions with the highest rate of poverty have the fewest resources to address their poverty needs. A key role for central governments is to ensure that regional disparities are not accentuated, but are mitigated, by the distribution of benefits. The central government should determine the level or threshold of social assistance or types of services for which individuals across the country will be eligible and ensure that social assistance programs are adequately financed. However, in some cases the state

Box 9.4 Community Targeting of Cash Benefits in Uzbekistan

An alternative approach to federally determined targeting rules is to allow local communities to determine eligibility for social assistance benefits, while the financing of the benefit remains a federal responsibility. Several countries follow this approach including Uzbekistan.

Faced in 1994 with the dissolution of guaranteed employment and consumer subsidies—the main safety net in the socialist era—the government of Uzbekistan created a targeted lump-sum cash benefit program. The unique feature of this program is that Uzbekistan uses a traditional community group, the Mahalla committee, to target and administer the benefit. The Mahalla committee is a community-based entity, the chairman of which is elected by the local community from candidates nominated by the local political authority. Salaries of the chairman and secretary of the Mahalla committee are paid by the state.

The choice of the appropriate level of benefit (between one and three times the minimum wage) and the definition of who is poor (within broad federal guidelines) are decentralized to the Mahalla committee level. This program assumes that Mahallas are better informed than the federal government about who is poor and the appropriate level of benefit they should receive. Eligibility for the benefit is based on many factors in addition to income. These include assets, number of working household members, and assessment of whether household members are shirking (for example, whether they could obtain more revenue from better use of their agricultural plot). If the Mahalla committee votes to give assistance, the recipient is entitled to receive a monthly benefit of between one and three times the minimum wage for a period of three months.

In 1997 the universal child benefit was replaced with a child allowance benefit targeted to the poorest households using the Mahalla committee system. The procedure for obtaining assistance is quite similar to that for the poverty benefit. The main difference is that the family must provide detailed information on its income for the past 12 months, as well as documentation on its children. Mahallas have some discretion in setting the size of the minimum monthly per capita income threshold for determining eligibility as well as discretion in determining who should be awarded assistance even if the family meets the income test. The size of the benefit depends on the number of children in the family. Coudouel and Marnie (1999)

may delegate the exact type of service, or identification of the poor (according to some guidelines), to the community. The community has an advantage over the state, because it knows the needs and conditions of its population better. Yet the state needs to monitor local governments to ensure that they are allocating resources and delivering services according to the agreed upon rules.

Groups with special needs. An issue that cuts across all transition countries is how to provide for populations with special needs. Institutional care, which includes the provision of shelter and food, is generally available in the region to orphans, children with special needs, the severely disabled, and the elderly in need of assistance. Transition countries have tended to rely too heavily on institutions to care for disadvantaged groups, at the same time that resources for institutions have been squeezed. Institutionalized groups, given the lack of voice in society, are most often the

Box 9.4 *(continued)*

conducted an evaluation of the system based on household surveys in 1995 and 1999 in the Fergana Valley oblast.

How well have Mahalla performed the task of allocating the low-income benefit? In 1999 the low-income benefit was distributed progressively: the poor in the Fergana oblast received a larger share of benefits than the well off. In 1999 the bottom two quintiles received almost half of all expenditure. Despite this relatively favorable result, targeting efficiency has declined slightly over time, down from 59 percent in 1995. In 1995, 27 percent of all expenditures on the low-income benefits were targeted to the lowest quintile, but in 1999 the lowest quintile received 23 percent of total program expenditures.

The program appears to be well administered in the Fergana oblast. Most households know about the program, and program knowledge has increased over time. Few households report "waiting for an answer" on their applications. More than two-thirds of those who did not apply said that they would do so if they were ever in need. The most common reason stated for not wanting to turn to the Mahalla for help was a complicated application procedure and discomfort at having their situation discussed in public. Few—about 5 percent of those refused assistance—cited corruption at the Mahalla level as a reason for not receiving the benefit.

Nevertheless, there appears to be room for improvement. In 1999, nearly 22 percent of top-quintile households applied for the program (as in 1995), and about 8 percent received assistance. Of the bottom quintile, only 42 percent applied and 27 percent were granted help. Apparently, many of those who would be most likely to receive the benefit are choosing not to apply.

How much has coverage of full allowances improved? In 1999 nearly 40 percent of poor households received child allowances compared with 12 percent of poor households in 1995. This shows that a greater number of poor are receiving child allowances through the Mahalla system.

Source: Coudouel and Marnie (1999).

first to be penalized when resources are scarce. Providing protection for these groups must be an integral part of a social assistance strategy for all countries, no matter what their level of income, but reforms are needed to improve opportunities for these groups while reducing the overall cost of the program. A few countries are experimenting with innovative reforms in this area (box 9.5).

Diversification. The state can also move away from relying solely on the public sector to deliver social services and work with nongovernmental organizations to deliver services. However, NGOs require an effective legislative environment that allows them to raise revenues and enter into contractual arrangements—an environment lacking in some transition countries. High-income transition economies may be in a better position than low-income countries to diversify provision of social assistance and

Box 9.5 The Shift Away from Institutionalized Care in Transition Economies

One of the most deleterious legacies of socialist social assistance programs was their overreliance on residential institutions for social care. Institutionalization was often the only option for the elderly who were unable to live on their own, adults with physical and mental disabilities, and children in difficult circumstances because of poverty, ethnicity, disability, or other risk factors. In many cases the most vulnerable and marginalized members of society were placed in institutions.

Recent data suggest that nearly 1.3 million people—820,000 of them children—live in about 7,400 highly structured institutions in Central and Eastern Europe and Central Asia. As the effects of economic decline weakened families, the lack of community alternatives forced families to rely on these large institutions. As a result, the number of individuals in custodial care has increased (chapter 1) at the same time that living conditions in these institutions have deteriorated significantly because of shrinking budgets and higher operating costs.

Many transition economies have begun exploring alternatives to institutions. Experience in Western Europe and the United States suggests that community-based services, such as home care and day care services, and special education programs for children with learning disabilities can be more effective, efficient, and humane. Transition economies are well positioned to begin developing such services. Decentralization and increased NGO activity and community participation in civil society have laid the groundwork for greater consumer involvement in social services.

Making the move to community-based care involves significant changes in social policy. Six elements form a comprehensive and integrated strategy:

- Changing public opinion and mobilizing community support.
- Strengthening the community-oriented social welfare infrastructure, such as schools of social work, training programs for staff in residential institutions, and staff in local social assistance offices.
- Piloting community-based social service programs to provide the flexibility for testing a wide range of approaches.
- Designing pilot projects to reduce the flow of individuals entering residential institutions and to reintegrate individuals into the community.
- Redesigning, converting, or closing individual institutions.
- Developing a national system of community-based social services.

A few transition economies are leading the way in this transformation. For example, in 1996 Lithuania introduced day schools for handicapped children and multiservice community centers—serving battered women, socially vulnerable children, and former prisoners. These pilot projects have already demonstrated noteworthy achievements, including deinstitutionalization of severely disabled children in Moletai and Utena, sharply reduced demand for an elderly home in Svencionys, and provision of safe and stable care for battered women and their children in Vilnius. In Constanza, Romania, apartments with house parents are used to care for HIV-positive children who attend a regular school. And in Shkodra, Albania, a center for at-risk families provides counseling, home visiting, parent training, and referral services.

Source: Tobis (1999).

social services to NGOs. However, low-income transition economies can begin to develop the necessary legislative framework for future involvement. In high-income countries some social services and institutionalized care could be provided mainly through community organizations and

NGOs. Partnership with nonstate actors can help increase the range of social services that is available, improve quality through competition, and foster greater public participation and ownership of social assistance programs in civil society.

Utility Subsidization Programs and the Poor

Unlike other parts of the world, in Europe and Central Asia many of the poor are connected to a variety of utility services. In most parts of the region, close to 100 percent of the poor are connected to electricity, and two-thirds are connected to water (except in Moldova). Significantly fewer benefit from centralized provision of gas, sewerage, hot water, and heat. The relatively high connection rates reflect the heavy investment in infrastructure during the socialist period, the high degree of urbanization and urban poverty, as well as the exigencies of the cold climate prevailing in much of the region. Because of these factors, affordability of these services is a major poverty issue in the ECA region.

Approaches to Energy Subsidization for the Poor

Utility subsidies for households can be grouped into three broad categories: no disconnection of delinquent households; price subsidies of various types (across-the-board price subsidies, life-line tariffs, and price discounts to "privileged" households), and compensatory household income support (burden limits and other earmarked cash transfers). This section looks at the merits of each of these approaches in terms of coverage of the poor, the efficiency with which resources are targeted to the poor, the impact on prices, and administrative ease.

No disconnection of delinquent households. In a few countries—notably in the Commonwealth of Independent States and in South and Eastern Europe—utilities are pressured by governments not to disconnect households that do not pay their bills. Although one might expect that poor households would be over-represented among households with payment arrears, evidence shows that there is considerable leakage of this benefit to the nonpoor. Some poor households do not benefit from this policy—in part because its application tends to be erratic and not formalized: governments are reluctant to make "no disconnection of delinquent households" an official public policy. Moreover, benefits may accrue disproportionately to nonpoor households to the extent that their monthly utility bills are larger than those of the poor. Targeting efficiency is low. This policy has little to recommend it except administrative simplicity.

Across-the-board price subsidies. Across-the-board subsidies cover all households that are connected to the utility—so while coverage of connected poor households is universal, there is considerable leakage to the nonpoor. Targeting efficiency is further undermined to the extent that utility consumption increases with income. While across-the-board price subsidies are simple to administer, they distort energy prices for all consumers.

Life-line tariffs. Many governments in Europe and Central Asia introduced life-line tariffs for utility services with metered or relatively easily estimated consumption, especially electricity and gas. Under this system the price subsidy is restricted to the initial block of consumption called the basic need level. This offers a less costly alternative to across-the board-price subsidies since only part of consumption is subsidized; coverage is provided to all consumers connected to the utility. Targeting efficiency is increased by restricting the size of the first block so that it does not exceed the consumption levels of the poor—assuming that consumption increases with income. Targeting can be further improved by a three-block tariff structure, assuming that the third block is set above cost, so it includes a negative subsidy. Under this system nonpoor households effectively subsidize poor households. Thus, for the same total cost a bigger subsidy can be granted on the price of the first block.

Price distortions can be kept relatively low in a two-block tariff as long as the first block is kept sufficiently small so most consumers, including the poor, consume more than the first block. This ensures that the last unit of consumption is priced correctly. A three-block tariff structure distorts the marginal price signal more, however. Life-line tariffs are more complex to administer than across-the-board price subsidies, since they require reliable, tamper-proof metering or a reasonable consumption proxy. They are not suitable for water and sewerage in countries where residential water use is not metered.

Price discount for privileged consumers. Some countries provide price discounts to certain households selected on the basis of such factors as occupation, medical history, age, and merit. The FSU countries operated a system of merit-based utility price discounts—not only to reduce poverty but to reward service in certain occupations and to compensate for human suffering (war, hard labor, catastrophe). Price discounts ranged from 25 to 100 percent. While the Baltic states have made inroads on eliminating the system of privileges, many CIS countries have made less progress. Since the primary goal of the system of privileges is not poverty alleviation, it is not surprising that the system only covered some of the poor. For example, in Moldova in 1997 only about 35 percent of the people benefiting from electricity price privileges were poor. Moreover, the privileges tended to be inadequately targeted to the extent that the poor consume less utility services than do the nonpoor. Like across-the-board price subsidies, privileges can be highly distortionary, although they create distortions only for a selected group of consumers. Privileges are also administratively more demanding than the no-disconnection, across-the-board price subsidy or life-line tariff mechanisms, since they require the government to issue a list of privileged consumers that the utility then must take note of when calculating the monthly bill.

Burden limits (housing allowances). Starting in 1995, a number of FSU countries introduced subsidies to limit the burden placed by utility expenditures on household incomes. Housing allowance offices in government receive their funding from the budget and make payments to utilities on behalf of households whose combined utility expenditures exceed a certain share of their income. This share—the burden limit—typically varies from 15 to 30 percent, and its calculation may include fuel costs (in rural areas) or rental payments on apartments in cities.

Coverage of the poor depends on whether the poor apply for the benefit, and if they meet the eligibility criteria. Evidence suggests that many poor do not receive the benefit. Burden limits do an inadequate job of targeting resources to the poor because of the weak connection between per capita household income and the share of the utility bill in household consumption. A solution for the problem of low targeting efficiency is to replace actual utility expenditures with normative utility expenditures in the formula that is used to calculate the allowance. The norms can be set on the basis of per capita norms for apartment space (and associated heating requirements) and water and electricity consumption. Since the norms are independent of income, the allowance that a household receives under this modified burden limit mechanism is inversely related to income.[11] It is crucial, however, to set the norms sufficiently low (below the old "sanitary" norms applied in the former Soviet Union) in order to keep the number of beneficiaries limited and the amount of support affordable for the budget.

For example, the Kyrgyz Republic operates a system of housing allowances based on normative utility expenditures in Bishkek, the capital city.

To be eligible for the allowance, a household must live in an apartment building, and its normative utility expenditures (electricity excluded) should exceed 23 percent of its income (the burden limit). Normative utility expenditures depend on the number of people in the household and on the level of utility tariffs. In 1999 about 2,600 households received the support—a coverage ratio of 11 percent of poor households, assuming that there are about 23,000 poor households in Bishkek falling below the relative poverty line.[12] Burden limit schemes are highly distortionary insofar as the price of an additional unit of utility service covered under the scheme is effectively zero. Using normative consumption to fix the level of utility expenditures for the purpose of subsidy calculation can significantly reduce the distortionary effect. Like other income-tested schemes, burden limit schemes are fairly complex to administer.

Other earmarked cash transfers. Some countries provide other forms of earmarked energy benefits for low-income households. In Riga, Latvia, the energy benefit is calculated as the amount needed to cover utility costs so that the household is left with a minimum specified amount of income after paying its energy bill. In Bulgaria the guaranteed minimum income benefit includes an energy benefit component provided monthly to eligible households during the heating season. This supplement is intended to defray part of the energy costs. Schemes like the one in Riga can be highly distortionary to the extent that they make the cost of an additional unit of utility consumption zero for eligible households. On the other hand, the Bulgarian energy benefit in 1998–99 was paid in cash, so energy consumption patterns were not distorted. Earmarked cash transfers are administratively complex because eligibility is based on means testing. Although means testing reduces coverage of poor households with utility connections (to the extent that means testing is imperfect), it probably improves targeting.

Reform Options

Many countries in the region have extensive utility coverage that poor consumers are finding unaffordable as their incomes fall and utility prices are brought in line with the cost of supply. For political and other reasons—including the need to ensure adequate levels of heat for the poor—the way forward is not to abandon provision of these services but to improve the cost efficiency of the utility services, increase bill collections from those who can pay, while helping the poor cope with the higher prices. Some form of subsidy for the very poor may be necessary for a period of time until their incomes rise. The challenge is subsidize the cost of utility provision to the poor in the least costly and distortionary way possible.

In determining how to reform utility and housing benefits, governments must decide whether an energy-specific benefit, in addition to or instead of a generalized cash-transfer poverty benefit, is needed. A couple of considerations come into play. From a political economy angle, nonearmarked social assistance transfers lack the appeal of a benefit that is directly tied to the cost of consuming the commodity or service in question. Since energy costs are such a large share of household expenditure—unlike other commodities—a tied benefit certainly has considerable appeal.

Countries that do have a well-functioning cash benefit system may want to rely solely on it to cushion utility price shocks for the poor. The administratively less demanding attributes of life-line tariffs are presumably not a major advantage when countries can deliver means-tested benefits adequately. However, life-line tariffs may still be preferred because they provide universal coverage of the connected poor—which even well-functioning income-tested benefits are unlikely to do. The disadvantage is that life-line tariffs tend to introduce more price distortions than do nonearmarked cash benefits, something that countries with the ability to implement nonearmarked cash benefit schemes should consider. Burden limit schemes based on actual utility expenditures are not efficiently targeted and introduce price distortions. Burden limit schemes based on normative prices do a better job on targeting, but they are not clearly preferable to a cash benefit or a life-line tariff.

Life-line tariffs are the best option for countries that do not have the ability to operate an effective means-tested cash benefit program—likely the case for low-income countries. Life-line tariffs tend to be better targeted than across-the-boards price subsidies. Price distortions are usually less in two-block systems than in three-block systems, but the latter score better on targeting criteria. In the case of nonmetered water supply where no good proxy exists for actual consumption and where life-line tariffs are not feasible, an across-the-board price subsidy is the best option.

Price discounts for privileged consumers fare poorly on a number of counts. They generally do a poor job of reaching the poor, they introduce price distortions, and they require special agencies to certify eligibility, which in turn must be taken into account by the utility in calculating consumers' bills. Although it may not be possible for political reasons to eliminate all privileges, they can be phased out slowly by grand-fathering those currently on the rolls and/or keeping the amount of the benefit fixed. Assuming some inflation, such benefit caps will erode in real terms over time, freeing up resources that can be used for more effective social assistance programs or other urgent fiscal needs.

The Performance of Social Insurance Programs

In transition countries there are two main social insurance programs: pensions (including old-age, disability, and survivors' insurance) and unemployment. Social insurance programs enable individuals to smooth consumption against particular adverse events (such as unemployment or disability) or over their lifetime. They also have (explicit or implicit) redistributive objectives in reaching the poor. In most countries the ability of programs to insure individuals has been constrained, but pension programs have had an important poverty alleviation impact.

The Performance of Unemployment Benefit Programs

The ability of unemployment insurance programs to insure individuals against unemployment has been limited in most countries because of continual changes in contractual terms over time, delay, and nonpayment of benefits. During the transition, the first cohort of the unemployed was relatively more advantaged because it received more generous net benefits than did later cohorts.

In response to tighter financial conditions, many Central and Eastern European (CEE) countries reduced the level of benefits, cut generous eligibility conditions, and limited the duration of benefits in the second half of the 1990s. The long-term unemployed were the hardest hit. Poland limited benefit duration to one year, and FYR Macedonia, to 18 months. In Hungary, the Czech Republic, and Slovenia, maximum duration was halved. In many FSU countries, benefit duration was set even lower, at about six months. Benefit replacement rates were reduced, and maximums were established to cap growth in the level of the benefit. These changes were applied to all recipients in some countries (the Czech and Slovak Republics), while in Poland and Hungary changes were grand fathered.

In many countries real benefits fell because of high and persistent inflation. As a result, they became flat and close to the minimum wage, with almost no link to contribution history (of limited application during the transition). This was particularly the case in Russia and other FSU countries, where the real level of benefits has declined so much that most eligible unemployed do not claim benefits (World Bank 2000b). Moreover, in many FSU countries, benefits are often unpaid. In Russia, for example, benefit arrears have sometimes reached three to four months.

Even countries that have had trouble meeting their obligations in these programs have found it difficult to reduce benefits. In Romania and Bulgaria new entrants to the labor market (such as graduates of secondary school) remain eligible for assistance. This is not the case in most OECD programs.[13] In Romania it was politically impossible to reduce eligibility because of the participation of youth in the revolution. In FYR Macedonia a reduction in benefit for some insured was made politically palatable by increasing benefits for other recipients. Although the maximum benefit was reduced from 24 to 18 months for most workers, the maximum duration of benefit for those with a long contribution history (35 years) was increased until retirement, despite continuous deficits in the employment fund. In FSU countries, despite nonpayment of benefit or payment in kind, programs are still politically difficult to remove. Understandably, citizens want their government to fulfill its promises rather than make its obligations more consistent with financial realities. As a result, benefits in many countries are not paid or are paid sporadically.

Do unemployment insurance programs help the poor? It is difficult to say much about the *coverage* of the poor given very sparse evidence. Evidence on the *targeting efficiency* of programs suggests that, with the exception of FYR Macedonia and Latvia, program spending received by the poor is greater than their share in the population. In Estonia and Romania 60 to 70 percent of benefits are received by the bottom third of the population. Perhaps this is not surprising given the high correlation of unemployment and poverty in some countries. The targeting efficiency of unemployment benefit programs, where comparable data exist, is higher than for child allowances and social assistance in all countries (except for social assistance in FYR Macedonia, Romania, and Albania). However, the *effectiveness* of benefits tends to be low—more comparable to child allowances than social assistance, given the low share of total public spending on unemployment benefits. The lack of resources in CIS countries likely makes the effectiveness of programs particularly low in those countries (table 9.6).

Options for Reform of Unemployment Insurance Programs

Unemployment insurance programs are appropriate for a number of transition countries. They are useful risk-pooling programs when the number of unemployed is small relative to the pool of people employed in the

Table 9.6 Coverage, Targeting Efficiency, and Effectiveness of Unemployment Benefits in Selected ECA Countries, Various Years

	Cash benefit		
Country and year	*Coverage*[a]	*Targeting efficiency*[b]	*Effectiveness*[c]
Bulgaria 1997	6	—	17
Macedonia, FYR 1997	—	17	2
Albania 1996	—	25	—
Armenia 1996	—	26	—
Estonia 1995	—	60	—
Romania 1997	13	68	21
Croatia 1998	—	39	—
Latvia 1998	—	26	—
Kazakhstan 1996	2	33	1

— Not available.

Note: The "poor" are defined in Bulgaria as the bottom 36 percent; Romania, bottom 31 percent; Estonia, bottom 30 percent; and in Albania, FYR Macedonia, Armenia, Croatia, and Latvia, bottom 20 percent. For Kazakhstan, for targeting efficiency and effectiveness the "poor" are defined as the bottom quintile and for coverage as the bottom 35 percent.

a. Percentage of poor receiving benefits.

b. Percentage of total benefit expenditures received by poor.

c. Benefit as percentage of household expenditures.

Source: World Bank (1996a, 1998, 1999a, 1999b, 1999d, 2000a, 2000e); Rashid, Dorabawila, and Adams (1999); Tesliuc and Pop (2000).

formal sector. But they are a very costly way to deal with massive unemployment as a result of restructuring. Insurance-based programs are more appropriate for countries that can administer benefits well, can finance benefits at low tax rates, and can collect contributions attributed to individuals than they are for low-income countries. The transition economies in Central Europe and the Baltics are reaching this stage.

High-income countries. Where unemployment insurance is provided, the overall program should be affordable and financed without the imposition of high tax rates on contributors. One way to cap program benefits might be to set the tax rate for the program to a low and less distortionary level (say 1 to 2 percent), which is roughly at the lower end of the range of tax rates in transition countries. Imposing the tax on employer and employee, as in most OECD countries, would make the insurance link more clear to employees. Otherwise, when tax rates are quite high and the benefit provided is negligible, providing unemployment insurance results in a greater informalization of the economy.

Benefit duration should be limited to six to nine months to reduce work disincentives. This is based on a key finding in the literature for developed economies. The generosity of the unemployment insurance system, particularly the duration of benefit, has strong work disincentives. Most studies find that benefit duration is strongly and positively associated with the duration (not incidence) of unemployment.

In transition countries, however, the reduction in the generosity of benefit has not increased incentives to work. Outflows from unemployment to work have not increased. The exit from unemployment status does appear to be related to benefit duration—for example, in Romania—unemployment duration peaked at nine months, the maximum level of benefit. Once the benefit was exhausted, however, most of the unemployed withdrew from the labor force altogether (Boeri, Burda, and Köllo 1998), instead of returning to work.[14] One reason for limited incentive effects is the creation of social assistance benefits for which many unemployed qualify. In many transition countries these social assistance benefits continue to be of indefinite duration. Many unemployed shift to social assistance after their unemployment benefits expire. Reducing the unemployment benefit by supplanting it with another generous benefit counters any positive incentive effect from stricter benefit conditions.

Eligibility conditions should exclude, when politically possible, students and new entrants to the labor force. To preclude the moral hazard problems common in any form of insurance, unemployment insurance programs typically include co-payment as well as restrictions on eligibility.[15] As in OECD countries, incentives in Europe and Central Asia should include waiting periods for receiving benefits and eligibility restrictions on workers who have left the labor force voluntarily and because of misconduct or a labor dispute. There are penalties for false claims, and benefits can be suspended if two or more reasonable job offers are refused. In low-income countries—such as the Kyrgyz Republic and FYR Macedonia—and even in some lower-middle-income countries—such as Russia—moral hazard provisions are less relevant given the low level of benefit, but in upper-middle-income countries, such as Poland and Hungary, these provisions may reduce false claims.

Unemployment insurance programs might provide more generous benefits if it is found that in doing so, at least for a short period of time, enterprise restructuring is facilitated. But generous unemployment benefits are difficult to reduce or phase out, as many Central European countries have discovered. A more attractive option is the use of one-off generous severance payments paid by the central government (without increasing statutory severance payments) to spur layoffs and restructuring in state enterprises.

The administration of unemployment programs remains a challenge even for many of the higher-income transition economies. First, in countries where employment offices are not computerized or linked by automation to other programs, cross-checking across programs or regions for fraud is extremely difficult if not impossible. Another problem is that registration for unemployment is not limited to those who are genuinely seeking work or who have been in the formal labor market. Registration for unemployment, as an indicator that the person is seeking work, is a means to get poverty or health benefits. As a result, many people who have no intention of entering the labor market appear on registered unemployment rolls. Finally, in higher-income countries, employment services offices sometimes intervene too heavily in the job search process by forcing individuals and firms to legitimize employment offers through the employment bureau, driving up hiring costs, or creating incentives for firms and individuals to enter into contracts illegally.

Lower-middle income and low-income countries. Low-income transition economies are in a very different situation with respect to unemployment insurance programs for a number of reasons. First, contributory schemes have little relevance, given the large informal economy and the limited administrative capacity to implement contributory schemes. Second, since enterprise restructuring is still at a relatively early stage in a number of countries, more layoffs are likely once restructuring takes place. The cost of instituting or maintaining traditional unemployment insurance schemes with reasonably generous benefits of long duration would be very high under these circumstances. The risk is that resources spent on unemployment insurance programs would take benefits away from these countries' overriding poverty-reduction objective—namely, making sure that the basic needs of the poorest households and children at risk are met.

Can any case be made for unemployment assistance? This answer is probably yes, especially in countries where workers in restructured enterprises have actually been working and being paid by the enterprise. While enterprises may have statutory severance obligations, many are probably not in a position to pay them. The loss of income in such cases may make such households vulnerable to poverty. There also may be a strong political rationale for providing some assistance if it significantly facilitates enterprise restructuring. Under these circumstances, low-income countries should convert unemployment insurance programs into unemployment assistance programs financed from general revenues. In these cases the flat unemployment assistance can be offered (in lieu or in combination, depending on fiscal resources) as a severance package for laid-off workers. This assistance should be simple, affordable, flat-rate, and highly limited in duration. It also should take into account severance pay and other layoff arrangements provided directly by the enterprise. The political costs of converting schemes from a contributory to a flat rate basis are not insurmountable, as the examples of Poland and Albania, both of which have flat schemes, demonstrate.

The unemployment assistance benefit structure must be coordinated with social assistance benefits and with community works programs, for which the unemployed may become eligible after exhausting unemployment benefits. Rather than having a separate unemployment assistance benefit, many countries may find it simpler to have one noncontributory poverty benefit with eligibility based on weights for unemployment and poverty-related (number of children) characteristics. Combining unemployment with cash benefits may also be more administratively efficient, since unemployment offices do little more than pay benefits.

The Performance of Pension Systems

During the early part of the transition period, pension systems were often used to facilitate enterprise restructuring. They became unaffordable as pension costs rapidly increased. The deterioration of pension-fund financing led countries, in the short run, to meet pension obligations through a combination of lower wage replacement rates, higher payroll taxes, and higher deficits. High-income transition economies that maintained a large share of formal employment, and strong revenue collection performance, experienced modest declines in the covered wage bill. Through a combination of budget transfers and high contribution rates, these transition economies were able to maintain reasonably high benefit levels relative to wage levels.

But in countries that realized much greater declines in their GDP, such as Armenia and Georgia, the general inability to collect contributions or other taxes meant pensions often were unpaid, or they were allowed to erode in real terms. In many countries (Albania and Ukraine are two examples), the ratio of maximum to minimum pensions is already close to one; while in some other countries the distinction between social assistance and pension programs has vanished and a flat pension has been paid since 1996. As the link between contributions and benefits has weakened and pension systems have come under increasing stress, they have been less able to deliver on their insurance objective.

However, pension systems have played an important role in protecting beneficiaries against poverty. Indeed, as chapter 2 showed, in most countries the incidence of poverty for households headed by pensioners is much lower than for other socioeconomic groups, such as the unemployed or working poor. In addition, the elderly have a lower relative risk of poverty than other demographic groups have. But single elderly women with low survivor pensions are particularly vulnerable. In Croatia and Slovenia, pension spending as a share of GDP is very high, but poverty among the elderly or households headed by pensioners is high relative to other demographic groups. This indicates that pension spending is very unevenly distributed. In Croatia in 1998, 47 percent of pensioners received pension benefits of less than 1,000 kunas per month–slightly more than half of the mean monthly per capita household expenditure. Moreover, more than one fourth of persons in Croatia who are 60 years or older do not receive any pension benefit.

Pension benefits represent a large share of total public expenditures in CSB countries. This means that pension systems (for countries where comparable data are available) provide more generous benefits than social assistance and are therefore more effective. In some countries pension systems have the single largest impact of any cash transfer on reducing the incidence and depth of poverty and reducing inequality. In FYR Macedonia the incidence of poverty would have doubled (all else constant) had the pension system not existed. By contrast (and all else equal), the incidence of poverty would fall at most one or two points if social assistance or unemployment benefits were discontinued. Similarly, in Bulgaria, pensions contribute the most to raising households out of poverty. Almost 40 percent of households that were poor prior to the receipt of social transfers relied on pensions as the primary means of moving out of poverty. Social assistance, unemployment benefits, and child allowances contributed much less to reducing poverty in the country.

The targeting of pension expenditures is not as efficient as unemployment or social assistance benefits (table 9.7). This is to be expected since pension spending is more generally linked to prior wage earnings.

Pension System Reform Options

The most important immediate reason to reform pension systems is that the obligations of the public system are unaffordable and are becoming more so over time as populations age. Countries have taken a number of important steps to improve the long-term sustainability of their pension

Table 9.7 Coverage, Targeting Efficiency, and Effectiveness of Pensions in Selected ECA Countries, Various Years

	Cash benefit		
Country and year	*Coverage*[a]	*Targeting efficiency*[b]	*Effectiveness*[c]
Bulgaria 1997	68	—	48
Macedonia, FYR 1997	—	7	17
Albania 1996	—	18	—
Armenia 1996	—	19	—
Estonia 1995	—	17	—
Latvia 1998	—	12	—
Croatia 1998	—	12	—
Kazakhstan 1996	23	11	15

— Not available.
Note: The "poor" are defined in Bulgaria as the bottom 36 percent; Romania, bottom 31 percent; Estonia, bottom 30 percent; and in Albania, FYR Macedonia, Armenia, Croatia, and Latvia, bottom 20 percent. For Kazakhstan, for targeting efficiency and effectiveness the "poor" are defined as the bottom quintile and for coverage as the bottom 35 percent.
a. Percentage of poor receiving benefits.
b. Percentage of total benefit expenditures received by poor.
c. Benefit as percentage of household expenditures.
Source: World Bank (1996a, 1998, 1999a, 1999b, 1999d, 2000a, 2000e);World Bank 1999c, Rashid, Dorabawila, and Adams (1999).

schemes (Palacios and Rocha 1998; Gora and Rutkowski 1998; Government of Slovenia 1997; and Jelinek and Schneider 1997). They have raised actual or effective retirement ages, and they have changed indication rules from a link to wages to a combination of wage and price indexes (Hungary, Poland, Czech Republic) or price index (Croatia). While the high-income countries are doing a better job of meeting their obligations, the size of the required payroll taxes offers a substantial incentive for workers to opt out of the formal sector. Additional reforms are needed to enable pensions to meet their objectives of reducing old-age poverty and helping individuals smooth consumption over their life cycle.

Middle-income and high-income countries. The main public pension reform challenges for middle-income and high-income transition countries is to tighten the benefit-contribution link to maintain workers' incentives to contribute to the system, downsize public systems in order to reduce the burden on public finances, lower tax rates on employees (and employers), and create room for the eventual introduction of a defined contribution plan. The way to pursue this objective is to convert the PAYG pillar into the one based on the notional defined contributions principle, or to modify and downsize the earning-related defined benefit schemes.[16] In both cases the public system would continue to provide either a minimum pension or social assistance to the elderly to address poverty objectives. It is particularly important to reduce the demands of the public pension system on the budget if there are major unmet poverty needs in the country. Often, however, there is significant political opposition to pension reforms.

Upper-middle and high-income countries may wish to consider introducing a multipillar system, assuming that financial market administrative capacities are adequately developed, the government can effectively regulate and supervise funds, and the transition costs can be financed—conditions few transition countries currently meet.[17] These reforms allow individuals to obtain pensions from two sources: a benefit obtained from the downsized public-defined benefit pension system (or the first pillar) and the benefit obtained from a portion of mandatory individual contributions that accumulate in individual accounts and are invested (eventually) in a diverse portfolio of assets (second pillar). The accounts are managed by the private sector, which typically has a better performance record than the state in managing funds. The state, however, regulates and supervises the accounts.

Investing a portion of mandatory individual contributions in individual accounts is considered to have several advantages. First, in essence, this reform entails the conversion of the implicit debt of pension systems to an explicit pension fund deficit. Second, it allows individuals to obtain savings that reflect market returns on contributions. Third, by allowing individual contributions to be invested in the public system and in portfolios managed by private companies, and by allowing eventual international diversification of portfolios, individuals can diversify risk across countries/regions or assets.

To date, only two of the CSB countries, Hungary and Poland, have adopted a multipillar system. In Hungary 1.2 million workers—mostly under age 40—have diverted part of their pension contributions to private pension providers. All new labor market entrants are required to join. In Poland the new private pension funds are being licensed. In 1999 workers in Poland between the ages of 30 and 50 were given the choice to divert one-fifth of their overall pension contribution to these new funds. Workers under 30 will automatically join the new scheme. In Romania, Croatia, Latvia, Slovenia, and FYR Macedonia, the introduction of the second pillar is being planned. So far only one FSU country, Kazakhstan, has introduced a multipillar system. Kazakhstan is distinct in that it has fully privatized the pension scheme, leaving the public sector's role as one of coping with the risks of poverty in old age or disability.[18]

Countries adopting a multipillar system face a host of challenges (World Bank 2000b; Palacios and Rocha 1998). They must manage the financial costs of the transition, redefine the government's role as supervisor, design the institutions in the second pillar, and implement parallel reforms to ensure the success of the multipillar scheme.

Low-income countries. Low-income countries must ensure that the pension system does not let elderly pensioners fall into destitution, and they must free up resources to address the needs of others living in destitution. To accomplish these overriding objectives, poor countries may have to substantially flatten the distribution of the pension or adopt a flat pension. Special privileges accorded to particular groups of workers should be reduced. In the meantime these countries should focus on developing the institutional capacity for the eventual introduction of funded pension systems. When the wages start growing, these countries should consider a step-by-step movement toward a multipillar system.

Political opposition to pension reforms is considerable. Georgia recently introduced a flat pension, and now there is a huge debate about reintroducing differentiation in the benefit. In FYR Macedonia, despite the major financial problems with the pension fund, successive governments have promised increases in benefits prior to elections.

Administrative issues also plague many transition countries, especially the poorest ones. Actuarial capacity to forecast pension expenditures and revenues is still limited in many low-income countries. Collection of contributions remains a major problem, particularly given the emergence of the private (and informal) sector. Pension funds are often not audited. Because of borrowing and lending across insurance funds, the financial conditions of many funds are opaque. Particularly in CIS countries, record-keeping of individual work history and pensioner information remains deficient. As countries move to a multipillar system, selection of management of private pension systems, development of legislation, proper management of accounts, collection of contributions, and ways to build institutional capacity to regulate and supervise private funds become critically important.

Conclusions

Table 9.8 summarizes the programs that are likely to be the most appropriate for countries, given their income level.

Table 9.8 Typology of Reform Options by Country and Program

Income level	*Social assistance*	*Social insurance unemployment*	*Pensions*
High and upper-middle	Means-tested cash benefit assistance program, possibly supplemented by indicator targeting De-institutionalization	Insurance	Multipillar with minimum poverty-based benefit
Lower-middle	Categorical cash benefit (universal or targeted by indicator; means test possibly only where local institutions are strong Life-line tariffs De-institutionalization	Flat benefit or severance	Reformed PAYG linking contributions with benefits, with minimum poverty-based benefit
Low	Limited cash benefit probably based on geographic targeting or indicator targeting Life-line utilities tariff Self-targeting (for example, workfare) De-institutionalization	Flat benefit or severance	Flat benefit

Transition countries face tough political choices. Governments are under great pressure to provide a high level of security to their populations, a number of whom find the uncertainty and reliance on self required by the market system difficult to bear. For this reason, poor transition countries often have a more developed set of social protection programs than do other countries with a similar level of income. In some countries the levels of protection are not fiscally sustainable. They undermine the development of formal labor markets and sometimes undermine recipients' incentives to work. In Europe and Central Asia, like elsewhere in the world, political considerations often dictate that programs be expanded beyond the truly needy in order to ensure a more secure resource stream. Indeed, many countries in Western Europe spend substantial amounts on programs that provide support to all or most families with children. The United States is an exception in that it concentrates its social assistance expenditures on the poor (Bradbury and Janti 1999).

Democratization has allowed some groups to form powerful lobbies that can direct subsidies in their direction. Political pressure groups may explain why some countries (for example, Latvia) continue to subsidize utilities for urban groups when rural areas have almost no access to hot water and heating. Political pressure appears to have privileged pensioners while leaving many rural and urban populations and multichild households at high risk of poverty. Similarly, continued privileges to particular groups, and even an increase in groups with privileged benefits, attest to the importance of political influence in the design of social assistance systems in many CIS countries.

Social protection reforms may have to compromise program design for greater acceptance of overall program objectives. Flat benefits targeted to the most needy may not enjoy broad-based support. Programs for the poor often need broader participation in order to ensure that schemes are continued and adequately funded. What is unfortunate is when broad participation undermines the provision of adequate benefits to the truly destitute or to parents who cannot afford to feed their children, provide them with adequate health care, or send them to school.

Notes

1. This chapter draws heavily on World Bank (2000b), and the work of Andrews and Ringold (1999), Palacios, Rutkowski, and Yu (1999), and Rashid and Rutkowski (1999), as well as on the work on the paper of Lovei (2000).

2. Other family benefits—including birth grants, parental leave benefits, and maternity leave introduced early on in the transition—still exist, but they are negligible in value compared with these two types.

3. Most countries have a regular monthly-benefit social assistance program as well as occasional benefits for households in temporary need of assistance. In countries where social assistance means-tested programs were added to already existing programs (such as in Romania, FYR Macedonia, and the Slovak Republic); other benefits were included in the calculation of household income, so that double counting of cash benefits was avoided.

4. In OECD countries, eligibility for unemployment benefits requires minimum coverage (six months on average); benefits are capped, and duration varies between 8 and 36 weeks. Benefit replacement rates range from 40 percent to 75 percent of past earnings, and they are based on an average of recent wages. To reduce false claims, OECD countries impose waiting periods and require applicants to be capable and willing to work, and registered at the Employment Bureau. Laid-off workers and those who have not left work voluntarily, or due to strike, or as a result of misconduct are generally eligible for benefits. Refusing a reasonable job offer without good reason is cause for suspension of benefit (Tzannatos and Roddis 1998).

5. The Union of Soviet Socialist Republics (USSR) introduced a range of social insurance programs, including contribution-based old-age pensions, in the 1920s after the Russian Revolution.

6. In OECD countries, public systems are financed as pay-as-you-go, and they are composed of a flat rate pension and an earnings-related tier. Tax rates vary considerably, ranging from 38 percent in Germany to 6 percent in the United States. Program expenditures vary between 6 and 10 percent of GDP. The retirement age is about 65 years (at least for men); many countries have lower retirement ages for women. System replacement rates are far in excess of 40 percent per couple as stated in a convention of the International Labour Office. Eligibility restrictions include minimum years of contribution. Many countries have reformed their pension systems because of financial problems.

7. Cash benefits are not always allocated appropriately within a household. To address this problem, some countries provide benefits directly to the mother. In the United Kingdom this policy is followed because mothers are assumed to be less likely to use the cash for the consumption of goods that may not reduce—or (in the case of alcohol) aggravate—poverty. This approach could be considered for means-tested cash assistance in transition countries where differences in intrahousehold spending preferences are strong. This is an area that has not been well researched in transition countries.

8. The concept of "affluence testing" to exclude the rich as opposed to including the poor is gaining attention in OECD countries.

9. In higher-income countries, self-targeting is often achieved by imposing a cost to receiving social assistance—formally through a work requirement and informally by having long queues to receive benefits. The shame associated with receiving social assistance benefits may deter some individuals from applying. These costs will lower the net benefit to the poor from the program and must be considered in evaluating how cost-effective the program is.

10. This is calculated by dividing social assistance spending by the number of poor as estimated using the household survey. Not all of the spending actually goes to the poor.

11. The allowance (A) is equal to pcN – bY (or zero, whichever is larger), where p is the price of a unit of utility, b is the burden limit, Y is household income, c is the norm for per capita utility consumption, and N is the number of persons in the household. Since pcN does not change with income, the allowance decreases as household income grows.

12. For the purposes of the analysis, the relative poverty line is set at two-thirds median consumption. See Lovei (2000).

13. In some OECD countries, school leavers are eligible for benefits during recessions (Tzannatos and Roddis 1998).

14. Most hiring in transition economies has been from the ranks of the employed, not from the pool of unemployed. One reason cited for this phenomenon is the large surplus labor still existing in enterprises, and the low skill base of the

unemployed or those who have been laid off. There is very little unemployment among college or university graduates in Central European countries.

15. Moral hazard exists, for example, when program administrators do not have perfect information about beneficiaries. In this case individuals may try to keep benefits to which they are not entitled by claiming they are unemployed when they are not, or they may shirk on the job in order to get fired so that they can receive benefits.

16. The prototype of notional defined contribution (NDC) scheme reforms in transition economies was developed by Latvia. (Latvia followed the reform designed in Sweden.) The NDC system is based on individual accounts. Pension contributions are notionally accumulated (indexed), and the pension depends on the accumulated amount divided by the average life expectancy at the retirement age. Therefore, the system has automatic stabilizers enabling the pension level to be adjusted to changes in life expectancy. The system encourages recipients to work longer since the increases in the pension amounts are actuarial, not linear. This means that at the age of 62 or 63, one working year longer yields an 8 to 9 percent increase in the amount of the pension, not a 2 to 3 percent increase.

Despite certain advantages, the NDC system is an unfunded pay-as-you-go system, subject to some of the risks associated with these schemes. Countries may choose to modify their Defined Benefit Scheme by making benefits more tightly linked to contributions. This can be achieved by increasing the retirement age, reducing excessive target replacement rates, and introducing a lifetime assessment period. This particular first-pillar option has been adopted by Hungary in its multipillar system, and it is being considered by FYR Macedonia and Romania as an integral part of their pension reform programs. To reduce costs, many countries have raised retirement ages (Hungary, Poland, the Czech Republic, and FYR Macedonia) or effective retirement ages (Latvia); changed indexation rules from wage to a combination of wage and price (Hungary, Poland, Czech Republic); price (Croatia), or public sector wage; and changed the benefit formula (FYR Macedonia, which reduced replacement rates, and Slovenia).

17. The transition costs are not real costs since the implicit debt to future generations is paid. See Rutkowski (1998) for an overview of the movement toward multipillar systems in both transition economies.

18. In this regard the Kazakhstan reform resembles the Chilean, El Salvadoran, and Peruvian reforms in which no residual, unfunded public contributory scheme remained after the reform.

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