

**TO WHAT EXTENT DOES THE EXISTING SAFETY NET PROTECT THE POOR?**

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## **INTRODUCTION**

Within the set of poverty reduction strategies, social protection plays an important role. An effective social safety net protects households and prevents them from destitution. It cushions the potentially impoverishing effect of covariate or idiosyncratic shocks. It prevents households from adopting strategies, such as selling their last assets, which may result in irreversible losses.

The objective of social protection policies is to help families, individuals and communities with the prevention and mitigation of social and economic risks. Social protection policies are a range of public interventions to support the poor and vulnerable, and assist families, individuals and communities to better manage social and economic risks.

Within the whole range of social protection policies, the social safety net focuses on the provision of support to poor and vulnerable households. It is distinct from social insurance policies targeted to workers in the formal labor market, as eligibility does not depend on the work history, but is related to the immediate needs of the poor and vulnerable population not covered by formal social protection measures.

The objective of this paper is to assess the effectiveness of the Kyrgyz social safety net in protecting the poor using data from the 2008 KIHS. The analysis focuses on non-contributory social benefits targeted to poor and vulnerable households. The next section provides an overview of the current system of social benefits and recent reforms. Section three presents the results of the empirical analysis, focusing on coverage, distribution, adequacy and impact of the current non-contributory social transfers. Section four discusses the potential impact of the reform and further challenges.

## **CURRENT SYSTEM OF NON-CONTRIBUTORY SOCIAL BENEFITS<sup>1</sup>**

The Kyrgyz social benefit system includes contributory (social insurance) and non-contributory (social assistance) benefits. The social insurance component protects citizens against the risks of old-age, disability, loss of breadwinner and unemployment. It provides benefits upon the manifestation of the risks to those with a formal employment record, or contribution history. Just below six percent of GDP is annually allocated to the financing of the social insurance system (World Bank, 2009, p. 30).

Non-contributory benefits are allocated independently of former contributions made and cover categorical state benefits, also called privileges (*l'goti*), monthly social benefits and a unified monthly benefit targeted to poor households with children. Total spending on non-contributory benefits nominally increased from KGS 1.3 billion in 2005 to KGS 2.2 billion in 2009, which represents about one percent of GDP. Over the same period, the number of beneficiaries decreased from 975,000 to 708,000.

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<sup>1</sup> This section draws heavily on chapter 3 of the Social Safety Net Note (World Bank, 2009).

**Table 1: Government spending on non-contributory social transfers, 2005-2010**

		2005	2006	2007	2008	2009	2010 est
GDP*	bio KGS			141.9	188.0	196.4	229.1
Total spending on non-contributory benefits	mio KGS	1,323	1,605	1,670	1,905	2,204	3,790
<i>as percentage of GDP</i>	%			1.18	1.01	1.12	1.65
- UMB	mio KGS	508	773	695	673	755	1,147
<i>as percentage of GDP</i>	%			0.49	0.36	0.38	0.50
- MSB	mio KGS	220	329	365	542	619	1,033
<i>as percentage of GDP</i>	%			0.26	0.29	0.32	0.45
- Categorical state benefits (l'goti)	mio KGS	595	503	609	689	829	1,609
<i>as percentage of GDP</i>	%			0.43	0.37	0.42	0.70
Population**	mio	5.14	5.20	5.25	5.31	5.37	5.44
Total number of beneficiaries	'000	975	972	837	789	708	487
<i>as percentage of the population</i>	%	19.2	18.9	16.1	15.0	13.3	9.1
- UMB	'000	482	481	475	434	362	396
<i>as percentage of the population</i>	%	9.4	9.3	9.0	8.2	6.7	7.3
- MSB	'000	54	57	59	59	61	65
<i>as percentage of the population</i>	%	1.1	1.1	1.1	1.1	1.1	1.2
- Categorical state benefits (l'goti)	'000	439	434	303	296	285	26
<i>as percentage of the population</i>	%	8.5	8.3	5.8	5.6	5.3	0.5
average amount of UMB per month	KGS	89	124	125	120	135	205
average amount of MSB per month	KGS	367	456	461	656	715	1,295

Source: MLSP 2006, 2007, ASP 2009, World Bank (GDP), IMF (Population)

\* GDP 2009: preliminary; \*\* Population: estimates for 2007-2010.

## Unified Monthly Benefit

The Unified Monthly Benefit (UMB) is a means-tested and categorical non-contributory benefit targeted to poor households with children. The UMB is a variable benefit and covers the gap between the Guaranteed Minimum Income (formerly called Guaranteed Minimum Consumption Level) and the average per capita family income for eligible beneficiaries. Until 2009, the following household members were eligible for the UMB<sup>2</sup>:

- Children under the age of 16 (and pupils under the age of 18 still attending general educational institutions);
- Pupils of primary vocational schools and students of secondary and higher vocational institutions up to the age of 21;
- Persons with disabilities (confirmed by medical commission); and
- People of pension age without other pension entitlements.

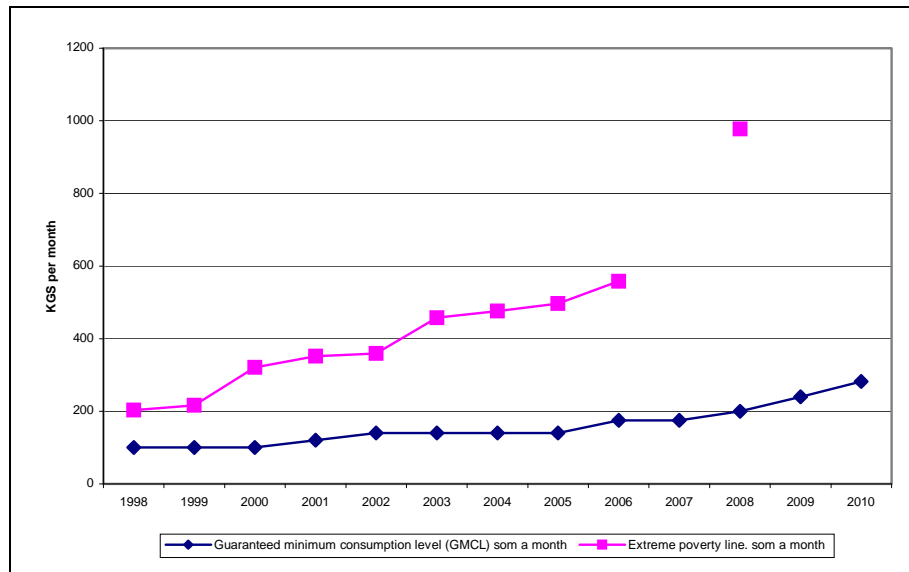
Total household income includes net income of all household members from all sources, cash as well as in kind.<sup>3</sup> Not included is income from livestock, unemployment benefits, MSB, or single transfers such as funeral allowances or child birth grants.

<sup>2</sup> Law on State Benefits.

<sup>3</sup> Income included, among others: from employment, bonuses, commercial activities, leases, income from assets and deposits, imputed income from land (based on productivity coefficients), pensions, private transfers, scholarships and inheritance.

The Guaranteed Minimum Income (GMI) is a social standard established by the GoKG in 1998 and adjusted regularly. The level of the GMI depends on available budgetary resources and the predicted number of beneficiaries.<sup>4</sup> Upon its establishment in 1998, the value of the GMI (GMCL) was set at KGS 100, which at that time was about half the value of the extreme poverty line, i.e. the costs of a food basket comprising 2,100 kcal per capita per day. Over the years, the gap between the GMI and the extreme poverty line widened further, contrary to the objective of the GoKG to gradually converge towards the Minimum Consumption Budget (MCB)<sup>5</sup>. In 2008, it was KGS 200, representing only 20 percent of the extreme poverty line (figure 1).

**Figure 1: Development of GMI (GMCL) and extreme poverty line, 1998-2010**



Source: MLSP/ASP

Eligibility for the UMB is determined in two steps. First, only households whose average per capita income is below the set standard are eligible for the program. Secondly, only household members falling into one of the eligible categories are entitled to the benefit. In addition to the variable UMB, fixed benefits are granted to poor families upon submission of the appropriate birth certificate:

**Table 2: UMB categories eligible for fixed amounts**

Category of UMB beneficiary	Fixed UMB (- 2009)	Fixed UMB (2010 -)
Benefit at child birth	300% of GMCL	300% GMI
Benefit to children under 1.5 years	100% of GMCL	
Benefit to children under 3 years		200% GMI
Benefit to twins aged 0-3 years	100% of GMCL per child	100% GMI
Benefit to triplets and higher multiple births aged 0-16 years	150% of GMCL per child	150% GMI

<sup>4</sup> Until 2009, both expected UMB and MSB beneficiaries determined the level of the GMI. Starting from 2010, the GMI only applies to the UMB.

<sup>5</sup> The MCB basket contains food, non-food, services, taxes and other payments. In 2008, its value was KGS 3,570 per month.

The UMB is entirely financed from the republican budget. Spending has been rather volatile in the past, neither related to the number of beneficiaries nor to economic growth or inflation (figure 2 and 3). The available budget, and subsequently the level of the GMI (and average UMB), is based on fiscal considerations and lacks a regular adjustment mechanism. As a result, the average value of the UMB is very small, undermining its potential to mitigate hardship and protect the poorest families (table 1). In 2009, the average UMB was KGS 135 per month (USD 2.95<sup>6</sup>).

Since 2007, the number of UMB beneficiaries has been decreasing substantially from 475,000 to 362,000 beneficiaries in 2009. While increasing incomes (prior to the onset of the financial and economic crisis in 2008) may partly explain the decline, the main reason for the reduction of the number of beneficiaries is the revision of the land coefficients used to impute income from land. The majority of UMB beneficiaries are children (87 percent in 2007). Most of the beneficiaries reside in the southern oblasts of Jalalabad, Osh and Batken.

#### *Reforms per January 2010 and beyond*

The GoKG adopted a new Law on State Benefits in the Kyrgyz Republic in December 2009. The revised UMB will be targeted to children only. The few other categories eligible under the previous law have been removed. The formula for the calculation of the GMI has been slightly modified, but essentially follows the same principle of budgetary dependence. In response to the energy tariff increase in January 2010, the GoKG raised the GMI from KGS 240 to KGS 282 per month.<sup>7</sup>

In order to improve the targeting efficiency of the UMB, the GoKG is planning further reforms of the UMB. It is currently testing the introduction of additional filters such as possession of livestock and of durable assets. At the end of 2009, it was foreseen to exclude households, which possess two of more cows or 25 or more sheep (goats), from UMB eligibility. This filter accounts for income from livestock which currently is not included in the calculation of family income. Secondly, by excluding households possessing more than three durable assets, the GoKG aims at reducing the inclusion error even further<sup>8</sup>. Additional plans envisage a larger role for ail okmotus in eligibility assessments, especially with respect to the valuation and use of land.

**Figure 2: Dynamics of safety net beneficiaries, 2000-2010**



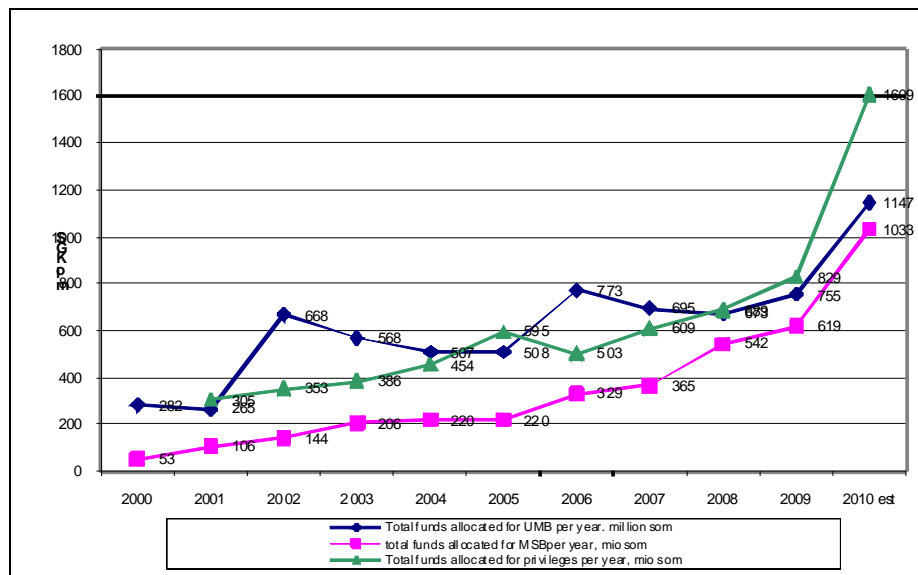
Source: MLSP/ASP.

<sup>6</sup> Exchange rate: 1 USD = 45.7 KGS (May 2010)

<sup>7</sup> Note that the energy price reform was reversed after the events in 2010.

<sup>8</sup> Accountable durable assets: car, truck, agricultural machinery, color TV, fridge, washing machine, mobile phone.

**Figure 3: Dynamics of safety net spending, 2000-2010**



Source: MLSP/ASP.

### Monthly Social Benefit

The Monthly Social Benefit (MSB) is a categorical benefit targeted to vulnerable groups with limited income generating opportunities. It is an income maintenance program providing a ‘social pension’ to people with disabilities, orphans, and elderly without pension rights. The MSB is assigned irrespective of the income of the beneficiary. Until 2009, the value of the MSB was based on the GMI. It varied between 75 and 300 percent of the GMI depending on the category. In 2003, a top-up of 20 percent was added to the original values. More top-ups have been added since.

Similar to the UMB, the MSB is entirely financed from the republican budget. Due to its link to the GMI and the various top-ups, the average value of the MSB has been increasing from KGS 367 per month in 2005 to KGS 715 in 2009 (USD 15.65) (table 1), but it still remains below the value of the extreme poverty line.

The number of MSB recipients has been gradually increasing from 37,000 in 2000 to 64,000 beneficiaries in 2009. According to the Agency of Social Protection, the main reason for this increase is the growing number of children with disabilities from birth. Deteriorating health care of pregnant women, deterioration of nutrition and lack of vital nutritive components in the diet of pregnant and lactating women and young children, poor living conditions and limited access to health care are potential reasons for the growing incidence of disability among children (CASE, 2008). 54 percent of all MSB beneficiaries are children. While the number of MSB recipients increased 1.64 times, spending increased in the same period with a factor 11.8 (table 1 and figure 3).

#### Reforms per January 2010

The new Law on State Benefits introduced some major changes to the MSB program. First and foremost, the MSB is no longer tied to the GMI. The ‘Decree on determining the amounts of state benefits’ defined flat rate benefits for 15 categories of former MSB recipients. The new flat rates vary between KGS 1,000 and KGS 2,000 per month depending on the category. The average monthly MSB increased to KGS 1,295 (USD 28.3) per month.

**Table 3: MSB: before and after reform (changes introduced per January 2010)**

	persons	% of total	Average monthly benefit (KGS)	
			old	new
Disabled children with CPIP	3,864	6.0	1164	2000
Disabled children	18,013	27.8	848	1500
Children with HIV or AIDS	120	0.2	948	2000
Children born from mothers with HIV/AIDS	108	0.2	948	2000
Disabled from childhood - I category	4,012	6.2	1164	2000
Disabled from childhood - II category	15,449	23.8	848	1000
Disabled from childhood - III category	5,189	8.0	532	1000
Disabled - I category	444	0.7	848	2000
Disabled II category	2,144	3.3	532	1500
Disabled III category	672	1.0	316	1000
Elderly citizens	1,602	2.5	402	1000
Elderly citizens of high-mountainous areas.	442	0.7	532	1000
Hero-mothers	167	0.3	848	2000
Children, in the event of breadwinner loss	12,237	18.9	532	1000
Orphans without both parents	332	0.5	848	2000
Total beneficiaries	64,795	100		

Source: ASP.

### Categorical State Benefits

Categorical state benefits (also called privileges – l’goti) are a legacy from the former Soviet era. Specific categories of privileged or vulnerable citizens are eligible for state subsidies and benefits. Until 2009, the system knew 38 different categories of beneficiaries and 14 different types of benefits and subsidies (tables 4 and 5). The value of the benefits is differentiated for different categories. Some groups of beneficiaries, e.g. disabled veterans of World War II, receive 100 percent of the entitlement, while others receive only a certain percentage. The largest group of beneficiaries, families living in mountainous regions are only entitled to a specific electricity subsidy. Eligibility is mainly categorical and independent of household income.

Historically, all categorical benefits were granted in kind. Except for the utility subsidies, which were directly transferred to utility providers, take-up of the various entitlements was limited. Based on expenditure data, we estimate that actual take-up of benefits other than utility subsidies was in the range of 20 percent. Starting from 2003, a gradual monetization has taken place. In 2008, the majority of the benefits were monetized with the exception of glasses, hearing aids, trips within the CIS and sanatorium vouchers.

The large majority of categorical benefits is financed from the republican budget (95 percent). Despite the shrinking number of beneficiaries, expenditures from the republican budget have been increasing substantially over the years, not the least as a result of the monetization of benefits (Figure 4).

**Table 4: 38 Categories of categorical state benefit recipients**

	Categories	# of beneficiaries			as % of total
		2007	2008	2009	2009
1	Disabled from WW2	1809	1645	1329	0.47%
2	Participants of WW2	4282	3919	3183	1.12%
	Disabled Soviet Army, of which:	1086	1127	1155	0.41%
3	Disabled DRA (Afghanistan)	193	196	176	0.06%
	Home front workers of which:	14422	13700	11766	4.13%
4	Disabled	2120	2029	1860	0.65%
5	Military heroes of KR in the USSR	3	3	3	0.00%
6	Survivors of the Leningrad siege	56	55	49	0.02%
7	Under aged survivors of Concentration camps	78	76	66	0.02%
8	Participants of the Hungarian "events"	28	27	23	0.01%
9	Internationalists	6290	6336	6225	2.19%
10	Military workers later rehabilitated.	36	35	30	0.01%
11	Families of fallen soldiers of which	864	825	731	0.26%
	Soldiers in WW2	393	338	248	0.09%
12	Widows of disabled soldiers in WW2	4604	4443	3886	1.37%
	Widows of soldiers in WW2 with later				
13	disabilities	2583	2543	2264	0.80%
14	Widows of Leningrad siege survivors	3	3	4	0.00%
15	Participants of clean up of Chernobyl 86-87	352	342	320	0.11%
16	Participants of clean up of Chernobyl 88-89	83	76	90	0.03%
17	Disabled due to Chernobyl	1041	988	892	0.31%
18	Families that lost breadwinner in Chernobyl	195	194	189	0.07%
19	Personal pensioner due to medals etc	2272	2285	2301	0.81%
	Recipient of orders/medals by the Kyrgyz				
20	Republic ...	22	20	19	0.01%
21	Pensioners from the military	1423	1501	1485	0.52%
22	Pensioners from MOI	5206	5231	4973	1.75%
23	Families of MOI staff that died in duty	159	134	178	0.06%
24	Staff of criminal justice system	864	918	846	0.30%
25	Pensioners of criminal justice system	198	224	502	0.18%
	Families in mountainous regions not receiving				
26	other privileges	159349	161288	154658	54.35%
	Alone living pensioners with less than 660				
27	soms in pension	1223	1002	1010	0.35%
	Alone living pensioners with less than 1220				
28	soms in pension	3337	3511	3292	1.16%
	Alone living pensioners with less than				
29	1880soms in pension (gas)	440	463	448	0.16%
	Non working pensioners; of which	26303	27795	29604	10.40%
30	Alone living (gas)	3134	3071		
	Families with disabled children up to the age				
31	of 18 years	12736	13916	13882	4.88%
32	Non working pensioner that lost breadwinner	10634	11558	9241	3.25%
	Non-working pensions with pensions less than				
33	the base pension of 363 soms	372	354	253	0.09%
34	Rehabilitated and victims	3101	3084	3044	1.07%
35	Deaf people	3142	3241	3225	1.13%
36	Blind people	9190	9614	10258	3.60%
37	Heroine mothers (=>3 children)	15748	15652	15179	5.33%
38	Blood donors	413	561	628	0.22%
	<b>TOTAL</b>	<b>290446</b>	<b>295879</b>	<b>284571</b>	<b>100%</b>
	From the republican budget	274202	280151	269302	
	From the local budget (16+37+38)	16244	15728	15269	

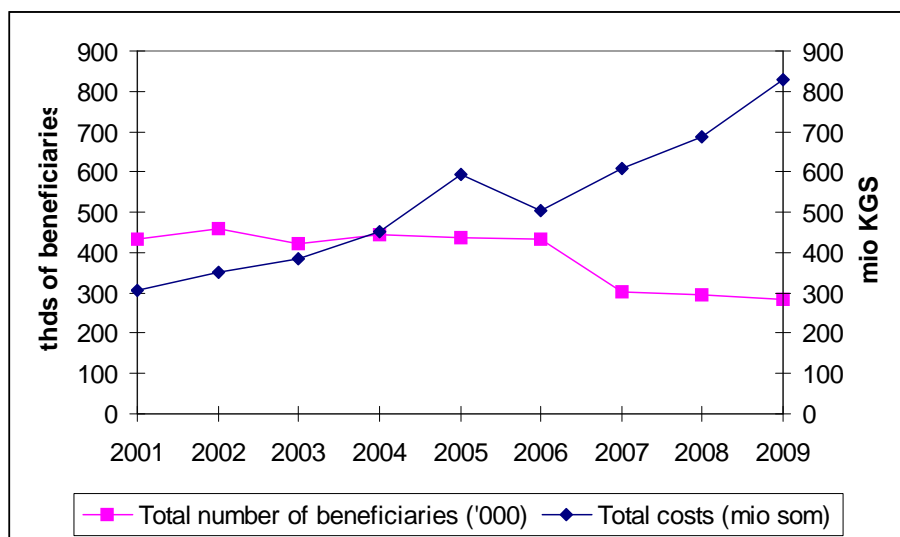
Source: ASP.

**Table 5: Examples of state categorical benefit package: most and least generous, KGS per month, 10/2009**

Utilities	Sanatorium/resort vouchers	Free travel within CIS once a year (round trip ticket)	Compensation for medicines	Lump sum cash benefit for 9th of May occasion	Additional cash benefit for 9th of May occasion	Free glasses once in 3 years	Hearing aid once in 3 years	Dental work	Free public transport	Free travel within the country	Free travel within suburb	Compensation for transportation services	Subscription to newspapers
Example 1: Disabled veterans of World War II													
1040	867	3195	66.6	50	250	11.1	116.6	140	80	210	40	67	34.6
Example 2: Families living in mountainous regions													
60													

Source: ASP.

**Figure 4: Categorical state benefits (I'goti): costs and beneficiaries**



Source: ASP.

#### Reforms per January 2010

The GoKG introduced major reforms to the system of categorical state benefits. The presidential decree 'On providing monetary compensations to selected categories of citizens in connection with energy prices' replaced the previous system of in-kind subsidies and benefits by flat cash benefits and reduced the eligible groups of beneficiaries. New benefit values vary between KGS 7,000 (USD 153) per month for war veterans and KGS 1,000 (USD 22) per month (table 6) and are all paid in cash. As a result of this reform, the number of beneficiaries is expected to drop with 240,000, leaving about 26,000 entitled beneficiaries. However, government expenditures are expected to double to KGS 1.6 billion per year as a result of the full monetization and the benefit increase due to the energy tariff reform.

**Table 6: Categorical state benefits as per January 2010 according to President's Decree**

<b>Category</b>	<b>Monthly compensation (KGS)</b>
1 WW II disabled people	7000
2 WW II Veterans	7000
3 Disabled of Soviet Army and Afghanistan war	7000
4 Heroes of KR and Soviet Union	7000
5 Workers of rear services with group of disability	2000
6 Underage prisoners of concentration camps	7000
7 Leningrad siege survivors	7000
8 Participants of international conflicts	6000
9 Labor service people	2000
10 Families of fallen soldiers (FFS)	1000
Widows of WW II disabled and participants, siege participants	
11 with disabilities	1000
12 Workers of rear services	1000
13 Persons suffered in Chernobyl NPP in 1986-1987	2500
14 Disabled of Chernobyl NPP	3000
15 Persons suffered in Chernobyl NPP in 1988-1989	1000
16 Families of dead disabled in Chernobyl NPP	1000
17 Children under 18 years of victims of Chernobyl NPP	1000
18 Rehabilitated citizens	1500
19 Hearing impaired	1000
20 Visually impaired	1000
21 Honorable blood donors	1000

*Source: ASP.*

## **TARGETING PERFORMANCE AND POVERTY REDUCTION IMPACT**

This section assesses the performance of social protection benefits in terms of coverage, distribution and adequacy of the transfers. The analysis is based on data from the 2008 Kyrgyz Integrated Household Survey and covers all social and private transfers for which information is available in the KIHS. First, we consider the distribution of benefits and beneficiaries across welfare quintiles and other socio-economic household characteristics, and secondly, assess the impact of the various transfers on poverty reduction. While the GoKG has implemented a number of reforms in January 2010, this assessment considers the system as it was applicable in 2008. The implications of the recent reforms will be discussed in the next section.

### **Methodology**

Average household consumption per capita as calculated by the National Statistics Committee (NSC) is the main welfare indicator. The population is ranked and grouped into quintiles (five groups of equal size) based on counterfactual household consumption per capita in the absence of social transfers (25 percent substitution rate).<sup>9</sup> We then analyze the coverage, distribution and benefit adequacy for the different transfers. The second part of the analysis assesses the impact of social and

<sup>9</sup> See Annex 1 for more details.

private transfers on poverty reduction. Poverty indicators are estimated before and after transfers. The poverty lines used to analyze the poverty reduction impact of social and private transfers are those developed by the NSC. We use the absolute and extreme poverty line. The value of the extreme poverty line is equivalent to the costs needed to cover a minimum of 2,100 kcal per capita per day. The absolute poverty line includes an allowance for non-food goods and services deemed necessary to cover basic needs. Both poverty lines were calculated by the NSC in 2003 based on the new KIHBS which was first introduced then, and have been updated annually using the consumer price index.

Poverty rates (poverty headcount rate and poverty gap) are calculated for after-transfer per capita consumption and the counterfactual pre-transfer consumption.<sup>10</sup> The constructed variables relevant for poverty analysis, such as aggregate per capita consumption and poverty lines are provided by the NSC as daily values. However, information on income from different sources is for the year as a whole. For the subsequent analysis we use annual values. Daily per capita consumption and the poverty lines have been adjusted to annual values by multiplying with 365. All results are calculated at the individual level (measuring ‘people’ not households). Sampling weights are used in order to render the results nationally representative, unless otherwise noted.

A few words of caution are warranted: the results of coverage and poverty impact in particular tend to be under-estimated when using household survey data. The main reason is incomplete respondent recall both on the receipt of a given transfer (coverage) and on the amount received (poverty impact, adequacy). In particular the results on the MSB and on housing and utility privileges have to be treated with caution as they are severely underreported in the current survey.

### **Coverage, distribution and benefit adequacy**

In 2008, almost half of the population was receiving a social transfer, either contributory or non-contributory (table 7). This is slightly less than in 2005 (figure 5). The share of social benefit recipients is largest among the poorest 20 percent of the population, where almost two out of three individuals benefit from a transfer. Compared with 2005, coverage of the poorest with social transfers declined from 74 to 65 percent, while it increased from 23 to 29 in the richest quintile. Pensions account for the largest share in terms of coverage. More than one third of the population lives in a household receiving pensions (one in two of the poorest 20 percent). Other social insurance benefits are much less important with a very low coverage rate.

The UMB as the main social safety net program explicitly targeted to the poor has an overall coverage rate of 10 percent (15 percent in 2005). Compared to 2005, coverage of the poorest decreased from 26 to 18 percent. Coverage of the MSB according to the KIHS is exceptionally low with two percent.<sup>11</sup> Utility and housing subsidies reach almost one fifth of the population. Coverage rates are similar across the welfare distribution.<sup>12</sup>

For comparative purposes, the analysis in this section also includes informal transfers, money received from relatives.<sup>13</sup> 30 percent of the population benefit from informal transfers, a reduction with four percentage points compared to 2005.

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<sup>10</sup> We use the standard Foster-Greer-Thorbecke family of poverty measures (Foster et al., 1984).

<sup>11</sup> This is not in line with administrative data reporting an increase of MSB beneficiaries. As mentioned earlier, MSB receipt seems to be severely underreported. Results have to be treated with caution.

<sup>12</sup> Note that compared to 2005, coverage with privileges almost doubled. This result should be treated with caution due to measurement problems in the survey.

<sup>13</sup> This also includes remittances received from abroad.

**Table 7: Benefit coverage of social protection benefits and private transfers, percentages, 2008**

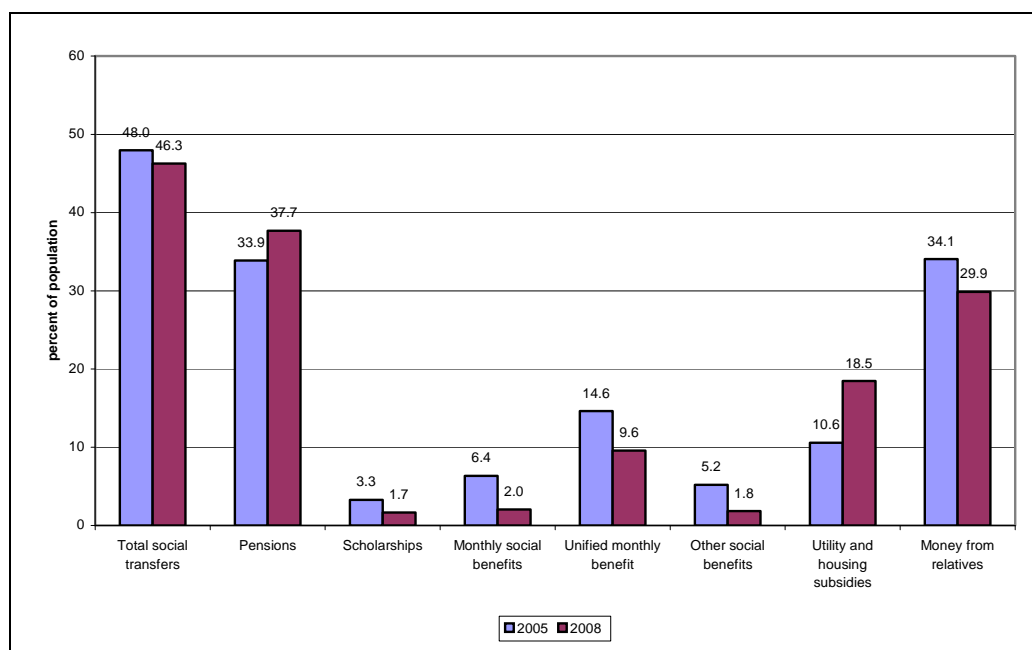
Type of benefit	Quintile I	Quintile II	Quintile III	Quintile IV	Quintile V	Total
Any social transfer	65.2	56.7	39.1	41.3	28.8	46.3
Pensions	50.7	45.4	30.3	36.8	25.2	37.7
Scholarships*	1.9	1.7	0.9	1.1	2.8	1.7
Monthly Social Benefit	3.5	2.3	2.3	1.8	0.2	2.0
Unified Monthly Benefit	17.9	14.5	10.4	3.7	1.4	9.6
Other social insurance benefits*	2.4	3.5	1.4	1.3	0.6	1.8
Utility and housing subsidies*	21.7	16.8	20.2	18.5	15.1	18.5
Money from relatives*	28.3	34.5	30.9	26.1	29.6	29.9

Note: Quintiles are based on annual per capita consumption before transfers, assuming a marginal propensity of 25 percent.

\* Differences between groups are not significant at the 10 percent level (Chi-square test).

Source: own calculation based on KIHS 2008.

**Figure 5: Benefit coverage, 2005 and 2008**



Source: Own calculation based on KIHS 2005 and 2008.

The distribution of beneficiaries along the welfare distribution (table 8) slightly worsened compared to 2005 to the benefit of richer households. In 2008, 29 percent of social transfer beneficiaries belonged to the poorest 20 percent of the population (a reduction of two percentage points compared to 2005), while 12.5 percent belong to the richest quintile (three percentage points increase compared to 2005). Considering different types of transfer separately, the largest change occurred among pension recipients. In 2008, 27 percent belonged to the poorest quintile compared to 33 percent in 2005. The shares are highest among the poorest 20 percent of the population for the MSB and the UMB. 38 percent of UMB and 35 percent of MSB recipients belong to the poorest quintile. The higher on the welfare distribution, the lower the share of beneficiaries, especially with respect to the UMB, the only means-tested safety net program targeted to the poor. Compared to 2005, a clear shift in the distribution of beneficiaries took place with respect to informal money transfers. In 2008, the distribution across welfare quintiles is rather uniform, while in 2005, the largest share of beneficiaries (29 percent) belonged to the poorest quintile.

**Table 8: Distribution of beneficiaries from social protection and private transfers across groups, %, 2008**

Type of benefit	Quintile I	Quintile II	Quintile III	Quintile IV	Quintile V	Total
Any social transfer	28.7	24.0	16.9	17.9	12.5	100
Pensions	27.4	23.6	16.1	19.5	13.4	100
Scholarships*	22.8	20.2	10.3	12.9	33.7	100
Monthly Social Benefit	35.1	22.0	22.6	18.0	2.3	100
Unified Monthly Benefit	38.0	29.6	21.7	7.7	3.0	100
Other social insurance benefits*	26.8	36.9	15.3	14.2	6.8	100
Utility and housing subsidies*	23.9	17.9	21.8	20.1	16.4	100
Money from relatives*	19.3	22.7	20.7	17.5	19.8	100

Note: Quintiles are based on annual per capita consumption before transfers, assuming a marginal propensity of 25 percent.

\* Differences between groups are not significant at the 10 percent level (Chi-square test).

Source: own calculation based on KIHS 2008.

The distributional incidence of social transfers varies significantly by program (table 9). Scholarships, utility and housing subsidies and informal transfers are regressive, with richer households benefiting proportionally more than poorer households. 34 percent of utility and housing subsidies are allocated to the richest 20 percent households, while the poorest 40 percent receive only 24 percent of the total benefit value. Compared with the distribution of beneficiaries in table 8, one can conclude that richer households benefit from significantly higher privileges than the poor households. This is most probably due to the fact that (i) privileged citizens are not predominantly poor, and (ii) richer households consume more gas and electricity and benefit proportionally more from central heating. A similar pattern applies to informal transfers. While the share of the population receiving informal transfers is rather uniform across the welfare distribution, richer households receive larger informal transfers. Almost half of all informal transfers are going to the richest 20 percent.

**Table 9: Distribution of social protection benefits and private transfers across groups, %, 2008**

Type of benefit	Quintile I	Quintile II	Quintile III	Quintile IV	Quintile V	Total
Any social transfer	26.9	21.9	14.8	17.3	19.1	100
Pensions	25.7	22.0	14.7	17.8	19.8	100
Scholarships	16.7	21.1	8.5	16.0	37.8	100
Monthly Social Benefit	52.6	5.0	17.1	19.7	5.7	100
Unified Monthly Benefit	51.9	22.7	19.7	4.0	1.7	100
Other social insurance benefits	39.0	24.9	7.8	8.2	20.2	100
Utility and housing subsidies	13.2	11.1	22.5	19.6	33.6	100
Money from relatives	7.2	14.0	13.4	19.3	46.1	100
Total consumption	9.8	14.0	17.6	22.7	35.9	100

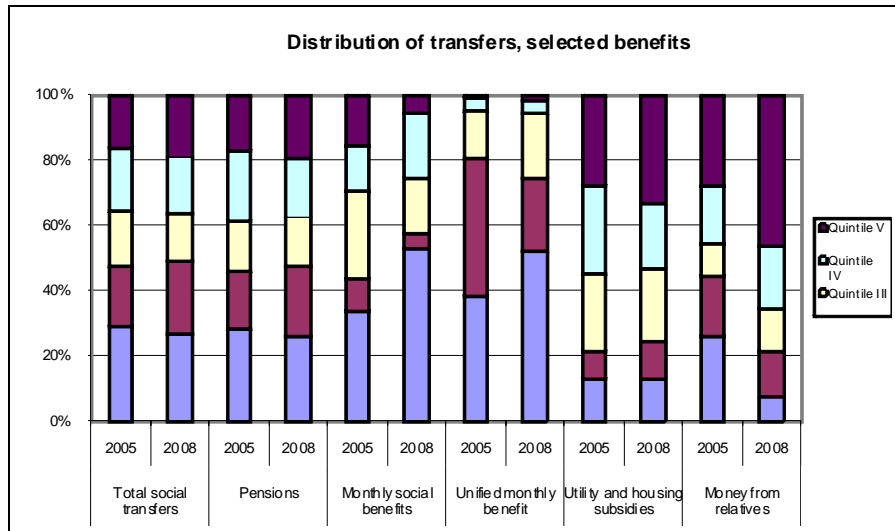
Note: Quintiles are based on annual per capita consumption before transfers, assuming a marginal propensity of 25 percent.

Source: own calculation based on KIHS 2008.

In terms of targeting accuracy (distribution of benefits), the UMB and MSB manage to transfer the majority of the funds to the poorest households. More than half of total transfers are accrued by the poorest quintile. This constitutes a significant improvement compared with 2005, when only 38 percent (33 percent) of the UMB (MSB) was allocated to the poorest 20 percent (Figure 6). Compared to other countries in the region, the UMB performs very well in terms of targeting accuracy, similar to social assistance programs in Macedonia and Lithuania (Figure 7).

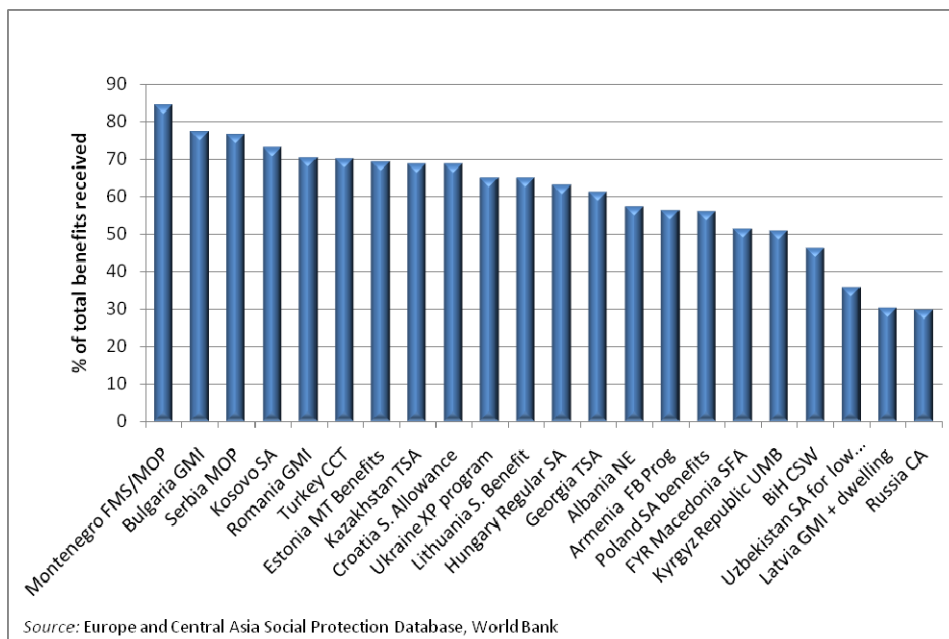
The redistributive impact of social transfers can be assessed by comparing the share of benefits captured by the poorest quintile with their share in total consumption and their size in the population (Tesliuc, 2004). Taken together, social transfers are highly progressive. The poorest quintile receives 27 percent of all transfers. This is more than their share in total consumption (ten percent) and as a group of the total population (20 percent). Scholarships and privileges are mildly progressive, while pensions, UMB, MSB and other social insurance benefits can be classified as highly progressive. Only informal transfers exhibit a regressive pattern. The poorest quintile captures only seven percent of total informal transfers, which is even less than their share in total consumption.

**Figure 6: Distribution of selected social transfers, 2005 and 2008**



Source: Own calculation based on KIHS08.

**Figure 7: Targeting accuracy of the UMB compared to targeted social assistance programs, selected ECA countries\***



Source: Europe and Central Asia Social Protection Database, World Bank

\*Data is the most recent available for the respective country and is subject to further update.  
Source: Lindert (2008).

Table 10 presents the accuracy of benefits, or formulated differently, the relative importance of social transfers as a share of average consumption in each quintile. The upper panel presents results for all households (including non-recipient households), and the lower panel shows the results for recipient households only. Relatively speaking, total social transfers are slightly more important for poorer households (relative progressivity). They constitute 10 percent of after transfer household consumption for those in the poorest quintile, compared to six percent for the richest households. However, the importance of social transfers as a share of total household consumption of the poorest group considerably declined compared to 2005, when social transfers accounted for 21 percent of the total. Pensions remain the most important social transfer. They account for 9 percent of total household consumption in the poorest households (17 percent in 2005). Considering only recipient households, pensions cover one fifth of total household consumption. This is four percentage points less than in 2005. The importance of pensions has mainly declined in wealthier households. While pensions accounted for one quarter of total household consumption in the top 40 percent in 2005, their share declined to 17 percent in 2008 among recipient households. Income from informal transfers remains the second most important transfer for all households. They contribute between 14 and 21 percent to total household consumption in receiving households.

The UMB and MSB, both targeted to poor and vulnerable households, are progressive in relative terms, with benefits representing a higher share of total household consumption for those in the lower quintiles. Still, the magnitude of the transfers remains low due to their low coverage and inadequate benefit values. Especially the UMB further lost consumption power compared to 2005.

**Table 10: Benefit adequacy: Share of benefits in total household consumption, 2008**

<b>Type of benefit</b>	<b>Quintile I</b>	<b>Quintile II</b>	<b>Quintile III</b>	<b>Quintile IV</b>	<b>Quintile V</b>
<b>Benefit adequacy (ratio of benefits/consumption) for all households (including non-beneficiaries)</b>					
Total social transfer	10.4%	7.9%	6.2%	6.4%	5.6%
Pensions	8.6%	7.5%	5.8%	6.2%	5.5%
Monthly Social Benefit	0.3%	0.0%	0.0%	0.0%	0.0%
Unified Monthly Benefit	1.3%	0.4%	0.2%	0.0%	0.0%
Other social insurance benefits	0.2%	0.1%	0.0%	0.0%	0.0%
Utility and housing subsidies	0.2%	0.1%	0.2%	0.2%	0.2%
Money from relatives	3.9%	4.2%	4.1%	4.4%	6.5%
<b>Benefit adequacy (ration of benefits/consumption) for beneficiary households (excluding non-beneficiaries)</b>					
Total social transfer	18.2%	15.2%	14.9%	15.1%	14.6%
Pensions	21.1%	17.9%	17.5%	16.7%	15.5%
Monthly Social Benefit	8.0%	2.0%	2.9%	2.8%	2.5%
Unified Monthly Benefit	6.7%	2.6%	2.6%	1.1%	0.6%
Other social insurance benefits	0.2%	0.1%	0.0%	0.0%	0.0%
Utility and housing subsidies	0.9%	0.8%	0.9%	1.2%	1.1%
Money from relatives	13.8%	12.4%	13.2%	16.7%	21.2%

Note: Quintiles are based on annual per capita consumption after transfers.

Source: own calculation based on KIHS 2008.

## **Poverty Reduction Impact**

In this section we compare extreme poverty rates (poverty incidence and poverty gap) before and after transfers. The poverty rates are calculated for after-transfer per capita consumption and the counterfactual pre-transfer consumption. The extreme poverty line is adjusted to represent the annual value. The change in the poverty incidence rate accounts for every individual that crossed the poverty line due to income from a social transfer. By targeting individuals close to the poverty line, a social

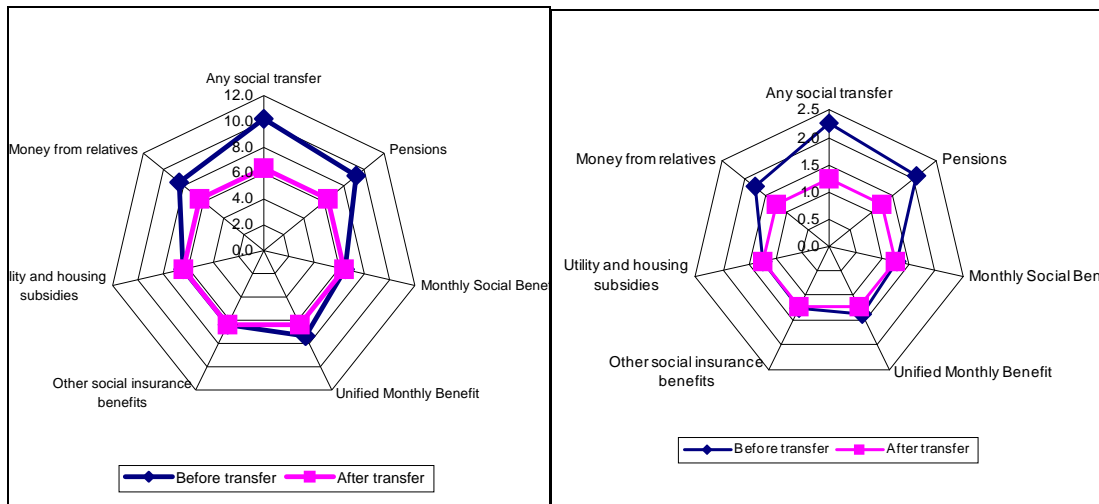
transfer can be very effective in reducing the poverty rate without changing the poverty gap significantly. In terms of the poverty gap, a social transfer is more effective if it manages to reach those households with the largest distance to the poverty line and close their poverty gap fully or to a certain extent. Strictly speaking, a social transfer can be very effective in closing the poverty gap without changing the poverty incidence rate.

In the absence of any social transfer, extreme poverty rates would be considerably higher (figure 8, left panel). The extreme poverty rate is reduced with four percentage points when accounting for all social transfers. Social transfers reduce the extreme poverty gap from 2.3 percent to 1.2 percent (figure 8, right panel). The extreme poverty gap is almost halved.

Pensions are the most important transfers in terms of poverty reduction, although poverty reduction is not their main objective. They are primarily meant to redistribute income of the life cycle. However, pensions provide significantly higher transfers than other social transfers, as they are often related to previous income. Pensions are the largest social transfer program in terms of allocated resources (government budget and social fund). Informal transfers are the second most important transfer in terms of poverty reduction. They reduce the extreme poverty rate by two percentage points.

Non-contributory benefits are far less effective in reducing extreme poverty. Their impact on the poverty incidence and gap are limited. Nonetheless, the UMB remains the most effective targeted transfer. Its impact on poverty reduction could be further increased by increasing coverage and benefit levels. Note, that the GMI determining UMB eligibility is lower than the extreme poverty line.

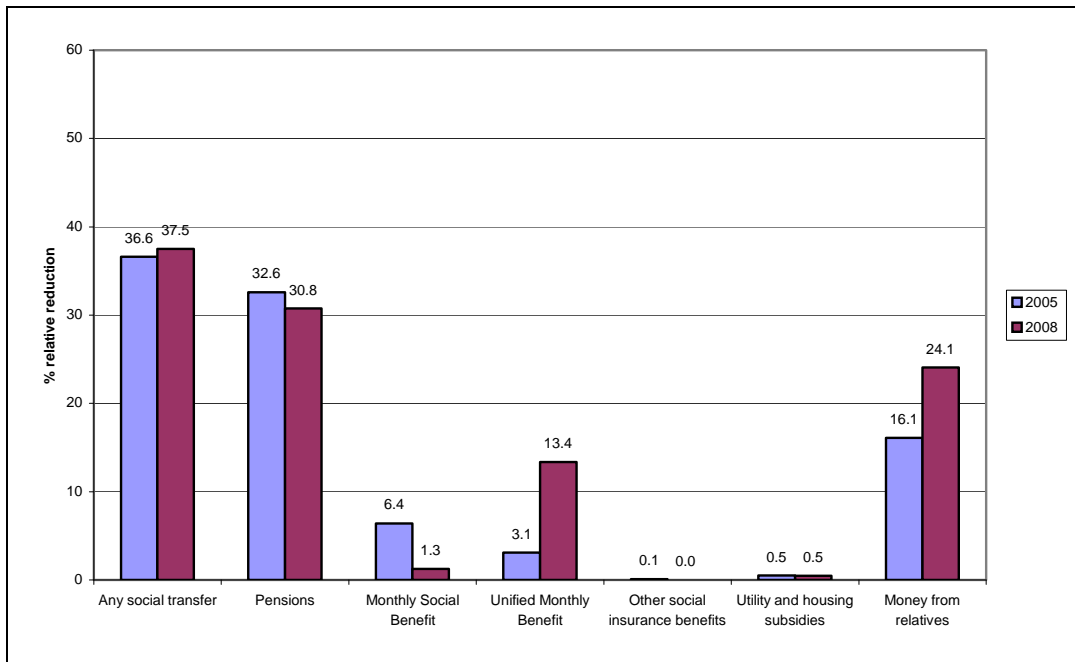
**Figure 8: Extreme Poverty Reduction (left: incidence; right: gap), 2008**



Source: Own calculation based on KIHS08.

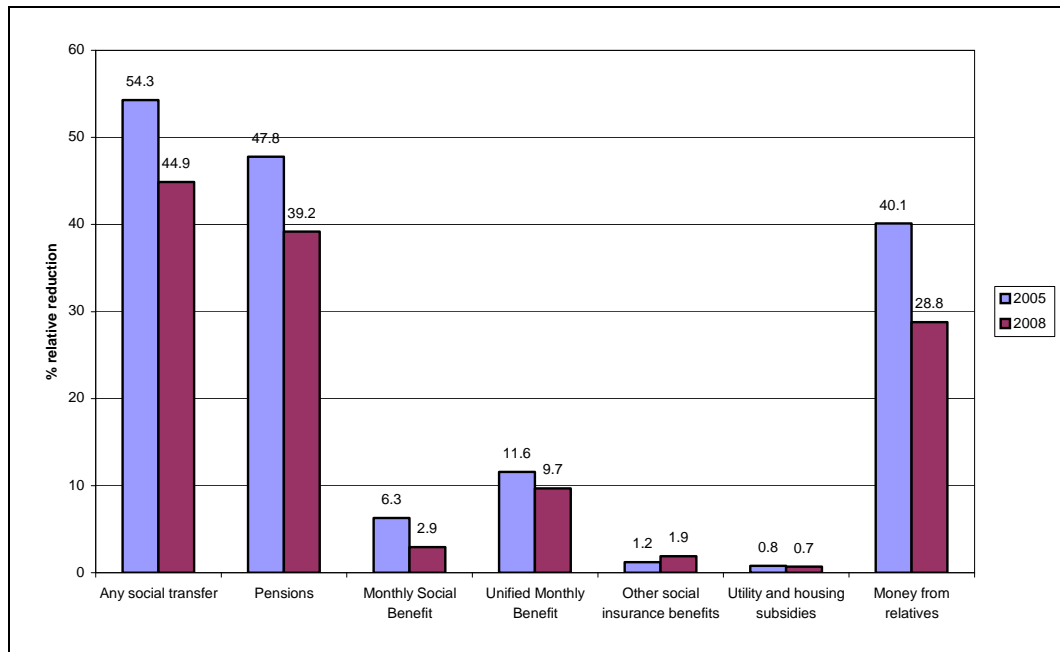
Comparing the poverty reduction performance of 2008 with 2005, figures 9 and 10 present the relative poverty reduction of different transfers in terms of poverty incidence (figure 9) and poverty gap (figure 10). Overall, the effectiveness of reducing the extreme poverty rate increased slightly compared to 2005. This improvement is driven by the UMB, which achieved a reduction of extreme poverty of 13 percent in 2008. The MSB lost out compared to 2005, but this result has to be interpreted with caution considering the very low number of observations in the 2008 KIHS. In terms of poverty gap reduction, all social transfers are less effective compared to 2005. Taken together, one may conclude that social transfers became more effective in targeting those households close to the poverty line, but less effective in reaching the extremely poor.

**Figure 9: Relative reduction of extreme poverty incidence rate, 2005 and 2008**



Source: Own calculation based on KIHS08.

**Figure 10: Relative reduction of extreme poverty gap, 2005 and 2008**



Source: Own calculation based on KIHS08.

## CHALLENGES AND THE ONGOING REFORM

Following the analysis in the previous section, one can conclude that the poverty reduction impact of social safety net transfers is rather limited. Coverage with transfers targeted to the poor is extremely limited. Overall, only ten percent of the Kyrgyz population benefits from the UMB. The exclusion error among the poorest 20 percent is more than 80 percent. Nevertheless, the allocated monies reach

the poorest. Coverage with MSB is even more limited with two percent of the population living in beneficiary households. More widespread are categorical state benefits (privileges). Almost one in five individuals benefits from a utility or housing subsidy. But these subsidies are not very well targeted to the poor and benefit rich households as well.

The social safety net reforms introduced by the GoKG in January 2010 primarily aimed at mitigating the impact of the energy tariff increase for the poor and vulnerable households. While the energy tariff reform was reversed mid-2010, the changes to safety net remained. The reforms described above (increase of UMB, flat MSB benefits and changes to the categorical state benefits) have an impact on the coverage and distribution of benefits and the poverty reduction impact. Using data from the KIHS 2008, we simulate the potential impact of the reforms as if they were introduced in 2008.

Overall, the change in beneficiaries and benefit levels due to the reform has no significant impact on poverty (table 11).

**Table 11: Poverty reduction impact of safety net reforms, percentage of individuals, 2008**

	Poverty incidence		Poverty gap	
	Before reform	After reform	Before reform	After reform
Absolute poverty	31.5 (1.7)	28.8 (1.7)	7.6 (0.7)	7.0 (0.7)
Extreme poverty	6.4 (1.1)	5.8 (1.1)	1.2 (0.4)	1.1 (0.4)

Standard errors between parentheses.

Source: own calculations based on KIHS08.

The reforms of categorical state benefits have the largest impact on benefit coverage and distribution. Coverage decreases from 18 to 6 percent (table 12). 83 percent of beneficiaries will lose their entitlements for categorical state benefits. Coverage and distribution remain rather uniform across the welfare distribution. The reforms of the MSB have no impact on coverage and distribution of beneficiaries, as the groups remain unchanged.<sup>14</sup> The reform of the UMB (increase of GMI and limitation of eligibility to children) has a minor impact on the performance indicators. Limiting eligibility to children only has no significant impact on coverage rates. Less than two percent of individuals would lose UMB entitlements. This is due to the fact that 95 percent of the poorest quintile lives in a household with children eligible for the UMB.

**Table 12: Benefit coverage and distribution after the reform, percentages, 2008**

	Quintile I	Quintile II	Quintile III	Quintile IV	Quintile V	Total
<b>Coverage after reform</b>						
UMB	17.3	14.4	10.4	3.5	1.4	9.4
Categorical state benefits*	8.4	4.8	5.6	6.0	5.0	6.0
<b>Distribution of beneficiaries</b>						
UMB	37.3	30.0	22.1	7.5	3.1	100
Categorical state benefits*	28.7	15.9	18.7	20.2	16.6	100
<b>Distribution of benefits</b>						
UMB	47.7	24.9	20.3	4.6	2.6	100
Categorical state benefits*	16.7	20.8	25.5	19.3	17.7	100

\* not significant at 10% level.

Source: Own calculation based on KIHS08.

<sup>14</sup> The impact of the reform from variable to flat rate benefits cannot be assessed using KIHS data. It is impossible to distinguish the different groups. Therefore, an average increase of MSB benefits has been assumed, leaving the initial distributions unchanged.

It remains questionable to what extent the introduced changes to the safety net are financially sustainable in the medium term. Since public finances are already stretched, there is little room for the GoKG to increase government expenditures even further. Economic growth has slowed down considerably since 2008, and revenues are expected to be lower than projected. Thanks to a substantial grant from the Russian Government, the revenue shortfall was softened. However, total revenues are expected to decline in 2010, further limiting Government expenditures (table 13).

**Table 13. General Government Budget, as a percentage of GDP**

	2008	2009	2010	2011	2012	2013	2014
	Act.	Prel.	Proj.				
General government finances (in percent of GDP) 1/							
Total revenue and grants	29.8	33.0	30.1	28.6	28.1	28.5	28.8
<i>of which:</i> Tax revenue	23.0	22.7	22.0	22.1	22.2	22.9	22.7
Total expenditure (including net lending)	29.2	37.1	38.2	36.3	34.9	34.0	32.3
<i>of which:</i> Current expenditure	24.8	29.1	29.0	28.0	29.2	29.9	27.8
Capital expenditure	4.0	5.2	6.6	6.3	5.8	4.2	4.6
Overall fiscal balance	0.0	-3.2	-8.1	-7.7	-6.8	-5.5	-3.5
Primary balance	0.8	-2.3	-7.2	-6.9	-5.7	-4.2	-2.0
Primary balance excluding grants	-1.0	-7.6	-9.9	-8.5	-6.8	-5.0	-3.3
Total public debt	48.4	52.2	60.5	67.5	71.2	72.7	68.3

Source: World Bank

1/ General government comprises state government, Social Fund and development fund (from 2009) finances

While the increase of the GMI is a first steps towards a more generous UMB, the measure is not appropriate to reduce exclusion and inclusion errors. The European Union (EU) is supporting the Agency of Social Protection (ASP) with the reform of the UMB. During 2009, alternative targeting criteria have been tested based on administrative and survey data from seven pilot districts. The team simulated the impact of the following criteria, separately and combined (Delarue & Nikaj, 2009):

- Reduction of inclusion error:
  - Exclusion of households with livestock above a specified minimum;
  - Exclusion of households possessing three out of five durable assets;
- Reduction of exclusion error:
  - Exclusion of pension from income assessment for families with three or more children;
  - Higher GMI thresholds.

The simulations show that the inclusion of livestock as additional criteria has only a minor effect on the inclusion error. In the pilot districts, the number of potential beneficiaries would decrease with less than three percent. This confirms the conclusions of the Social Safety Net Note (World Bank, 2009). Using the possession of durable goods as an additional filter would have a larger impact reducing the number of potential beneficiaries with 16 percent compared to the current situation. Excluding pensions from the calculation of family income would significantly increase the number of eligible households by 46 percent. Increasing the GMI threshold extends coverage as well. Table 13 summarizes the expected impact of the new criteria. The financial impact depends on the level of GMI. Only applying the new criteria without changing the GMI level (base case: KGS 200), would increase the costs with 10 percent. The new criteria combined with higher GMI levels increase costs significantly more. Under the most generous scenario with a GMI at KGS 485 per month, financial needs would increase more than five times compared to the base scenario (Delarue & Nikaj, 2009, p. 15).

**Table 13: Summary table: all criteria included at the different levels of the GMI, number of observations**

	GMI 200		GMI 280		GMI 485	
	Base Scenario	+new criteria applied	Update to 280	+new criteria applied	Update to 485	+new criteria applied
Number of eligible households	447	582	555	688	772	881
Number of potential beneficiaries	1239	1773	1532	2103	2090	2672

*Source:* Delarue & Nikaj (2009, p. 14).

The reform effort of the GoKG with respect to the social safety net was highly welcome. The reform of categorical state benefits increases the transparency of public expenditures and allows beneficiaries to spend the cash benefits according to their own preferences. The increase of the GMI is a first step towards strengthening the poverty reduction impact of the UMB. However, major challenges are lying ahead.

The complete monetization and increase of categorical state benefits requires double the amount of funding in 2010 compared to 2009, raising doubts about the sustainability of the reform. Categorical state benefits are the most expensive program, though with the least number of beneficiaries (table 1). Even more, these benefits are not targeted to the poorest households. The program is highly regressive.

The UMB is essentially the only benefit purposefully targeted to the poorest households. While it performs very well in terms of targeting efficiency, the program is too small to have a meaningful impact on poverty. Coverage is limited and benefits are extremely small, especially when compared with the generous categorical state benefits. The GoKG needs to focus on the exclusion error and the low generosity of the program if the program is to have a meaningful impact as mitigation measure in times of crises and beyond. More funds should be allocated to the UMB, allowing the GMI getting closer to the extreme poverty line over time. More concretely, in order to improve the targeting efficiency of the social protection measures and the effective support of the poor and vulnerable households, we recommend completely abolishing the remaining categorical benefits and reallocating the budget to the UMB. This would substantially increase the funds available for the UMB. Increasing the GMI would also allow extending the coverage of the poorest with the UMB and protect the GMI from inflationary erosion in the future.

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## Annex 1: Modeling the behavioral response of households to public transfers

The strongest assumption and widely used in benefit incidence studies is that households do not compensate the lack of transfers with income from other sources. It assumes that households do not replace lost income through savings, a second job, money from relatives or other behavioral changes in the absence of transfers. The opposite is to assume that households would fully compensate foregone transfers. Pre-transfer consumption is equal to after-transfer consumption. Both assumptions are not plausible, especially for poorer households that may not have sufficient alternative income generating capacities to fully replace foregone benefits.

Following the methodology used by Tesliuc (2004), we estimate the marginal propensity to substitute consumption in the absence of social transfers. Using the data from the survey, we estimate the share of income that would be replaced. The model aims at estimating the proportion of social transfers households would replace with income from other sources in the absence of these transfers. It is based on the assumptions that households would adjust their behavior if they did not receive any social transfers. Household members may, for example, take a second job, engage in subsistence farming, migrate or ask relatives and friends living outside the household for assistance. Not all behavioral changes may be positive. Households may take children out of school, send them to work or engage in hazardous activities. The estimated model is similar to a typical consumption regression. Per capita consumption is the dependent variable to be explained by the model. In addition to variables for household characteristics, income from social transfers is included as an explanatory variable on the right hand side of the model:

$$y_i = \alpha + \beta ST_i + \gamma X_i + \varepsilon_i$$

where  $y_i$  is household consumption per capita (in Som),  $ST_i$  income from social transfers (in Som),  $X_i$  a vector of household characteristics,  $\gamma$  a vector of coefficients to be estimated,  $\alpha$  a constant and  $\varepsilon_i$  the error term representing the variance not explained by the model.  $\beta$  is the coefficient we are looking for as it expresses the marginal propensity to consume out of social transfers.

The estimated marginal propensities vary between 0.07 and 0.48, depending on the estimated model. The simple arithmetic average is 0.25, which we will take for the analysis. This is half the value as estimated by Tesliuc (2004) based on the 2001 data, but matches the findings from 2005 data (World Bank, 2009). This is most probably still overestimated taking into account that in two of the four models the coefficient for Social Transfers is not significantly different from zero. It means that for every 100 Som foregone in transfers, a household would substitute 75 Som with income from other sources. Stated differently, a 100 Som reduction in social transfers will reduce per capita consumption with 25 Som. The results are sensitive to changes in the rate of substitution. In case of zero substitution, targeting accuracy of the UMB is further increasing. The opposite is the case if we assume 100% substitution of foregone transfers (see also World Bank, 2009).

Ideally, marginal propensities would be calculated for each type of transfer separately. Transfers like the UMB are not exogenously determined, as pensions or privileges. They depend on pre-transfer income. Propensities may also differ across socio-economic groups. The estimate used for the analysis is by no means precise. Using a different counterfactual consumption measure has an impact on the distribution of the benefits, the share captured by the poor and the level of progressiveness.