

Chapter V: Ensuring a Sustainable Poverty Reduction Process

This report described the levels and dynamics of poverty, and identified the main factors that resulted in a drastic reduction of poverty between 1999 and 2003 while increasing gaps among different types of settlements: poverty reduction was associated to the fast but unbalanced growth across sectors and regions (Panel A in Figure 5.1). The poverty reduction in large cities was led by industrial growth that increased wages -- but not employment -- in urban areas (blue line in Panel B). In rural villages, poverty reduction was characterized by the impact of farm restructuring. Even though agricultural wages (green line in Panel B) are much lower than the average wages in the economy, these recovered after 2001 due to increases in agricultural productivity. The agricultural wage increases, however, were almost offset by employment reduction in the more productive organizations, resulting in little gains in real incomes from agriculture. Rural areas were also affected by the dynamics of pensions since a larger fraction of households live with pensioners in rural villages. Rural households suffered the decline in real pensions between 1999 and 2000, but they also benefited from the significant increase in real terms between 2001 and 2003 (and even more in 2004).

Figure 5.1: Poverty by Location 1999-2003
(percent non-poor)

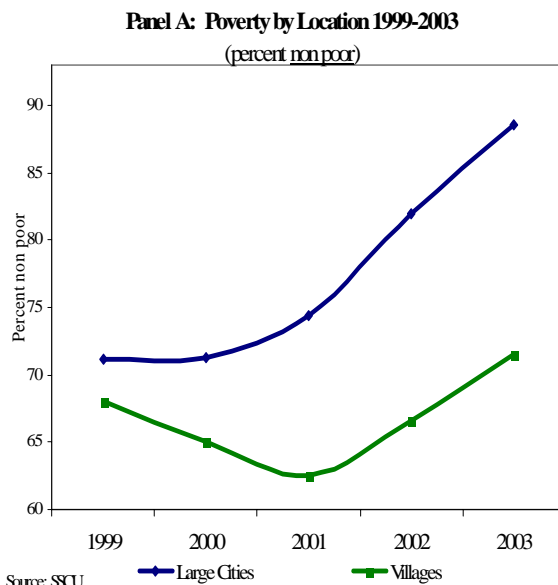
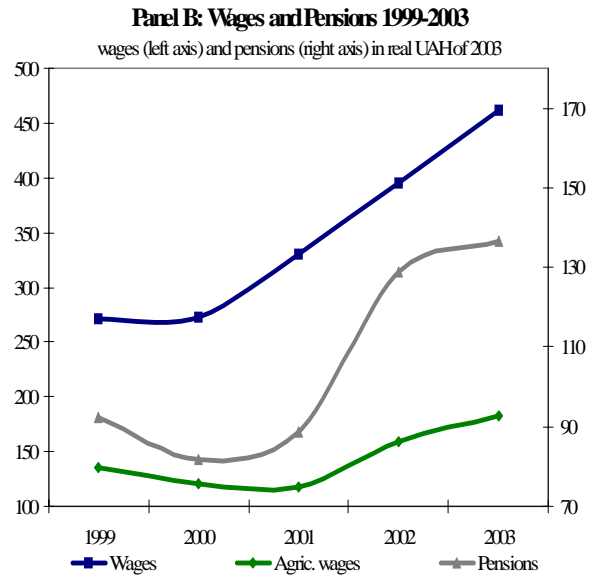


Figure 5.2: Wages and Pensions 1999-2003
wages (left axis) and pensions (right axis) in real UAH of 2003



This section discusses two broader areas where improvements are needed to strengthen the long-term linkages between growth and poverty reduction, and to better inform policy makers about the impact of specific policies. The first area is a set of policies to provide the poor with better economic opportunities to benefit from growth, particularly through employment and in rural areas, and through social safety nets. The second area is to develop a better system of poverty monitoring in order to respond to the changing nature of poverty in the country, and thus, better assess the impact of their policies not only on income poverty dimensions but on other human and social dimensions as well.

5.1. *Improving economic opportunities for the poor*

A better business environment to enhance employment generation. As shown in Chapter 2, the increase in wages and productivity in Ukraine has not been accompanied by additional jobs despite increase job dynamism in the manufacturing sector. The pattern of significant job turnover and restructuring in the private sector, accompanied by rising productivity is similar to what was experienced earlier in Poland, Slovakia or Lithuania, and resulted in growth not being reflected in rising employment in the initial period. Then, employment can start to grow if the environment for private sector development remains favorable. A recent study on employment creation in the Europe and Central Asia region found that for countries like Ukraine, Russia or Kazakhstan it was found that the three most important obstacles perceived by businesses are licensing and operating permits, tax administration, and access to land. Reforms that swiftly address these three obstacles will provide an environment where economic growth could be paralleled by additional employment. Over the medium term, a key aim is to increase labor markets flexibility and competitiveness, while compliance to labor regulations is increased as well. It is required then to examine the labor code to identify potential rigidities that are needed to ease as labor market. To strengthen the link between growth and poverty reduction, job creation has to be broadened even further to provide opportunities to those involved in less productive employment (or underemployment).³³

Strengthening the agricultural reform to provide the better chances for the poor. Agriculture plays a critical role in Ukraine and the proposed accession to the World Trade Organization and to the potentially lucrative high value European markets is an important opportunity to stimulate growth. Chapter 1 described how rural areas are lagging behind the poverty reduction process and then Chapter 3 linked these features to the offsetting effects of reduced employment with increased productivity and wages. Three broader sets of policies are presented: enhancing the environment for rural development; improve the operation of land markets; and increase efficiency and productivity in agricultural organizations. First, sustainable rural development requires an environment that favors investments. Modernization of agriculture has to be accompanied by *better market infrastructure and better off-farm opportunities*. Improving infrastructure and services would will bring down costs and contribute to higher farm gate prices and thus farm incomes. Since the absorption of labor in rural areas is limited by the increasing productivity, off-farm opportunities need to be developed taking advantage of processing activities with high value added. Second, the reform of land needs be deepened to *broaden opportunities to new entrepreneurs and provide fair gains to landowners*. The land reform process has already established a functioning land registration system but the reform has not yet reached other critical non-land assets such as machinery, which has resulted in concentrating the primary means of production in the groups of former collective farm insiders. This, in turn, has the effect of limiting the pool of potential land renters and placing downward pressure on land rental prices. In the longer run it creates the risk of distorted wealth and power structures in rural areas that will result in a rapid concentration of land ownership, with negative social and economic consequences. On the landowners' side, the process of land titling needs to complete the conversion of temporary land titles into State Acts since it would also improve economic conditions for those renting out their land. Third, policies to *enhance productivity and efficiency* are needed in agriculture since agricultural organizations show a large variation of outcomes depending on their size and ownership structure. As wages are increasingly reflecting

³³ The World Bank is currently working in a detailed study of Labor Markets in Ukraine to assess these linkages and provide specific recommendations.

productivity in agriculture, policies to improve technical and economic efficiency at the firm level would translate the improvements in the agricultural sector into better wages and incomes.

Sustainable pension policies and better targeted assistance. While the benefits of additional pension incomes have resulted in large reduction of poverty, they also carried large financial costs that jeopardize the gains from growth. The increased burden due to pension deficits weakens not only the pension system but the fiscal position of the government. The pension system requires a fundamental reform to: (i) ensure the financial sustainability of the insurance component; and, (ii) separate its social insurance component from its social assistance activities. On the first area, the pension system requires a significant reform to avoid increasing fiscal costs. The Government of Ukraine has drafted plans for reform that rely on addressing critical parameters of the system such as the indexation mechanism, retirement age, among others. The second objective is driven by the *social pensions*, benefits that are provided to a small number of pension-aged individuals that lack a contribution history. While small in quantity, social pensions reflect the blurred objectives of the pension system: a difficult balance between social insurance for those contributing and social assistance for those in need. The Government has recently adopted measures to separate these roles, and a component of the social pensions has been transferred to the Ministry of Social Welfare with additional income testing criteria and age constraints.

Major reforms are still needed on social assistance programs to effectively reach the poor and improve the delivery of benefits. Ukraine led the process of introducing targeting mechanisms when, in 1995, income testing criteria were introduced in housing subsidies. This process, however, has not continued its progress and poverty-related social assistance covers a small fraction of the poor. The number of small programs and their diverse targeting criteria does not provide an effective instrument to reach the poor and suggests the need for consolidation strengthening those that are already targeting the poor. In fact, despite the effort in improving targeting in Ukraine, the system has faced operational difficulties in implementing some criteria due to the rapidly changing economy and profile of the poor. This suggests the need to improve the targeting system moving from an income-tested to a proxy-means tested criteria given the increasing importance of other non-formal sources of income and consumption, such as remittances.

One area of future policy reform is addressing the privileges and subsidies for communal services. Subsidies to communal and housing services are channeled mainly to urban areas and disproportionately favor the better-off. This requires a detailed analysis to assess the impact on their original objectives (financial protection of the poor) and devise specific to reform. Broader elements in the reform of in-kind subsidies include cashing-out the transfers for increased transparency and phasing out some of the programs with poor targeting.

5.2. Developing a monitoring and evaluation system to enhance policy design

Improving the poverty monitoring system. The poverty dynamics and its changing profile underscore the need to improve the system of measurement and monitoring. The Government of Ukraine, in particular the State Statistical Committee, and other non governmental research organizations have excellent technical capacity to assess the levels and nature of poverty in the country. The joint development of a revised methodology to monitor poverty provides additional elements to better assess the qualitative changes over time. Improvements in the existing methodology include the formal adoption of an absolute poverty line, revision of the existing consumption aggregate, while introducing some elements to align the social monitoring system with European Union criteria.

Ukraine requires better instruments to identify the poor, and to design and evaluate policies targeted to the reduce poverty. Additional techniques to estimate poverty at the local level, such as districts, pose new technical challenges. This is particularly important given the strong geographical patterns in poverty and the increased differentiation within regions, such as poverty pockets in the Eastern region. Ukraine has available Census and HBS data that can be combined to generate poverty maps that are intensively used for policy purposes. Poverty maps are increasingly used in the design of sectoral policies that involve investments in infrastructure or even in the allocation of resources across regions in fiscally decentralized structures.

Non-income dimensions of poverty need to be included in the poverty monitoring system. Emerging disparities in access or utilization of other social services also require better instruments to measure wellbeing. The documented disparities and geographic patterns in poverty are also reflected in enrolment of children in upper secondary education, where those in rural areas and small towns dropout of school earlier and faster than those in large cities. Some of these patterns may evidence differential funding across facilities, like in the health sector, where more rural oblasts receive less expenditure per capita on health than more urban ones despite their higher costs. These other dimensions of poverty need improved monitoring instruments to inform policy makers. The existing HBS instrument, however, does not provide enough information to obtain accurate information on human and other social dimensions of poverty such as enrolment rates. The pilot Education and Health HBS module introduced in June 2004 should be revised and fielded repeatedly in order to provide a dynamic picture of these rapidly changing outcomes.

Introduce a systematic evaluation of social programs and broader policies. Ukraine has led the design of some social programs and reforms in the region such as the targeting of housing subsidies in 1995. The effects of some policies, however, have not been fully examined and little is known about the real impact on wellbeing and the underlying reasons for their performance. Since the country is embarking on a number of policies to improve the living standards and improve social services, a system of evaluation that accurately describes the impact of specific policies on poverty and other dimensions of wellbeing is required. Learning from their own experiences and improving the design of programs and policies will not only benefit the target population but position Ukraine as a leader in the region from which other countries can benefit as well.