## Executive Summary

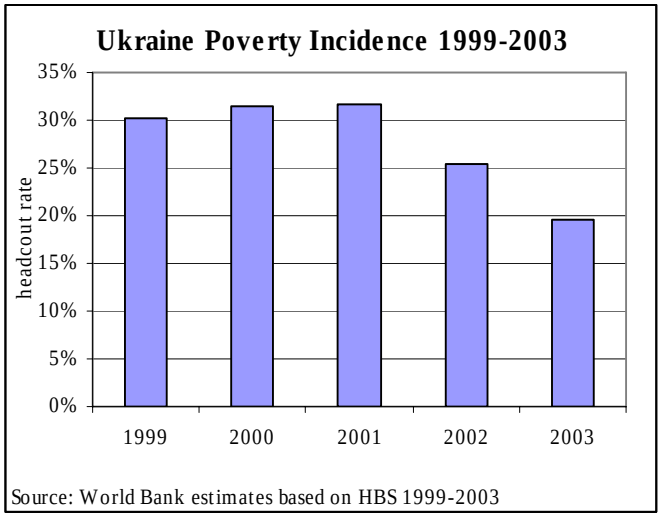
This Poverty report is aimed to improve the understanding of poverty in Ukraine, and provide linkages between growth, evolution of economic sectors, and poverty. The report summarizes also a joint assessment of the official method for poverty estimation in Ukraine by the World Bank staff and experts involved in poverty analysis and legislation in Ukraine. The report applies the suggested improvements on methodological areas with direct relevance on inequality measurement.

The main findings can be summed up as follows:

- An absolute poverty line and a revised consumption aggregate -- jointly developed with Ukraine experts -- indicate that **around 19 percent of the population lived in poverty by 2003**. Poverty incidence has declined recently after several years of rapid economic growth, from more than 30 percent in 2000.
- The **reduction of poverty has been faster in Ukraine than in some neighboring countries**. While in 1999 Ukraine had a poverty incidence higher than Poland, Russia, Lithuania, or Bulgaria, by 2003 it was the lowest compared with these countries.
- The overall improvement, however, has been paralleled by an **increasing poverty gap between rural and urban households, reflecting the fast but unbalanced economic growth**: large cities have benefited from rapid industrial growth coupled with increased activities in construction and services, but rural areas have faced irregular weather and major restructuring of agricultural organizations. These developments have also defined a geographic picture of poverty where the more urban and industrial Eastern region have slightly lower poverty rates than those in the more rural and agricultural Western ones.
- The **growth experience has not changed the rather stagnant level of employment**. The improvement in labor markets are associated to gains in productivity and efficiency with resulting wage gains. There is also increased differentiation within workers since the fraction of **underemployment has also increased, reflecting partly the subsistence agriculture, and precarious labor markets in some small towns**.
- **The combined effects of higher productivity but lower employment in commercial farms left real incomes in agriculture lagging behind other sectors**. Rural areas had a slower reduction in poverty due to the combined effect of weather shocks, and restructuring in agriculture. Land reform increased the private sector role in agriculture, making it more efficient by shedding excess labor and modernizing machinery. The excess labor was absorbed by household farms with lower productivity and limited marketing opportunities Major weather shocks have increased uncertainty in harvest and prices, and imperfect land and crop markets have not protected poor households from the adverse effects of uncertainty in agriculture.
- The **government has played a critical role in reducing poverty by increasing substantially the social insurance transfers**. Pensions have increased faster than other income sources except wages, and represent more than one fourth of average household incomes, particularly for families in small towns. In fact, the late reduction of poverty in rural areas – where are larger proportion of elderly live-- is also associated with the rapid increase of pensions after 2002. Pensions, however, are a very costly transfer mechanism for poverty reduction. Other government transfers have become better targeted but still have very limited coverage. The reduction of poverty, however, provides a window of opportunity to reform the safety net system in order to effectively target the poor.

## Poverty incidence has declined in the recent years

**Figure 1: Ukraine Poverty**



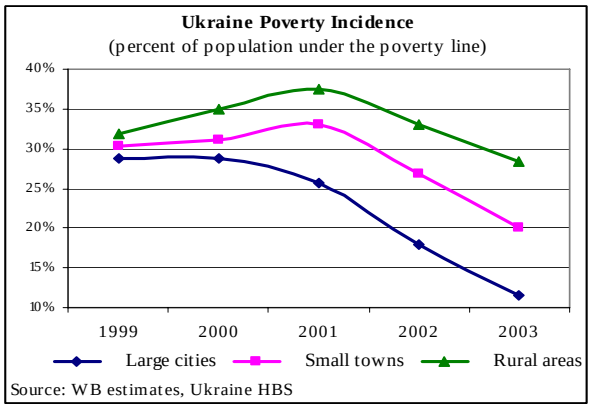

After initial years of persistent levels of poverty around 30 percent, by 2003 the population below the poverty line was less than 20 percent. Poverty is defined as those individuals whose consumption falls below a level sufficient to cover the cost of a food basket of about 2500 calories per day, plus a significant allowance for non-food goods and services. This level of calories reflects the country's minimum calorie requirements according to the consumption patterns and the demographic composition of the populations. The cost of this basket is UAH 151 per person per month in 2003.

**Poverty reduction in Ukraine was faster than in comparable countries**. Using poverty lines that are comparable across countries, poverty incidence in Ukraine is among the lowest of the region, much lower than Russia, Poland, Bulgaria or Lithuania. In fact, the reduction of poverty in Ukraine has been somewhat faster than in those countries since by 1999 Ukraine showed higher poverty. The poverty reduction after the nineties has been as dramatic as in Belarus or Hungary where poverty rate were reduced by 40 to 50 percent.

**Inequality in Ukraine is stable in the recent years**. Household consumption levels show lower inequality than other indicators such as income or total expenditures. The Gini coefficient for consumption is about 0.28 in 2003 and rather stable in the last years, despite small increases between 1999 and 2001. Inequality measures of other indicators of wellbeing such as expenditures or income are around 0.30 and with similar stability during the period. Gini estimates, however, are mainly driven by the changes in the middle of the distribution.

The major reduction in overall poverty incidence and relatively stable inequality measures, however, hide emerging differences in poverty and living conditions.

**Figure 2: Regional Poverty Incidence**

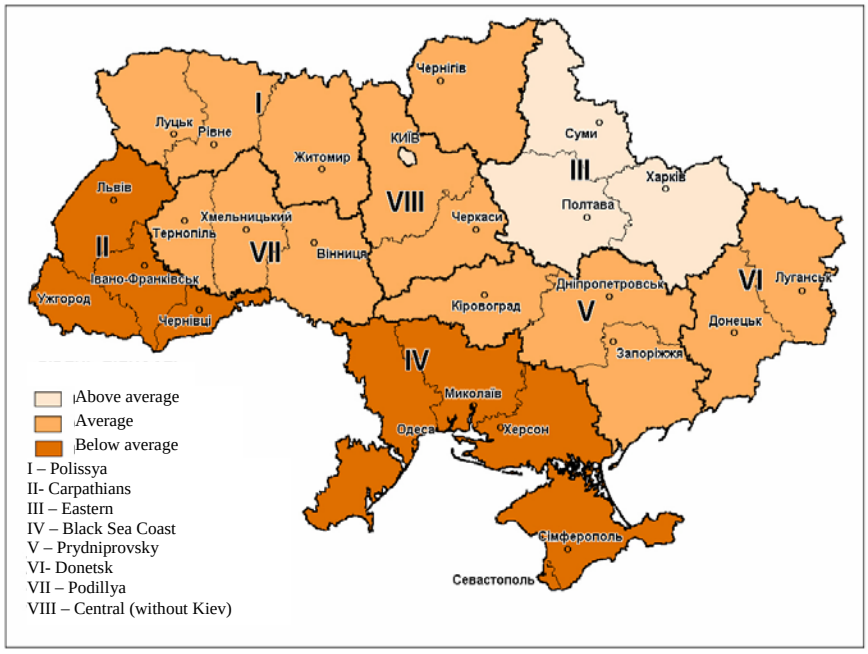



**Despite overall poverty reduction there are increasing disparities across different types of settlement**. Poverty reduction has been slower in rural areas and small town compared to large cities. Starting from similar levels of poverty across locations in 1999, poverty incidence in rural areas in 2003 is more than twice that of large cities, increasing the regional disparities in living conditions. The capital city, Kyiv, has the

lowest poverty incidence in 2003 with less than 6 percent.

**Disparities across economic regions reflect these emerging gaps in poverty**. Economic regions in Ukraine also show a pattern of differentiated poverty levels (Figure 3) that are associated to their urbanization levels and type of economic activity. While most of the regions have poverty levels around the national average, regions in Eastern Ukraine such as Sumit, Kharkiv, and Poltava, have lower than the average (light orange). These are more urban oblasts and where industrial centers are located. In the West and Black Sea Coast regions, where more agricultural and rural oblasts are located, have higher than the average (dark orange).

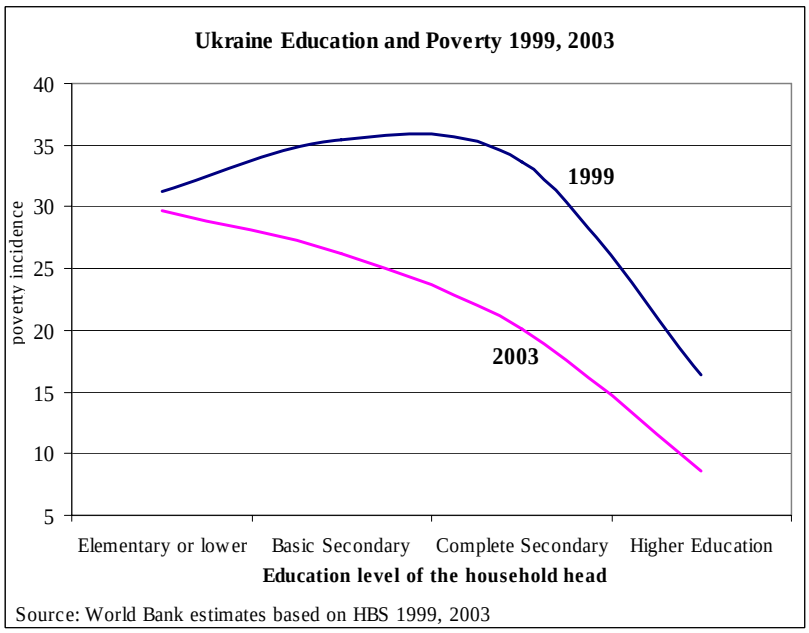
**Figure 3: Regional poverty levels**




**Who are the poor? Poverty is an increasingly rural phenomenon**. The differentiated reduction of poverty has changed the profile of the poor in Ukraine. In 1999 about 36 percent of the poor lived in large cities, 35 percent in rural areas and less than 30 percent in small towns. The large proportion of poor in large cities in 1999 reflected, in part, the effects of the Russian crisis that affected mostly urban areas in the region. By 2003, instead, almost half of the poor in Ukraine live in rural areas and still 30 percent in small towns. Still, in regions with average levels of poverty there are large pockets of poverty, particularly in one-company towns or other mining towns. The economic regions with the larger number of poor are Black Sea Coast (1.45 million), Carpathians (1.33 million), Donetsk (1.30 million), and Polissya (1.22 million).

**The poor live in larger households with more children and youth**. About 20 percent of the population lives in households with 4 members or more, but these individuals living in large households represent about 40 percent of the poor. This partly reflects the importance of children and youth among the poor: 42 percent of the poor are children and youth (0-24) compared to only 30 percent in the overall population. The rest of the poor are 47 percent of adults (25-64) and 11 percent of elderly (65 or more years). The increasing importance of younger populations among the poor and the rapidly aging population in rural areas and small towns suggest a more interesting dynamics within rural areas. In rural areas, about 21 percent of the rural population is elderly (more than 65 years of age) but they represent only 12 percent among the poor. Larger and younger families in rural areas have highest poverty rates, despite the pension benefits that the elderly member can obtain, if there is anyone.

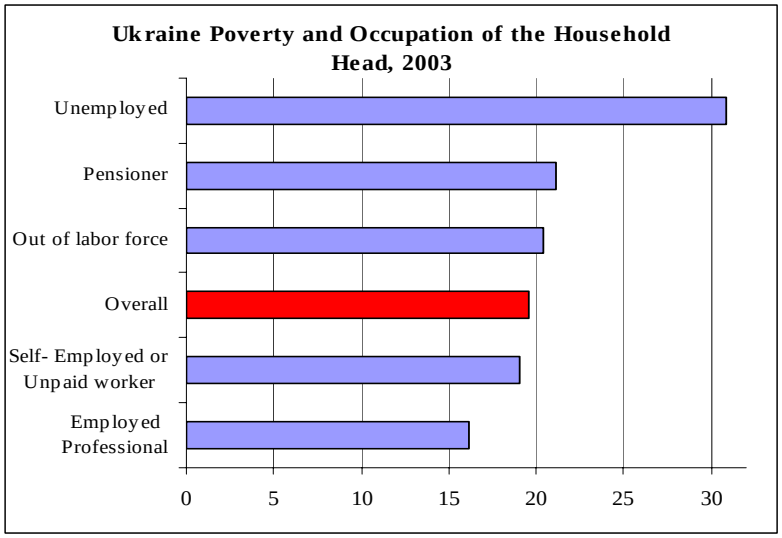
**Figure 4: Poverty and Education**




Source: World Bank estimates based on HBS 1999, 2003

**Poverty is closely associated to education of the household head and the relationship has strengthened over time**. Ukraine's population has very good educational achievements, since more than 78 percent of the population lives in households with heads that completed Secondary or Higher education. Still, 21 percent of the population lives with heads with basic Secondary education or less, and this fraction is even large among the poor (30 percent). Most of the poor live under a head with Secondary education Figure 4 shows the poverty incidence for education level of the household head for 1999 and 2003. Between 1999 and 2003 poverty was reduced across all education levels of household heads, but the reduction in poverty was larger for those in better educated households: poverty for those with heads with Elementary or lower attainment remained almost unaltered around 30 percent. The more direct link between education and poverty, partly reflects the increased of returns to education in a more dynamic labor market.

**Figure 5: Poverty and Employment**




**Most of the poor live with employed or pensioner heads, but the risk of poverty is the highest among those with unemployed household heads**. While most of the poor live with household heads that are either employed (42 percent) or pensioners (35 percent), still a significant fraction live with unemployed heads (17 percent). The risk of poverty is twice for unemployed (31 percent) compared to those employed (16 percent). This, however, hides some differences across regions since in small towns, a larger fraction of the poor lives with unemployed heads (22 percent). In rural areas the poor are equally distributed between households with pensioner or employed heads (39 percent) given the rapidly aging profile of rural settlements.

**II. Poverty dynamics reflect fast, though unbalanced, economic growth.**

**Ukraine experienced fast economic growth in the last years averaging about 7 percent per year**. Growth was initially driven by a strong external demand, particularly for manufactured products, due to the depreciation of the domestic currency, and the economic recovery in Russia and other CIS countries. The positive external context was also accompanied by key elements in domestic policy such as macroeconomic stability, budget discipline, and financial transparency; consolidation of privatization efforts, and external liberalization; and, reform in agriculture, among other factors.

**Table 1: Ukraine Real GDP Growth (bi-annual average, % change)**

| | 1998-99 | 2000-01 | 2002-03 |
|---|---|---|---|
| **GDP** | **-1.1** | **7.5** | **7.3** |
| *of which:* | | | |
| Industry | 3.0 | 8.1 | 10.1 |
| Construction | -3.5 | 0.6 | 9.5 |
| Agriculture | -7.5 | 11.3 | -4.1 |
| Trade | 2.9 | 24.9 | 13.5 |
| Transportation | -3.1 | 3.9 | 9.9 |
| Other Services | -2.3 | 7.3 | 6.5 |

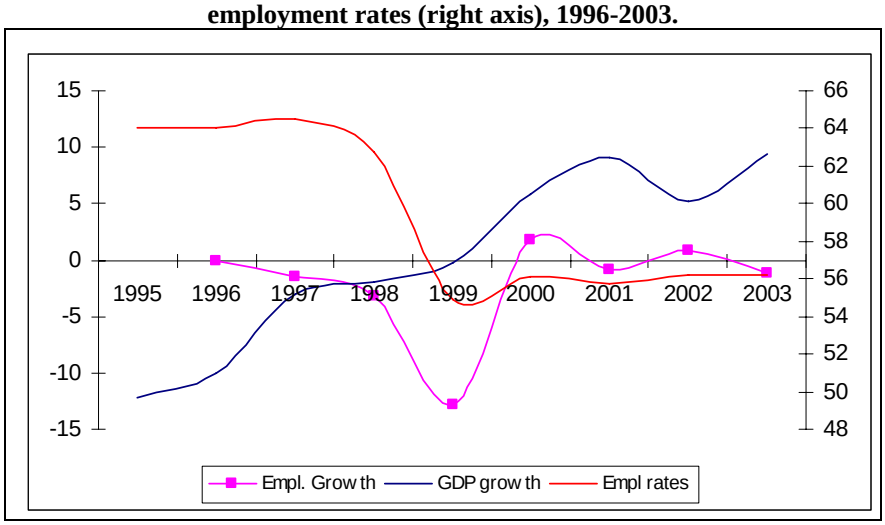
Source: IMF Ukraine Statistical Appendix (2004).

**Economic growth, however, has been uneven across economic sectors**. The recent years are characterized by very rapid growth in industry and trade. While industrial growth was led by machinery production for export between 1998 and 2000, it has shifted towards the domestic market after 2001. The production of machinery directed to the internal market is due to the expansion of food and machine-building activities, which reached close to 40 percent of all industrial manufacturing by 2003. This also reflects the rapid growth in fixed capital investment that has even outpaced GDP growth in recent years.

**The recent growth has not yet paid off in terms of employment in Ukraine.** Overall employment has remained stagnant. In fact, employment rates – the share of population aged 15-70 that are actually employed – fell significantly in 1999 and remained at stable levels (Figure 6). In spite of another year of high output growth in 2003 (9.4 percent), employment numbers have still not shown any sign of reinvigoration. Unemployment has declined in recent years from almost more than 11 percent in 2000 to 9.1 percent in 2003, and preliminary estimates for 2004 suggest even further decreases. The paradox between declining unemployment rates and stagnant employment rates is partly explained by the sustained out-migration – that declined in 2002 and 2003 -- and declines in labor force participation.

**The stagnant aggregate employment numbers hide important sectorial shifts.** An important shift in labor has occurred between the public and the private sector, since the period 1999-2002 saw a doubling in private employment, while public employment and especially collective employment fell. Yet, state owned organization, entities or institutions remained the single largest source of employment in 2002, still absorbing 47 percent of all employment. Collective enterprises (mostly farming enterprises in rural areas) accounted for 10 percent, while only one in five workers were employed in a private company. This mimics the privatization process during the last years where a substantial number of public enterprises have been privatized.

**Figure 6: GDP growth and employment growth (left axis) 1/, and employment rates (right axis), 1996-2003.**




Source: World Development Indicators, Statistical State Committee of Ukraine (SSC).
1. Annual percentage change, for age groups 15-70.

**The increasing role of the private sector has also resulted in shifts within economic sectors**. One sector of particular interest is agriculture, where the land reform process has converted a number of farms into private organizations. Once under private ownership, firms have gained in productivity by increasing investment and modernizing the existing machinery while reducing excess labor by almost a million workers between 2000 and 2003, the largest sectoral reduction in labor in this period (about a third of the agricultural workforce). In turn, most of these workers have turned into their own household lands and turned self-employed workers: more than 60 percent of the former farm labor is now occupied in cultivating their own lands. Industry, despite rapid growth, has not increased its importance in the economy keeping constant levels around 19 percent of workers.

**The dynamics in labor market participation and unemployment closely follow the poverty profile.** Labor force participation is larger in large cities compared to small towns and rural areas: in 2003 labor force participation rates reached 78 percent in Kiev and 73 percent in other big cities, compared to 64 percent in rural areas. Declines in labor market participation in rural areas and small towns have widened this gap in recent years. Unemployment rates have declined since 1999 but the youth face much higher risks. While participation rates among the youth (15-24 years) are the lowest compared to other age groups because of their alternative education activities, unemployment rates for this age group are twice that of the rest of the adult population, reflecting the lack of capacity to absorb new cohorts of labor market entrants.

**The decline in unemployment is partly due to decreasing participation but to rising *underemployment* as well.** This report uses the Household Budget Survey (HBS) to establish links between sectoral development, such as employment, and poverty. This survey provides alternative measures of labor market performance, such as underemployment which is defined in this report as those workers that report labor incomes lower than the minimum wage but declared themselves as unemployed. In the Ukraine HBS workers in *underemployment* has increased, from 8.4 percent to 9.2 percent of the population between 1999 and 2003. This important fraction of population who still define themselves as unemployed in spite of earning some income suggests that many more would like to be fully employed than is currently the case. Underemployment also shows concentration in rural areas, particularly in agricultural and retail

trade activities where most of poor are involved. These factors evidence the increasing importance of the link between poverty and labor markets. Individuals from better off households have better access to labor markets and show lower unemployment rates than those in poorer ones, and this gap has not declined over time.

**Labor markets in some sectors like industry show increasing dynamism: job markets in the industrial sector are significantly more dynamic in Ukraine than previous years and more that other countries.** Evidence from a rich industrial firm-level census-type panel dataset provides a dynamic picture of job dynamics in Ukraine. After the initial years of transition when job destruction rates were larger than those of job creation in 2001 net employment growth turned positive for the first time since independence. Given the continued high rates of job destruction, excess job reallocation also jumped. These are signs that not only employment is growing, but there is also an important reallocation process going on, with jobs simultaneously being created and destroyed (Table 2). Moreover, job flows are becoming less and less of a primarily a temporary phenomena: some 8 out of 10 newly created jobs in 2000 remained filled in 2001, while 8 out of 10 jobs destroyed in 2000 remained unfilled on year later. This is also evidence of a positive trend, as the persistence rate of job creation has increased significantly over time, while that of job destruction is declining. In all, this implies that workers who get a job also get to keep it over time, and that long-term unemployment on the other hand is on decline. In sum, the job market appears to have responded to economic growth with increased dynamism, more employment growth and higher job turnover.

**Table 2: Aggregate job flows, Ukraine and comparators**

| Country | Year | Creation | Destruction | Gross job reallocation | Net employment growth | Excess job reallocation | No. firms |
|---|---|---|---|---|---|---|---|
| **Ukraine** | **2001** | **10.6** | **8.2** | **18.8** | **2.4** | **16.4** | **7281** |
| Ukraine | 1996-2000 | 2.2 | 10.0 | 12.1 | -7.8 | 4.3 | 7000 |
| Russia | 1996-2000 | 3.5 | 8.7 | 12.2 | -5.2 | 7.0 | 16500 |
| Estonia | 1994 | 10.1 | 11.0 | 21.1 | -0.9 | 20.2 | n/a |
| USA | 1973-1986 | 9.2 | 11.3 | 20.5 | -2.1 | 18.4 | n/a |

Source: Chapter 3.

**The job market dynamics reflect job reallocation from firms with low labor productivity and low wages, to firms with higher productivity and higher wages**. Job dynamics differ by firm size, type of enterprise, region and type of ownership. Large enterprises are least dynamic in terms of job turn-over, and are associated with low job turnover and less severe net employment losses than other types of firms. Private firms stand out for high positive net employment and high job reallocation rates. Moreover, this trend has strengthened over time, as job creation has increased markedly since 1999 while job destruction has fallen somewhat. State firms see the lowest levels of job destruction – probably for the same reasons as large firms above –and, surprisingly, job creation has increased over time since most of new jobs are created in the industrialized Eastern region. While job creation rates have increased in all regions, the Western region is diverging negatively from other regions since job creation is not strong enough to offset the job lost. In the South, where job turnover is also high, job creation has offset job destruction since 2001 and net employment growth is positive. Yet, most of job dynamics occur at the firm level, rather than due to reshuffling between sectors, regions, or firms of different size categories. A decomposition of sources of job reallocation shows that these dynamics are linked more to differences between firms within sectors, within regions, within type of ownership and within size categories, than between these categories. More than half of the excess job

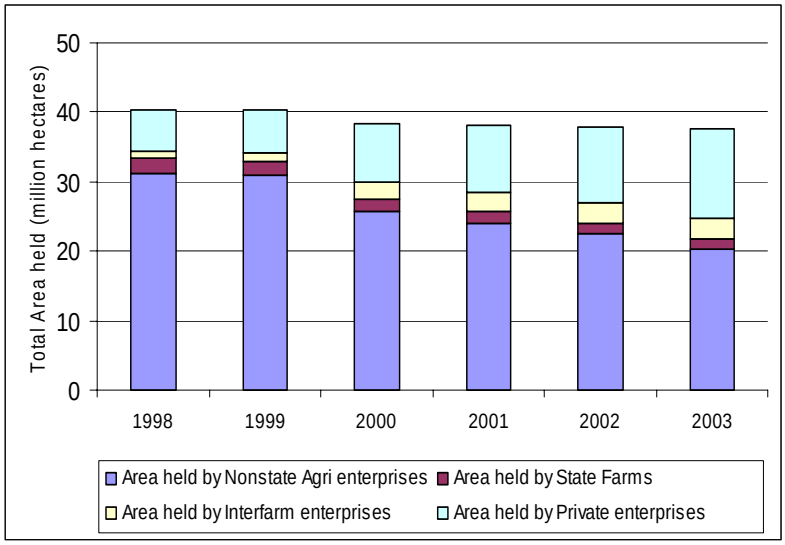
reallocation is due to shifts between firms in each of these classifications and this is due to high job destruction in low productivity firms and high job creation rates among high productivity firms.

Economic growth and employment dynamics have supported the rapid poverty reduction in Ukraine, despite the lack of employment growth. The slower reduction of poverty in rural areas, however, underscores other issues that are critical from a poverty perspective.

## III. Poverty in rural areas reflects the slow dynamics and market imperfections

**Agriculture is a key sector in understanding growth and poverty in rural areas**. The poverty profile and the nature of employment in rural areas employment indicates that agricultural development is closely linked to poverty in Ukraine. In fact, Ukraine has over 40 million hectares of agricultural land, most of which are arable and agriculture represents almost 23 percent of the employment and about 10 percent of GDP.

**Figure 7: Ownership Structure in Agriculture 1998-2003**




**Land reform has changed the ownership structure in rural areas.** In 1999 the Government started a land reform process to make agriculture more efficient and stimulate growth. State farms were converted into collective ownership farms, and this land was later distributed to households. Households rented most of the received land back to different types of agricultural organizations. The most important types of organizations are: *agricultural companies*, private entities with ownership distributed across a number of shareholders; *private enterprises* where ownership and labor were clearly separated; and *agricultural cooperatives*. The size of land managed by private enterprises and agricultural companies has increased by more than 14 million hectares, which is mainly the result of households renting land out to these new agricultural organizations.

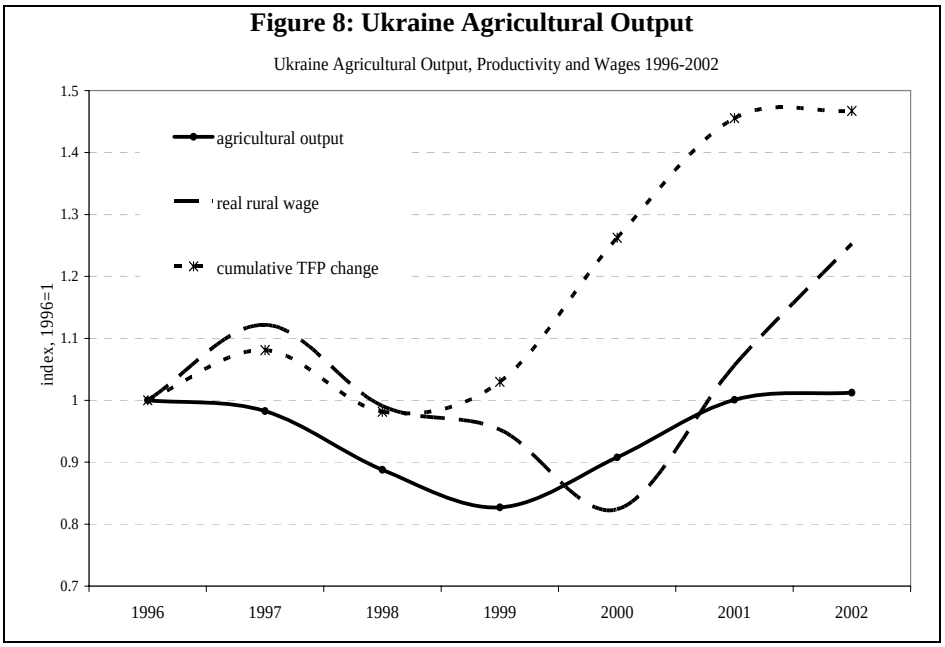
**Despite an egalitarian land distribution, access to markets and managerial capacity affect the patterns of land use.** According to the HBS, the land reform process has distributed land in an equal fashion across income groups. In 1999 the poorest 40 percent of the rural population owned about a third of the land in households' possession. By 2003 the fraction of total land in under these households' ownership is about 35 percent. The use of the land is where differences emerge between poorer and better off households. While most of the distributed land is being used by existing agricultural organizations by renting out from households, only 40 percent of rural households reported renting at least one plot their land. This suggests that other households are either involved in self cultivating their land or renting from other households for commercial purposes. Differences in renting patterns are associated with poverty since poorer households are more likely to rent than better off ones, suggesting that differences in asset

holdings, education and managerial capacity, and access to markets are playing an increasing role in entrepreneurial agricultural activities.

**The new agricultural organizations exhibit quite large variation in agricultural efficiency and productivity, which are associated to type of ownership**. The newly created *private enterprises* exhibited larger efficiency levels than other types of agricultural organizations. The gains in productivity are associated to increases in direct investment as well as reduction in the existing oversupply of labor since employment in agriculture was reduced. Wages across agricultural organizations are closely associated with productivity reflecting the differences in management practices and in land types.

**Agriculture has gained a lot on efficiency grounds but agricultural wages are lagging behind the rest of the economy**. The gains in efficiency are reflected in major gains in total factor productivity between 1999 and 2002 (Figure 8). These gains are due to both modern machinery and shedding of excess labor in the former farms. Productivity gains and the recovery in agricultural output until 2002 have translated into better wages in agricultural jobs but still a fraction of labor and land is not managed in an efficient manner. HBS evidence indicates that income from wages in rural areas increased faster than other income sources except pensions. Wages in agriculture are still the lowest in the Ukraine economy and have had the slowest progress in recent years. Agricultural wages were about 58 percent of the average in 1999 but only 47 percent in 2003.

**Figure 8: Ukraine Agricultural Output**




**Leasing incomes have been stagnant in real terms, partly reflecting the imperfection in land markets in the villages and the large degree of uncertainty in agriculture**. Incomes from assets, such as land leasing, represent about 23 percent of average income for households in villages but evidence large differences between the poor and the non poor. Leasing rates that are larger for better-off households reflect their better capacity to bargain prices, and higher reservation prices given their own capital to cultivate the land. Evidence suggests that there are still significant factors limiting access to markets like transportation and license costs, in addition to the opportunity costs of marketing. These costs have a larger burden on poor households.

**Cash incomes have increased in importance, due to wages effectively paid in agriculture and rental incomes.** The increase in wages and pensions has increased cash incomes in rural areas. While real consumption from own production has remained stable

between 1999 and 2003, incomes from agricultural sales and other entrepreneurial activities has increased as fast as wage incomes doubling its importance in rural household incomes. Still, only 11 percent of households market their own production.

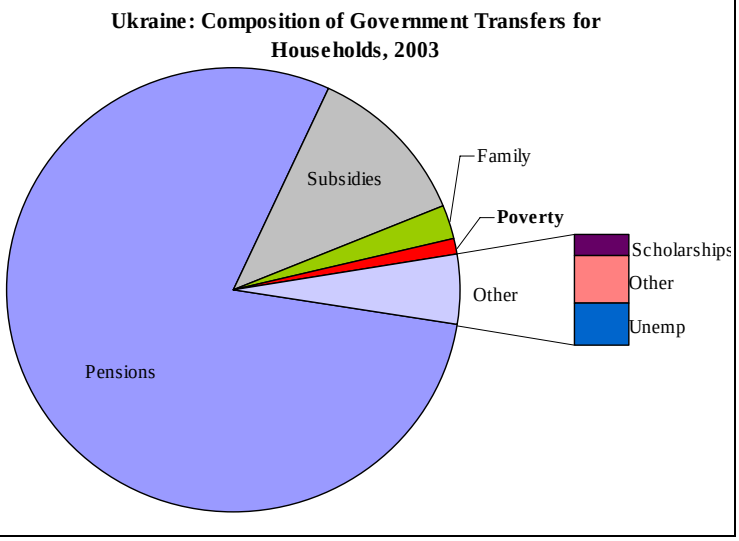
**Rural households and economic organizations in Ukraine still face significant risks in agricultural activities**. The drought of 2003 evidenced the lack of market and infrastructure instruments to restore market equilibrium. In 2003 the harvest of grain, the most important agricultural product in Ukraine, was about 5 million TM, compared to an average of 20 million TM in 2001 and 2002, which represented an economic loss of about 2.5 percent of GDP. The decline in grain harvest in 2003 due to bad winter weather conditions produced an increase in grain prices that affected urban consumers. The price increase, however, only marginally translated into higher agricultural incomes, leaving rural households with the same level of incomes but higher prices in other goods and services.

**The overall gains in productivity coupled with shifts in rural employment shifts have produced little change in rural poverty**. The combined effect of increased productivity and wages in agricultural organizations, with agricultural employment shifting from privatized farms to family farming has left rural households with real incomes that have not increased at the same pace as other sectors in the economy. The modernization process in agriculture that would expand the gains from higher productivity and efficiency to agricultural workers needs to be coupled with better off-farm economic opportunities for the resulting excessive labor. Better market and infrastructure would also provide the basis for increased competition in land and crop markets in the rural sector.

## IV. The role of government transfers in poverty reduction

**The government has three main transfer mechanisms that cover about 76 percent of the population: pensions, subsidies and a number of other social transfers**. *Pensions* are directed to the elderly with age- related eligibility criteria and more than half of the population lives in households with pension beneficiaries. *Subsidies* are waivers provided to households to partially cover their utility bills. *Social transfers* can take the form of family benefits, poverty transfers, unemployment and other occupational benefits. Public resources into these programs are massively dominated by pensions, followed by subsidies. The rest of social transfers are very small, including a poverty benefit (Figure 9).

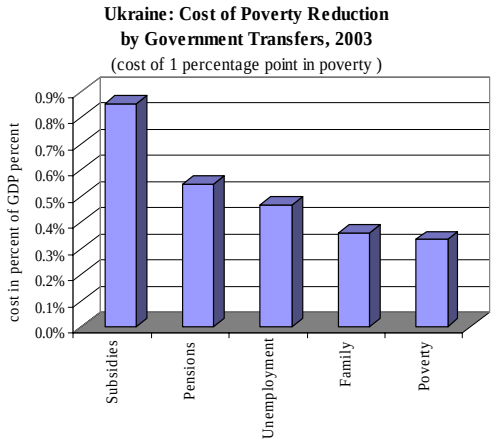
**Figure 9: Composition of Government Transfers for Households**




**Pensions represent the largest transfer with benefits relatively uniform across beneficiaries which represent 25 percent of incomes among the poor**. Even though the fraction of population benefited from pensions is similar across income groups, and benefit levels are similar as well, households from the better off quintiles get twice as much benefit than the poorest households, partly due to the presence of two pensioners in better off beneficiary households. Pensions are a very regressive transfer since the poorest quintile only gets 12 percent of all pension expenditures. Pension incomes, however, represent about 29 percent of the consumption of the poor, compared to only 17 percent for the top quintile. Real pensions have increased more than 16 percent per year, for the last four years. Poor households with pensioners have then benefited from increased public transfers, particularly in rural areas. Pension benefits, as other transfers, do have poverty reduction effects and in the case of pensions it is their magnitude, not their targeting, that drives these effects. Reducing poverty through expansion of pension is the one of the most expensive mechanism compared to other transfers, since one-percentage point reduction of poverty costs more than half percent of GDP (Figure 10).

**Utility subsides, while originally aimed to protect the poor population from large energy expenditures, but mainly benefit the better-off quintiles in large cities**. The allocation of subsidies for energy is conditional on energy consumption given that the subsidy is transferred to the utility company. Households are eligible when their expenditures on energy are 20 percent or more than their income and about half of the population receive these benefits. The distribution of the beneficiary population, however, is concentrated in large cities where coverage is the highest (60 percent) compared to rural areas (42 percent). In fact, subsidies are mostly captured by households in large cities (53 percent of transfers) or small towns (30 percent). Even within large cities, better-off households do capture four times more than the poorest households in the same locations. The urban bias in utility subsidies is due to the eligibility criteria that combines the utility cost as reported in the bills and reported or estimated income subject to major underestimation. This way, households in areas with fewer utility services -- due to lack of centralized heating in rural areas, for example – are less likely to qualify

**Figure 10: Cost efficiency of social transfers**

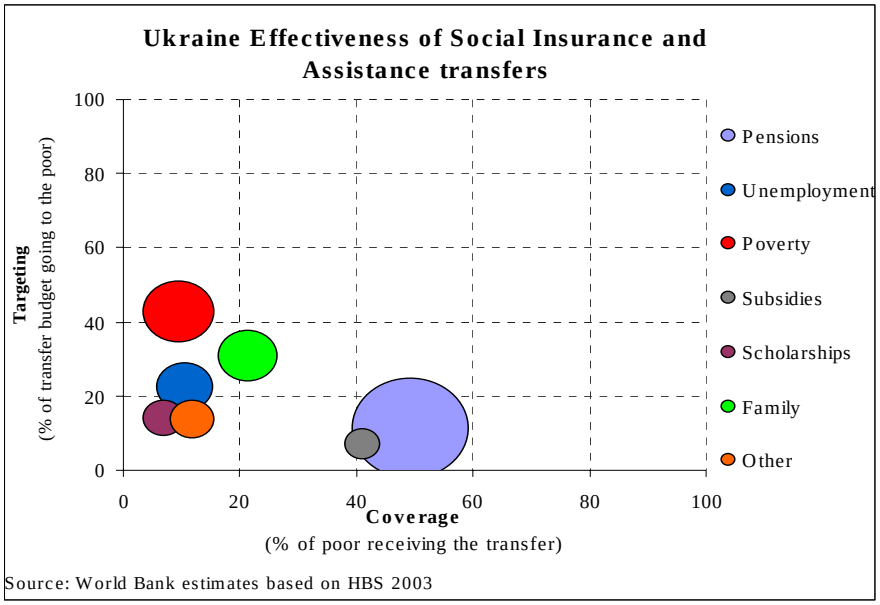


for the subsidy since there is no objective evidence about their expenses on energy. Since 29 percent of the population are users of solid fuel, mostly in rural areas, and they have the highest poverty incidence, subsidies are the most costly government transfer for the poor.

**Social assistance transfers comprise a number of small benefits with little coverage but efficient poverty reduction effects.** Among social assistance transfers there are scholarships, family transfers (child benefits), poverty targeted transfers, and unemployment benefits. These programs have relatively low coverage of the population although some of them improve their coverage among the poor. Recent changes in legislation have introduced income testing criteria for eligibility into these programs. There are two programs that evidence significant focus on the population with lower incomes: poverty targeted assistance and family benefits. The *poverty targeted transfer* has very low coverage (only 4 percent of the population) but still reaches 12 percent of the population under the poverty line, particularly in rural areas. The average benefit during 2003 is around UAH 70 per month compared to more than UAH 200 in pensions. Despite coverage limitations and the level of benefits, more than half of the poverty transfer reaches the poorest quintile despite significant leakages to better off households. This program is the most cost-effective in terms of poverty reduction, but expansion of programs usually involve targeting efficiency losses. This program can be an opportunity to expand social assistance to the poorest population if the targeting mechanism is systematically revised to reduce the inclusion of non poor households. *Family benefits* also have an income filter that has improved their targeting in recent years. The average benefit of UAH 50 resulted from collapsing previous benefits to specific demographic groups, or for certain family events such as births. By 2003 this transfer covered about 12 percent of the population and about 30 percent of the benefits went to the poor. Only 8 percent of benefits were captured by households with the highest incomes (fifth quintile).

**The set of government transfers still require better coverage of the poor and better targeting of transfers**. Because of its broad coverage, pension is the transfer that covers most of the poor even if the poor capture only a small fraction of those transfers. The poverty targeted transfer (red circle) displays the best targeting performance since almost half of its resources end up in households in poverty. The program, however, is still limited in its coverage.

**Figure 11: Effectiveness of Social transfers**



## V. Poverty monitoring and analysis capacity in Ukraine is very strong

**The increased differentiation in Ukraine and the rapidly changing profile of the poor require strong technical capacity and better instruments**. 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. Given the strong geographical patterns in poverty and the increased differentiation within regions, such as poverty pockets in Eastern region, Ukraine requires better instruments to identify the poor, and to design and evaluate policies targeted to the reduce poverty. Estimation of poverty at the local level, such as districts, is a technical challenge in Ukraine but combining available Census and HBS data other countries have successfully produced poverty maps that are intensively used for policy purposes.

**Emerging disparities in access or utilization of other social services 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 in 2005 in order to provide a dynamic picture of these rapidly changing outcomes.