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Poverty, Inequality, and Social Policy Reform in the Former Soviet Union

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Ben Slay
Senior Economist
UNDP Bureau for Europe and CIS

Introduction

Links between poverty and transition in the Soviet successor states[1] are complex and controversial. If the Soviet system had fallen into deep crisis by 1990, how could it be that poverty until then was believed to have been non-existent? Why are poverty rates today thought to be higher in virtually all these countries than was the case in the Soviet period—even though many of these countries now report much higher levels of GDP than was the case in 1990? Are higher poverty rates really unavoidable consequences of transitions to market democracies? If so, are such transitions truly necessary and desirable? Or have higher poverty rates resulted from otherwise avoidable mistakes made in the macroeconomics, political economy, or social aspects of transition? Do they reflect the end of the large subsidies provided by the Russian Federation to poorer republics within the framework of the integrated Soviet economic space? What about the role of military conflicts that have afflicted roughly half of these countries? Or perhaps significant problems of poverty and inequality were present during the Soviet period as well—but were hidden by ideology and by the absence of the data, institutions, and policies needed for effective poverty measurement and monitoring?

These questions do not have simple answers, and this paper does not attempt to provide such. It seeks to (briefly) contribute to discussions of these issues by proposing observations in four general areas:

- Many disagreements about poverty trends in these countries reflect different assessments of the Soviet system's successes in reducing poverty in a sustainable manner, and the use of different methodologies in measuring poverty. This places a premium on analyses of both Soviet-era and post-Soviet poverty trends that are based on standardized, comparable methodological frameworks.

- Concerns regarding the quality and methodological comparability of poverty data in the former Soviet republics remain significant. However, the World

[1] Understood as the eleven countries belonging to the Commonwealth of Independent States (CIS) and Georgia. The CIS acronym is often used in this paper in reference to all 12 or these countries (including Georgia), when such references pertain to Georgia prior to its August 2009 withdrawal from the CIS.

Bank's POVCALNET global poverty data set,[2] which represents a significant improvement in regional data on absolute income poverty, show that absolute income poverty levels did fall significantly during the period between the 1998 Russian financial crisis and 2005, thanks largely to the strong economic growth recorded during this time. Further reductions in income poverty are likely to have occurred during 2006-2008—years of continuing strong economic growth that ended with the onset of the global financial crisis.

- On the other hand, when measured against a poverty threshold that corrects for living costs in the northern hemisphere, poverty levels through 2005 remained quite high, especially in Central Asia—even before the global economic crisis began to affect the region. The POVCALNET data also show that significant levels of income poverty were present during the Soviet period.

- The social policy frameworks inherited from the Soviet period have proved to be quite poorly suited for poverty alleviation in the former Soviet republics. Despite reform efforts, these frameworks remain complex, difficult to administer effectively, and do not direct most social benefits to those most in need of them. In many countries of the region, adequate frameworks for poverty monitoring have not yet been put in place. These policy frameworks are also poorly placed to address the growing threats to household access to utility services (especially electricity and water supplies, also communal services) that are afflicting much of the region. Social policy reform should be high on the poverty reduction agenda in the former Soviet republics.

Measuring poverty in transition economies

The many dimensions of poverty are too complex to be captured in a single universal indicator. Measures of absolute, relative, and subjective levels of poverty, based on individual reports of income, consumption, or perceived levels of welfare, are the most common instruments in this respect. Absolute poverty in most of the former Soviet republics is defined relative to the subsistence income or wage levels needed to purchase a minimum (defined in social or biological terms) basket of consumer goods. Relative poverty is measured vis-à-vis some average living standard (generally 40-60% of median income or consumption), while subjective poverty assessments involve analyzing individual or household perceptions of how well their needs are met.

Each method has its weaknesses. National measures of absolute poverty are not very useful when making inter-state comparisons, since different methodologies are used to calculate household budgets, minimal consumption baskets, and the like. Relative poverty indicators really measure inequality, not poverty *per se*: by such measures, wealthy countries can seem poorer than impoverished countries if

[2] For more on this, see Chen, S. and M. Ravallion, *The Developing World Is Poorer Than We Thought, But No Less Successful in the Fight against Poverty*, World Bank Policy Research Working Paper, August 2008. These data can be downloaded from http://web.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTPROGRAMS/EXTPOVRES/EXTPOVCALNET/0,,contentMDK:21867101~pagePK:64168427~piPK:64168435~theSitePK:5280443,00.html.

inequality levels in the former exceed those in the latter. Choices of different baseline years further complicate such comparisons.

An absolute income poverty threshold of $1 per person per day in purchasing-power-parity (PPP) terms, which was pioneered by the World Bank in the 1980s, has traditionally been used to measure and compare poverty in developing countries. This threshold has become one of the best-known indicators associated with the Millennium Development Goals that were articulated at the United Nations' Millennium Summit in 2000. Since low-income households in the northern hemisphere face additional expenditures for heating, winter clothing, and related supplies not generally present in the more temperate African and Asian climates where the PPP$1/day poverty standard was developed, the World Bank in 2000 proposed using an absolute income poverty line of PPP$2.15/day for the CIS (and European) countries. The World Bank also introduced the daily threshold of PPP$4.30 at this time, as the per-capita income level needed to satisfy such human needs as education, healthcare, and access to information.

The World Bank's POVCALNET data set contains income poverty data collected at three-year intervals during the 1981-2005 period, from methodologically comparable household budget surveys measuring per-capita equivalized consumption expenditures (as proxies for income) for most of the world's developing and transition economies. These expenditures are made comparable by the use of global PPP exchange rates that were recently updated within the framework of the by the International Comparison Project.[3] This data base allows the researcher to calculate income poverty using whatever poverty threshold s/he wants.

Of course, the quality of these data is not beyond reproach. Differences in ostensibly identical goods included in different countries' minimal consumption baskets, the different paces at which prices for goods included in these baskets are liberalized, different levels of household willingness in different countries to honestly answer interviewers' questions about their incomes and spending—all this can bias estimates of household welfare or PPP exchange rates. In addition to these more generic problems common to most such exercises, the POVCALNET data raise some other, more specific concerns. These pertain *inter alia* to the: (i) reconciliation of multiple poverty estimates for a given year via arithmetic averaging (irrespective of the variance across these estimates); and (ii) presentation of income poverty data during the Soviet period for individual Soviet republics, at a time when the capacity of collect these data is widely understood to have been wanting.

Despite these caveats, the POVCALNET data base provides the best quality, methodologically comparable data base on absolute and relative income poverty in the region. When the trends it presents for the former Soviet republics are examined, a number of conclusions emerge.

Poverty trends in the former Soviet Union

During the Soviet period, incomes and consumer goods in the formal sector were theoretically distributed in a broadly egalitarian manner within the framework of

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[3] For more on the International Comparison Project, see http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/ICPEXT/0,,pagePK:62002243~theSitePK:270065,00.html.

central planning. Household incomes were in principle determined by centrally set wages, and were supplemented by significant public consumption that provided quasi-universal access to heavily subsidized (sometimes nominally free) public heath, education, housing, transport, culture, and other social services. Social policy rewarded "service to the country" according to broad categorical principles, and supported such "deserving" social groups as war veterans, the elderly, families, and children—irrespective of actual household or individual poverty risk. This policy framework, and the ideology that accompanied it, precluded serious consideration of poverty issues; research into such questions was not encouraged. Although a "living wage" was set by the statistical authorities at 75 rubles per person per month, this was not officially called a poverty line, nor did it serve an explicit social policy function.

Table 1—Poverty trends in FSU countries (PPP$4.30/day threshold)

Country	***1981***	***1984***	***1987***	***1990***	***1993***	***1996***	***1999***	***2002***	***2005***
Armenia	31%	33%	34%	59%	83%	77%	89%	89%	83%
Azerbaijan	82%	83%	84%	85%	86%	86%	84%	67%	55%
Belarus	5%	3%	3%	14%	16%	69%	33%	14%	7%
Georgia	32%	34%	35%	36%	37%	48%	63%	76%	71%
Kazakhstan	3%	3%	3%	24%	63%	60%	57%	67%	50%
Kyrgyz Republic	24%	26%	29%	34%	58%	84%	85%	95%	90%
Moldova	97%	97%	96%	87%	85%	74%	95%	82%	77%
Russian Federation	55%	49%	48%	43%	30%	29%	42%	29%	19%
Tajikistan	44%	47%	49%	40%	92%	99%	97%	95%	90%
Turkmenistan	95%	94%	93%	96%	98%	91%	85%	81%	72%
Ukraine	86%	80%	78%	45%	14%	46%	66%	39%	15%
Uzbekistan	35%	34%	39%	47%	49%	56%	89%	96%	95%

Source: World Bank POVCALNET database.

The realities of poverty and inequality, of course, were more complicated. The differentials in wage incomes needed to induce migration from "labour surplus" to "labour shortage" regions, and to encourage workers to acquire human capital, generated wage inequalities that were on par with those reported in at least some capitalist countries.[4] The public services provided to collective farm workers (who did not receive state pensions until the 1960s) and other rural areas and small town residents were often inferior to what urban dwellers enjoyed. Shortage conditions forced many households to pay whatever the (black) market would bear for consumer goods. Likewise, low wages in the state sector led many workers to seek additional earning in the informal sector, outside of the protections offered by labour regulations.

Post-Soviet research paints a less flattering picture of the Soviet record on poverty and inequality. The POVCALNET data shown in Tables 1 and 2 indicate that income poverty levels (even when defined vis-à-vis the PPP$2.15/day threshold) during the 1980s were significant in much of the Soviet Union, especially in Moldova, Turkmenistan, and Azerbaijan. Using the PPP$2.15/day threshold, these data suggest that—despite reductions in poverty levels during the 1980s, some 30 million Soviet citizens (roughly one in eight) were still living in poverty at the time of

[4] Overall income inequalities in capitalist countries were generally much higher during the Soviet period, due to the presence of significant non-labour incomes that typically accrue disproportionately to wealthy households.

the Soviet Union's dissolution (1990). If the PPP$4.30/day threshold is used, this figure rises to nearly 120 million—slightly less than half the Soviet population at that time.[5] According to another study, 16% of blue collar households and 39% of collective farm households in 1985 earned less than the officially set living wage.[6]

Table 2—Poverty trends in FSU countries (PPP$2.15/day threshold)

Country	***1981***	***1984***	***1987***	***1990***	***1993***	***1996***	***1999***	***2002***	***2005***
Armenia	7%	7%	8%	24%	52%	42%	54%	52%	34%
Azerbaijan	40%	41%	43%	45%	46%	47%	43%	22%	0%
Belarus	0%	0%	0%	0%	0%	18%	4%	1%	1%
Georgia	8%	9%	9%	10%	10%	15%	26%	38%	33%
Kazakhstan	0%	0%	0%	6%	20%	21%	17%	25%	13%
Kyrgyz Republic	0%	0%	0%	8%	32%	58%	46%	71%	56%
Moldova	65%	61%	56%	48%	48%	36%	77%	44%	33%
Russian Federation	8%	6%	5%	7%	9%	9%	12%	5%	2%
Tajikistan	8%	9%	10%	8%	56%	92%	82%	73%	56%
Turkmenistan	64%	61%	56%	70%	88%	69%	53%	46%	35%
Ukraine	26%	20%	19%	12%	0%	10%	17%	5%	1%
Uzbekistan	0%	0%	0%	9%	29%	22%	63%	79%	74%

Source: World Bank POVCALNET database.

As mentioned above, these data are not without problems. Still, they are broadly consistent with the argument that, as economic growth slowed to a crawl (and then went negative) in the last years of the USSR, growing numbers of Soviet citizens found that their incomes dropping below poverty thresholds. Meanwhile, the upper echelons of the Soviet elite enjoyed such privileges of rank and status as access to scarce consumer goods (at official prices) and the ability to more easily travel abroad. With the onset of *perestroika* in the mid-1980s, well connected members of the *nomenklatura* were increasingly able to transform these privileges into income and wealth. Accelerating social stratification combined with slow economic growth could have further exacerbated absolute income poverty. Reasonable individuals will disagree about the extent to which the data on poverty and social stratification in these countries that began to appear in the 1990s simply reflected trends that had begun during the Soviet period, and became increasingly visible following the Soviet collapse.

Since the 1990s witnessed sharp declines in GDP, as well as the appearance of new sources of non-labour incomes that accrued disproportionate to wealthier households, it is reasonable to assume that absolute (and relative) poverty in most former Soviet republics increased during the 1990s—probably significantly. This assumption is born out by the POVCALNET data, which show income poverty rates rising sharply during the 1990s—particularly in Central Asia. These data indicate that the numbers of people living below PPP$4.30/day in the former Soviet republics rose from some 120 million in 1990 to nearly 150 million in 1999. Roughly 20 million of

[5] Residents of the Baltic states are included here.

[6] Source: Falkingham, J., *Inequality and poverty in the CIS7, 1989-2002*, presented at the Lucerne Conference of the CIS-7 Initiative, 20-22 January 2003. See also Ovcharova, L.N., I.I. Korchagina, and E.V. Turuntsev, *Sistema indikatorov urovnya bednosti v perekhodnyi period v Rossii*. Moscow, 2009, EERC-Russia/The Eurasian Foundation.

this 30 million person increase would seem to have occurred in the five Central Asian countries. These data are by and large consistent with the national literatures on poverty that emerged during the 1990s, reflecting *inter alia* more accurate (generally smaller) estimates of the size of these transition economies (especially for the low-income countries in Central Asia and the Caucasus), the emergence of poverty reduction strategy papers as policy frameworks for managing the links between macroeconomics and poverty alleviation, and the obvious hardships experienced by millions of people during the 1990s.

The POVCALNET data also indicate that absolute poverty levels fell in virtually all the former Soviet countries between the mid-/late 1990s and 2005. Use of the PPP$4.30/day threshold suggests that some 60 million people moved out of income poverty between 1999 and 2005; the numbers of those living below this threshold had dropped to some 90 million by 2005. Higher household incomes and expenditures produced by these countries' post-1998 economic recoveries would seem to have been a main cause of this progress—along with significant reductions in income inequality reported in the Russian Federation (which comprises some 60% of the population in this region).

On the other hand, these data also show the extent to which absolute poverty remains a serious problem in the less wealthy former Soviet republics. If the PPP$2.15/day threshold is used, then in 2005 more than half of the population in Kyrgyzstan and Tajikistan—and nearly three quarters of Uzbekistan—was living in poverty; this share was roughly a third in Armenia, Georgia, Moldova, and Turkmenistan. While these numbers no doubt dropped further during the 2006-2008 period, the global financial crisis seems likely to reverse many of these gains—particularly in Armenia, Georgia, and Moldova, where large declines in GDP are unfolding in 2009.

Inequality in the former Soviet Union

Income inequality data for transition economies suffer from many of the methodological drawbacks afflicting absolute income poverty data, for many of the same reasons. On the other hand, a wealth of national and comparative studies strongly suggest that income inequalities (as measured by Gini coefficients) increased in virtually all CIS economies experienced during the 1990s. While many factors seem to have contributed to these increases, some of the most important include:

- The slow pace at which prices and commerce were liberalized in many CIS countries, which created numerous arbitrage opportunities for well connected rent-seekers;
- The privatization of state assets to well connected insider buyers, often at preferential prices;
- The high/hyperinflations of the early 1990s, which sharply reduced real incomes for most workers and those living on fixed incomes;
- Significant increases in the shares of non-labour incomes accruing disproportionately to wealthy households;
- Drastic cutbacks in social benefits and minimum wage levels, due to fiscal pressures; and

- The appearance of significant arrears in social benefit and wage payments, particularly from state-owned enterprises and budget-funded institutions.

Table 3—Inequality trends in FSU countries (Gini coefficients)									
Country	***1981***	***1984***	***1987***	***1990***	***1993***	***1996***	***1999***	***2002***	***2005***
Armenia	0.44	0.44	0.44	0.44	0.44	0.44	0.50	0.53	0.50
Azerbaijan	0.35	0.35	0.35	0.35	0.35	0.35	0.36	0.37	0.17
Belarus	0.23	0.23	0.23	0.22	0.22	0.25	0.30	0.30	0.28
Georgia	0.37	0.37	0.37	0.37	0.37	0.37	0.38	0.40	0.41
Kazakhstan	0.26	0.26	0.26	0.29	0.33	0.35	0.33	0.35	0.34
Kyrgyz Republic	0.26	0.26	0.26	0.37	0.54	0.43	0.35	0.32	0.33
Moldova	0.24	0.24	0.24	0.29	0.35	0.36	0.37	0.37	0.36
Russian Federation	0.24	0.24	0.24	0.34	0.48	0.46	0.37	0.36	0.38
Tajikistan	0.32	0.32	0.32	0.32	0.32	0.32	0.32	0.33	0.34
Turkmenistan	0.26	0.26	0.26	0.30	0.35	0.39	0.41	0.41	0.41
Ukraine	0.23	0.23	0.23	0.25	0.26	0.35	0.29	0.28	0.28
Uzbekistan	0.25	0.25	0.25	0.29	0.34	0.41	0.45	0.45	0.45

Source: World Bank POVCALNET database.

The POVCALNET data base contains time series estimates for Gini coefficients, which are methodologically consistent with the absolute income poverty data described above. Although they are likewise not without quality concerns, these data can be used to monitor trends in relative poverty and inequality. These data show relatively low pre-transition inequality levels, followed by increases in inequality during the 1990s—increases that are only sometimes reversed with the return to economic growth after 1999. For every country (like Kyrgyzstan, Azerbaijan, Russia, Ukraine) which by 2005 could report significant declines in inequality relative to the 1990s, there are others (Armenia, Georgia, Kazakhstan, Turkmenistan, Uzbekistan) where the opposite trend is apparent, or where inequality levels seemed to remain relatively unchanged (Belarus, Moldova, Tajikistan). These data also indicate that, while a number of these countries continue to enjoy income inequalities that are well below developing country averages (Azerbaijan, Belarus, Ukraine), other countries (Armenia, Uzbekistan, Turkmenistan, Georgia) as of 2005 were reporting Gini coefficients in excess of .40.

Poverty risk factors: Location, gender, age

The available data on poverty in transition economy suggests that the risks of poverty in the former Soviet republics are particularly high for traditional low-income groups—pensioners and those unable to work, individuals living alone, single-parent families, families with many children.[7] They are also high for the "new poor" of the transformation, such as:[8]

[7] This is a particular issue in Central Asia, where average family sizes are significantly larger than in other former Soviet republics.
[8] Falkingham, *op cit.*

- the unemployed (including officially employed workers on unpaid or partly paid leave, or who have experienced significant wage arrears) and their families;
- farm workers and petty traders, particularly in rural areas (and their families); and
- the working poor, including public servants in such sectors as education, health, science, and the arts (and their families);
- unemployed youth with no work experience; and
- refugees and internally displaces persons.

Research from the late 1990s and early years of the current decade points to large numbers of working poor. In Russia, the majority of the poor (87%) at this time lived in families where one or several members of the family was employed. In Ukraine, 78% of poor families had at least one member who was employed.[9] Poverty risks generally vary inversely with education levels as well. Locational (urban-rural) factors are important determinants of poverty levels in former Soviet republics: poverty rates in rural areas during the last ten years have generally been well above those in urban areas. Poverty in rural areas also concerns issues of access to quality education, health care, and other social services. Poverty levels in medium-sized and small towns—particularly in "company towns" where local economies rely heavily on small numbers of large companies that were products of the Soviet system—are likewise often well above rates reported for larger cities.

The gender dimensions of poverty in these countries differ noticeably from those of other regions.[10] On the one hand, the evidence on the feminization of poverty are ambiguous: the World Bank data shown in Table 4 below indicate that people living in female-headed households around the turn of the millennium were less likely to be living in poverty than those in male-headed households. World Bank data also suggest that, with the exception of Tajikistan, significant gender differences in primary and secondary education attendance or completion rates are not apparent. Outside of Central Asia, secondary education attendance rates for women are generally above those for men. Likewise, the ratio of female to male labour force participation rates has increased in most former Soviet countries over the course of the transition. And demographic data show that women in Russia, Belarus, Ukraine, and Moldova outlive men in these countries by 9 to 13 years (well above global averages).

On the other hand, as in other regions, gender remains an important indicator of vulnerability in the former Soviet republics. Women in these countries earn less than men (in Tajikistan this gap had reached 25% in 1999[11]); unemployment rates for women in these countries are generally higher than for men. The sharp cutbacks in

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[9] See, for example, Ovcharova, L., *Bednost' v stranakh s perekhodnoi ekonomikoi*, presented at a regional conference on "Sotsial'naya politika realii XXI veka: regional'nyi aspekt," Barnaul, October 2002; and Libanova, E., "Bednost' v Ukraine: diagnoz postavlen—budem lechit?", *Zerkalo nedeli*, № 337, 2001 (http://www.zerkalo-nedeli.com/ie/archiv/337/).

[10] See Paci, P., "Gender in Transition", World Bank, 2002; and *Development and Transition*, December 2007 (http://www.developmentandtransition.net/index.cfm?module=ActiveWeb&page=IssuePreview&IssueID=20).

[11] World Bank, *Growth, poverty, and inequality: Eastern Europe and the former Soviet Union*, 2005, p. 136.

social services that took hold in the early 1990s disproportionately affected women, for whom the role of primary care giver within the household increases the importance of access to quality child care, health care, and education. The collapse of the Soviet system has also meant the reappearance or deepening of traditional gender roles (particularly in Central Asia and the Caucasus), which are sometime difficult to reconcile with contemporary beliefs about gender, choice, and development.[12] Perennial concerns about domestic violence remain.

Table 4—Gender dimensions of poverty in former Soviet republics

Country	Year	Gender of household head by:			
		Poverty level*		Poverty structure**	
		Male	Female	Male	Female
Russian Federation	1997	10%	7%	38%	62%
	2002	9%	6%	32%	68%
Ukraine	2002	2%	2%	48%	52%
Moldova	1998	63%	58%	66%	34%
	2003	38%	32%	63%	37%
Armenia	1998-1999	52%	54%	72%	28%
	2003	46%	42%	73%	27%
Georgia	1997	41%	37%	67%	33%
	2003	46%	45%	69%	31%
Kazakhstan	2001	26%	18%	63%	37%
	2003	18%	10%	63%	37%
Kyrgyzstan	2000	75%	55%	73%	21%
	2003	67%	36%	79%	21%
Uzbekistan	2000-2001	50%	39%	81%	19%
	2003	43%	29%	83%	17%

Source: World Bank, Growth, poverty, and inequality: Eastern Europe and the former Soviet Union, 2005, pp. 250-53.

** On the basis of the PPP$2.15/day poverty line, 2000 PPP exchange rates.*

*** Sums to 100%.*

If the associations between old age, gender, and poverty in the former Soviet republics are complicated, the links between youth and poverty seem less so. World Bank data[13] indicate that, for every country in the region for which comparable data were available before and after the turn of the millennium, individuals age 15 and under are at greater risk of poverty than those over 65—often very much so. Whereas the elderly in 2003 only rarely accounted for more than 10% of those living in poverty in CIS countries,[14] children 15 and under accounted for 25%-45% of those living in poverty. These trends are particularly stark in Central Asia: members of families in Kyrgyzstan with three or more children faced a 90% poverty risk in 2003; in

[12] Polygamous practices have returned to some areas in CIS countries in which large gender imbalances have appeared, due to armed conflict or the out-migration of male workers. The Russian Federation's Republic of Ingushetia (in the Northern Caucasus) actually passed legislation legalizing polygamous marriages in the late 1990s. This law was struck down by the federal authorities.
[13] World Bank, *Growth, poverty, and inequality: Eastern Europe and the former Soviet Union*, 2005, pp. 250-53.
[14] Measured according to the PPP$2.15/day poverty line.

Uzbekistan, nearly half (49%) of those living in poverty in 2003 were members of families with at least three children.

Poverty and social policy

The increases in poverty these countries experienced during the 1990s are an indictment of the social policy frameworks then in place. Here, three issues are fundamental. First, funding for social services and social protection fell sharply, due to sharp declines in GDP and in shares of GDP available for social policy via public sector redistribution. Second, the social policy frameworks inherited from the Soviet-period have proved quite ineffective in helping those most in need of social assistance during the transition. Two decades after the dissolution of the USSR, some countries (e.g., Armenia, Russia, Kyrgyzstan, Ukraine, Kazakhstan) have made much more progress than others in putting place the institutions and policies needed to effectively measure, monitor, and respond to poverty and inequality. Effective poverty reduction therefore requires both resources and social policy reform. Third, these policy frameworks are also poorly placed to address the growing threats to household access to utility services (especially electricity and water supplies, also communal services) that are afflicting much of the region.

The labour market and social policy (pensions, health care, education, social protection) frameworks inherited from the Soviet period suffer from significant gaps between the "desirable" (stated goals of universal social benefit coverage, extensive labour market protection, "free" access to quality health and education services) and the "feasible", in terms of these countries' demographic trends, post-communist propensities for tax evasion, and not-unlimited state capacity. In particular:

- The high tax rates needed to fund universal benefit and extensive formal worker protection schemes, and centralised wage setting mechanisms, can drive significant amounts of economic activity into the informal sector, where taxes are not collected, and *de facto* worker protection and wage levels fall far short of *de jure* prescriptions. The sustainability of pension and health care systems is jeopardised by unfavourable demographic and employment trends, reflecting the merciless logic of aging, shrinking labour forces and the rationalisation of post-communist labour demands. Complicated tax, benefit, and protection systems overwhelm the not-unlimited capacity of the relevant stage agencies and depress job creation rates.

- The relatively extensive and complicated social benefit systems bequeathed by the Soviet system can create disincentives to work ("poverty traps") that take people out of the labour force, further reducing employment. This is particularly an issue for Roma in Southeast and Central Europe, and for low-skilled workers in general.

- State budgets do not have enough income to pay teachers, doctors, etc., "what they are worth", thereby worsening the quality of services and strengthening tendencies (inherited from socialism) toward corruption. These problems are exacerbated by skill mismatches within these institutions (e.g., too many teachers for shrinking primary school classes; too many health care specialists but not enough primary care doctors . . .).

- The emphasis on universal (but often low or poor-quality) social protection schemes often precludes the targeting of vulnerable groups. The focus on categorical (as opposed to targeted by vulnerability) benefit schemes generates a profusion of complicated and overlapping beneficiary categories, many of which do not provide support to those who are in greatest need. In Russia, prior to reforms in 2005 that simplified and monetised many of these benefits, the federal government alone provided some 156 different social payments, credits, price discounts, and subsidies to more than 236 different categories of social groups (e.g., the children and grand children of World War II veterans). This complexity burdens the not-unlimited administrative capacity of social welfare agencies, promotes corruption, and reduces the take up of these benefits.

- Passive labour market policy instruments (i.e., payment of benefits) are emphasised over active labour market policies, welfare to work programmes, and the like.

These systems, combined with unfavourable demographic trends and the large declines in incomes that took hold in the 1990s, play a large role in explaining the sharp increases in poverty and inequality that took hold in the first decade of transition. Despite the large burden on companies imposed by the redistribution of some 30-45% of GDP through the public sector,[15] the state often remains unable to target support to those who need it most. However, the large state programmes that provide universal benefits to the middle classes (e.g., subsidised public education, health care) and employment for powerful lobbies (e.g., teachers, doctors) are politically hard to change.

This picture is not a disaster, of course. Some potentially vulnerable people are kept out of poverty by these measures. Still, other vulnerable communities (e.g., Roma) who are most in need of assistance are poorly served by these systems. And prospects for economic and employment growth are constrained by the high taxes needed to fund these benefit systems.

In response to these problems, many former Soviet republics have introduced reforms (often under the aegis of the World Bank, with the support of the European Commission) that have sought to better target social benefits, reduce the unintended side effects of tax systems and labour market regulations, strengthen work incentives, and shore up the sustainability of pension and health care systems in the face of unfavourable demographic trends. Specific measures have included:

Tax reforms: These generally correspond to the “flat tax” motif, based on tax simplification (reducing tax rates and the numbers of exemptions) and aligning the *de jure* tax burden with the *de facto* capacity of the tax administration. These reforms are most common for value added, personal, and corporate income taxes; they are less

[15] By contrast, this share is in the 20-25% range in the low-income countries of the Caucasus and Central Asia.

common for social security taxes. This is perhaps regrettable, as it is often the latter which introduce the greatest distortions into labour markets.

Labour market reform. Specific measures include:

- Labour code reform, to align *de jure* employee protection legislation with the *de facto* capacity of the state bodies charged with its enforcement. By making it easier to fire workers and hire workers on short-term contracts with fewer benefits, this can increase employment.

- Shifting from passive labour market policies (i.e., paying out unemployment benefits) to active labour market policies (training, public works, apprenticeships). However, as in other regions, there is little evidence from the region proving that active labour market policies have a perceptible impact in the face of unfavourable macroeconomic conditions (i.e., when large aggregate imbalances between labour demand and supply are present).

- Engaging the private sector in employment generation by subsidising the employment of "marginal" workers, introducing "welfare to work" schemes, and permitting private employment companies to compete with labour offices in finding jobs for workers. Corporate social responsibility frameworks can be quite important in this respect.

- Decentralising collective bargaining systems, to allow wages to more flexibly reflect local labour market forces and increase employment.

Social benefit reform. Specific measures include:

- Reducing the scale and frequency of poverty traps by increasing incentives for proactive, otherwise desirable behaviour by social benefit recipients via conditional cash transfers (e.g., linking child support payments to school attendance or unemployment benefits to participation in training courses; providing benefits in the form of vouchers that can not be spent on alcohol and cigarettes; etc.).

- Restructuring social policy frameworks to reflect changing demographics, such as: (i) introducing fully funded obligatory private pension funds (as has occurred in Kazakhstan); (ii) restructuring primary schools to reflect shrinking class sizes; and (iii) emphasising preventive health care.

- Introducing competition and other market principles into the provision of social services (e.g., tendering social service delivery to private companies, NGOs).

These reforms, which are generally supported by the European Commission as being in line with the European Social Charter and the Lisbon Strategy, have recorded a number of successes. These are most apparent in:

Reduced tax burdens: In much of the region (e.g., Russia, Georgia, Moldova), reforms introduced after the turn of the millennium reduced tax rates without reducing tax revenues, by broadening the tax base and reducing the numbers of exemptions. These "flat tax" reforms are widely seen as helping to reduce corruption and accelerate GDP and employment growth.

More sustainable pension systems, as growing numbers of younger workers are paying for their own retirement rather than relying on transfer payments from future workers. Pension reforms have also boosted the demand for domestic securities, deepening financial systems and increasing fiscal space. Within the former Soviet republics, pension reforms of this sort were first introduced in Kazakhstan in the 1990s; they have since spread to Russia and elsewhere.

Labour market and social policy reforms have increased employment, and rationalised social protection systems, by "making work pay". The introduction of new labour codes in a number of former Soviet republics after the turn of the millennium has been accompanied by more rapid employment growth.

However, these reforms also have their downsides, which can be associated with their ("neoliberal") emphases on market-based solutions to social problems. Even when beneficial for society as a whole, these emphases can have unfortunate effects for vulnerable groups. For example:

Innocent losers: Children can suffer when their parents lose their social benefits because they are unwilling or unable to return to/enter the labour force. Workers who benefited from more extensive employee protection measures and were in no danger of becoming redundant can be victimised by labour market deregulation that reduce the employment protection they receive.

Pension reform—demographic and financial challenges. The collapse of financial markets that were the harbinger of the global financial crisis raised the spectre of under-funded (or otherwise poor supervision of) private pension funds.[16] While financial markets since the second quarter of 2009 have rallied, at least some of the bloom has come off the rose of state pension privatisation. In Russia and Ukraine, the demographic pressures that are driving increases in retirement ages also feature increases in male mortality rates and constant or declining male life expectancy. Growing numbers of men are therefore dying before reaching pension age.[17]

Successful health care reforms are few and far between. Attempts at strengthening the role of market forces—especially in terms of competition among health care providers and insurers, increased consumer choice, and the introduction of explicit patient co-payments—have been conspicuous in their lack of robust successes.

Popular reactions against benefit reductions, actual and perceived: In January 2005, millions of demonstrators in the Russian Federation protested the "monetisation" of social benefits which (among other things) attempted to simplify and better target Russia's social protection mechanisms. Public opinion ran strongly

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[16] Whether they have become as under-funded as public pension systems remains an open question.
[17] While this convergence may boost pension systems' long-term sustainability, it can also serve as a quintessential example of "throwing out the baby with the bathwater". It also illustrates how gender issues in the region concern men as well as women.

against "making people pay for things that used to be free" (e.g., free public transport for World War II veterans).

Education reform—not enough? Deep changes in demographics, labour market trends, and technologies have made education reform inevitable in much of the region. Important progress has been made in a number of areas, particularly curricular reform and the introduction of distance learning. In three respects, however, serious problems remain. First, education systems continue to produce graduates with skills that are poorly aligned with post-communist labour market demands. Second, problems of corruption—particularly in post-secondary education institutions—are clearly deepening in many former Soviet republics. Anecdotal evidence indicates that the quasi-purchasing of university degrees in former Soviet republics is leading growing numbers employers and graduate schools in OECD countries to dismiss these degrees as worthless pieces of paper. Third, corruption and other "informal user fees" (often due to low teacher salaries) are limiting access to quality education services for growing numbers of students from poor or vulnerable families.

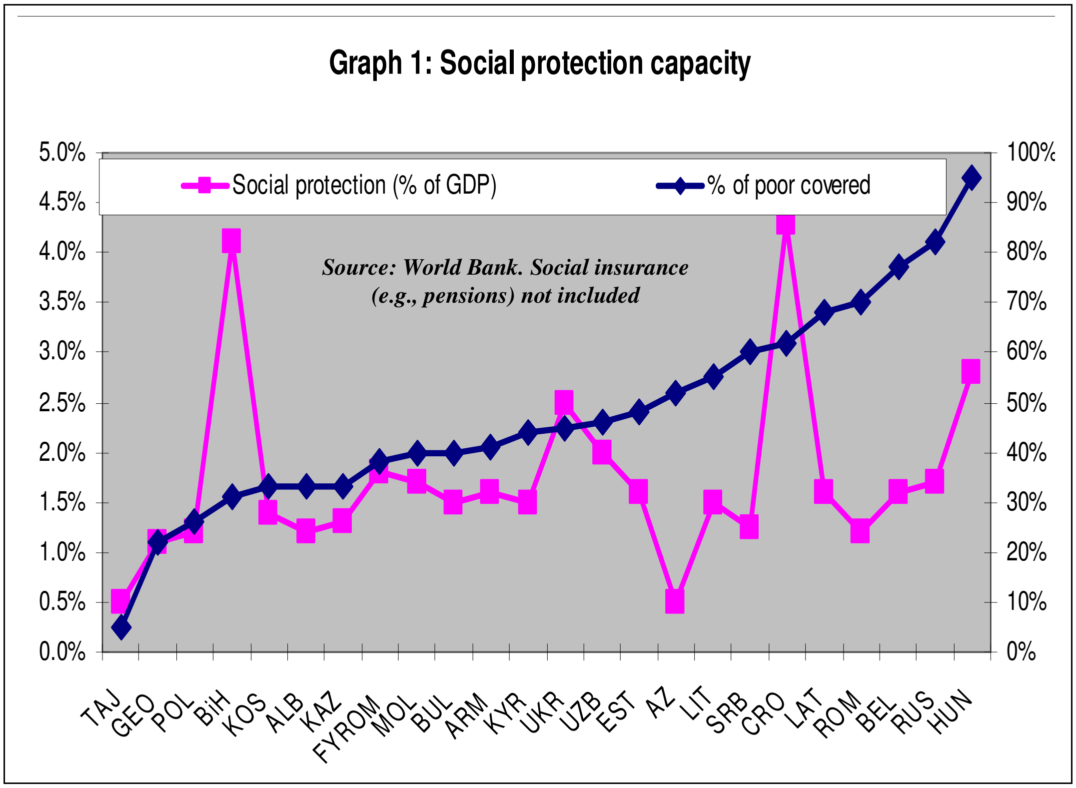
Trafficking and exploitation in the workplace: The emphasis on market mechanisms in many of these reforms reflects the limited capacity of state institutions charged with labour market regulation and social service provision. However, this emphasis on aligning the *de jure* responsibilities of state regulatory and control agencies with the *de facto* institutional capacity may downplay the need to strengthen this capacity, in order to better protect social and labour market rights. For example, human trafficking and other forms of worker exploitation can be partly addressed by removal of counter-productive labour market regulations—particularly in terms of migration regimes. But more capacity in border control and law enforcement institutions, as well as in labour market inspectorates, is also clearly needed. This is clearly the case in the poorer former Soviet and West Balkan countries, where democratic controls over security sectors are quite weak.

How serious are social policy inadequacies in the region? Recent World Bank research provides a rough-and-ready guide to social policy effectiveness in transition economies by comparing them in terms of the shares of: (i) GDP devoted to social protection (narrowly defined, so that spending on pensions and other social insurance programmes are excluded); and (ii) poor households that actually benefit from these social protection programmes. These results, which are shown in Graph 1 below, are not terribly encouraging. Compared to all the transition economies in Europe and Central Asia, the CIS countries (and Georgia) fall into one of three groups:

- Countries that devote relatively large shares (compared to regional averages) of GDP to social protection (thus defined), but for whom coverage of poor households is relatively weak—Ukraine and Uzbekistan;

- Countries which are relatively good at targeting benefits to poor households, but which devote relatively small shares of GDP to social protection—Azerbaijan, Belarus, and Russia; and

- Countries that devote relatively small shares of GDP to social protection and for whom coverage of poor households is relatively weak—Armenia, Georgia, Kazakhstan, Kyrgyzstan, and Tajikistan.[18]



While not without their problems, these data suggest that, relative to their comparators (i.e., the new member states of the European Union, Turkey, and the West Balkan countries), the former Soviet republics continue to face important social policy reform challenges.

Developments during the past 2-3 years have also underscored the importance of declining access to energy, water, and communal services. Household tariffs for these services were typically set at zero or at minimal amounts during the Soviet period; their provision was funded almost completely from central budgets. Two decades on, Soviet-era beliefs that provision of these services should be "free" have begun to give way to market realities, as central subsidies for these services have been drastically reduced. However, tariffs charged by service providers (typically utilities and local governments) have not kept up with sharp increases in the costs of service delivery. World Bank research indicates that, in 2002, nominal residential electricity tariffs in 2002 were at cost-recovery levels in only 14 of the 19 countries in the Europe and Central Asia region studied. In Tajikistan and Uzbekistan, these tariffs were at 24-25% of cost-recovery levels; in Albania, Azerbaijan, Kyrgyzstan, and Russia, they were at 50-55% of cost-recovery levels.[19] This has resulted in an on-

[18] Turkmenistan was not included in this study.

[19] Source: Lampietti *et al.*, *Power and People: Electricity Sector Reforms and the Poor in Europe and Central Asia*, World Bank, 2006, p. 166.

going decapitalization of local-level energy, water, and communal service infrastructures, as well as in rapid tariff growth as service providers struggle to remain solvent. These problems were further exacerbated by the rapid growth in global energy prices that took place during 2007-2008.[20] When combined with the sharp increases in food prices occurring at this time, these trends pose particular hardships for vulnerable households in the region's poorer economies.

These problems are particularly apparent in the low-income countries of Central Asia. Following a decade of apparent recovery from 1992-1996 civil war and strong economic growth, Tajikistan during the winter of 2007-2008 experienced a "compound crisis" of interlinked water and energy insecurity. Already weakened by two decades of energy- and water-sector mismanagement, the national electrical energy infrastructure buckled under the strains of severe winter weather. Although the winter of 2008-2009 was much milder, drought conditions aggravated these water/energy tensions in Tajikistan and caused them to spread to neighbouring Kyrgyzstan—necessitating emergency humanitarian appeals in both countries. Hundreds of thousands of households and small businesses in Tajikistan and Kyrgyzstan lost access to reliable electricity, and often water and sanitation, services. Evidence of accumulating water and energy insecurities in Uzbekistan, while less transparent, can also be found. These local drought conditions during 2008 also interacted with spiralling global food prices to raise new food security concerns: official statistics indicate that food prices last year rose by some 25-35% across Central Asia.

Although the drought of 2008 now seems to have ended, the mismanagement of Central Asia's water resources continues—as evident in the region's extremely high per-capita water consumption levels;[21] the on-going desiccation of the Aral Sea and growing threats of land degradation and desertification in the Aral Sea basin; continued extensive reliance on the water-intensive cotton monoculture in Uzbekistan, Turkmenistan, and Tajikistan; and perennial tensions between upstream and downstream countries regarding the water/energy nexus, as well as the prospective construction of large hydropower plants in the upstream countries. Although global food prices collapsed during the second half of 2008, food security concerns in Central Asia continue; national statistics indicate that food prices across Central Asia during the first half of 2009 were 8-10% above year-earlier levels. Electricity/gas/water/communal service tariffs paid by households typically increased at double or triple this rate.

Longer term, Central Asia faces the challenges of climate change adaptation, particularly in the form of melting glaciers and eventual changes in the levels and timing of river flow from snowmelt.[22] All this despite the fact that, as the data in

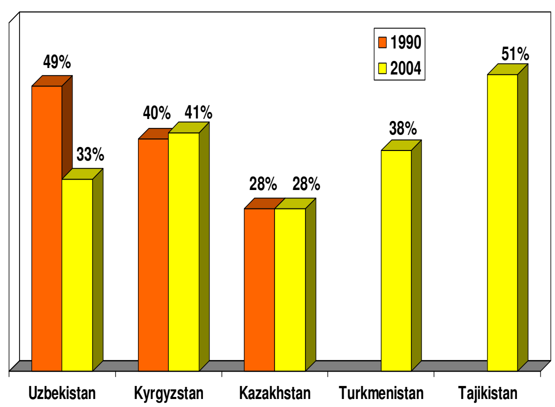
[20] IMF commodity price data indicate global energy prices have risen by more 50% since 2003. Prices for primary energy (especially gas) traded among former Soviet Republics have risen significantly faster.

[21] According to 1998-2002 FAO data (http://www.fao.org/nr/water/aquastat/dbase/index.stm), per-capita water use in Turkmenistan was the highest in the world; the other four Central Asian countries were the third- through sixth-largest per-capita water consumers.

[22] Some 87% of the runoff in the Aral Sea basin is generated by snow and glacier melt in the mountainous upstream countries. (Source: "Central Asia – Regional and National Water Sector Review", UNDP, 2008; available at http://waterwiki.net/index.php/Central_Asia_%E2%80%93_Regional_and_National_Water_Sector_Review.

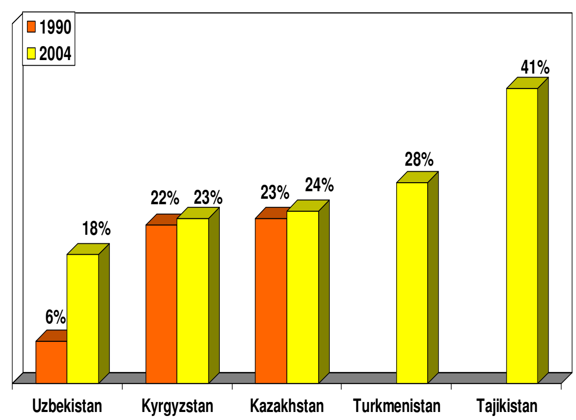
Charts 1 and 2 below show, problems of access to improved water sources and sanitation services were important even before the compound crisis—particularly for Tajikistan and Kyrgyzstan. The absence of significant improvements in these indicators during the post-Soviet period must likewise be a matter of concern.

Chart 1: Share of population without access to improved sanitation services



2004 data. Source: UNDP *Human Development Report 2006*, pp. 306-307.

Chart 2: Share of population without access to improved water sources



2004 data. Source: UNDP *Human Development Report 2006*, pp. 306-307.

Water, energy, and food insecurities may be particularly sharp in Central Asia, but they are hardly unique to this sub-region. In 2004, 23% and 46% of the population in Azerbaijan did not have access to improved water and sanitation services, respectively; the numbers for Moldova were 8% and 32%. (Power shortages are all too common in much of Kosovo and, during times of drought, parts of Albania.) Deforestation (and its associated consequences of soil erosion, increased flooding and landslides, biodiversity loss) in parts of the Caucasus and the Western Balkans reflect reductions in access to energy services (due in part to sharp increases in heat, electricity, and gas tariffs) and increased reliance of wood fuel for heating and cooking. Despite these higher energy prices, tariffs for electricity and gas services across the CIS region remain well below world levels—as (not surprisingly) do energy efficiency indicators. Households and businesses across the region are facing sharply higher prices for electricity, water, and communal services, as service providers struggle to extend services to new users, or maintain existing service levels while compensating for decades of tariffs set below cost-recovery levels.

Rising food prices and utility tariffs are affecting household incomes and vulnerability even in middle-income countries where physical access to food, water, and energy is generally not an issue. In Ukraine, for example, despite the economic crisis and collapsing domestic demand, communal service tariffs rose 30% during the first half of 2009 (over the same period in 2008), while food prices were up 14%. Similar trends are apparent in Belarus: official data show that household electricity tariffs were up 38% in the first half of the year; food prices rose 17%. For Turkey, the corresponding figures were 21% and 9%, respectively. The anticipated repricing of carbon—key to climate change mitigation prospects, both globally and in the region—will put further strains on the region's energy inefficient economies, as well as on low-income household budgets. It will further reinforce the importance of accelerating the development of alternative, renewable energy sources, and of reforming legal, regulatory, and commercial structures to strengthen incentives for their use.

Table 5—Select vulnerability indicators in CIS countries

Country	Those living below the poverty line:[23]		Inflation rates:[24]		Population without access to improved:[25]		GDP change (2009:H1)
	Millions	Pop. share	Food	Energy[26]	water	sanitation	
Belarus	0.7	7%	17%	38%	0%	16%	0%
Kazakhstan	7.5	50%	8%	17%	14%	28%	-2%
Kyrgyzstan	4.6	90%	9%	30%	23%	41%	2%
Russia	27.9	19%	12%	25%	3%	13%	-11%
Tajikistan	5.9	90%	10%	58%	41%	49%	3%
Ukraine	7.1	15%	14%	30%	4%	4%	-19%

All data are from national statistical offices unless specified otherwise.

Quantifying degrees and trends in household vulnerability is not a simple task. However, a rough-and-ready set of vulnerability indicators is presented in Table 5 above, in the form of first-half 2009 food- and energy-price inflation in select CIS countries, World Bank POVCALNET income poverty data (comparable across countries), data on access to improved water and sanitation services, and GDP trends during the first half of 2009 (showing the overall impact of the economic crisis). Regrettably, the income poverty data (measured against a threshold of $4.30 in daily per-capita expenditures, in purchasing-power-parity terms) are from 2005; income poverty levels in all the countries shown in Table 5 clearly fell further during 2006-2008. But even if, for the sake of argument, income poverty rates were cut in half during these three years, then at the end of 2008 (i.e., at the start of the crisis) some 40 million people in the Europe and CIS region would still have been living on PPP$4.30/day, or less. Since expenditures on food and utilities comprise between one- and two-thirds of the consumer price index in these countries, and since household incomes in these countries are either stagnant or declining, food- and energy-price inflation trends of the magnitudes now being reported can have a significant impact on real household income, food security, and access to energy, water, and sanitation services.

Some tentative conclusions

Poverty, inequality, and threats to food, water, and energy security were posing significant development challenges to many of the former Soviet republics even before the global economic crisis began to affect the region. The impact of the crisis can be expected to exacerbate the difficulties—even for countries (like

[23] 2005 World Bank POVCALNET data, calculated vis-à-vis the PPP$4.30/day threshold.
[24] January-June 2009 compared to January-June 2008.
[25] 2004 data. Source: UNDP *Human Development Report 2006*, pp. 306-307.
[26] Alternatively electricity, gas, fuels, or other communal service tariffs. Data are for January-June 2009 compared to January-June 2008.

Uzbekistan) which reported continued strong economic growth in the first half of 2009. Policy makers, businesses, and households everywhere will face challenges of "doing more with less".

In contrast to capital markets (which were the harbinger of the global economic crisis in 2007-2008, and are currently serving as a leading indicator for the global economic recovery in late 2009 and 2010), labour markets and state budgets can be expected to respond to the crisis with a lag. In the labour market, employers that have laid off workers in response to the crisis may be unlikely to hire them back quickly. In terms of social protection, many of the regrettable reductions in state funding made inevitable by macroeconomic trends in the region seem likely to occur during 2010-2011. In terms of the crisis's impact on poverty and inequality, the worst still seems ahead of us. While this particularly seems to be the case for countries like Russia, Ukraine, and Armenia (which reported double-digit declines in GDP in the first half of 2009), no country in the region is likely to emerge unscathed. Using a PPP$5/day poverty threshold, Horváth *et al.* estimate that the global economic crisis by 2011 will push some 30 million additional people living in the Europe and Central Asia region into income poverty.[27] It remains to be seen whether this estimate will prove to be optimistic, pessimistic, or realistic.

[27] Balázs Horváth, Andrey Ivanov and Mihail Peleah, with Michaela Pospíšilová, "The Human Development Impact of the Global Crisis in the Europe and CIS Region", forthcoming in *Development and Transition*, December 2009.