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Ukraine:

SOCIAL SAFETY NETS AND POVERTY

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Currency equivalents

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1 UAH	=	\$ 0.1850
\$1	=	5.4041 UAH

Weights and measures

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Fiscal year

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Abbreviations and acronyms

CIS	Commonwealth of Independent States
CPI	Consumer Price Index
DEM	German Mark
GDP	Gross Domestic Product
ILO	International Labor Organization
Kcal	Kilocalories
OECD	Organization for Economic Cooperation and Development
PADCO	Planning and Development Collaborative International
PPP	Purchasing Power Parity
PTSU	Primary Territorial Sampling Unit
UAH	Ukrainian Hryvna
USAID	United States Agency for International Development

Vice President	Johannes Linn (ECAVP)
Country Director	Luca Barbone
Sector Manager	Michal Rutkowski (ECSHD)
Program Team Leader	Galina Sotirova (ECSHD)
Task Managers	Hjalte Sederlof/Emily S. Andrews (ECSHD)

UKRAINE: SOCIAL SAFETY NET AND POVERTY

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The Ukraine Social Safety Net and Poverty report was written Emily Andrews and Arvo Kuddo (ECSHD), with contributions from Katerina Petrina, Ruslan Yemtsov, and Maria Shkaratan. Peer reviewers were Neeta Sirur, Mansoor Rashid, and Branko Milanovic. Andras Peter and Sidonie Jocktane were responsible for document processing. From the Ukrainian side, background papers were prepared by the team of researchers from the Council of Productive Forces Study, National Academy of Sciences of Ukraine headed by Ella Libanova, and included also Elena Makarova, Lydmila Cherenko and Irina Pronina; Inna Osipova and Natalia Ivonchik from the State Statistics Committee of Ukraine; Natalia Burkat from the Institute of Reforms, and Natalia Kvitko from the Ministry of Finance. The authors would like to acknowledge the support by the Ministry of Labor and Social Policy of Ukraine, and in particular Minister Ivan Sakhan and Director of Department of Social Assistance Mykolai Noschenko, and the State Statistics Committee of Ukraine, and in particular Deputy Director Natalia Vlasenko.

UKRAINE: SOCIAL SAFETY NET AND POVERTY

INTRODUCTION

This report is intended to determine how well the social protection system meets the needs of the poor and what changes can be instituted to improve it. To accomplish this objective, the report measures poverty in Ukraine, assesses the success of current programs, and suggests a framework for system redesign. Social safety nets in market economies are primarily intended to protect the poor by mitigating life cycle risks and providing targeted benefits to cope with income inadequacy. One of the particular challenges of a transition economy is in the realization that poverty can appear even among the employed population and that childhood poverty will affect the future of the nation.

The Government of Ukraine requested assistance from the World Bank in its preparation of a National Poverty Reduction Strategy. The redesign of social benefits is a key priority as current programs are not meeting Government's objectives. This report has been written in response to Government's request and has been prepared in close cooperation with Ukrainian counterparts. Four working groups comprised of Government officials and local experts have been created to assess the incidence of poverty and evaluate the effectiveness of social safety net programs using the results of the newly designed Ukrainian Survey of Income and Expenditure (SIE). Preliminary findings of these reports have been widely discussed in Ukraine.

The Ukrainian social support system could address social needs well, as it has sufficient resources to do so, but, currently, it does so poorly. Ukrainian expenditures on social programs are high compared to other countries, at 3 percent of GDP. Nonetheless, social programs are poorly targeted, with considerable resources spent on families that are not poor. This is particularly true in the case of housing allowances and so-called 'privileges'. While these programs have reduced poverty (and extreme poverty) by several percentage points, leakage to the non-poor is considerable. In other words, resource allocation needs to be improved to do the job. Targeting can be done in a variety of ways including categorical benefits, income testing, asset tests, and proxy means testing in which indicators are used to substitute for the direct measurement of income. The question is to decide which method is most effective.

Identifiable pockets of poverty are visible in Ukraine. Families with many children, families with small children, the poorly educated, the elderly over age 70, and households headed by the unemployed all exhibit poverty rates higher than those of the rest of the population. Further, regional differences in poverty are considerable. Although Ukraine is in a situation of economic stress, better program design could alleviate poverty more effectively and reduce expenditures as well. Government is aware that social assistance programs need to be redesigned. This will require additional quantitative analysis, planning for better management and effective evaluation.

Suggestions for such a redesign are provided that would reduce funding for poorly targeted programs and increase funding in the rest. In particular, a specific strategy is proposed, which would carefully phase in such a social assistance reform over a four-year period, to which the World Bank could lend its support.

1. HOUSEHOLD SURVEY BACKGROUND

1.1. Study Background

1.1 Ukraine re-established its independence in 1991, after more than 70 years of Soviet rule. As a nation of almost 50 million people, Ukraine is strategically located at a crossroads between east and west, with a great endowment of human and physical capital. For all the potential that the country holds, the first decade of independence must be considered one of missed opportunities and great disappointments on the economic and social fronts, despite many achievements on the political side.

1.2 After an initial period when economic reform took a back seat to political and nation-building imperatives, expectations were set very high in 1994-96, when Ukraine seemed to embark on an ambitious program of reform. Very soon, however, the Government began displaying a lack of sustained commitment to the reform agenda. As a consequence, the transition from the command-and-control socialist state, with its cradle-to-grave social protection, to a transition market economy resulted in substantial dislocations, which were amplified by weak social institutions. Official statistics indicate that, between 1991 and 1999, measured national income declined about 60 percent, on a cumulative basis.¹ Real incomes declined sharply, leading to strong dissatisfaction with reduced living standards.

1.3 By 1999, the ratio of the employed to the total population was at an all time low. Formal sector employment dropped by 14.2 percent between 1990 and 1999, from 24.5 million to 21.8 million workers. Wages remain low and wage arrears are prevalent, accounting for more than one third of the public debt.² Based on an survey of enterprises (designed by the ILO), about a third of all industrial workers have been laid off without pay at any one time and four in five factories have wage arrears.

1.4 While the unemployment rate based on the Ukrainian Labor Force Survey (LFS) was 12 percent in 1999; the registered unemployment rate, which represents applications to the Employment Services, was far less – around 4 percent. That is, only one-third of the unemployed was registered. Further, only around half of all registered unemployed were receiving unemployment benefits. Benefit reciprocity, covering only one sixth of the unemployed, is below international standards. Over time there have been substantial increases in both the registered unemployment rate and the overall LFS unemployment rate, which have likely resulted in a significant increase in the poverty

¹ At the same time the size of the shadow economy has grown significantly. While the size of the informal economy has yet to be determined with any certainty, by all accounts it is substantial, ranging up to 50 percent of measured GDP. The last country CEM established the size at around 40 percent. But household surveys do not indicate massive unreported employment. Thus, the bulk of the estimated informal economy appears to be a reflection of underreporting by officially registered firms, which hide income and expenses to avoid taxes.

² As of January 1, 2000, wage arrears were 6.4 billion, or 5 percent of GDP. Wage arrears were 2.4 billion UAH in industry, 2.0 billion in agriculture, and .5 billion in construction – to list the largest contributors.

rate, as well. These facts suggest that the population has had to develop considerable coping mechanisms to deal with economic decline.

1.5 Nevertheless, there are indications that by 1999, the Ukrainian economy may have started to turn around. Recent political events have been favorable to reform. After the presidential elections last November 1999, the new Government prepared and Parliament approved a pro-reform program. For the first time in many years, the 1999 consolidated budget showed a surplus, and economic performance has started improving in 2000. With these positive signals, Ukraine may be starting on a slow path towards recovery. Government is now committed to reforming the social safety net and targeting benefits to the poor.

1.6 The last poverty assessment for Ukraine, based on 1995 data, was conducted prior to the 1998 Russian crisis, which had a negative impact on the entire CIS region. The objective of this report is threefold: (i) a poverty update that presents a current snapshot of the profile of poverty in Ukraine, (ii) policy analysis of the social safety net based on that update, and (iii) a policy framework to address insufficiencies within the system. The need for a combined poverty update and policy review is substantial, as most economic and demographic indicators since independence have been discouraging, suggesting that poverty has been increasing over time.

1.2. Study Design

1.7 This report measures poverty in Ukraine based on household expenditure data from the State Statistics Committee's (Goscomstat) improved 1999 Survey of Income and Expenditure (SIE).³ According to the basic poverty line, 26.7 percent of the population was poor. A more stringent poverty line included only 13.5 percent of the population. These are measures of relative poverty, as the basic poverty line is equal to 75 percent of median expenditures, and the extreme poverty line is equal to 60 percent of median expenditures.

³ These findings are based on data for the first three quarters of 1999. This survey is nationally representative of the population and is based on a random sample of the population (see Volume II).

BOX 1. UKRAINE: WHAT IS THE HOUSEHOD SURVEY?

In Ukraine, regular household surveys conducted since 1952 were based on samples of enterprises, organizations, collective farms, and other establishments. In 1999, the first quarterly Survey of Income and Expenditure (SIE) was conducted by the State Statistics Committee based on residence, following standard practices used in market economies. The initial sample of around 12,200 households was selected on the basis of 195 sample towns and 190 rural districts. Smaller towns (less than 100,000 inhabitants) and rural districts were selected randomly based on stratification criteria proportional to the population. Thus the survey was also regionally representative. Changes in territorial sampling are scheduled every 5 years. (Annex 1). Out of different poverty lines tested, including absolute, proportionate or relative, food shares and caloric, a relative poverty line of 75 percent of median expenditures was chosen as a criterion for poor households for analytical purposes, and 60 percent of median expenditures as a criterion for very poor households. The choice of a slightly modified OECD equivalence scale for calculation of poverty rates in which the first adult (and Group I and II disabled) received a weight of 1.0, second and subsequent adults – 0.7, and children (regardless of age) – 0.5 was stipulated by the Ukrainian Law “On Subsistence Minimum” and the Government Regulation “On Provision of Targeted Social Assistance to Low Income Families”. Only the energy value of food basket was calculated per household member.

1.8 Children, the disabled, and the aged are considered vulnerable in most societies, as they are less able to take care of themselves. As in other transition economies, this study finds that poverty among children is more prevalent than that among pensioners. It examines current safety net programs to devise methods to reduce childhood poverty more effectively while helping others in the population who are also in need.

1.9 The study is divided into the following chapters.⁴ Chapter 2 assesses the incidence of poverty within the population by selected household groupings according to lifecycle characteristics and size. Characteristics related to the head of household are explored next to determine their correlation with the incidence of poverty. Finally, attention is drawn to regional differences.

1.10 Chapter 3 reviews programs designed to provide social protection. The five basic Ukrainian programs are social privileges, Chernobyl benefits, housing allowances,

⁴ Volume II discusses the methodology behind the study, including the basis for the analysis, the 1999 Ukrainian Survey of Income and Expenditure (SIE). Issues of distribution and poverty measurement are addressed as background to the poverty analysis. Findings from the study’s multivariate analysis are provided. Topics related to social programs and workgroup recommendations are also presented. Tables in Appendices provide extensive additional tabular information.

family allowances, and targeted social assistance.⁵ In Chapter 4, the targeting efficacy of these programs is discussed and program expenditures are reviewed. Social assistance and family benefits are found to be somewhat more pro-poor than housing benefits and privileges, which are concentrated among the non-poor. Total expenditures, however, while poorly targeted, if reorganized, would be sufficient to fill the poverty gap.

1.11 In Chapter 5, a discussion of measures to revamp current social programs and directions for future analysis concludes the update. The steps already outlined by Governmental working groups are reviewed and a proposal is made which schedules a series of reforms over a four year horizon to complete and consolidate social assistance reform. Subsequent analysis will be needed to develop sound programs to change the poverty profile. Simulation analysis (statistical scenario testing) is suggested as a means to evaluate and fine tune proposed social assistance policy alternatives that could reduce poverty at a reasonable cost by minimizing leakage and reducing work disincentives. Further, it is recommended that the regional components of poverty be examined more carefully to ensure that targeted programs are successful at the local level.

⁵ In this report, pensions are considered to be deferred compensation rather than social assistance. Targeted social assistance is defined to include four other programs, which are income tested. These are i) cash benefits to individuals unable to work and with low incomes; ii) state cash benefits to some categories of pensioners; iii) supplementary monthly benefits for living; and iv) additional one-time social assistance to the most needy households.

2. POVERTY PROFILE

2.1 The incidence and depth of poverty can be analyzed from several different perspectives to assist policymakers in their efforts to allocate scarce budgetary resources effectively. This report provides an initial snapshot of poverty in Ukraine according to three criteria – household structure, characteristics of the head of household (usually the principal provider), and geographic location. Household structure reflects life-cycle circumstances and size of household. Life cycle circumstances include childhood, adulthood, and retirement. In Ukraine, as in other countries, poverty is greatest among families with children. And children are of particular concern in all countries as they are both vulnerable and constitute the country's future.

2.2 The economic situation of children's parents (or guardians) ultimately determines childhood poverty. For that reason, a thorough understanding of the characteristics of household providers, and particularly of household heads, is important. Those characteristics most likely to be correlated with poverty include age, education, and the principal activity of the household head. Further, poverty is contingent not only on personal characteristics but also on the economic situation faced by the household, including the regional characteristics of the economy.

BOX 2. UKRAINE: WHAT ABOUT INCOME INEQUALITY?

The 1999 Ukrainian SIE indicates that aggregate income and consumption inequality was relatively modest, in the range of 0.27-0.29. This is comparable to Gini coefficients observed in Central European countries and in Lithuania, Latvia, and Belarus but lower than those of most other CIS states. Gini coefficients in Ukraine measuring money income and expenditures were significantly higher, at 0.35 and 0.36 respectively based on data for quarters I-III of 1999 (see Volume II Tables 1.2 and 1.3). Other inequality measures, such as decile ratios, confirm that inequality in Ukraine is somewhat less than in other countries.

Lower Ukrainian Ginis can be attributed partially to survey methods. In 1999, Goskomstat survey data were collected cumulatively, and quarterly data were not made available. As a result, the transitory components of incomes and expenditures were averaged out, and the Gini for I-III quarters reflects long-term inequality, which is less than that of any given month or quarter. Further, measurement was based on a consumption-based Gini, which is less volatile and more likely to reflect permanent income, especially from informal activities. These are particularly important in Ukraine where wage income accounted for only 34 percent of total income in the survey period. Generally, differences between income inequality and consumption inequality are significant. In addition to the inclusion of the consumption of home produced goods (such as foodstuffs from subsidiary plots valued at average regional market prices), the value of non-cash housing allowances and social privileges was also imputed.

The value of non-cash benefits was based on information reported by households on housing allowances and discounts for housing, fuel, and public transport and telephone service. The share of home produced goods and housing allowances in total expenditures was higher among poor households while the share of privileges was slanted towards non-poor. The calculated Gini coefficient also was low in 1999 because large purchases of some consumer goods were smoothed using a special calculation formula. While most of these adjustments probably more accurately reflect the degree of household inequality, the Ukrainian coefficient cannot be compared to earlier Ukrainian Ginis or to those of other countries in the region.

2.3 The poverty profile indicates higher rates of poverty among household heads with lower levels of education and among unemployed heads. Further, there are significant regional differences in poverty in Ukraine. In the poverty and policy assessment planned for 2001, interaction effects between characteristics related to poverty will be investigated further and regional differences in poverty will be studied in detail. In addition, greater emphasis will be placed on measures of poverty depth.

2.1. Household Structure.

2.4 Several household structures were selected to analyze the overall incidence of poverty in Ukraine. These groupings are traditionally used in poverty studies and present an initial framework for poverty incidence analysis. Households are categorized by the presence of pensioners, children, or only adults (Table 2.1). Pensioner households form the largest group representing fully one-third of the population. Households with children amount to 30 percent of all households. Adult-only households comprise 15 percent of the total.

Table 2.1. The structure of Ukraine's households, their incomes and expenditures, I-III Q, 1999

Type of households	Number (1000)	percent of total	Total equivalent expenditures	Total equivalent incomes	Ratio of Income to Expenditures
Pensioners					
1 pensioner	2,843.00	16.00	207.3	142.9	1.45
of which: 70 years and older	1,428.00	8.03	190.7	132.3	1.44
2 pensioners	2,125.00	11.96	209.0	155.8	1.34
1 adult and 1 pensioner	926.80	5.21	209.1	156.5	1.34
Adults					
1 adult	761.70	4.29	271.2	177.9	1.52
2 adults	1,264.00	7.11	246.5	174.4	1.41
3 adults	725.60	4.08	203.3	152.7	1.33
Children					
1 adult and 1 child	493.00	2.77	230.2	148.6	1.55
2 adults and 1 child	2,080.00	11.70	219.1	154.8	1.42
2 adults and 2 children	1,641.00	9.23	194.6	145.9	1.33
3 adults and 1 child	737.50	4.15	167.5	129.7	1.29
Household with 3 children	350.90	1.97	160.1	123.4	1.30
Household with 4 children	61.80	0.35	132.3	112.4	1.18
Household with 5 and more children	44.40	0.25	98.4	111.1	0.89
Total	17,771.50	100.00	204.5	148.9	1.37

2.5 In general, adult-only households had higher expenditures and higher ratios of expenditure to income, potentially signaling lower rates of poverty. Similarly, households with children reported lower average per capita expenditures and lower expenditure-to-income ratios.

2.6 Poverty rates, calculated for each household group, support these observations (Table 2.2). Adult-only households had considerably lower poverty rates, and pensioner households had lower than average poverty rates, as well. Extreme poverty rates were relatively rare for two-pensioner households, suggesting that two-pension families benefit from scale economies that raise living standards. Extreme head-count poverty rates⁶ indicate, however, that the incidence of poverty and extreme poverty is higher in households headed by elders over 70-75 years of age, mainly because their health status limits their ability to earn additional income.

Table 2.2 Household Poverty Rates

Household type	Household Poverty Rate	Extreme Household Poverty Rate
Pensioners		
1 pensioner	24.1 %	12.5 %
Of which pensioner 70 years older	28.4 %	14.8 %
2 pensioners	20.8 %	8.7 %
1 adult and 1 pensioner	25.1 %	13.2 %
Adults Only		
1 adult	15.6 %	7.1 %
2 adults	15.3 %	6.8 %
3 adults	26.0 %	14.3 %
Households with children		
1 adult and 1 child	19.5 %	7.4 %
2 adults and 1 child	22.8 %	12.0 %
2 adults and 2 children	25.9 %	13.3 %
3 adults and 1 child	38.3 %	20.4 %
Households with 3 children	45.0 %	21.1 %
Households with 4 children	63.8 %	45.8 %
Households with 5 and more children	86.9 %	58.6 %
All Households with children	28.9 %	13.5 %
Total	26.7 %	13.5 %

2.7 The distribution of poverty in families with children is more complex. The poverty rate for all households with children, at 28.9 percent, is somewhat higher than that of the population overall. Similarly, the extreme poverty rate for families with children is also virtually the same as that of the population overall. Poverty in households with three or more children is much higher, however, with nearly two-thirds of all households with five or more children in extreme poverty. While only 8.4 percent

⁶ In the Ukrainian 1999 household survey, poverty rates were calculated using the OECD equivalency scale as discussed in Volume II.

of these households have three or more children, targeting social assistance to families with many children provides a simple measure with which to proxy income.

2.8 Of course, poverty in large families tells only part of the story. While households with many children are more likely to be in poverty, most poor children are in smaller households. Overall, 83 percent of households with children in poverty (and children in extreme poverty) have fewer than three children. Consequently, additional policies are needed to address the situation of child poverty.

2.9 Headcount poverty rates for families with children are not essentially different from the household poverty rates presented above. The headcount poverty rate for all households with children is 31 percent and the extreme poverty rate is 14 percent. Again, poverty rates increase substantially with additional numbers of children.

2.10 Another pocket of poverty can be found among families with very young children, less than three years of age (Table 2.3). Like families with many children, these families represent a relatively small proportion of households. However, when nearly three-quarters of households with two small children are poor (by headcount measures), and over half are in extreme poverty, this is a situation which can be addressed through categorical targeting of social assistance.

**Table 2.3. Poverty Rates among Households with Children under Age 3 Years
(Percentage, I-III Q, 1999)**

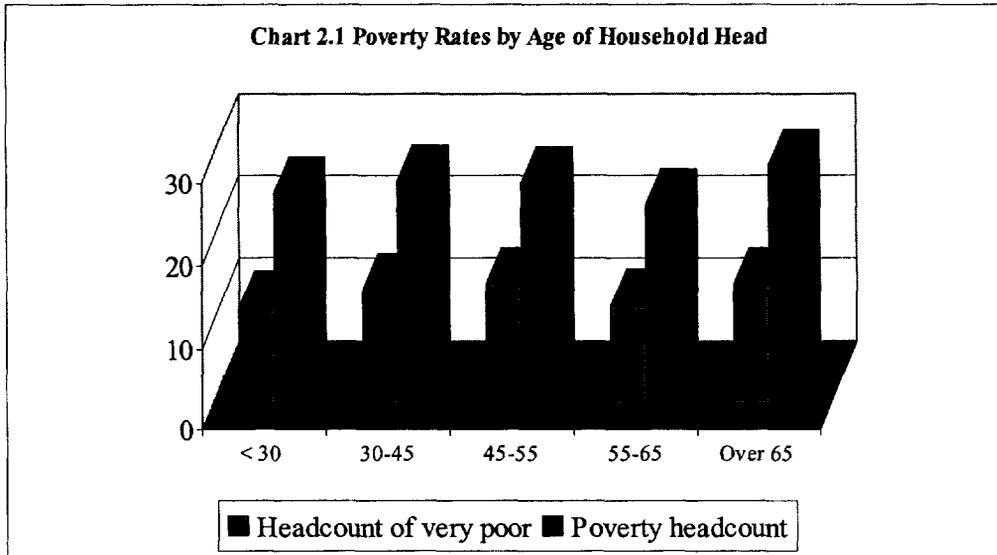
Number of children under 3 years	Very poor	Poor	Non-poor	Total	Poverty headcount	Headcount of very poor
One child	8.69	7.70	4.77	5.55	36.99	21.12
Two children	0.67	0.44	0.06	0.16	73.80	56.11
Total	9.35	8.14	4.83	5.71	38.02	22.10
Households without children under 3 years old	90.65	91.86	95.17	94.29	25.99	12.98
All households	100.00	100.00	100.00	100.00	26.68	13.50

2.2. Head of Households

2.11 Child poverty is not an outcome of the children themselves, but rather is related to the family situation in which they live. In other words, to understand the why's and where's of child poverty, one must learn more about their responsible adults. Of course, poverty in households with children is likely to be higher since the income of the responsible adults must be stretched further when children are present, even with household scale economies and lower consumption requirements for children compared to adults. But this is only part of the equation. While this issue requires additional analysis, the characteristics of household heads help explain why some children are poor while others are not.

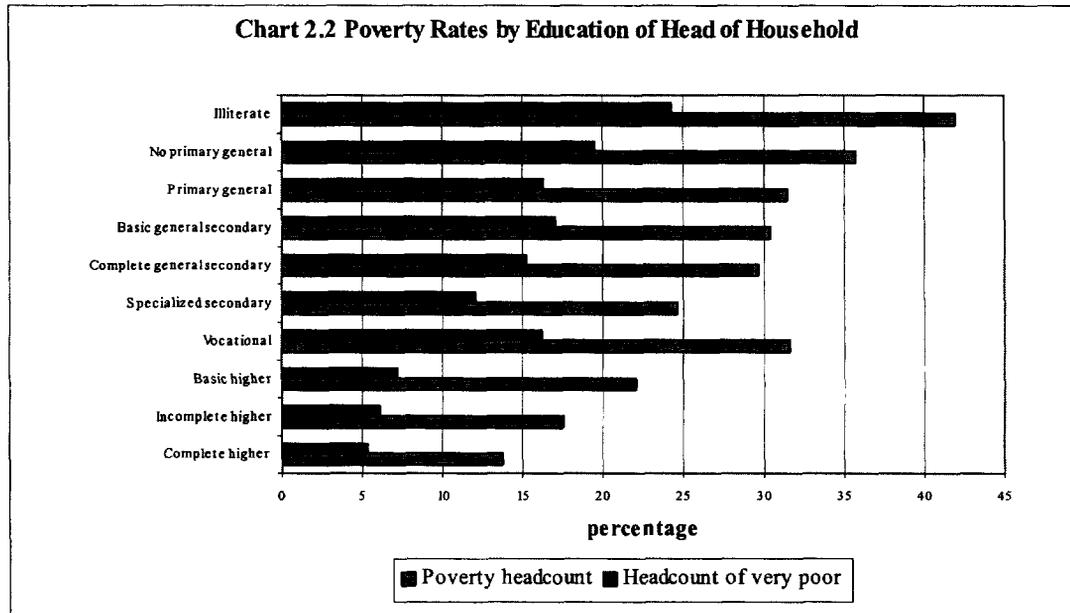
2.12 *Age Structure.* While poverty rates vary relatively little by the age of the household head, age still appears to reflect household structure (Chart 2.1). The lowest

poverty rate is found among households heads aged 55 to 65 years. These households if still employed are also likely to receive pensions, which often are provided more regularly than wages. They also may receive incomes from subsidiary land plots. Further, older household heads are likely to have grown children and, consequently, no longer share their income with dependents. Likewise, household heads under age 30 have lower rates of poverty, possibly because they may be less likely to have dependents than somewhat older household heads. The poverty rate for household heads over age 65 is higher than that of younger cohorts and probably reflects greater poverty among older pensioners relying on social pensions.



2.13 Unlike the situation in many countries, female-headed households are not significantly poorer than those headed by men. The poverty rate of female-headed households was 28 percent compared to 25 percent among men. This appears to coincide with the finding that poverty rates for households with one adult and one child are lower than average.

2.14 *Education.* Poverty among household heads is also closely related to years and type of education (Chart 2.2). In particular, household heads with no more than a primary education are much more likely to be in poverty. But, less than 5 percent of household heads are in this situation. Typically, such household heads tend to be elderly. A more important demarcation is the difference among those who have completed higher education and those who have only a secondary education. In particular, extreme poverty rates for those with higher education are well under 5 percent, while those with only a secondary education are over 10 percent. This finding supports the hypothesis that in Ukraine, as in other transition economies, returns to education are high and education is a way to escape poverty. Further, if household heads with higher education are more likely to have smaller families, this could further identify factors contributing to child poverty.



2.15 *Primary Activity.* The primary activity of the household head (e.g. work, unemployment, or retirement) is also closely correlated with the likelihood that the household will experience poverty (Chart 2.3). The most prevalent activities are those of employees, pensioners, members of collective or cooperative enterprises, and the unemployed. These four groups account for 95 percent of household heads' primary activities. While some smaller groups (self-employed, students, and trainees) exhibit substantially different – higher or lower -- poverty rates, each accounts for an extremely small proportion of the total population.

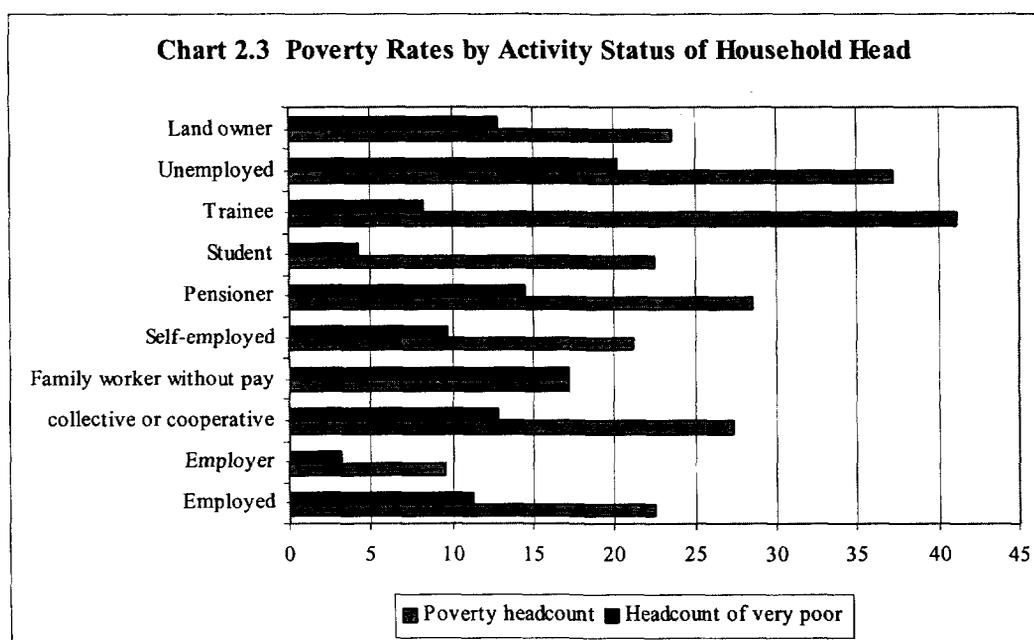
2.16 Employee household heads experience a somewhat lower poverty rate (and extreme poverty rate) than the household head average. By contrast, pensioner household heads have a somewhat higher than average poverty rate. Compared to one another, pensioner heads have a poverty rate that is nearly 6 percentage points higher than that of employed heads. Clearly, while pensioners are relatively protected from poverty, families of household heads holding jobs are in a preferable situation.

2.17 The situation of unemployed household heads, who account for 9 percent of the activity groupings, is less favorable. The poverty headcount rate of unemployed household heads is 37 percent, or nearly 15 percentage points higher than household heads who are employed. Poverty among members of collective or cooperative enterprises is closer to that of the unemployed than that of employees.

2.18 Another categorical indicator that could be used to identify the poor would be household-head unemployment. Subsequent analysis is needed, however, to identify interactions between education, the presence of children in a family, and activity status. In particular, one would expect that unemployment among household heads in families with children would have a seriously adverse impact on household well-being. Nonetheless, some 41 percent of the poor live in households in which the head of

household is employed. Again, while such categorical targeting mechanisms can identify many of the poor, errors of exclusion are likely to be large if other household types are ignored.

2.19 While unemployment among household heads is negatively related to household well-being, unemployment among other household members does not appear to increase the poverty rate. In fact, the headcount poverty rate for households with unemployed members other than the head is only one percentage point higher than that of other households. This suggests that unemployed members in households in which another family member is employed may actively engage in other productive activities, such as the development of private plots, which generate income or products for home consumption.⁷



2.3. Geographic Variation

2.20 Regional differences related to poverty status may be independent of household or personal attributes that are correlated with poverty.⁸ In other words, within a country, as between countries, economic conditions may lead to higher poverty rates even if all other circumstances are the same. In Ukraine, unlike Kazakhstan and Latvia,⁹ poverty does not appear to be concentrated in rural areas, as poverty rates are similar in urban and rural environments. This might be explained by the fact that non-cash incomes from land plots constitute a significant portion of household incomes in Ukraine – almost

⁷ Compared to the Labor Force Survey, questions in the Ukrainian Survey of Income and Expenditure are relatively less detailed so that many individuals engaged in the informal sector of the economy may have income from such activities and not consider them as employment.

⁸ See Volume II Appendices Map 2.

⁹ See World Bank, 1998. Kazakhstan: Living Standards during the Transition.

a quarter of total incomes for all groups of population, by their poverty status, including for the non-poor, the poor and the very poor households. Poverty is closely related to the size of household plots, and land holdings per household are significantly larger in rural areas (Volume II, Appendices Table 6.A.3).¹⁰

At the same time, this paper does not take into account access to health, education and other basic services in the poverty analysis, as the SIE did not provide data on these topics.¹¹ Typically, basic social services are less accessible to rural populations. Significant differences in poverty can be discerned across regions, however, with poverty rates varying from a low of 11 percent in the capital city of Kiev to highs of over 40 percent in Luhansk and Mykolayiv.¹² While these differences are considerable, they are not as wide as those observed in other parts of the CIS such as Kazakhstan. The reasons for regional differences in Ukraine and the relation between regional and personal attributes that are correlated with poverty need to be considered further in subsequent analysis.

2.4. Multivariate Analysis

2.21 Multivariate analysis examines the combined effects of different factors associated with poverty (see Volume II, Chapter 2). Preliminary analysis indicates that the relative risk of poverty is substantially reduced for most primary activity groups after controlling for demographic factors (household size, dependency ratios). Education is found to be the strongest correlate of poverty in Ukraine. When controlling for education, all other variables lose their significance to a certain extent. In other words, higher education reduces the likelihood of poverty considerably. This is particularly important in large cities, especially Kiev.

2.22 Sizes of households and dependency ratios (child and elderly) are strongly correlated with poverty in some cases. This means that if the average person lived in a single-family household with no dependants, the relative likelihood of poverty for this person would be significantly lower. For business owners it would change from 43 percent to 0 percent, for employees – from 81 percent to 29 percent, for family members working at a family enterprise – from 112 percent to 0 percent, for students – from 122 percent to 1.9 percent. In other words, poor people who are engaged in these activities generally live either in large households or in households with high dependency ratios, and those demographic factors are causal reasons for high risk of poverty that they face.

¹⁰ Nonetheless, this finding may be incorrect if the refusal rate in urban areas was higher among upper income families.

¹¹ The following rounds of the SIE would make it possible for a more thorough investigation into the matter.

¹² Refusals to participate in the survey were especially high in big cities with higher incomes, such as in Kiev (42 percent), Odessa (27 percent) and Sevastopol (23 percent). This could distort rural-urban poverty differentials and actually lead to higher regional differentials if refusals are concentrated among high-income households. Further, underreporting could also affect measures of income inequality. These hypotheses need to be reinvestigated using 2000 SIE data.

2.23 The outcome of the overall analysis can be interpreted in the following way: when combined, the factors examined are, to a large extent, causes of *lack of* poverty rather than causes of poverty. In other words, it is almost guaranteed that individuals will not be poor if they have high levels of education, preferable employment status, and live in small families located in big cities. But what does this mean for policy analysis?

2.24 These findings suggest that future improvements in education could have a significant impact in reducing poverty in Ukraine. Further, to the extent that large households are relatively rare, poverty will decline with improvements in income. The findings also suggest that to a great extent regional variations in poverty rates are independent of demographic and educational factors. Lastly, if one's major activity (or lack thereof), is unemployment, the likelihood of poverty is higher. Yet, if demographic factors are standardized, poverty rates for the unemployed would be considerably reduced. Thus, it appears likely that the unemployed have larger households and more children. Consequently, a disproportionate number of children are placed in poverty as a result of a household head's unemployment. Targeting should take that relationship into consideration.

3. SAFETY NET PROGRAMS

3.1 The former socialist system provided an implicit safety net characterized by full-employment (whether or not productive), special assistance for the vulnerable (persons with disabilities, pensions for the aged, etc.) and privileges as compensation or reward (for war heroes, mothers with many children, special pensions, etc.). A network of personal relationships also supported families providing extra goods and services depending upon connections. With the transition, some of these old mechanisms were expanded to provide new types of support (housing assistance and expanded privileges), while other coping mechanisms were substituted at both the family and government level. Families became more dependent on household plots and government started income-tested social assistance. This led to a hodge-podge of programs that now needs systematic reform. Chapter 3 describes formal coping mechanisms in Ukraine as a preface to evaluating their effectiveness in reaching the poor and reducing poverty.

3.2 Social programs targeted towards specific categories of the population can be divided into five major categories (whose beneficiaries are not mutually exclusive):

- ◆ Social privileges
- ◆ Chernobyl benefits
- ◆ Housing and utilities allowance (housing subsidy);
- ◆ Family benefits; and
- ◆ Support for low-income families.

These programs are an amalgam of pre-transition benefits and new initiatives; each has numerous sub-categories, and none are particularly effective in reaching target populations. Most programs are under funded, and most are not well targeted to the poor. This section describes the basic characteristics of each program as a preface to the analysis of targeting effectiveness and fiscal cost in Chapter 5.

BOX 3. WHAT ABOUT COPING MECHANISMS?

A. Work and Pay. Employers have accommodated economic circumstances by shifting payments to in-kind transfers. In August 1998, such payments amounted to an estimated 13.7 percent of the wage fund of enterprises. In agriculture, this amounted to 63 percent of all payments. Another employment-based coping mechanism is the off-the-record payment of wages, reducing expenses for employers and increasing income for employees. In addition, almost one-fourth of total reported income came from household plots, an increase from one-tenth in 1990. Fortunately, almost two-thirds of Ukrainian households own subsidiary plots.

B. Education, and Family Formation Higher education may be a coping mechanism for young people who cannot find a job, as unemployment rates in 1998 for youth age 15-19 were 28 percent compared to average rates of 11 percent overall. Youth have increased their enrollment in higher education by 38 percent during 1991-1998, while the number of graduates from secondary vocational schools declined by 30 percent during the same period. This represents a sensible step, as better-educated persons are less likely to be poor. At the same time, the birth rate in Ukraine has fallen from 11.4 births per thousand in population in 1992 to only 7.8 births per thousand in 1999. Given higher poverty rates among families with young children and among families with many children, this is an obvious coping mechanism that women have used to maintain their standard of living and not impoverish their families by having more children.

C. Drawing Down Assets. One traditional way that populations cope with economic declines is through dissaving. Significant dissaving appears to have taken place in consumer durables. Based on official data, the decline in the ownership of standard household items during transition includes reductions in numbers of televisions, refrigerators, vacuum cleaners, washing machines and tape recorders. Only the prevalence of passenger cars has increased. Coping strategies can also be inferred by comparing the expenditures of the poor to those of the non-poor. In households that are not poor, 2.9 percent of consumption expenditures goes towards household durable goods compared to 0.8 percent among the poor and 0.7 percent among the very poor.

D. Reducing Consumption. The poor and very poor have lower consumption rates in percentage terms in almost all areas relative to the non-poor. They spend less on healthcare, education, and purchases of clothing in percentage terms. By contrast, the percentage spent on housing is higher, as is that spent on the consumption of foodstuffs. These core expenditures appear to be used to adjust household consumption as incomes decline. While the share of food expenditure is quite similar for all income groups, food consumption among the poor is based on a somewhat higher proportion of home production. Further, the share of non-poor households consuming fewer than 2,100 calories per day is 14 percent among the non-poor, 58 percent among the poor and 71 percent among the very poor. Thus differences in the quantity and quality of food consumption across income categories document adjustments made to cope with poverty.

D. Private Transfers. Private transfers also help the poor. Non-cash transfers make up 5 percent of all expenditures. However, non-cash transfers make up a larger proportion of income and expenditures for the non-poor. Thus, private transfers in Ukraine are not efficient substitutes for social safety net protection.

3.1. Social Privileges

3.3 Like many other CIS countries, Ukraine has an extensive and complicated system of social privileges, which it has started to streamline and dismantle. More than 20 different types of social privileges were identified based on laws, presidential decrees and government resolutions for 1999.¹³ These established social privileges for certain groups of the population, civil servants, and other professional groups such as the

¹³ The working group on social privileges identified at least 39 laws and Codes, 26 Resolutions of the Cabinet of Ministers, three Decrees of the President, and other ministerial documents.

military, police, deputies, judges, attorneys and customs officers. Privileges are categorical and not subject to a means test.

3.4 A substantial reduction of social privileges was undertaken through the 2000 State Budget Law. Many benefits were suspended and a more limited set of beneficiaries was retained. As a result, Government liabilities to finance privileges decreased from more than UAH 30 billion to around UAH 17 billion annually, and the number of eligible families was cut by half. In particular, groups that enjoyed privileges because of official or professional status were taken off the lists. War veterans, participants of combat operations, family members of servicemen who died in action, persons who suffered in consequence of the accident at the Chernobyl nuclear power plant, and a few other groups retained their privileges for subsidized payments for rent, municipal services, electricity, and gas.¹⁴

3.5 Social privileges consist of cash and in-kind benefits and include:

- ◆ housing and housing maintenance,
- ◆ public transportation,
- ◆ renovation of residences,
- ◆ acquisition of housing below market cost,
- ◆ subsidized credit,
- ◆ subsidized phone service,
- ◆ free or subsidized drugs and medical services,
- ◆ free or subsidized automobiles,
- ◆ tax exemptions, and
- ◆ free legal services.

3.6 The rationale behind social privileges cannot easily be understood or explained within the rubric of a market economy, as it is conceptually related to the former system, despite the fact that the use of privileges has been expanded considerably since transition. Benefits are provided to numerous types of 'veterans', the disabled, and a variety of occupational groupings (see Volume II Chapter 4). When privileges are occupationally targeted they act more or less as employee benefits, providing non-cash supplements to income.¹⁵

3.7 According to the State Statistical Committee (SSC), around two-fifths of all families enjoyed privileges without consideration of income as a result of the status of one family member. In 1999, 42 percent of Ukrainian households were entitled to some type of social privilege; most often, housing (Table 3.1). For example, families of war veterans have been entitled to a 50 percent discount on housing and municipal services.

¹⁴ The list of persons who are family members of social privileges recipients has also been reduced. Referred to them are now only a wife (husband) and children under the age of 18 years. It is anticipated that the 2001 state budget law will reduce the list of recipients of social privileges even more.

¹⁵ In addition to all these subsidies, an additional program of privileges is offered to numerous individuals who gained entitlement based on the Chernobyl disaster (see Chapter 3).

Some 30 million people (with possible duplication) have been entitled to subsidized transportation and more than 13 million have had access to free or subsidized drugs.¹⁶ Reflecting the expansion of the privileged population, the proportion of privileged old-age pensioners increased from 14.6 percent in 1990 to 28.3 percent in 1998.

Table 3.1 Social Privileges, 1999 (I-IIIQ)

Social privileges	Share of households using privileges %	Average monthly amount of privileges per household UAH
Total	41.7	20.0
Fuel and liquefied gas	10.4	9.1
Housing and utility services	26.8	14.5
Recreation and health resorts	4.9	62.9
Inter-urban transport	9.1	3.8
Telecommunication services	9.8	4.2

3.2. Chernobyl Benefits

3.8 The Chernobyl Nuclear Power Plant accident on April 26, 1986 caused human, environmental and economic damage to 12 oblasts and 4.6 million hectares of land, including 3.5 million agricultural hectares. Prior to the dissolution of the USSR, Moscow established programs to deal with the disaster. Subsequently, in 1991, the Law "On the Status and Social Protection of Citizens Who Suffered from the Chernobyl Catastrophe" was approved. Chernobyl eligibility is based on four groups:

- ◆ Category I – disabled due to the accident;
- ◆ Category II – evacuees from 30-km zone;
- ◆ Category III – resettled from the zone of 'unconditional alienation', and
- ◆ Category IV – persons who lived nearby and still live there.

An earmarked payroll tax of 12 percent funded these programs until 1998 at which time the rate was dropped to 10 percent. Since 1999, these measures are financed from general revenues. According to the 2000 action plan of the Cabinet of Ministers, benefits will be more focused on special medical services rather than on subsidies for pharmaceuticals, transportation, and resettlement.

3.9 In the 2000 state budget law, UAH 979 million are to be dispersed through the Chernobyl program to designated beneficiaries such as liquidators and residents of the area. While the Chernobyl disaster was a horrific event, not only for Ukraine but for

¹⁶ The number of entitled individuals cannot be accurately estimated due to considerable overlaps in eligibility

neighboring countries, not all beneficiaries of the Chernobyl program are medically disabled or were displaced by the disaster. In fact, only are 2.5 percent disabled (Category I), that is, 54,000 recipients of a total of 2.1 million eligible for benefits. Among the beneficiaries, only 17 percent are liquidators, that is those who were directly involved in the clean up. In fact, of the 2.1 million, 1.2 million are persons who continue to reside in nearby areas (Category IV). The remainder represents persons who were evacuated or resettled. Over 70 percent of the disabled and evacuees were liquidators. For the most part, Chernobyl Fund resources have been spent on compensation payments (about two-thirds of the total), followed by resettlement costs. Relatively little has been allocated for health protection, although this is being rectified.

3.3. Housing and Utilities Allowances¹⁷

3.10 The Housing and Municipal Service Allowance Program was approved in February 1995 and launched in May 1995¹⁸. In 1997 the right to determine the increase in tariffs and rents for housing and utilities services to achieve full cost recovery was given to regional state administrations. The local budget is the sole source of financing for the housing allowance program. The program is operated nationwide through a network of 761 Housing Subsidy Offices, which receive and process applications using an automated management system.¹⁹

3.11 Housing and utilities allowances are intended to shield families from the undue impact of rapidly increasing fuel costs as the economy moves towards market pricing. The ultimate goal is to allow for the recovery of operating costs. The scope of this change is considerable as household payments are expected to cover 80 percent of operating costs by 2000 starting from a base of 4 percent coverage in mid-1990s. Thus, the allowance system, in effect, shifts budgetary subsidies from producers to consumers. Almost one-fourth of households received housing allowances in 1999, and three percent of households received fuel and gas subsidies (Table 3.2). In addition, some 16 percent of households receive privileged reductions in housing and utilities payments, generally amounting to 50 percent of costs. In other words, all together some 43 percent of all households are subsidized.

¹⁷ These are also called housing subsidies.

¹⁸ This was instituted through the Cabinet of Ministers Decree No. 89, February 4, 1995

¹⁹ All but 280 housing offices are computerized. The World Bank and USAID have provided technical assistance.

Table 3.2. Housing Allowance in Ukraine, I-III Q, 1999

Household Category	Share of households, %	Average monthly amount of allowance UAH	Living space per household member, m ²
Recipients of housing allowance	24.1	24.4	18.5
Recipients of fuel and liquefied gas allowance	3.2	10.3	23.9
Households who do not receive subsidies	74.4	-	18.5

3.12 Because local budgets are responsible for financing housing allowances, this has led to shortfalls in regions with a weak revenue base. All in all, the program has not been particularly successful. On the one hand, benefits are not targeted towards the poorest families (see below). On the other hand, arrears have accumulated for utilities and housing services (see Volume II Chapter 3). Arrears stem from both the municipalities and households, which have little incentive to pay for domestic utilities without full metering. In addition, housing costs are also subsidized through the system of privileges, which also leads to payment arrears to service providers, and has negative budgetary implications.

BOX 4. HOW DO HOUSING ALLOWANCES WORK?

The Housing and Utilities Allowance is a subsidy paid directly from the local budget to the Zheks (municipal housing maintenance companies) and other municipal service enterprises to cover household expenditures on housing and utilities in excess of certain thresholds. Initially assistance was provided for families paying more than 15 percent of their monthly income on utilities, rent and maintenance. In 1999 that amount was raised to 20 percent for working families. It was maintained at 15 percent for households without a wage earner. The basis for the allowance is 21sq. m. per family member plus 10.5 sq. m. per household, and norms on utilities consumption based on the number of tenants or apartment's floor space. A coefficient of 1.1 is used for extra floor space. For example, instead of a rent of 19 kopecks per sq. meter, the payment for excess floor space equals 20.7 kopecks per sq. meter. Subsidies are awarded to applicants for a period of six months. Most recipients of housing allowance are urban dwellers living in multi-story apartment complexes, since the costliest expenditures on housing are for central heating. Rural dwellers and households living in private houses can apply for a solid fuel and liquefied gas allowance to compensate for expenditures in excess of a standard amount ('life line') based on the number of tenants in the household and floor space.

3.4. Family Benefits

3.13 The Law on "State Assistance to Families with Children" became effective in January 1993. There are 11 different types of family allowances. Some are categorical and others are means-tested. All families with children up to age three are entitled to a benefit (for non-working mothers the age limit is 2 years). Single mothers with children up to age 16 are also entitled. Child benefits are provided without a means test to foster care families, military servicemen, and families with handicapped children. A lump-sum birth grant is available to all. Eligibility for other benefits is contingent upon an income-based means test, with limits on monthly per capita family income of UAH 41. Local social welfare offices can pay additional assistance to poor families with children at their

discretion. Until 1999, most family allowances were paid through enterprises, although non-working families received benefits at social welfare offices. The system is slowly being reformed, however, so that eventually all family benefits will be paid at local social protection offices. Maternity and birth grants are paid through the Social Insurance Fund; benefits for the children of servicemen are paid by the state, and virtually all other benefits are the responsibility of local budgets

3.14 Family benefits can have two objectives. First, they are used to reduce child poverty. In Ukraine, categorical allowances for young children and single mothers can be justified on these grounds, as well as means-tested benefits for older children. Second, family benefits are used to promote population growth. This is likely to be one of the motives in Ukraine, as birth rates dropped sharply since transition. In general, the first objective, poverty reduction, is more likely to be achieved than the second is, as population policies most often are not effective. Given the substantially higher rates of poverty among larger families, the population of Ukraine has selected an effective coping mechanism by postponing family formation and reducing family sizes. In Ukraine, 6.6 million families with close to 8 million children are potential recipients of child allowances. The most prevalent benefit, child allowance for children under 16 (students under 18), awarded on the basis of an income test, only covers 259,604 recipients. Another 229,926 allowances were paid to families with young children (Table 3.3).

3.15 Seventy-five percent of all family benefits are paid out of local budgets. Financial resources have been insufficient to pay benefits to all entitled families, however. In 1999, only UAH 0.5 billion was allocated for this purpose while payment requirements were UAH 2 billion. As a rule, benefits range between UAH 5.2 and UAH 16.6 per month – between three and 10 percent of the average wage. Less than one-fifth of all families with children receive family allowances. While this is related to means testing, it also reflects non-payment by enterprises and self-selection by families for whom the low benefits are not worthwhile. Based on household survey data, only 16 percent of households with children received family allowances during the first three-quarters of 1999.

Table 3.3. Recipients of Child Allowances in Early 1999

Type of allowance	Number of		Means-tested, Yes/No
	Recipients	Size of the benefit, UAH	
Maternity allowance	5,097		No
Birth grant	38,216	35.8	No
Childcare allowance for children aged 2 (3) years and less	229,976	16.6 - those employed; 5.2 - unemployed	No (except for non-working parents)
Childcare allowance for mothers (fathers) with 3 or more children under 16	30,328	9 (10.5) - those employed; 18 (20.9)- unemployed	
Allowance for care of disabled children	35,550	14.7	No
Child allowance for children under 16 (students under 18)	259,605	6.7	Yes
Childcare allowance for single parent	37,332	5.2 (10.5)	No
	578	9	
Childcare allowance for servicemen on active duty			No
Childcare allowance to a parent temporarily unable to work and looking after a sick child	21,900	16.6 - those employed; 5.2 - unemployed	Yes

3.5. Assistance for Low Income Families

3.16 On February 22, 1999, the Cabinet of Ministers issued Decree No. 238 "On Implementation of Targeted Social Assistance to Low Income Families." The program had strict eligibility criteria for: (i) pensioners with dependent children up to 16 years (students 18 years); (ii) non-working parents with dependent children; (iii) mothers of three or more dependent children; and (iv) individuals with disabled or elderly dependents (80 years of age and older). Monthly family income had to be less than UAH 41 per capita, the same as the family benefits program. The benefit is awarded for 6 months for families with working members and three months for families with non-working members. Regulations list 17 types of income that should be counted including wages, social benefits, and in-kind income.

3.17 The 1999 targeted social assistance program has stringent criteria for low-income families, so that only about 4.5 percent of Ukrainian families are eligible. As of January 1, 2000, monthly allowances were granted to 7,165 families at UAH 106.8 per family. However, only 47 percent of the eligible households actually received such an allowance with the rest in arrears. The reason is that targeted social assistance is financed from local budgets, and regions with the highest proportion of poor are those with the most limited resources. Under the consolidated state budget for 2000, UAH 7 million was allocated for the program. Nonetheless the situation has not changed substantially. By April 1, 2000, 6,101 families had applied for social assistance, 2,059 were certified, and only 52 percent of approved benefits were actually paid.

3.18 Other means-tested benefits include (i) cash benefits for low-income persons unable to work, (ii) state cash benefits for some pensioners, and (iii) supplementary monthly benefits for living. These programs each have different eligibility criteria and

are not coordinated with the 1999 targeted social assistance program. Social pensions are awarded by the pension fund (and reimbursed by the state budget) to that 3 percent of the retirement age population that is ineligible for normal work-related pensions. Further, the same program provides social pensions to persons disabled from childhood. Cash benefits are also provided through the pension fund (reimbursed by the state budget) to certain pensioners based on total family income. And local governments provide supplementary benefits to low income families based on the decision of local authorities on an ongoing or one-time basis.

BOX 5. UKRAINE: CATALOGUING SOCIAL ASSISTANCE

Ukraine has one of the most complicated social assistance systems in the region. It is composed of five generic types of assistance containing numerous separate programs (excluding pensions and unemployment benefits): (1) social privileges; (2) housing and utilities allowances; (3) family benefits (11 separate programs); (4) Chernobyl benefits; and (5) targeted social assistance. The latter includes (i) assistance to low income families; (ii) cash benefits to individuals unable to work and with low incomes; (iii) state cash benefits to some categories of pensioners; (iv) supplementary monthly benefits for living; (v) additional one-time social assistance to the most needy households. In the 1999 consolidated state budget, 3.1 percent of GDP was spent on such programs. Most programs are under-financed relative to the eligible population.

These programs are financed from several different sources. In 1999, family allowances were financed from the state budget, local budgets, the pension fund, and the social insurance fund. Many social assistance benefits are financed from local budgets. Regions are unequal in revenue collection capacity, and budgetary transfer mechanisms are insufficient to cover benefit gaps. Consequently, regions provide benefits unevenly.

Most social assistance is given in the form of cash benefits, but some transfers are directed towards providers (e.g. housing allowances). Other benefits are provided in-kind, including the majority of one-time social assistance grants awarded locally. Benefits are calculated and paid by different levels of government, including state social protection offices, branches of the pension fund, municipality housing units, and other local authorities. The administration of social assistance has been strongly fragmented. To remedy that situation to some extent, in 1999, family allowances began to be paid by social protection offices rather than enterprises.

Benefits are based on different eligibility rules, such as total household income or per capita income, standard space set for housing, characteristics of children (their age, disabilities, etc.), merit criteria and other categorical indicators. Benefits have different eligibility thresholds, as well.

A myriad of laws, codes, decrees, resolutions and other normative acts issued by the President, the Rada, the Cabinet of Ministers, ministries and local authorities regulate the whole social assistance system. A major institutional reform is needed to consolidate and streamline the whole system of social assistance in close collaboration with other reforms in social protection, such as pension reform or reforms in unemployment insurance.

4. TARGETING EFFECTIVENESS AND FINANCING

4.1 Cash assistance payments in Ukraine are a higher percent of GDP than in many other countries. But the question is whether they are targeted towards the poor and provide a floor of income protection. Analysis shows that some programs are better targeted than others are but a thorough redesign is needed to ensure that resources reach the poor rather than going to the non-poor in the population.

4.1. Targeting Effectiveness

4.2 The success of social program strategies can be evaluated according to a number of criteria. Perhaps the most important indicator is the degree to which social transfers reduce poverty. In other words, poverty rates can be measured before (ex ante) and after (ex post) benefit reciprocity. Using SIE data, these measures are statistically reliable for two programs -- housing allowances and social privileges. To the extent that these program benefits reach the poor, they decrease both the poverty rate and the extreme poverty rate. In the first instance, the poverty rate would have been 3.7 percentage points higher over the Q1-QIII 1999 without program expenditures, and in the second instance, the extreme poverty rate would have been 3.0 percentage points higher. This can be translated into some 13.8 percent more families who would have been in poverty and some 22 percent more families who would have been in extreme poverty (Table 4.1). Nonetheless, these figures do not mean that these programs are as effective as they might be, only that they had a positive impact.

**Table 4.1. Poverty Reduction through
Housing Allowance and Social Privilege Programs,
I-III Q, 1999**

	Poverty line (75% of median expenditures)	Extreme poverty line (60% of median expenditures)
1. Poverty headcount, %, Ex ante	30.4	16.5
2. Poverty headcount, %, Ex post	26.7	13.5
3. Equivalent expenditures per household, UAH, Ex ante	101.4	84.5
4. Equivalent expenditures per household, UAH, Ex post	102.7	85.1
5. Poverty deficit of extremely poor households, Ex ante, UAH per month	410.94	154.89
6. Poverty deficit of extremely poor households, Ex post, million UAH per month	355.83	130.36

4.3 The efficacy of social programs also can be measured by the percentage of benefits received by the poor. This is an indicator of the good or bad use of program resources. In Ukraine, the poor only received 16.3 percent of housing allowances and social privileges. Looking only at social privileges, merely 12.6 percent of total program expenditures reached the poor, while the non-poor received 87.4 percent. Thus, although these programs did reduce poverty, they did so at a very high cost.

4.4 While these findings exclude expenditures on family benefits and targeted social assistance, exclusion errors and inclusion errors still appear to be high overall when other evidence of targeting effectiveness is considered.²⁰ Fully 54 percent of the poor do not receive benefits from the social programs identified in Table 4.2 (housing allowances, child allowances, unemployment benefits, and low-income benefits), while only 43 percent of the non-poor receive at least one type of benefit. Child allowances, unemployment benefits, and targeted social assistance are modestly pro-poor, and while non-poor households tend disproportionately to receive housing and utilities allowances.²¹ Because non-poor households tend to have larger apartments, they benefit more from the housing subsidy program.

²⁰ (The included expenditures account for only 77 percent of social programs for the population, 65 percent for the poor and 58 percent for the very poor.)

²¹ This table assesses ex-post poverty. If ex-ante poverty were measured, the findings would be somewhat more favorable to the pro-poor design of these programs. Nonetheless, leakage would still be considerable as would undercoverage.

Table 4.2. Social Benefit Reciprocity, I-III Q, 1999

Type of benefit	% reciprocity among	
	Poor households	Non-poor households
Housing and utilities allowance	23	28
Child allowance	10	6
Unemployment benefit	8	5
Targeted allowance for low income families	6	3
Total	46	43

Ex ante – before receiving housing allowances and privileges;

Ex post – after receiving housing allowances and privileges;

4.5 The distribution of benefits in monetary terms is another way of describing targeting efficacy. All together, social programs amounted to 5.8 percent of per capita equivalent expenditures for the poor and 4.4 percent of per capita equivalent expenditures for the non-poor for the first three quarters of 1999.²² Dividing social programs into social assistance, housing and energy subsidies, and social privileges tells a somewhat different story (Table 4.3). Social privileges amounted to 5.1 percent of expenditures for the non-poor and less than 1.7 percent for the poor. By contrast, housing and energy subsidies and social assistance represent a larger percentage of equivalent expenditures for the poor than the non-poor. When assessed in monetary terms, the picture is bleaker. Both the poor and the non-poor receive almost equal monetary amounts of social assistance based on equivalent expenditures; the non-poor receive fifty percent more in subsidies, and nearly three times the amount in terms of privileges.

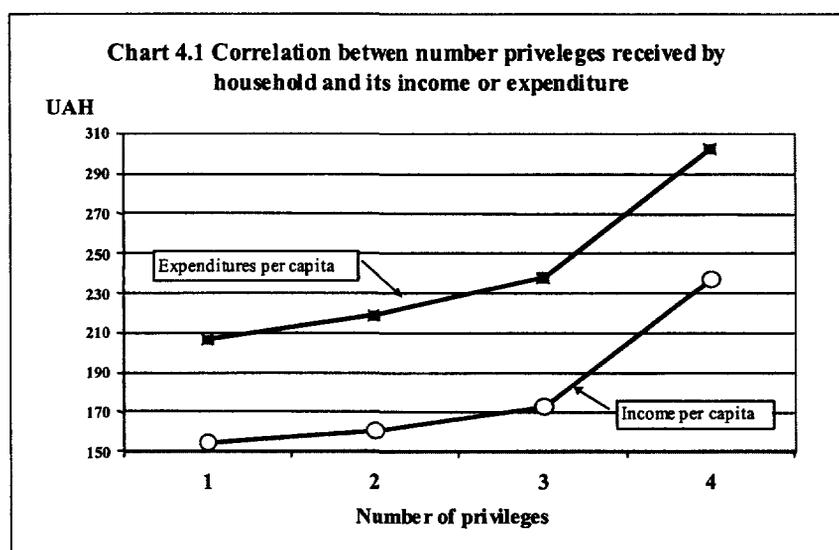
**Table 4.3 Contribution of Social Programs to Household Incomes
I-III Q 1999****(average per month UAH & percentage)**

	Total	Poor	Very Poor	Non-poor
Average equivalent expenditures, UAH	204.5	102.7	85.1	241.5
Percentage of households in the group	100	26.7	13.5	73.3
Average equivalent incomes, UAH	148.9	92.2	80.3	169.5
of which:				
Social assistance	2.19	2.08	2.17	2.19
Housing and Energy Subsidies	2.99	2.14	1.70	3.29
Social Privileges	4.17	1.73	1.29	5.10
Social programs – total	9.35	5.96	5.16	10.58
Average equivalent income (percentage)	100	100	100	100
of which:				
Social Assistance	1.47	2.26	2.70	1.29
Housing and Energy Subsidies	2.01	2.32	2.12	1.94
Social Privileges	2.80	1.88	1.61	3.01
Social programs – total	6.28	6.46	6.43	6.24

²² Once again, poverty is measured ex-post and not ex-ante.

4.6 Another measure of the severity of poverty is the poverty gap, defined as the difference between the poverty line and mean equivalent expenditures. The poverty gap *ex post* was 23.5 percent; the *ex post* extreme poverty gap was 36.7 percent. A measure of the success of income transfer programs is their *effectiveness* in closing the poverty gap – calculated as ratio of social assistance as a percentage of the *ex ante* poverty gap. Transfers only closed a relatively small 13.8 percent of the *ex ante* poverty gap.

4.7 *Social Privileges.* Other measures based on specific types of expenditures evaluated on an (imperfect) *ex post* transfer basis also support the finding that social privileges are not targeted towards the poor (which is not particularly surprising given the occupational groups provided these transfers in 1999). For example, the number of privileges received increased with per capita expenditures and incomes, especially for recipients of at least four different types of privileges (Chart 4.1). That is, those with greater resources receive a greater number of privileges.



4.8 Per capita equivalent expenditures for households receiving privileges ranged from UAH 182 to UAH 282 for each of five privileges (Table 4.4). Accounting for all privileges, household equivalent expenditures are UAH 165. The expenditures of families receiving each type of privilege are above the UAH 134.3 poverty line, providing further evidence that social privileges are tilted towards the non-poor.²³

²³ Nonetheless, compared to the average expenditures of the population, at UAH 204.5, the expenditures of privilege recipients are somewhat lower. It should be kept in mind that given income inequality in Ukraine, average incomes are considerably higher than median incomes.

**Table 4.4. Privileges:
Reciency and Household Income, 1999 (I-IIIQ)**

Social privileges	Per capita equivalent income of the household that uses privileges, UAH	Per capita equivalent expenditures of the household that uses privileges, UAH
Total	120.0	165.4
Fuel and liquefied gas	160.7	181.9
Housing and utility services	154.3	206.4
Recreation and health resorts	207.5	281.5
Inter-urban transport	165.5	222.0
Telecommunication services	156.3	221.8

4.9 *Housing allowances:* Housing allowance recipients have expenditures considerably above the poverty line. The average per capita equivalent expenditures of these recipients is similar to recipients with privileges at UAH 167 overall (Table 4.5). These findings support the hypothesis that the non-poor also gain from housing allowances. While the benefit appears to be targeted when only cash income is considered, with only reported incomes are considered for eligibility, these findings are not surprising.

Table 4.5. Housing Allowance: Household Income, I-III Q, 1999

Household Category	Average per capita cash income UAH	Average aggregate per capita income UAH	Average aggregate per capita expenditures UAH
Recipients of housing allowance	65.7	119.7	166.8
Recipients of fuel and liquefied gas allowance	55.8	128.0	179.0
Households who do not receive subsidies	81.1	121.7	167.4

4.10 *Family Benefits:* Family benefits appear better targeted than housing allowances, as households with children receiving benefits have, on average, per capita expenditures below the poverty line, while those not receiving child benefits have per capita expenditures slightly above the poverty line. (Table 4.6). Nonetheless, the difference is marginal in view of the higher incidence of poverty among families with two or more children.

**Table 4.6. Family Allowances: Income of Recipients and Non-Recipients
UAH per month, I-III Q, 1999**

Type of household with children	Equivalent per capita expenditures	Equivalent per capita income	Equivalent per capita cash income
Households with children receiving benefit	123.8	95.0	59.2
Households with children who do not receive benefit	138.7	101.2	67.9
Households with children aged 3 years and less and receiving benefit	116.0	90.3	57.3
Households with children aged 3 years and less who do not receive benefit	124.9	88.1	58.0
Households with 3 or more children receiving benefit	84.1	69.0	32.1
Households with 3 or more children who do not receive benefit	101.4	78.3	42.2

4.11 Further, only half of all families with children less than 3 years of age, a vulnerable group, received family allowances – and poverty rates among such families are high (Table 4.7). Errors of exclusion are considerable as both recipient and non-recipient families with young children or three or more children have, on average, equivalent expenditures below the poverty threshold.

Table 4.7. Recipients of family allowances, I-III Q, 1999

Household type	Number of relevant households, 1000	Number of households receiving allowances	Percentage of beneficiaries out of total households of a relevant type	Average allowance size, UAH
All families with dependent children	7,858.6	1,266.3	16.0	10.3
Families having 3 children or more	457.1	294.9	64.5	19.3
Families with children aged under 3	1,015.2	529.4	52.1	17.7

4.12 *Social Assistance.* Information on the efficacy of targeting for the mix of social assistance programs is considerably less complete. Broadly defined, it is received by only 6 percent of the population and accounts for some 2 percent of expenditures of the poor and very poor. The distribution of recipients across oblasts is closely correlated with the distribution of the poor across oblasts (correlation coefficient of 0.46). The distribution of payments is also quite strongly correlated with the distribution of the poor across oblasts (correlation of 0.43). (This correlation is much weaker with the distribution of the non-poor (0.20).) By contrast, housing allowance expenditures are highly correlated with the distribution of *non-poor* across regions (0.44) compared to the poor (0.16). In terms of recipients, housing allowances are correlated strongly with the

overall population distribution. In other words, regional data provide supportive evidence that housing allowances are considerably less pro-poor than social assistance.

4.2. Financing

4.13 Social programs in Ukraine result in both over spending and under spending. As a percentage of GDP, the allocation of funds is substantial and should be sufficient to alleviate poverty. Funds needed to bring all households who are poor up to the poverty line in 1999 would have been UAH 355.8 million monthly. Based on data for the first three-quarters of 1999, this would cost UAH 4.2 billion or 3.4 percent of GDP. Ukraine actually spent more than that, almost UAH 4.5 billion, on social programs in 1999 or 3.5 percent of GDP (Table 4.8), suggesting that Ukraine can easily afford an effective poverty program by reallocating current expenditures.

4.14 Family allowances, unemployment programs, housing allowances, and other social assistance (including sickness and parental leave) amounted to 2.2 percent of GDP in 1999. Other programs including social privileges to war participants and labor 'veterans', programs for the disabled, and Chernobyl programs accounted for another 1.3 percent of GDP in 1999. The 2000 budget expenditures for the first group were projected to be 2.7 percent of GDP and those for the second group 0.9 percent.

Table 4.8. Financing social programs and social benefits in Ukraine

Indicator	1996	1997	1998	1999	2000**
Main social programs financed from all sources, million UAH:					
Pensions (including military pensions paid from State budget)	8,102.9	10,380.7	10,645.8	13,155.8	14,901.9
Family allowances and maternity benefit	450.5	519.5	434.6	504.5	660.0
Employment programs financed from the Employment Fund	79.1	193.3	331.8	521.1	597.0
Funds taken by the general budget from the Employment Fund	188.8	21.7	125.2	29.7	0.0
Housing allowances	289.1	930.4	1076.9	1175.7	1188.6
Social privileges to war and labor veterans	248.9	612.9	695.8	624.7	264.4
Programs for the disabled	43.0	96.7	77.0	101.5	170.0
Chernobyl programs	804.8	844.8	718.3	827.1	979.0
Other social assistance programs****	3,248.7	2,829.5	1,433.6	680.4	1,871.3
Main social programs as % of GDP					
Pensions	9.9	11.1	10.2	10.3	9.4
Family allowances and maternity benefit	0.6	0.6	0.4	0.4	0.4
Employment programs financed from the Employment Fund	0.1	0.2	0.3	0.4	0.4
Housing allowances	0.4	1.0	1.0	0.9	0.7
Social privileges to war and labor veterans	0.3	0.7	0.7	0.5	0.2
Programs for the disabled	0.1	0.1	0.1	0.1	0.1
Chernobyl programs	1.0	0.9	0.7	0.7	0.6
Other social assistance programs	4.0	3.0	1.4	0.5	1.2
Main social programs as % of consolidated budget					
Pensions	24.1	24.8	26.2	28.2	28.0
Family allowances and maternity benefit	1.3	1.2	1.1	1.1	1.2
Employment programs financed from the Employment Fund	0.2	0.5	0.8	1.1	1.1
Housing allowances	0.9	2.2	2.7	2.5	2.2
Social privileges to war and labor veterans	0.7	1.5	1.7	1.3	0.5
Programs for the disabled	0.1	0.2	0.2	0.2	0.3
Chernobyl programs	2.4	2.0	1.8	1.8	1.8
Other social assistance programs	9.7	6.8	3.5	1.5	3.5

* - Pension Fund, Social Insurance Fund, Employment Fund, Invalids Fund and Chernobyl Fund are included

** - 2000 consolidated budget; GDP – estimate;

***- Since April 1997 the Pension Fund is excluded from the budget. In 2000 the Social Insurance Fund was included into the budget.

****including sickness and parental benefits financed from Social Insurance Fund

4.15 In terms of legislated expenditures, that is, the laws on the books, arrears have built up for virtually every program. While social privileges have been the worst targeted, most social privileges also remained unfunded or under-funded, and their provision has been erratic.²⁴ The number of individuals eligible for some sort of privilege has also mushroomed in recent years. For example, in 1994 3.4 million 'veterans of war' were eligible for some benefit; their ranks had increased to 5.2 million by 1995, or one in every 10 persons. The reason for this increase was the significant broadening of categories listed in the law in 1995 for participants of military actions, war

²⁴ For example, in 1998 UAH 100 million were allocated to programs for the disabled, while only 23 percent of that sum was delivered. Only 17 percent of all applications at social welfare offices for medical treatment at sanatoriums and resorts were accepted. While 178,000 persons with disabilities were wait-listed for a free car, only 1,239 persons received one.

invalids and participants of war.²⁵ Many eligible citizens do not even apply for benefits knowing that these funds are limited. Furthermore, providers of subsidized services have not been appropriately compensated. The estimated (theoretical) cost of providing all privileges would be UAH 32 billion annually, or almost one third of GDP. This would exceed the entire state budget for 2000.

4.16 In 1999, budgeted social privileges were two percent of total (theoretical) costs. In the 2000 budget, budgeted privileges were UAH 2.6 billion, including UAH 1.6 from the state budget and UAH 1.0 billion from local budgets. At the same time, all privileges (including Chernobyl benefits) accounted for an estimated one-half of the social protection budget (excluding pension and employment programs). In the 2000 budget, 15 percent of safety net expenditures (excluding pensions and employment programs) and 0.9 percent of GDP were to be spent on Chernobyl.

4.17 Housing allowance finance is fiscally problematic from many points of view. On the one hand, the percentage of housing subsidies out of total revenues for housing and utility companies has risen from 8.5 percent in 1996 to 24 percent in 1999. On the other hand, total household debt to housing and utilities companies increased from 3.5 billion UAH in 1996 to 5 billion in 1999, or 3.9 percent of GDP. By 2000, arrears had built up to 6.2 billion UAH or 55.8 percent of total operating costs. Across regions, the correlation between housing payments and housing arrears is high at 0.48, suggesting that those oblasts that make higher housing allowance payments also tend to have higher arrears. This not the case in terms of social assistance as arrears are not correlated with payments. Nevertheless, social assistance arrears are correlated with housing allowance arrears across regions, suggesting that there is consistent behavior in arrears-creating oblasts.

4.18 Financial resources to provide family allowances to all entitled families have not been sufficient either. In 1999, only 500 million UAH were allocated to pay family allowances, while payments should have been 2 billion UAH. Administrative data suggest that fewer than one-fifth of all families with children receive family allowances. While this figure reflects means testing, it also results from arrears at the enterprise level, as family benefits are not all paid at social assistance offices. Further, some families do not even apply for benefits as they have ranged between 5.2 and 17.7 UAH per month, that is, 3 to 10 percent of the average wage.

4.19 The targeted social assistance benefit administered by the MLSP reached only 7,000 beneficiaries in 1999, compared to many more beneficiaries of other programs. Further, the current targeted and means tested social assistance program could at most include 17.2 percent of the population *with per capita incomes of less than UAH 41* (according to USAID calculations) given the categorical overlays.

²⁵ The term “veterans of war” includes the many different groups with privileges that had some connection with World War II or other wars. They are not war veterans in the usual sense of military service in wartime or, even more narrowly, combat veterans.

4.20 In terms of locally provided targeted social assistance, benefits amounting to 764,000 UAH were awarded. Of that, less than 50 percent, or 361,000 UAH, was actually paid. Payment percentages ranged from 100 percent in City of Kiev, Mykolayiv, and Zaporizhya to nothing in Dnipropetrovs'k and Transcarpathia. Across regions, funding was not related to the distribution of poor families. The situation requires additional attention to determine the reasons for regional differences in arrears and, perhaps, to propose stronger regulation from the state to ensure those targeted expenditures are made. In part, shortfalls may be a result of allocation formulae and unfunded mandates that put serious constraints on local and regional budgets.

5. A SYNOPSIS OF PROGRAMS AND TARGETING

5.1 Poverty in Ukraine is widespread and difficult to target. It affects families with many children and with young children, unemployed heads of households and many others, both working and retired. Ukrainian poverty has been hard to monitor, in part, because of worsening economic circumstances that have degenerated into hyperinflation, a barter economy, budgetary arrears, and negative economic growth. This has led to the growth of an informal sector, disintegrating public institutions, ineffective regulation, and wage arrears. Income remains undeclared and living standards have collapsed .

5.2 This section reviews difficulties in the current structure of programs and problems with targeting benefits in CIS transition economies such as Ukraine. These findings help motivate the recommendations of the final section of this report.

5.1. Problems with Current Programs

5.3 Five basic program types form the nucleus for social benefits in Ukraine -- social privileges, Chernobyl benefits, housing allowances, family benefits and social assistance. Of these, family benefits and social assistance are the best targeted. Social privileges and housing allowances are not well targeted. These simple findings can guide program redesign.

5.4 *Social Privileges.* Ukraine already has eliminated some of the most egregious privileges, which were actually employee benefits and not appropriate objects of government funding in a market economy. A valuable Ukrainian study has been prepared on social privileges (through World Bank funding) and further analysis is underway to determine the impact of the 2000 benefit reductions. Ongoing social privileges are provided primarily to persons with disabilities and 'veterans of war.' The 2001 proposed budget law has restructured privileges even more.

5.5 Privileges should continue to be reviewed and cashed-out particularly given the expansion in certain types of 'veterans' benefits that has occurred in recent years. While it is understandable for a country to provide assistance to those who suffered and fought valiantly during the World War II (the Great Patriotic War), military actions since that time have not affected Ukraine directly. Veteran's benefits should be restricted to soldiers and their (wartime) survivors. Further, veteran's benefits for military service should be included in the defense budget, as should child allowances for conscript families. While this would not reduce the overall state budget, it would improve transparency.

5.6 Privileges should not be used as substitutes for adequate pensions that would enable the elderly to pay for housing, utilities, and transportation directly on their own. Additional reductions in social privileges used for this purpose could reduce expenditures from 0.2 percent to 0.1 percent of GDP. The minority of elderly recipients who fall into

poverty because of the elimination of privileges ought to receive social pensions and social assistance instead.

5.7 *Chernobyl Benefits:* The reasons for instituting benefits for the victims of the Chernobyl disaster are reasonable and understandable. Such a nuclear accident (and its unfortunate handling at the time) calls for additional compensation to persons who suffered from contamination and participated in the clean up (often without sufficient information about the risks). Nonetheless, the program as originally structured was excessively costly providing benefits that were frequently duplicative and not necessarily targeted towards those who were radiation victims.

5.8 Ukraine has already taken an important step to reforming the Chernobyl program by moving its financing to general revenues. Now the time has come to limit benefits and provide greater funding for medical research and treatment. The latter is a direction being taken by Ukraine. In terms of limitation, Category IV benefits provided to persons who lived close to the accident should be discontinued. Patterns of radiation are considerably more random than Category IV residence, and, to the extent that such radiation has or will cause injury, Category I benefits take over. Further, health care should cover normal testing for any radiation caused disease. There are 1.2 million persons in this category – that is 55 percent of all beneficiaries and 2.1 percent of the population. The benefits and costs of this program should be evaluated thoroughly and steps taken to reduce the beneficiary rolls based on this evaluation. Reductions could likely lower costs from 0.6 percent of GDP to 0.3 percent of GDP without giving up protection for those who were substantively affected by the Chernobyl disaster.

5.9 *Housing Allowances:* Housing allowances are not targeted towards the poor as the program does not use an adequate income or means test. Households' aggregate declared incomes are verified and matched with expenditures on housing within the range of a "life line" (or so-called social norms on housing and utilities). There are three ways to change the system. The first is to eliminate housing allowances, the second is to reform them, and the third is to integrate them into a consolidated, means-tested social assistance system. As the increase of housing costs is a major issue in Ukraine and other CIS countries, housing allowances should be retained but retargeted.

5.10 *Family Allowances:* Family allowances appear to be better targeted than other benefits. With poverty rates of 63 percent in households with 4 children, and higher thereafter, and rates of 73 percent in households with 2 children under age 3, categorical targeting based on numbers of children and young children would appear administratively simple, resulting in very little leakage. Of course, these benefits are best paid through social welfare offices and not by employers. Further, benefit coordination ultimately would be improved further if social welfare offices provided all social benefits and family allowances through a consolidated social assistance program.

5.11 Currently, there are several family benefit programs for different groups of families. These should be consolidated quickly, unless, like maternity leave, they are part of mandated employee benefits (social insurance). Maternity leave, birth grants, and child

allowances for the military account for some 20 percent of the family allowance budget that should not be part of social assistance. Military allowances should be transferred to the defense budget, as they are part of the compensation paid to those serving in the armed forces.

5.12 *Social Assistance.* The new program of targeted social assistance is currently too small to reliably identify targeting effectiveness. Social assistance programs, however, appear better targeted than others. Nevertheless, separate programs should be combined, including benefits for all low-income groups, whether children, the unemployed, pensioners, or persons with disabilities. A combined program would be easier to administer and would reduce instances of fraud and abuse, which are now possible particularly with a decentralized benefit administration.

5.2. Problems in Targeting the Poor

5.13 Ideally, in a market economy, social assistance should be targeted towards the poor. However, targeting is administratively difficult, particularly in a country in which consumption expenditures far exceed income and cash income exceeds reported income. To avoid these problems, some countries have tried using indicators as proxies for income, e.g. substituting other family attributes correlated with poverty for the direct measurement of income. But unlike Central and South America, the identification of proxy targeting indicators has not been particularly successful in transition economies. The third method of targeting, categorical targeting, is frequently used in transition economies based on basic information such as age, disability, household size, or marital status. Categorical screens for program eligibility have included families with many children, families with young children, the unemployed, and the oldest old. But these frequently narrow screens are likely to eliminate many genuinely poor and, moreover, do not necessarily identify groups with high poverty rates.

5.14 The current government program incorporates a variant of categorical indicators for targeted social assistance -- non-working parents with dependent children; mothers of three or more dependent children; and individuals with disabled and elderly dependents. Yet poverty among young children less than 3 years of age is not adequately addressed although there is a universal program in place. Lastly, these groups only represent a fraction of the poor. The bulk of poverty is hidden in families with fewer children, families with older children, families with average educational backgrounds, workers with unpaid wages, and even pensioners.

5.15 In many societies, housing characteristics, including type of housing, water supply, sewerage, and heating facilities differentiate the poor from the non-poor. In Ukraine, these simple indicators do not differentiate income groups (Table 5.1). In particular, the percentage of households with a separate flat, a separate house, central heating, central water supply, sewage systems, and land plots varies very little across income groups. While there is somewhat more variation by size of flat or land plot,

errors of exclusion and inclusion would be too large to use these objectively verifiable assets as triggers for social protection eligibility.²⁶

Table 5.1 Housing Standards by Poverty Status, percentage of households

Indicator	Very poor	Poor	Non-poor	All
Share of households with separate flat	45.1	44.6	45.1	44.9
Share of households with separate house	47.2	48.1	48.9	48.7
Share of households with central heating at home	44.2	43.6	44.6	44.3
Share of households with piped water at home	60.6	60.6	64.6	63.5
Share of households with sewerage system at home	53.1	53.5	59.3	57.7
Share of households with hot water supply system at home	31	29.9	33.4	32.5
Share of households with land holdings	62.3	64.8	68.5	67.5

5.16 Thus more informative targeting criteria still need to be designed. Currently, according to the Decree of the Cabinet of Ministers dated February 2, 2000, an asset test has started to be applied to recipients of social privileges. In particular, no subsidy shall be granted if any household member leases out housing or the household possesses more than one apartment, or has bought an apartment/house, or possesses a vehicle less than 10 years old.

5.17 Imputing individual incomes has also been suggested, refocusing assistance towards families whose earnings capacity is low, rather than families whose actual earnings are low. The benefit of this approach is that it imputes reasonable amounts of income to families who underreport. The drawback, however, is that families who do not receive this imputed income stream are indeed be poor. Poverty rests in the inability to support actual consumption (not theoretical consumption) at socially adequate levels. If the family has children, those children suffer in the present, even if their parents are not living up to their earnings capacity.

5.18 Experiments have been carried out in the Russian Federation to determine the efficacy of different methods to means-test benefits. Three methods were used including (i) income-testing (Voronezh Oblast); (ii) an earnings-capacity approach (Komi Republic); and (iii) proxy means testing (three districts of Volgograd Oblast). Unfortunately, the findings were inconclusive. One reason is that their coverage was limited to a narrow slice of the poverty population due to funding constraints. Thus, eligibility was at most 15 percent of the poor population and benefit amounts differed regionally as well (aside from regional cost-of-living differences). While experiments in the Komi Republic and the Volgograd Oblast resulted in the greatest poverty alleviation,

²⁶ The household possession most closely correlated with poverty status is the availability of a telephone, with 44 percent of non-poor households having access, compared to 31 percent of poor households, and 28 percent of very poor households. Yet even these differences are relatively small, and the removal of a phone to ensure eligibility would be all too easy. No one would consider using this indicator for a proxy means test.

Volgograd was likely less successful only because benefit amounts were small. The means-testing methodology in the Komi Republic was reported to be the most cost-effective and socially acceptable.

5.19 In sum, while other country experience is available, Ukraine will need to devise its own solutions to redesign social assistance means testing. These solutions should consider errors of inclusion and exclusion through analysis of alternative eligibility criteria and benefit amounts. This can be achieved, in part, through simulation methodology using the SIE survey databases. In addition, administrative costs must be taken into account, which can be considerable for more sophisticated procedures. The next section provides a recommended starting point from which to do fine-tuning.

6. RECOMMENDATIONS AND WORLD BANK ASSISTANCE

6.1 The basic changes needed to improve the Ukrainian safety net are clear. Expenditures should be shifted from programs that are poorly targeted to those that are better targeted. Further, programs should be consolidated since the plethora of programs and program rules makes efficient implementation impossible. In addition, program administration should be improved to reduce errors of omission and inclusion. These worthy objectives are more easily said than done.

6.2 Anti-poverty measures also include the strengthening of financial institutions and the provision of stable fiscal and monetary policies. Risk-prevention measures to reduce poverty in the future also include the development of education strategies to establish a work force attuned to the requirements of a market economy. Risk-mitigation measures include pension and unemployment insurance to protect against fluctuations in life-cycle consumption, which can be predicted for the population as a whole but not necessarily for particular individuals and families. As these steps are taken, wage and transfer payment arrears should be eliminated, which will normalize the economy and assist in poverty reduction as well. These measures are important components of the anti-poverty policy framework, in conjunction with a strong social safety net.

6.3 Fortunately, sufficient budgetary resources are currently allocated to social programs in Ukraine to enable a relatively painless restructuring of expenditures compared to other transition economies, which face more stringent budgetary constraints. As discussed earlier, at 3.4 percent of GDP, Ukraine already had sufficient funding in the 2000 budget for social programs to eliminate poverty. (Even though no country can really completely eliminate poverty.) Thus Ukraine could potentially afford to reduce its social safety net expenditures to the benefit of other sectors of public spending or for deficit reduction.

6.4 According to USAID calculations, if all families had been guaranteed the minimum subsistence income of UAH 90.7 per capita in 1998, costs would have been UAH 2.1 billion, or 2 percent of GDP.²⁷ In 2000, 2 percent of GDP would equal UAH 3.1 billion. Thus, a program costing between UAH 3.2 billion and UAH 5.4 billion would have adequately provided a floor of protection for the poor. For 2000, social assistance and housing subsidies together amount to 1.9 percent of GDP, close to the lower limit.

²⁷ Based on calculations by USAID for 1998, it would have cost UAH 33.8 million to raise the monthly income of eligible families to UAH 41 per capita – the amount set in the current social assistance program. If this guarantee were extended to all families with per capita income below UAH 41, costs would have been UAH 197 million per year. Had all eligible families been brought to the minimum subsistence level of UAH 90.7 per capita, costs would have been UAH 606 million.

6.1. Government Initiatives

6.3 Government realizes that a major reallocation of social program expenditures is needed if social assistance is to be efficient, equitable and targeted to the poor. As a consequence, the authorities mandated working groups to address this issue. Agreement was reached to initiate policies addressing issues in five areas (see Annex IV):

- ◆ The revision of social privileges
- ◆ The coherence of the social protection system
- ◆ Improvements in targeting, and
- ◆ Improvements in administration
- ◆ Strengthening information on poverty and living standards

These objectives are very much in concert with the findings of this report. If resources are to be used more effectively, Government will need to adopt a coordinated approach to program development. In addition to providing a coherent social assistance program, interactions between social assistance, unemployment benefits, and pensions will require careful consideration.

6.4 The working groups have also offered very specific policy recommendations in five key areas (Volume II Chapter 5):

- ◆ redesigning programs;
- ◆ reforming financing
- ◆ redesigning administrative procedures;
- ◆ measuring poverty, and
- ◆ informing the public

These detailed suggestions provide a strong initial framework for policy reform but must be predicated on a comprehensive program redesign, which has been highlighted as one of the key issues within this report.

6.2. A Program for Change

6.3 If social privileges, family allowances, and housing allowances were transformed, financing equal to 2.7 percent of GDP would be available to fund a consolidated poverty program targeted towards the poor. A blueprint for such a social program reform would not have to be implemented overnight, but could be developed incrementally. Further the blueprint would need to be refined, based on additional quantitative and qualitative analysis.

6.4 The underlying principals of such a reform would be protection for the vulnerable in society -- defined initially as children, the aged, and persons with disabilities, and additionally as the unemployed, and, under current circumstances, persons with wage arrears. Funding for social programs should be secure and arrears

should not arise. The back-payment of arrears, while representing one-time assistance to poor families, misses the point that they were poor in the past when no help was forthcoming. Further, another underlying principle should be that a reasonable definition of poverty is in force, and program criteria reflect that definition in an objective manner.

6.5 The following multi-year plan could accomplish such a transformation and is in keeping with the vision of the Ukrainian task force. The strategy also takes into account the problems of targeting benefits to the poor through income testing strategies. Consequently, it attempts to first target families with children through fully funded benefits for children under 3 years of age. Then, cash income eligibility standards are set low to reflect differences between consumption expenditures and cash income received. Higher limits are set for families with no access to household plots on the premise that land holdings are recorded (either independently or in concert with housing registration) so that negative certification could be accomplished. Further, the relationship between social assistance and unemployment benefits needs to be explored to ensure coordination between these two programs, particularly since unemployed household heads are more likely to be in poverty than others.

Year 2001: The objective for the first year would be to continue to transform expenditures for privileges and Chernobyl benefits and also conduct analytic work to prepare for changes to take place in 2002.

Step 1: Remove privileges (as is being done already) so they are as low as possible; transfer funds to other programs (to be described); cash out privileges; transfer military privileges to the defense budget for clarity (as they are not social assistance);

Step 2: Restrict Chernobyl benefits to Groups I and II;

Step 3: For the purposes of analysis and overall welfare development monitoring, adopt on a poverty standard that is roughly in keeping with a relative poverty line of 75 percent of medium consumption expenditures and conduct analysis to relate it to total income and cash income. Establish the poverty line based on 2000 SIE data. Establish this line as basis for future analysis. This could also be updated for inflation in future years and act as absolute poverty line with which to track changes in well-being. Institute framework for the establishment and indexation of benefit based poverty line.

Step 4: Study administrative procedures for awarding benefits in regions; determine a simplified income testing strategy and potential assets that are easily measurable for means testing. Determine coordination between employment services, housing allowances, and other programs.

Step 5. Study options for changing housing allowance into a cash benefit program for households or merging allowance into a unified poverty benefit.

Step 6: Use SIE to determine effects of financial requirements for changes in housing allowance and child allowance programs for 2004.

Step 7: Prepare budgets and enact child allowance and housing allowance reforms in 2002.

Year 2002: The objective of the plan for the second year would be to provide adequate funding for a reformed system of housing allowances and family benefits by transferring these responsibilities to the center and also to conduct analytic work to prepare for 2003.

Step 1: Transfer financing of housing allowances and child benefits to the state budget; allocate sufficient funds to local authorities to pay benefits according to structure indicated below;

Step 2: Improve financing of child allowances program to include more children, as poverty among children is one of the strongest differences across households in Ukraine. We would suggest all children age three and under should receive child allowances. Children over 3 should receive allowances if their families meet an income and asset test. These benefits should be restricted to families with three or more children, however, and to single parent families. We suggest that benefits of UAH 20 per child per month (in 1999 terms) would approximately fill the poverty gap. Compared to the current program, this would include more poor children and all children under age 3 years. The amounts would encourage more families to participate. The funding would be sufficient to pay for all eligible children, as it would be financed from the budget. No child allowances should be paid through enterprises. While this strategy might result in errors of inclusion, the objective of ensuring that children have adequate resources overrides the inclusionary errors.

Step 3: Reform housing allowances to include poor families only. We would suggest that income/asset threshold be approximately the same as that for child allowances and that similar cash income testing be applied. Standards should be maintained for maximum sized apartments and perhaps standards should be revisited. Households would have to show that their expenses on housing exceed 30 percent of their cash income (except for those with no household plots, when 20 percent would be sufficient). Adult family members, except caregivers, would need to have proof of employment, income, or registration at the employment service. A phase out of benefits could be introduced to reduce work disincentive effects. Cash benefits should go to families who should then be monitored to ensure that payments are made. Monitoring can be provided through the recipient housing and utilities companies.

Step 4: Launch public affairs campaign for new program.

Step 5: Determine residual post-reform needs of the poor through development of a full micro-simulation model using SIE data.

Step 6: Develop mechanism to transfer funds (via ear-marked transfers, matching grants or other re-distributional methods) for unified social assistance programs based on regional poverty rates.

Step 7: Prepare budget and change laws for social assistance reforms in 2003.

Year 2003: The objective of this year's program would be to transfer funding of social assistance to the center; consolidating all social assistance programs through a new social assistance law and appropriate legislative changes, removing all former laws on the books. Local agencies would administer the social assistance programs, which would be monitored by the center. While the program would be open to all persons, preference would be granted to poor families with children, families with the aged and families with persons with disabilities. Localities could continue to grant in-kind benefits and one-off assistance through their own budgets. Further, localities would be responsible for providing social services to families and individuals with a variety of social problems such as drug abuse, alcoholism, family violence, and other behavioral problems.

Step 1: Allocate funds for social assistance to local levels;

Step 2: Reform social assistance as a single program administered by the regions and based on an income test (including cash income, child allowances, housing allowances, employment or registered unemployment,) and a means test (second dwellings, new cars, etc.). The cash income threshold should be the extreme poverty line, which, based on 1999 figures, would be about 48 UAH (in 1999 terms) in cash income, increased to about 58 UAH (in 1999 terms) for families without plots of land.²⁸ This expands eligibility compared to the current targeted social assistance program and also includes constituencies from other social assistance programs. Benefits should ideally top up family income to the extreme poverty line.

Step 3: Launch public affairs campaign to explain new program.

Step 4: Plan for amalgamation of offices into a single focal point ("one-stop" services) for combined delivery of family allowances, housing allowances, and family benefits including legal issues and administrative changes based on the approach successfully tested in the Mykolayiv oblast.

Step 5: Prepare budget to include funding for the amalgamation of social assistance offices.

Year 2004: The objective for this year would be to amalgamate offices for social assistance to include all three programs: family allowances, housing allowances, and family benefits.

²⁸ Again, these suggested UAH thresholds are in terms of the 1999 poverty line. The actual thresholds would differ as they would be based on a 2000 extreme poverty line adjusted for inflation to 2003.

Step 1: Provide funds to regions for funding social assistance programs at the local level based on formula related to regional poverty rates;

Step 2: Launch public affairs campaign to explain new application requirements.

6.3. World Bank Assistance

6.6. In summary, Ukraine already spends a sufficient proportion of GDP to provide an adequate social safety net. In this respect, the country is fortunate, as resources are available to help the poor. The irony is that current programs are poorly targeted and under-funded, while the poor receive relatively little. Until the system is redesigned, the non-poor will continue to receive the lion's share (and perhaps expect even more) while the poor, and especially poor children, will not have enough.

6.6 As next steps, the World Bank could work in close coordination with the Ukrainian authorities to meet policy objectives for social assistance reform. For the first year program, we would suggest working with government to conduct:

- ◆ Updated poverty estimates using 2000 SIE data to recalibrate poverty measures and reassess the profile of the poor;
- ◆ Simple micro-simulation analysis to evaluate the impact of proposed 2002 reforms of eligibility and benefits for child allowances and housing subsidies on poverty and government expenditures;
- ◆ Assessment of administrative requirements for the reforms based on international experience and on regional analysis;
- ◆ Labor market analysis to evaluate active and passive labor market programs, understand the potential for job growth to reduce poverty, and how to coordinate unemployment programs with social assistance.

6.7 Using the SIE, simulations (statistical scenario testing) can be done assigning varying categorical and/or income eligibility criteria and varying benefit amounts to survey families. On the basis of these simulations, incorporating the expertise of Ukrainian program experts and statisticians, a new social assistance scheme could be designed to meet both poverty reduction targets and fiscal constraints. Subsequently, SIE data can be used to monitor the program and provide evaluation guidelines with respect to errors of "inclusion" and "exclusion."

6.8 Within this process, another area that needs further consideration is the depth of poverty *among different types of households*, as this measure identifies how close the poor are to destitution. Countries with shallow poverty may have less need to devote significant resources to social safety net provision. On the other hand, shallow poverty may also signal an income distribution in which most families are close to the poverty line, and in which small changes in the poverty line can include or exclude major portions

of the population. To date there has been no full assessment of the sensitivity of the poverty rate and the depth of poverty to slight changes in the poverty line.

6.9 Sensitivity analysis can be helpful to policymakers with regard to the selection of eligibility criteria, as there are likely to be behavioral responses by prospective clients. For example, some may abstain from applying for benefits if their income is close to the entitlement criteria and others may flood the social assistance offices if small shifts in eligibility criteria make applications suddenly worthwhile. Thus the issue of targeting in a country with minimal disparities in income, and one in which most families may believe they are poor, is a challenge that must be based on careful factual analysis. This is an issue that should be followed up again in Ukraine, as the Gini coefficients for 1999 were quite low suggesting a relatively flat distribution of income.

6.10 Childhood poverty also should be assessed from the perspective of the responsible parenting population to discover how to improve the economic situation of their families. In addition, regional aspects of poverty and income will be assessed both in terms of the economics of regional poverty and the determinants of social assistance payments. Preliminary analysis indicates that social protection expenditures are neither positively nor negatively correlated with regional poverty. Consequently, regions are affected by criteria that are uncorrelated with poverty and, as such, represent administrative constraints to efficient targeting of expenditures.

6.11 Further, the operation of the labor market needs to be analyzed in depth since job growth is a good cure for poverty. This analysis will include an investigation of the interactions between work and wages, the non-payment of wages, occupation, industry and poverty. In particular, the study will assess the independent impact of factors such as education and industry on wages and unemployment. One of the potential links between poverty and the workplace in Ukraine results from arrears in wages; this relationship has yet to be studied. It is possible that heads of households facing wage arrears have poverty rates equal to households headed by the unemployed.

6.12 During that process, the World Bank and Government could also investigate other means of cooperation to help implement the multi-year reform program suggested and/or to refine and redesign that program. For example, technical assistance could be provided with Bank lending to design better monitoring, evaluation, and policy simulation procedures, to build and strengthen institutional capacity, to assist in planning and carrying out of public information campaigns, and to support the reform with information technology enhancements. The reforms contemplated by the Ukrainian authorities are path breaking. While other CIS countries have identified many of the same problems, none have taken the steps needed to reform and fund their social programs so that public expenditures effectively target the poor.