Protecting the Poor During Economic Transition: Focus on Hungary

The transition from a centralized to a market economy poses new challenges for social policy in Eastern Europe and the former Soviet Union.

Two issues are of particular concern. First, national budgets can no longer support the wide social assistance networks that traditionally provided almost universal coverage under a centralized economy. Second, existing social programs may be unresponsive to transient poverty brought about by temporary changes in household circumstances. Economic transition is often associated with widening earnings differentials and emerging unemployment, problems which traditional safety nets may be ill-equipped to address.

Focusing on how an emerging market economy deals with poverty, a recent World Bank study examines how Hungary's benefit system performed between 1987 and 1989. Panel data was constructed expressly for the study from the Hungarian Household Budget Surveys. Through analysis of the relationship between current benefits and household living standards, the study quantifies the potential for improved targeting. Actual and simulated joint distributions of consumption over time explore the dynamics of poverty, making it possible to discern two distinct effects of the Hungarian cash benefit system: how well it protects households from falling into poverty, and how well it promotes poor families out of poverty.

The study also makes two contributions to statistical methods. It develops tools for analyzing the incidence of welfare programs in transition economies when the dynamics of poverty are of special concern. And, it illustrates the feasibility of constructing panel observations from existing survey data when some proportion of households in any given round is re-surveyed in the next.

Hungary's social safety net in the 1980s

In Hungary, public spending on social programs represented about one-third of GDP in the late 1980s, of which about two-thirds was on cash transfers. Recent policy discussions have been particularly concerned with improving the cash benefit system—which was providing near universal coverage under some programs—to one better targeting toward the poor.

The Hungarian system is quite progressive, as seen in Chart 1—net social income payments account for a much higher share of consumption by the poor than the rich.
However, the system is not well-targeted. Indeed, the absolute amounts received tend to increase with standards of living. The cash value of total transfers received by the richest households in 1989 represented 88% of the value of the poverty line, more than twice the cash gain of the poorest, whose average transfer represented 39% of the poverty line.

Targeting performance also differs substantially by program type. As a percent of total household consumption, the amounts received under the family allowance scheme decrease sharply as the standard of living rises, while the opposite is true of pension funds (see Chart 2).

### Poverty and the Social Safety Net

Poverty in Hungary increased between 1987 and 1989, from 21% to 26% of the population as measured by consumption. There was also considerable transient poverty. Roughly half of the persons who lived in poor households in 1989 did not live in such households in 1987, and roughly 4 out of 10 persons who were poor in 1987 escaped poverty by 1989.

Changes in the cash benefits system reduced poverty to a certain extent. Simulated distributions show that had no change in the amount or distribution of benefits occurred over the period (ignoring behavioral responses), the poverty rate would have been 6.6 percentage points higher by 1989 than that actually observed. Even taking behavioral responses into account, the estimated poverty rate would still have been 3% higher than actually observed had cash benefits not changed.

The Hungarian safety net was actually far more responsive to transient poverty than to persistent poverty. Between 1987 and 1989 it succeeded in preventing households from falling into poverty, but managed to help far fewer escape long-term poverty. Targeting was also little improved over the period. Under an equal per capita allocation of the same disbursement in 1989, the poverty rate would have been only slightly more than one percentage point higher and transitions into and out of poverty would have been virtually identical.

### Summary

As Hungary institutes a market economy, it presents a model for how a previously centralized state has to rethink dealing with poverty. Given the budget constraints and economic volatility inevitably accompanying transition to a market economy, substantial gains in efficiency can be made by reforming outmoded social assistance programs. Although changes in Hungarian social assistance programs did reduce poverty between 1987 and 1989, this success can be attributed to increased outlays rather than improved targeting.

The Hungarian case suggests that poverty in emerging market economies could be dealt with more efficiently through more accurate targeting. In Hungary, for example, concentrating family allowance benefits on younger and larger families would achieve a greater impact on poverty for the same budgetary outlay, or would achieve the same impact at a much lower cost.