



## Social Protection Responses to the Global Economic Crisis in ECA

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Besides affecting the private sector, the current global economic downturn will likely have a far-reaching impact on government revenues around the world. As country budgets are squeezed tight, social programs which directly help poor and vulnerable people will become pressure points for reducing government spending.

In many countries in Eastern Europe and Central Asia (ECA), two years of rising food prices, high energy costs and the global economic downturn have combined with other shocks like natural disasters and political instability. The impacts of these crises could reduce government revenues and affect social spending and pension systems, even as the need for unemployment and benefits increases.

How well-positioned are ECA countries to respond to these challenges? Are their pension systems safe? Can their social assistance programs be protected and expanded if necessary?

The Social Protection Team of ECA at the World Bank prepared a stocktaking Note, “Social Protection and Economic Shocks in ECA: The Social Side of the Global Crisis”, to examine the situation regionally and systematically, and help raise awareness of the current risks as well as potential for social protection during the crises.

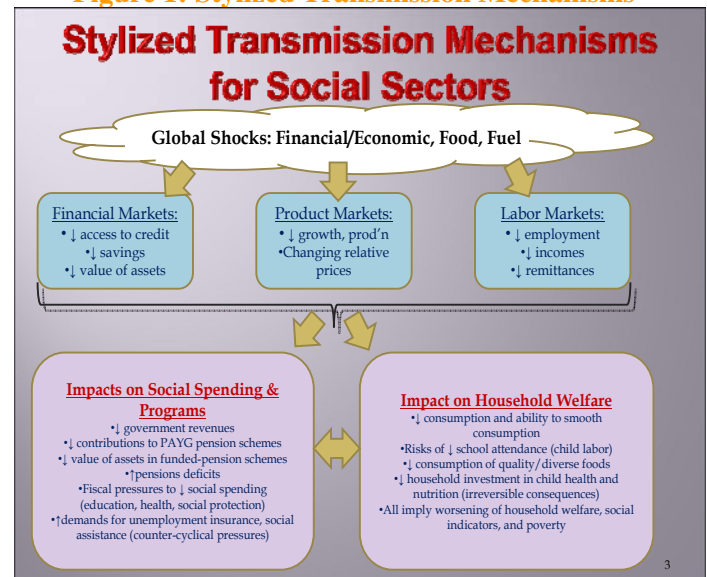
### Impact of the Crisis on Social Protection and Household Welfare

The impact of the global financial crisis will likely be felt by all ECA countries through the: (a) financial markets (reduced access to credit, falling value of savings and assets); (b) product markets (lower growth and production, changing relative prices); and (c) labor markets (reduced employment, wages and remittances), as illustrated in Figure 1.

As government revenues fall, these effects will be compounded by pressures to reduce spending on education,

health and social protection. The impact on household welfare could include reduced consumption and ability to smooth consumption inter-temporally, less food consumption and dietary diversity, and decreased household investments in child health and nutrition. While the global crisis could cause economic losses across the income spectrum and even force some families into a new situation of poverty, the chronic poor are likely to feel the most severe impact.

Figure 1: Stylized Transmission Mechanisms<sup>2</sup>



However, social assistance and unemployment programs in ECA can also act as potential crises response mechanisms, by expanding to help low income families to smooth consumption and mitigate the adverse impacts of the shocks. Their budgets, along with those for basic education and health services, should be protected and increased to leverage this potential.

### Impact on Pension Funds

The effect on pension systems in the ECA region will vary depending on the type of pension system in place.

<sup>1</sup> The authors thanks the Social Protection Team of ECA and other World Bank staff who contributed to the writing of the Note: “Social Protection and Economic Shocks in ECA: The Social Side of the Global Crisis”.

<sup>2</sup> All Figures are from the Note: “Social Protection and Economic Shocks in ECA: The Social Side of the Global Crisis”, November 2008, World Bank.

## Public PAYG Systems

Most ECA countries, except Kosovo and Kazakhstan, operate some type of pay-as-you-go (PAYG) system. In the public PAYG systems, the risk comes from the potential rise in unemployment due to the crisis, its impact on contributions, and consequent decrease in pension system revenues. Countries like Serbia and Ukraine already have significant deficits in their pension systems and are more likely to face constraints. Russia, Georgia and Kosovo, with their relatively modest pension systems, may find higher numbers of pensioners in poverty as pension increases remain modest while inflation raises the cost of living.

## Funded Pension Systems

Thirteen ECA countries have adopted fully-funded, defined contribution schemes, usually privately managed, as an integral part of their mandatory pension systems. They are directly vulnerable to the financial market crisis because the drop in financial markets could lead to a sharp decrease in the value of assets in their specialized private pension savings funds. Moreover, those retiring at the time of the crisis will end up annuitizing these low pension balances and, therefore, receive low pensions throughout their retirement period.

However, there are some mitigating factors to dampen these impacts. **First**, in most ECA countries the pension system is a mix between public and private schemes, usually heavily weighted toward the public PAYG scheme. Figure 2 shows the proportions of total pension contributions going to the funded systems. Only Kazakhstan and Kosovo have 100 percent of the contributions going into the funded private pensions. **Second**, pension reforms in many countries typically kept the oldest workers in public PAYG systems and only allowed younger workers to switch to the mixed systems. These younger workers have not yet reached retirement age so only a portion of the older individuals (who

have spent relatively few years contributing to the funded system) may be subject to direct financial market risk. The most immediately affected individuals will be in Kazakhstan, Hungary and Poland. In other countries, markets could recover at least partially by the time significant waves of second pillar participants begin to retire. But, if the crisis is prolonged and assets do not recover quickly, more people will approach retirement with low assets. A more immediate issue is the potential for panic by inexperienced investors as they see their portfolios fall in value; this may result in calls for reversals in pension reforms. A sensible strategy for countries with these schemes is to avoid hasty action and let markets recover, although some countries should reform their pension systems.

## Voluntary Pension Systems

Voluntary pension savings schemes may take a strong hit—especially defined benefit schemes in Russia and other countries, and defined contribution funds with their wider exposure to equity. This may cause a decline in the popularity of voluntary schemes which governments rely on to help cut spending on public pension programs (necessary because of the aging populations in many countries).

## Safety Nets: Potential for Rapid Crisis Response

Safety nets mitigate the impact of economic shocks by protecting incomes and helping families smooth consumption, avoiding irreversible losses of physical assets and human capital, maintaining political and social stability, and acting to some extent as counter-cyclical stabilizers (with permanent programs ‘automatically’ expanding with crises and contracting with restoration of growth). The ability of countries to leverage social safety nets in response to crises depends critically on their capacity to effectively target and implement such programs *in advance* of a crisis.

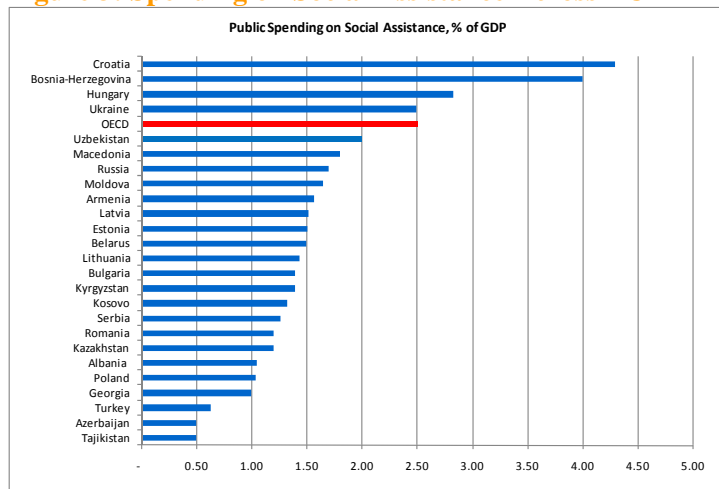
**Figure 2: Funded Pension Schemes Operate in 13 ECA Countries**

Country	% Wage to Funded	Proportion of Total Contributions to Funded	Year Funded Started	Participation in Funded	Year Funded Participants Retire
Bulgaria	5%	21.7%	2002	Mandatory <42	Full cohorts in 2023
Croatia	5%	25.0%	2002	Mandatory <40, Voluntary 40-50	Partial cohorts of women by 2012 and of men by 2017; full cohorts of women by 2022 and of men by 2027
Estonia	6%	20.0%	2002	Voluntary	Partial cohorts by 2012
Hungary	8%	23.9%	1998	Mandatory new entrants; voluntary for all others	Partial cohorts by 2008; full cohorts by 2035
Kazakhstan	10%	100.0%	1998	Mandatory for all	Full cohorts by 1999 but acquired rights in old system in addition
Kosovo	10%	100.0%	2002	Mandatory for <55	Full cohorts by 2012
Latvia	8%	24.0%	2001	Mandatory <30, Voluntary 30-50	Partial cohorts by 2013; full cohorts by 2033
Lithuania	5.5%	22.0%	2004	Voluntary	Partial cohorts by 2014
Macedonia	7.42%	35.0%	2006	Mandatory for new entrants	Partial cohorts by 2016; full cohorts of women by 2043 and of men by 2045
Poland	7.3%	26.1%	1999	Mandatory <30; Voluntary 30-50	Partial cohorts of women by 2009 and of men by 2014; full cohorts of women by 2029 and of men by 2034
Romania	2%, increasing to 6%	6.7% in 2008	2008	Mandatory <35; voluntary 36-45	Partial cohorts of women by 2023 and of men by 2028; full cohorts of women by 2033 and of men by 2038
Russia	6%	30.0%	2002	Mandatory for <35	Full cohorts of women by 2022 and of men by 2027
Slovak Republic	9%	31.3%	2005	Voluntary for all	Partial cohorts by 2015

### Overview of (Pre-Crisis) Safety Nets in ECA

ECA countries devote an average of 1.7 percent of GDP to safety net programs, with another 8.3 percent for pensions and other forms of social insurance (Figure 3). Most countries operate a mix of programs, usually in the form of cash transfers, with an emphasis on family allowances (child allowances, birth grants, etc.), social pensions, heating and housing allowances, and targeted anti-poverty ‘last-resort’ programs. In many countries, the programs are multiple and fragmented, leading to duplication of benefits.

**Figure 3: Spending on Social Assistance Across ECA**



Coverage of the poor by social assistance is not always correlated with fiscal effort as benefits are not usually targeted effectively. Often, less than 40 percent of the poor are covered and in some countries, like Tajikistan, less than a third of those in the poorest quintile are covered.

Targeting of overall social assistance is impressive in a few cases (Georgia, Serbia, Romania, Armenia, and Lithuania).

But, in many countries, the non-poor receive substantial social benefits from larger universal schemes with objectives other than poverty alleviation--child allowances, birth grants, restitution for war veterans and victims, and assistance to the disabled.

### Policy Options for Crisis Response via Safety Nets

Crisis response mechanisms will vary across ECA according to the severity and manifestation of the impending impacts on incomes, wages, jobs, migrant workers, remittances, etc., and the capacity and components of the existing safety nets. The best-prepared countries will likely be best-positioned to respond. The available policy options include:

- Leveraging existing programs by expanding proven interventions or protecting their budgets.
- Introducing new programs like Direct Cash Transfers, Conditional Cash Transfers and Public Works Schemes.

- Reforming safety nets by eliminating, reducing, or maintaining nominal values of untargeted benefits, removing automatic indexing of benefits to wages, and consolidating benefits into fewer well-targeted schemes.

The initial option should usually be on expanding existing safety nets that have proven track records, such as well-targeted social assistance programs or unemployment insurance. When countries do not have such programs, they have the option of introducing new ones. However, it takes 10-18 months (longer for fragile countries) to develop basic targeting, registry and safety net systems. This is too long for rapid crisis response. Nonetheless, there could still be value in using the crisis as a pretext for introducing new, well-targeted programs (as Turkey did in 2001 with the introduction of its conditional cash transfer scheme).

Crises can also be an opportunity to push the reform agenda forward. In addition to short-term measures, medium-term reforms for strengthening safety nets could include: (a) improved targeting and eligibility mechanisms such as Hybrid Means Testing; (b) improved household registries and management information systems; (c) strengthened payments, monitoring, and oversight mechanisms; and (d) overhauling and consolidation of weak safety nets.

### Are Existing ECA Safety Nets Prepared for Rapid Response?

Countries were classified into three categories (A, B and C) by asking the simple question: ‘Does the country already possess at least one well-targeted program that could be scaled up to channel resources to the poor in a cost-effective manner in a crisis situation?’ Most ECA countries can leverage existing targeted programs for crisis response, although some need significant reforms to effectively target the poor and vulnerable (Figure 4).

**Figure 4: Preparation Levels of ECA Safety Nets for Rapid Crisis Response to Impacts of Global Crisis<sup>3</sup>**

How Ready are ECA's Safety Nets for Rapid Crisis Response? A Typology of Countries		
Potential to Build on Existing Programs	Lack Well-Targeted Program, SSN Needs Major Improvements	
Usually have at least one fairly well-targeted program, though often with low benefit values & coverage (Type A)	Higher spending, weak programs (targeting, coverage of poor) (Type B)	Low spending, weak programs (Type C)
<b>LICs / Lower MICs</b> •Albania (NE Program) •Armenia (FPB) •Azerbaijan (ISA) •Georgia (ISA) •Kyrgyz (UMB, MSB) •Macedonia (SB with reforms) •Ukraine (Ext. Poor program)	<b>LICs / Lower MICs</b> •Moldova •Bosnia	<b>LICs</b> •Tajikistan
<b>MICs/Upper MICs</b> •Bulgaria (GMI) •Croatia (Support Allowance) •Estonia (GMI + FA) •Latvia (GMI + TFA) •Romania (GMI) •Serbia (MOP) •Turkey (CCT, Green Card)	<b>MICs</b> •Hungary (Type A-B) •Kazakhstan	<b>MICs</b> n.a.



*'A' Countries: Potential to Build on Existing Programs*

Most of these countries *do* possess at least one fairly well-targeted program that can be scaled up in times of crisis. Interestingly, this potential is not limited to middle income countries (MICs).

Several lower-income countries have developed some elements of effective safety nets, typically a single well-targeted program focused on poor families--such as the Unified Monthly Benefit in Kyrgyz, the Ndhima Ekonimike program in Albania, the Targeted Social Assistance programs in Azerbaijan and Georgia, the Family Benefit Program in Armenia. The targeting accuracy of these programs is reasonable to high. Depending on the country, further improvements could come from introducing geographic targeting with poverty maps, verification of income-testing with hybrid proxies, and strengthened implementation, registry, administration and oversight. Coverage is typically low and could be expanded with increased fiscal effort (possibly coming from consolidating other legacy 'privileges') and improved outreach to the poor.

Several MICs and higher MICs also operate effectively targeted 'last resort' programs. Eligibility for the programs is determined by means testing and targeting outcomes range from reasonable to strong. Coverage is usually low but the poor also benefit from other universal social schemes. Many of these MICs need to further strengthen their safety nets by improving benefits, coverage, implementation, and administration.

*'B' Countries: Adequate Spenders, Inadequate Programs*

These countries *do* allocate adequate resources to social assistance but have been unable to reduce poverty in a cost-effective manner due to weak targeting and implementation. Moldova spends about 1.7 percent of its GDP on about 15 untargeted programs; Bosnia spends 4 percent of GDP on a number of untargeted, categorical benefits for civilians and war veterans; and Russia spends 1.7 percent of GDP on categorical benefits and weakly means-tested subsidies but

<sup>3</sup> SSN: Social Safety Nets; MIC: Middle Income Countries; LIC: Lower Income Countries; NE: Ndhime Ekonomika Program; FPB: Family Poverty Benefit; TSA: Targeted Social Assistance; UMB: Unified Monthly Benefit; MSB: Monthly Social Benefit; SB: Social Benefit; GMI: Guaranteed Minimum Income Program; CCT: Conditional Cash Transfer; MOP: Material Support to Families Program

suffers from implementation and design challenges. Significant reforms are generally needed in these countries to consolidate programs, refocus design and eligibility criteria, develop and apply targeting tools, improve implementation, and strengthen oversight, monitoring and evaluation.

*'C' Countries: Inadequate Resources and Programs*

Tajikistan operates a few ineffective programs with very low funding (0.5 percent of GDP). However, within this budget, it does not optimize design and implementation, spending mostly on utility subsidies that do not reach the poor. In contrast Azerbaijan category A country operates better safety nets on a similar budget (about 0.5 percent of GDP) and effective conditional cash transfer programs elsewhere (Brazil, Mexico) use as much of a share of their GDPs, with much higher impacts.

**The Role of the World Bank**

In the short run, ECA countries may call on the World Bank to provide financial or technical support to help with the immediate impacts of the crises. Rapid support could include: (a) helping countries finance temporary scaling-up of well-targeted safety nets, either in beneficiary coverage or with a topping-up of benefits values; and (b) supporting actions to protect the budgets of well-targeted programs and other crucial spending on education and health.

The Bank may also be called on to support ECA countries in reforming their safety nets. This may generally involve: (a) protecting budgets of well-targeted programs; (b) eliminating or reducing spending on untargeted programs such as privileges; and (c) removing automatic indexing of benefits to wage inflation. In the medium-term, the Bank can help countries: (a) develop targeting mechanisms (such as hybrid means-testing tools); (b) strengthen the registration process; (c) unify, automate and strengthen beneficiary registry; (d) improve oversight, controls, monitoring, and evaluation mechanisms; and (e) consolidate benefits and/or introduce new better-targeted schemes.

Governments and the Bank need to be prepared to respond more adeptly in the future; safety nets are important not only in times of crises but, in the long-run, they help to protect the poor and allow governments to avoid other, more costly or inefficient policies.

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