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Former Yugoslav Republic of Macedonia Focusing on the Poor

(In Two Volumes) Volume I: Main Report

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Human Development Sector Unit
Country Department IV
Europe and Central Asia Region



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CURRENCY EQUIVALENTS

(as of June, 1999)

Currency Unit = Denars

US\$1 = 56.94 Denars

AVERAGE EXCHANGE RATES

Denars per US\$1

(Period Average)

1996	1997	1998
39.9	49.7	54.5

WEIGHTS AND MEASURES

Metric System

FORMER YUGOSLAV REPUBLIC OF MACEDONIA FISCAL YEAR

January 1-December 31

Vice President:	Johannes Linn
Country Director:	Ajay Chhibber
Sector Director:	Christopher Lovelace
Sector Leader:	Michal Rutkowski
Task Team Leader:	Mansoor Rashid

FORMER YUGOSLAV REPUBLIC OF MACEDONIA

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FORMER YUGOSLAVIA REPUBLIC OF MACEDONIA FOCUSING ON THE POOR

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THE KOSOVO CRISIS AND POVERTY

The Kosovo crisis has inflicted a severe strain on the Macedonian economy.¹ Trade with and through the Federal Republic of Yugoslavia has been cut off and the country has been forced to absorb a large and growing population of refugees from neighboring Kosovo into the northern part of the country. These recent events have severely undercut economic recovery, threaten macro-economic stability, strained social expenditures, will likely increase poverty over the duration of the crisis, and have the potential to rent the multi-cultural fabric of the country.

Due to the blockage of the main trade routes and the closure of its second largest export market in FR Yugoslavia. The Gross Domestic Product (GDP) is expected to contract by 4% (against an anticipated 5% growth prior to the conflict). Industrial activity is expected to be severely affected; Investment is likely to collapse from a decline in consumer confidence; and per capita consumption, a key determinant of poverty, is likely to decline because of the increase in the population due to refugees.

The increase in poverty occasioned by the contraction of economic activity and the decline in per-capita consumption is likely to aggravate and deepen poverty amongst the groups of poor identified in this report. However, the basic linkages and determinants of poverty found in this report: low-wage poor, less educated, unemployed, rural areas, agricultural households, families with many children are likely to remain the same.

The contraction in economic activity will have direct implications for the welfare of workers. Worker incomes are expected to decline sharply, and unemployment is expected to rise, as enterprises are likely to shed workers. Wage arrears are likely to worsen, and many more employees are likely to be put on paid leave. New jobs in the formal sector have been difficult to find (see Chapter 2 of this report) even during better economic times last year, and this trend is likely to continue. Agriculture, the main source of new jobs in the past is hard hit by the closure of its main market in Kosovo. Even during the last year, the bumper crop plus the Kosovo fighting led to a 23% decline in agricultural prices. Prospects for this year are far worse.

Preliminary estimates indicate that an additional 2-3% population may fall into poverty, adding to the 18% of the population that is already poor according to this report. The depth of poverty may increase as well, particularly amongst the unemployed, and low-wage workers, already an important group of poor in 1996, whose income may fall because of wage arrears and forced leave. The Kosovo conflict may also have a larger impact on rural poverty, where many households have absorbed refugees, and where the fall in agricultural income is likely to impact agricultural households, which are one of the most vulnerable groups of poor.

The rise in unemployment and poverty, coupled with additional expenditures associated with refugees will impose a strain on the budget, particularly on social expenditures such as health, education, unemployment benefits, and social assistance, rendering the protection of poor difficult at a stage when economic conditions are at their worse point. To this end, care will have to be taken—through better targeting of program—to protect the poorest and most vulnerable groups from falling into abject poverty.

¹ This section draws heavily on the World Bank Report, "Former Yugoslav Republic of Macedonia: Economic Impact of the Kosovo Crisis." The poverty estimates were estimated based on the data used in this Poverty report.

EXECUTIVE SUMMARY

I. Introduction

i. The objective of this poverty assessment report is to inform policies and programs that *focus on the poor*. To this end, the report traces the evolution of poverty between 1990-96, evaluates the characteristics and determinants of poverty status in 1996, and evaluates the effectiveness of public poverty alleviation programs in 1997 (first half) in achieving their stated objectives. The report relies on both quantitative data (Household Budget Surveys 1990-95; a special add on module of the 1996 Household Budget Survey)² and a Qualitative or Social Assessment (1998) to evaluate poverty.

ii. The important link between labor market status, education, cash transfers and poverty has focused this report on three key themes: (i) poverty trends and in-depth characteristics; (ii) labor markets and poverty; and (iii) poverty alleviation programs and policies (the education system and the cash transfer programs). These themes also serve to organize the chapters of this report. Two annexes support this report: *Annex 1 Data and Measurement*, discusses data, sources and limitations, and the basic measures of welfare used in this report; and *Annex 2: the Statistical Appendix*.

iii. A description of poverty requires a definition of the poor. In most poverty studies, a poverty line, or a particular threshold level of consumption, is used to define poverty. Consistent with OECD norms, the Macedonian Government has chosen a relative poverty line to define poverty in the country. According to this definition of poverty, individuals with consumption below 60% of median annual 1996 adult equivalent consumption—or 33061 Denars per year (2755 Denars--about \$50--per month)--are defined as poor (Annex 1). The report uses this official poverty line to profile the poor and evaluate the determinants of poverty.³

II. Poverty Trends and Characteristics

iv. Poverty is not a new phenomenon in the country. Prior to 1990, the former Yugoslav Republic of Macedonia was one of the poorest Yugoslav Republics heavily subsidized by transfers from Belgrade, and greatly reliant on internal markets for trade.⁴ Although literacy was almost universal (94% according to the 1994 Census) and life expectancy (72 years) at par with many higher income transition economies, infant mortality rates compared unfavorably with Central and Eastern Europe norms, and were

² An additional module comprising socio-economic characteristics of households was added to the last quarter of the 1996 annual Household Budget Survey. Most of the results of this report, particularly on socio-economic characteristics are from this additional module of the survey.

³ In a small section of this report, which deals with poverty trends, a slightly higher poverty line--70% of median adult equivalent consumption--is used to evaluate *changes* in the *level and composition* of poverty over time. This is a result of the small sample of households in the 1990-95 data, which do not allow robust results for socio economic groups, at the official poverty line. However, the report evaluates the sensitivity of poverty rates to alternate specifications of poverty lines (Annex 1/Chapter I).

⁴ Former Yugoslav Republic of Yugoslavia: An Introductory Economic Report. World Bank, 1995.

particularly high in rural areas and for ethnic minorities.⁵ The poorest households were mainly rural and derived their income primarily from agricultural sources.⁶ A cradle to grave protection system was also in place with the intention of providing individuals with full protection against income loss and other lifetime risks. The system provided guaranteed employment, child allowances, free education and health care, and pensions upon retirement. However, open unemployment was high compared to regional norms, and concentrated amongst new entrants to the labor force. The socialist worker management system gave the employed (or insiders) extensive powers to push up wages, restrict hiring and termination practices, and keep out younger and less skilled workers.

v. The transition exacerbated the poverty situation in the country. Independence from Yugoslavia, the loss of federal transfers, the external conflict amongst its neighbors, and the economic transformation from a socialist system to a market economy, led to a sharp economic contraction. Inflation rates soared, real wages declined and unemployment increased. Not surprisingly, poverty increased from 4% of the population in 1991 to approximately 20% in 1996. The increase in poverty was not uniform. Poverty rates remained largely unchanged between 1990-91, but increased sharply between 1993-95. The main reason for the increase in poverty was a major decline in real consumption. The inequality in consumption grew, but contributed far less to poverty growth.

vi. In 1996, the country overcame the deep recession of the early 1990s and realized a small positive growth rate (1%) for the first time since independence. However, the incidence of poverty increased further between 1995-96. As real consumption remained roughly constant over this period, the main reason for poverty growth was a growing inequality in the distribution of income.⁷ The modest growth realized in 1997 and 1998 may have reduced poverty over 1996 estimates, but these gains may well be eroded, at least over the short term, by the contraction of economic activity resulting from the Kosovo crisis. (See Box: The Kosovo Crisis and Poverty)

vii. **The diverse characteristics of poverty.** In 1996, according to the official poverty line, approximately 20% of the population was poor. An overwhelming share (two thirds) of the poor lived in rural areas. About 60% of the poor lived in households headed by individuals who worked.⁸ Of these, almost two thirds were wage/seasonal workers, and the rest were farmers. The remaining non-working poor were roughly evenly divided between pensioners and the unemployed/transfer recipients. The report identifies three distinct groups of poor:

- ***The traditional poor.*** Rural, agricultural households with more than three children, as earlier, have amongst the highest *incidence* of poverty in the country. These households are larger in size (with many children) and are characterized by the very

⁵ The Joint Country Assistance Strategy, Memorandum of the President, World Bank, July, 1998.

⁶ The 1990 Household Budget Survey.

⁷ Consistent with this trend, the poverty gap, an indicator of the depth of poverty, remained constant between 1993-95, but deepened between 1995-96.

⁸ The high number of employed poor is a result of the large population of employed in the population. The incidence of poverty amongst the employed is however far less than that of unemployed and other groups.

low education status of household heads and, particularly, of female household members. The poorest are those that survive exclusively on agricultural income.

- ***The new poor.*** The transition has changed the face of poverty in the country. Poverty remains a rural phenomenon, with nearly two thirds of the poor living in rural areas. However, non-agricultural households (now two thirds of all poor) have replaced agricultural households as the largest group of poor. Amongst socio-economic groups, the unemployed/transfer recipients have emerged as the new group of poor and have the highest incidence of poverty, followed by farmers, and wage earners. Pensioner headed households have the lowest poverty rates overall.
- ***The chronic poor.*** The elderly poor, particularly non-pensioners, the disabled, aged farm households without pension or other fixed income, and individuals not in households (institutionalized elderly, disabled, orphans) emerge as the most disadvantaged groups in society. These groups are least capable of work and are therefore the least likely to benefit directly from economic growth.

viii. **The common characteristics of the poor.** In 1996, the *common* characteristics of poverty include limited asset ownership (durables, and land), a large household size, and a high share of food in total consumption. However, low education attainment, labor force status, poor living conditions and low health status are also closely linked to poverty. While ethnicity is likely an important dimension of poverty, the sources of data for the report were not adequate to explore this important issue.⁹

- ***Low levels of education:*** Nearly 80% of the poor live in households headed by individuals with primary education or less. Rural household heads report a much lower education status compared to urban households. Most worrisome, poverty rates are much higher in households with non-attending children (25%) vs. those with children attending school (10%). This means that poverty amongst these households may persist in the future.
- ***Labor force status.*** Unemployment, low-wage share, and lack of enterprise ownership are the main labor market determinants of poverty. Low-wage share, indicative of low-wage jobs, is an important indicator of welfare in FYR of Macedonia in both rural and urban areas. However, unemployment is a strong poverty marker only in urban areas. In contrast, remittances and the ownership of a household enterprise reduce the chances of being poor in rural, but not urban areas.
- ***Poor living conditions.*** Living conditions (very poor sanitation, lack of water supply) are a hallmark of poverty in FYR of Macedonia. These conditions are particularly worse for the rural poor but are also difficult for peri-urban residents. Electricity is universally available in both rural and urban areas, but the poor often cannot afford to pay for this service.
- ***Low health status.*** Low education levels (particularly for women) coupled with poor living conditions contribute to the low health status of the poor. The higher infant and

⁹ The qualitative assessment of poverty sheds some light on the ethnic dimensions of poverty. (See Box 3.1 in Chapter 3, for example).

maternal mortality rates in rural vs. urban areas indicates that this problem is more severe in rural areas.

III. Labor Markets and Poverty

ix. Recent labor market developments have been at the root of growing poverty and the changing composition of the poor in FYR of Macedonia. The report finds that, in 1996, particular labor force participants have been harder hit than others over the transition to a market economy.

x. **The working poor.** The decline in real wages is the main reason for growing poverty amongst low-wage workers. *Wage disparity* has increased, mainly as a result of private sector growth, but has contributed far less to the increase in poverty. However, wage dispersion remains amongst the lowest in CEE countries. *Wage uncertainty* has also increased, as many employed do not receive their wages on time, or not at all, reducing worker welfare.

- ***Low-wage less educated workers have lost in both relative and absolute terms during the transition.*** The returns to education are high in the country. Well educated and top paid workers have gained in both absolute and relative terms over less educated and less paid workers.
- ***Private sector growth has helped employ a large number of the low-wage poor.*** The private sector has grown mostly in trade, services, and in agriculture. Over half of low-paid jobs are in the private sector.¹⁰ The private sector also employs the top paid workers in the country.
- ***Poor informal sector workers*** complain of the occasional and seasonal nature of work, the inability to get wages on time, the problems of surviving the winter, and the difficulties of starting up small enterprises (fees, limited collateral, and high interest rates). Seasonal workers have the highest poverty rates amongst all workers.

xi. **The unemployed.** In 1996, unemployment affected a large number of poor. Nearly half of all poor live in households with one or more unemployed worker.

- ***The majority of the unemployed are new entrants to the labor force.*** Unlike many countries in the region, layoffs comprise a small proportion of the unemployed indicating that limited entry, not exit is the reason for unemployment.
- ***The duration of unemployment is extremely high (relative to other countries in the region).*** Unemployment of long duration discourages labor force participation, depreciates labor force skills, and signals a “less productive worker” to the employer.

¹⁰ These results are from the 1996 Household Budget Survey (additional modules).

- ***New private sector hires match the characteristics of the unemployed.*** These are less educated, less skilled, and mainly urban workers. The only exception are women, who are least likely to be hired by the private sector. Women are also more likely to receive lower wages for the same work, particularly in the private sector.¹¹

IV. Public Poverty Alleviation Programs: Does Public Spending Reach the Poor?

xii. The main social programs include: (i) the public health care system; (ii) the public education system; and (iii) a cash transfer system, including *a pay as you go public pension system; means tested child allowances* for the employed and *two new programs—an unemployment insurance system, and a means tested social assistance system* established to combat increasing joblessness over the transition.

xiii. Real spending on social programs declined between 1990-96, as the economy contracted. The decline was not uniform across social programs. Real spending on health, education, and pensions fell sharply, but real spending on social assistance and unemployment insurance increased over the same period.¹² The composition of social expenditures has changed over the transition. The share of *current* social spending--unemployment benefits, pensions and social assistance programs increased--while the share of *investment* spending on (mainly) health and education has declined. In 1996, the Government spent roughly 70% of total budget (30% of GDP) on these programs. Of this the largest share was spent on pensions (44%), followed by education (21%) and health (22%). Child allowances (1%), social assistance (4%), and unemployment benefits (8%) comprised only a small share of public outlays.

xiv. **Education.** The country has made significant gains in raising the education status of the population. Younger cohorts—regardless of income, gender or rural/urban status are much better educated than older persons. The gender gap has been virtually eliminated at all levels of the education system in both rural and urban areas. Moreover, in 1996, rural/urban and income differences have been virtually overcome in attendance in compulsory basic education. The main findings for 1996, are as follows:

xv. **Quality of the education system.** The quality of the education system, or its contribution to learning, has not been formally assessed, either internally, or relative to international standards. Few students report being repeaters or dropouts and some school age children do not attend school because of failure and expulsion. This merits considerable concern and bears further investigation.

xvi. **Low enrollment rates of the poor.** In 1996, enrollment rates at all levels of the education system are lower than regional norms, but are the lowest for the rural poor,

¹¹ The Law on Labor Relations mandates equal pay for equal work. This problem is far less severe in the public sector.

¹² An increase in real benefits and number of beneficiaries in both newly created programs explains this trend. The decline in real resources has also often caused benefit payment delays in all public transfers, compromising the poverty alleviation objectives of all cash transfer programs. Real declines in pension spending are a result of a fall in real benefits; the number of pensioners increased over this period as a result of early retirement policies that were used to facilitate large scale layoffs.

particularly in secondary and higher education. The reasons for non-participation in the education system are diverse and include:

- *Indirect costs*: The need to earn a living to support their families is an important reason for not participating in the secondary education system for the rural poor. Some secondary age children work. This is more characteristic of rural areas than urban areas.¹³
- *Direct costs*: The cost of attending school is another reason for lack of participation in the school system. The poor spend more on education per enrolled child (relative to their income) than the rich. *Books and supplies* are the most important components of private costs in primary and pre-school education. *Transportation costs* dominate private spending at the secondary and post-secondary levels, while *admission fees* are important at the tertiary level.

xxvii. Public spending on education is overall very effective and egalitarian, but this result varies across programs.

- *Primary education is the most effective¹⁴ public program. Public spending on the program is also egalitarian.* Primary education subsidies comprise nearly 13% of total consumption of the poor. The poor receive a share of education spending that is roughly equal to their share in the population.
- *Secondary and higher education spending is less effective than primary education spending; it is also strongly non-poor.* The top 20% of the population receives nearly half of all spending on higher education and scholarships; and over 20% of total spending on secondary education. The low effectiveness and efficiency of public spending on education for the poor merits considerable concern.

xviii. Cash transfers. The four major cash transfer programs (pensions, social assistance, child allowances, unemployment benefits), taken together, have an important poverty alleviation impact. All else being equal, in the absence of public transfer programs the incidence of poverty would have been more than double the current level. The poverty gap would be almost five times as high and the severity of poverty would be even more greatly affected. (This analysis is based on first quarter 1997 household data).

xix. Pensions are extremely effective but very inefficient in targeting the poor. This is not surprising as pension benefits are linked to an individual's past wages. However, the pension system has the largest poverty alleviation impact of any cash transfer program.

¹³ However, unemployment rates are high for this group as a whole. Result is from the Household Budget Survey, Additional Module, 1996.

¹⁴ *Effectiveness* is measured as the share of public transfers or subsidies in household consumption. The higher this share the more effective the program. *Efficiency* is defined in terms of the share of public spending accruing to the poor. *Highly, or extremely efficient* programs are those in which the share of public spending accruing to the poor is higher than their share in total population. *Egalitarian programs* are those where the share of public spending on the poor is equal to the share in total population. Programs that are *moderately efficient* are those where the share in spending accruing to the poor is higher than their share in total consumption, but less than their share in total population. *Inefficient programs* are those where the share of public resources going to the poor are less than their share of total consumption.

- *The pension system has protected pensioners against poverty.* Poverty rates are amongst the lowest for pensioners compared to other population groups. However, many elderly women are not covered by the pension system, and therefore have high poverty rates. This is mainly the result of low labor force participation of women in the past, which means that they do not receive pensions.
- *The protection of pensioners against poverty has come at a very high fiscal cost* imposing a large tax burden on current workers. This decline in the number of contributors due to early retirement and growing unemployment and a very generous pension system (relative to other countries in the region) is the source of current financial problems of the system. In the future, an aging population will lead to increasing pension fund deficits.

xx. **The means tested social assistance system, the only poverty alleviation program, is efficient and effective** in reducing the incidence and depth of poverty. In recent years, the Government has made many changes to the program that have improved its efficiency. In 1998, the Social Assistance Decree was revised to target benefits to households with incomes less than 60% of the poverty line. (Targeting all households up to the poverty line is not affordable for the Government.) Complicated adult/child equivalence scales were revised and work incentives introduced. In addition, administrative problems including an influx of beneficiaries on the same day, and fixed monitoring of claims were addressed. However, problems that still plague the program include:

- *Benefits have often not been paid on time.* There are often two to three month delays in benefit payments to the poor.
- *The new decree may have reduced inclusion errors* (many ineligible households receiving assistance) which, in 1996, were found mainly in urban areas. Income is difficult to measure in a transition economy, where income sources are variable and records and registration procedures are in a nascent form. As a result, the new program may have to be fine-tuned to adjust any remaining problems. The report finds that the *exclusion errors* (eligible households who do not receive assistance) of the social assistance program are very small.
- *Information difficulties constrain delivery of benefits (to clients) and verification of claims (for social welfare officers).* Social assistance recipients claim that lack of information about the program, delayed benefits, and onerous documentation requirements limit the program effectiveness. Social workers also relate difficulties in monitoring and penalizing false claims.

xxi. **Child allowance benefits are neither effective nor efficiently targeted to the poor.** Child allowances are a very small share of household income and they are not well targeted to the poor.

xxii. **Unemployment benefits are neither effective nor efficiently targeted to the poor.** Unemployment insurance benefits are progressive and do reduce poverty, though their impact is quite marginal. It should be noted that the primary purpose of unemployment benefits is to replace income. The program is not intended to be pro-poor.

xxiii. **Institutional care.** Some poor or disadvantaged groups are without families and are under the care of institutions. These groups, marginalized from traditional family structures are perhaps the most disadvantaged groups in the population.

- A growing number of (mainly Macedonian) *elderly* are becoming institutionalized as family structures break down either due to financial problems or as a result of the migration of younger family members from rural to urban areas.
- *Disabled* children and adults are institutionalized under poor conditions and receive limited care and attention. Their education possibilities are limited.
- *Orphans* are also a vulnerable group. There is a growing problem with older institutionalized children (18 or so) who are having difficulty integrating into society, particularly given the lack of jobs. On the positive side, there appears to be some demand for adoptive children in FYR of Macedonia. However, adoptive parents are not screened properly and post-adoptive monitoring is limited.
- *Disability allowances for children* and foster care allowances have often been delayed due to budgetary constraints.

VI. Policy Implications

xxiv. The profile of the poor suggests that medium to long term poverty alleviation programs and policies should focus on *six* basic elements:

- **The promotion of economic growth** that increases employment and real wages to help alleviate poverty amongst the new poor. Easing rigidities in financial, land, and labor markets would help ease constraints for the promotion of small and medium enterprises.
- **Investment in human capital (both its quality and availability)**, particularly of the rural poor, to promote economic growth and alleviate long term poverty;
- **Well targeted, financially viable cash transfers** (with adequate work incentives), for the short term unemployed
- **Investment in community infrastructure** (water, sanitation, electricity), particularly in rural areas, to improve living standards. This investment in physical infrastructure together with investment in education and health sector reform,¹⁵ would help improve the health status of the population.
- **Community-based care** (and cash/in-kind transfers), based on an assessment of the financial and economic feasibility of these programs, for the chronic poor. Such programs could potentially focus on children at risk, disabled, and on non-pensioned elderly.
- **Continuous poverty monitoring** to identify changing poverty patterns and to assess the impact of the Government's poverty alleviation programs.

Each element of this strategy is discussed in detail below.

¹⁵ Health reform issues are outside the scope of this report.

xxv. **Promote economic growth** The decline in real income and wages, and growing joblessness, are the main reasons for increasing poverty in the country, earlier and also as a result of the recent crisis. Thus, particularly once the Kosovo crisis has abated, and trade is no longer constrained, efforts to promote economic growth that raise real wages and increase employment will be essential for poverty reduction. Two positive trends can be noted by the report in this regard. First, private transfers, in the form of remittances, have been very important in improving household welfare and reducing poverty particularly in rural areas. Second, and more importantly, private sector growth has been concentrated in less skill intensive industries—agriculture and trade. This is a striking difference between FYR of Macedonia and other economies where the private sector has generated demand for highly skilled workers. As such, private sector growth has helped employ a large share of the low-wage workers, particularly in rural agricultural jobs. Without this development, the unemployment and rural poverty problems in the country would have been far worse. Growth in the private sector that is skewed towards the creation of less skilled jobs should help reduce the depth of poverty amongst the unemployed.

xxvi. Measures to spur economic growth led by the private sector will need to focus on increasing labor market flexibility. Labor market restrictions and a weak financial sector continue to curtail robust economic activity. Labor turnover remains low and the unemployment rate had increased to over 30% by 1998. Despite privatization, labor adjustment remains incomplete. Many enterprises remain insolvent and over-staffed, supported through the accumulation of wage arrears and soft loans from banks. And, despite real declines in wages, labor costs (gross wages/GDP as well hiring/firing restrictions, etc.) remain higher than in neighboring countries with similar levels of income. Efforts are also required to promote the development of efficient financial markets that would help lower the cost of capital to small entrepreneurs, and instituting land titling procedures that would allow individuals to use land as collateral for loans, and easing fees and other restrictions on registration of small enterprises. Creating off farm employment, and agricultural sector reforms that ease rigidities in the pricing, sales, and marketing of agricultural products, and ensure that extension services and information services reach the poorest farmers.

xxvii. There are five caveats. *First*, the poor are concentrated along the poverty line. Thus, small changes in economic growth will have a large impact on poverty. However, it will take considerable, sustained economic growth to reduce poverty completely. *Second*, the creation of low-paid jobs will not reduce ‘poverty’ amongst workers. Given the large pool of unemployed and the potential for further layoffs, it will require a significant growth in real wages of less skilled workers to reduce poverty amongst the employed. *Third*, private sector growth may further increase disparities amongst workers. The worsening of the distribution of income, even as the decline in consumption has leveled off, should be monitored carefully. If recent trends are any guide, less educated individuals are the most vulnerable to this process; *Fourth*, the resumption of growth will require an aggressive restructuring of insolvent and overstaffed enterprises. While this will help improve economic performance over the long run, poverty amongst affected workers may actually increase over the short term. *Fifth*, many poor, particularly those not capable of work, may not benefit directly from economic growth.

xxviii. **Reduce labor market restrictions.** Reducing labor market restrictions (wage rigidities, hiring/firing costs, high minimum mandatory benefits) that constrain the employment of less skilled workers most vulnerable to the restructuring process will be critical for reducing poverty. Four measures are recommended:

- **Reduce high labor costs.** The Government has to take important steps in this regard: e.g. Hiring restrictions and excessive termination restrictions on small entrepreneurs should be reduced, and the court review of the rationale for small scale terminations should be severely curtailed.
- **Reduce remaining labor market rigidities** and adverse work incentives. These include: (i) eliminating or significantly reducing special benefits to unemployed with 25 years of contributions. (ii) further reducing the duration of unemployment benefits.
- **Reduce high payroll tax rates** and contain the growing informalization of the economy by reforming the social insurance systems (health, pensions, and unemployment insurance). Arresting the informalization of the economy would help improve tax compliance, and allow an enforcement of (less restrictive) labor contracts (including addressing discrimination against women); promote timely payment of wages in the private sector,
- **Minimum wages, if introduced, should be kept low as possible.** There is no public minimum wage in the country and this policy should continue, given the high level of unemployment of unskilled workers. Minimum wages tend to discriminate against the hiring of less skilled, poorer workers and perpetuate poverty amongst this group. However, if such public minimum wages are introduced, they should be kept as low as possible.

xxix. **Investment in human capital.** *Education has a high rate of return in FYR of Macedonia.* Investment in human capital is likely to be the most important longer-term poverty alleviation and growth strategy for the country. The Government is in the process of developing an education sector strategy to improve the quality, efficiency, and equity of the education system. The strategy should also focus on improving the participation of the poor in the education system:

- **Increase participation of the poor in the education system** The participation of poor students at all levels of the education system should be increased, but efforts should focus on the rural poor, and on secondary and higher education. Efforts should also focus on integrating minority populations (e.g., gypsies), and those with disabilities (cost effectively) into the education program. While qualitative reports point to a potential cultural, security constraint to the participation of Albanian girls in secondary education, it was difficult to assess ethnic differences using available data.
- **Reduce the direct costs of the education system.** Reducing the costs of education for the poor is one way of increasing their participation in the education system. The direct costs are essentially textbooks and books/supplies at the primary school level, transportation/boarding for the poor at secondary and higher education levels, and fees at the tertiary level. Introducing merit and needs based scholarships and re-

directing boarding subsidies towards the poor might be considered for increasing the enrollment rates of poor students.

- ***Improve efficiency of education spending, including targeting the poor.*** Real spending on education should not be reduced. However, there is scope for (i) shifting public spending on education from non-poor to poor through greater cost recovery in secondary and higher education; (iii) shifting public spending over time away from financing wage costs to non-wage investment costs; (iv) shifting social spending from current benefits (mainly, pensions) towards spending on education.

xxx. **Investment in community infrastructure.** *Investment in water supply and sewerage availability* will be essential, particularly in rural and peri-urban areas. Along with investment in education, this type of community-based investment would help improve the living standards and the health status of the poor. *Lifeline electricity rates* that provide a subsidized rate for the first few kilowatt hours used might be considered to help defray electricity costs for the poor.

xxxi. **Well targeted cash transfers.** Cash transfers, particularly pensions, help alleviate poverty but at considerable costs. Spending on pensions should be reduced, while other cash benefits should be better targeted and include incentives to work.

xxxii. **Reduce scope of public system and introduce private pensions.** Alleviating poverty in old-age, in a fiscally sustainable way, requires major pension reform that will reduce the scope of the public system, and allow individuals to save in well regulated privately managed schemes. This reform would help reduce high payroll tax rates and should help reduce poverty amongst the young without any adverse impact on pensioners. Over time, greater provision of private life and disability insurance would allow individuals to obtain greater coverage against disability and loss of life of the earning member.

xxxiii. **Fine tune and monitor social assistance reforms.** The program has been recently reformed, based in part on the findings of this report. The reform has eliminated unjustified rural/urban differences in benefits levels, simplified a complex benefit scale, introduced work incentives, and improved benefits administration.

- ***Reduce Disincentives to Work.*** The level of the social assistance benefit is established on the basis of fiscal considerations with the poverty line as a point of reference. However, minimum benefits also need to be coordinated with wage developments. Currently the minimum income for a single person household is 17% of average wage, but for a four person household (the average family size) the minimum income guarantee is 40% of wages. Given the growth in low-wage jobs, this level of benefit (almost equal to the minimum pension) reduces incentives to work. This benefit scale reflects recent reductions, but will have to be adjusted downward in the future if it constrains the beneficiary outflow from the system. In addition, while the recent changes in the decree may have reduced inclusion errors, further tightening of eligibility conditions may be required to further reduce false claimants from gaining access to the system.

- *Work incentives may be difficult to administer and should be monitored carefully.* The introduction of a term limit to social assistance of four years, and a gradual reduction in benefit over this time, may be difficult to enforce and administer. The ability of this incentive to keep individuals off social assistance rolls will have to be monitored carefully and fine tuned over time.
- *Pilot proxy means test approach to social assistance benefits* This approach targets social assistance to the poor based on simple, identifiable characteristics of poverty, reducing the administrative burden of the social assistance system. Empirical estimates indicate that such a program could help identify the bulk of the poor in the country, but an assessment of its fiscal costs and targeting efficiency vis. a vis. the current program and potential implementation issues would require further work and a pilot test.

xxxiv. **Phase out child allowance program.** Targeting the small amount of child allowances to households with two or three or more children will not have a large impact on poverty reduction. In any case, the social assistance is fairly effective in reaching poor households with many children. One possibility will be to use the number of children as an indicator for poverty in a proxy means test for the social assistance system.

xxxv. **Develop community-based approach to alleviate chronic poverty.** Institutionalized care is costly, and removing individuals from their own communities reduces the welfare of the chronic poor. Developing a community-based care program, focusing on poverty alleviation for children at risk, disabled, and non-pensioned elderly, with NGO involvement and support could be the focal point, along with cash transfers, of poverty alleviation efforts for the chronic poor. To de-institutionalize vulnerable groups, foster and adoption programs might be publicized, and the screening and monitoring of foster and adoptive parents could be improved. A full evaluation of the costs and associated benefits of this approach should be undertaken. Further child disability allowances, and allowances for foster parents, often delayed in the past, should be adequately budgeted and paid on time.

xxxvi. **Improve poverty monitoring capacity.** The Government has taken considerable interest in understanding the nature of poverty in the country. The Poverty Monitoring Group, comprised of members of the Ministry of Labor and Social Policy and the Statistical Office of FYR of Macedonia, has been active in participating in the development of the Poverty Report—both quantitative and qualitative aspects. The Group has expanded to include the Macedonian research community to evaluate the qualitative aspects of poverty. The poverty monitoring capacity of the Government could be improved through the following measures:

- *Monitor poverty incidence and the effectiveness and efficiency of cash transfer programs.* The incidence of poverty, program effectiveness and efficiency measures, based on the Household Budget Survey, should be investigated on a regular basis. Periodic sampling of client concerns in all programs through a social assessment of poverty should be instituted for all main social programs. This social or client based assessment could be carried out by the Ministry of Labor and Social Policy, with the involvement of other ministries, and with the assistance research institutes and the

Statistical Office. It could also be investigated through an add-on questionnaire along with the Household Budget Survey.

- *Improvements in Household Survey sampling efficiency and measurement.* Measures include: improvements in the sampling efficiency of the survey, the measurement of consumption (less detailed), separation of the consumption and income modules, to reduce under-reporting of income.

I. POVERTY: CHARACTERISTICS AND TRENDS

1.01 The objective of this Poverty Assessment Report is to inform policies and programs to address poverty in the former Yugoslav Republic of Macedonia. To this end, the report traces the evolution and characteristics of poverty; and evaluates the effectiveness of public poverty alleviation programs in achieving their stated objectives. The important link between labor market status, education, cash transfers and poverty found by the report has focused the Poverty Assessment on three key themes: (i) poverty trends and in-depth characteristics; (ii) labor markets and poverty; and (iii) poverty alleviation programs and policies (the education system and the cash transfer programs). These themes also serve to organize the chapters of this report. Two annexes support this report: *Annex 1 Data and Measurement*, discusses data, sources and limitations, and the basic measures of welfare used in this report; and *Annex 2: the Statistical Appendix*.

1.02 The objective of the first chapter is to identify characteristics of the poor and the determinants of poverty. The *first* part of this chapter describes the development of poverty during the early years of the transition: 1990-96. This analysis is based on the Household Budget Survey carried out annually by the Statistical Office of Macedonia. The *second* part of the chapter describes poverty and its determinants in 1996. The results presented in this section are based on an 'add on' survey which increased the sample size and scope of the Household Budget Survey data collected in the final quarter of 1996. This was done in order to provide an in-depth review of the socio-economic characteristics of poverty. This entire chapter, and the chapters that follow, also rely on a social assessment of poverty, based on in-depth interviews with the poor, that complements the quantitative review of poverty. This social assessment was carried out in early 1998 by the Institute for Sociological and Political Research, in Skopje, in collaboration with academics and representatives of the Statistical Office and the Ministry of Labor and Social Policy.

1.03 The impact of the Kosovo crisis on poverty is described in a separate Box, "The Kosovo Crisis and Poverty" in the beginning of this report. As noted there, the conflict and ensuing economic disruption are likely to increase poverty by 3-4% and deepen its effect on the vulnerable groups of poor identified in this report: the unemployed, low-wage workers, agricultural and rural households. The basic determinants of poverty, education and labor force status, and the concentration of poverty in rural areas are likely to remain the same.

A. Defining the Poor

1.04 Describing poverty requires a definition of the poor. Consistent with OECD norms, the Government of the former Yugoslav Republic of Macedonia has chosen a relative poverty line to define poverty in the country. According to this definition of poverty, individuals with an income (consumption) below 60% of median monthly 1996 consumption -- or 33,061 Denars per year and 2755 Denars per month -- are defined as poor (Annex 1). This official relative poverty line (approximately \$50.00 per month or

Box 1.1 Perceptions of Poverty.

How poor Macedonians explain and experience poverty is influenced by their previous socio-economic status. Those who were relatively poor before consider poverty the inability to meet minimal needs for food, cooking and heating fuel, shelter, and medical care. For both urban and rural families, hunger is the worst aspect of poverty. A villager summarized poverty as the fact that she and her husband eat only once a day so their children have enough to eat. Poor households "pray that they will not become ill," considering illness "a death sentence" because they know they will not be able to manage the many expenses that even insured households must pay. People who thought of themselves previously as middle class define poverty more broadly as the loss of social status, the impossibility of buying clothes for their children, and the inability to enjoy cultural events or celebrate holidays with friends. Particularly urban households, which rely more than rural households on electricity for heating and cooking, describe getting their electricity cut as a very humiliating sign of poverty. An urban woman explained: "Poverty is the fact they cut off our electricity; this has already happened two times. Can you imagine life without electricity in the middle of a city?"

"I was a common worker in a textile factory. When I worked, I was able to buy an apartment and furnish it using credits from the factory where I worked and from the banks. Two years ago, when I had to buy a hearing aid, my request for help was very rudely refused by the factory where I had worked my whole life and where I had actually lost my hearing."

Respondents feel that the Government should be devising a programs and opening factories to employ people. Poor people: "They closed the factories and left the people without bread." Many respondents thought that enterprise managers deliberately ran enterprises poorly so they could buy them cheaper during privatization: "What the workers were building for years was stolen in one month by a manager who never worked in our company. He left 75 people without work." Respondents who had not been part of the skilled labor force were more inclined to attribute their poverty to their own lack of education and work qualifications. Those who used to work abroad blamed other countries for effectively closing Macedonian borders by refusing to issue visas.

\$1.7 per day) to construct the poverty profile and evaluate the determinants of poverty in this report. However, a slightly higher poverty line (70% of the 1995 median adult equivalent consumption) is used to profile changes in the level and composition of poverty over time.¹ This is because the small sample size of the Household Budget Survey (600 households) does not yield very sound results on the composition of the poor at the low level of consumption represented by the official poverty line.²

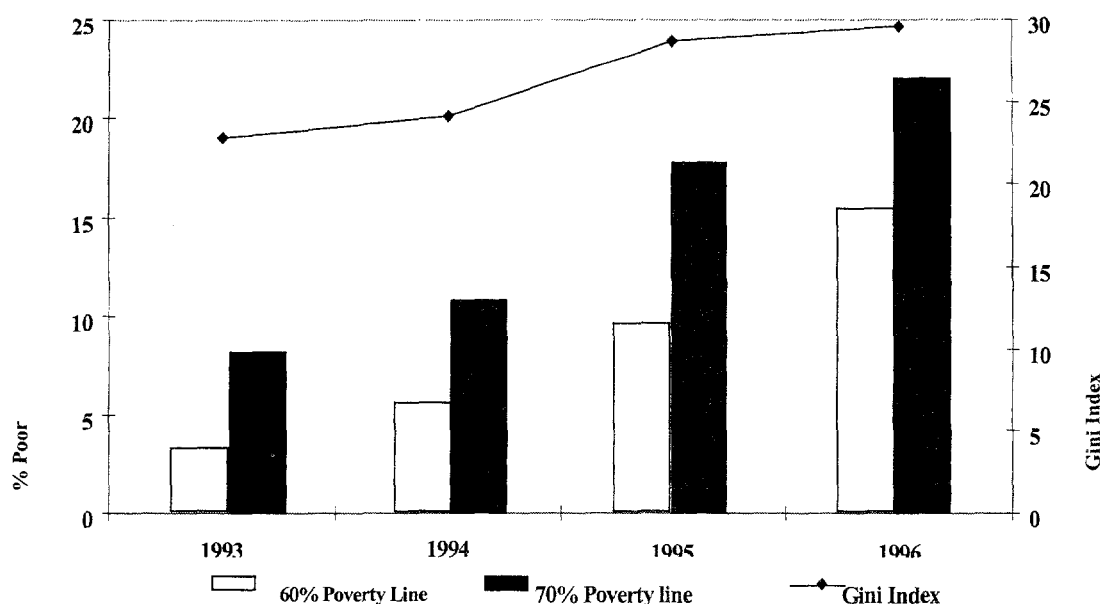
1.05 The measurement of poverty is based on a few key indicators. The *poverty rate* (the incidence of poverty) is the proportion of poor in a particular group. Groups with high poverty rates may be small in relation to the total poor population. *The proportion of a particular group in the total poor population* is therefore important for identifying the size of the poverty problem. The *expenditure gap ratio* (hereafter referred to as the *Poverty Gap*)³ captures the difference between the average consumption of the poor and the poverty line as a proportion of the poverty line. The greater this measure, the lower inequality of income or consumption. The higher this measure, the greater the inequality

¹ The 1995 median adult equivalent consumption was used to construct the poverty line used for over-time analysis because this study was completed before 1996 data became available. The 1996 data were later added to this analysis.

² However, the report provides an assessment of changes in the poverty rates (national, rural, and urban) over the entire range of possible poverty lines (including the official poverty line).

³ The Poverty Gap differs from the Poverty Gap Index. [See Annex 1]

Figure 1.1: Growth in Poverty and Inequality



of the average consumption level of the poor relative to the poverty line, and the “deeper” or more serious the condition of the poor in the country. The Gini Index is a measure of the inequality of consumption. The higher the index the greater the inequality in the distribution of consumption. The empirical measurement of poverty is supplemented by the qualitative assessment of poverty that elicits a more personal assessment of poverty by the poor. The “personal experience” of poverty experienced by different groups of poor is summarized in Box 1.1.

B. The Evolution of Poverty over the Transition: 1990-96

1.06 Poverty Trends. As in all Central and Eastern European countries, poverty increased in Macedonia in the early years of its transition to a market economy. However, the increase in poverty over the transition was not uniform. The poverty rate increased slightly between 1990-91;⁴ rose rapidly between 1993-95, and continued to increase between 1995-96. In general, the increase in poverty is a result of two factors: a decline in consumption and/or a growing inequality in its distribution. For 1990-96 as a whole, the main reason for the growing poverty in the country was a sharp decline in real consumption. The inequality of consumption grew but contributed far less to the growth in poverty. However, the growing disparity in consumption has become increasingly important in explaining the increase in poverty over time (Annex 1). In 1995-96, it was the major factor explaining growth in poverty.⁵ The poverty gap remained fairly constant

⁴ Poverty declined between 1992 and 1993. This may be due to the exceptionally high rate of inflation in 1992, and the fact that the currency was re-denominated (scaled down by a factor of a 100) in 1993. The possible error introduced by annualizing income and expenditure data and an annual CPI may be particularly severe. This problem introduced a discontinuity in the data. Therefore the report focuses on two sub-periods, 1990-91 and 1993-96.

⁵ Changes in the poverty rate are sensitive to the poverty line chosen for two periods: 1990-91; and 1995-96. In the former, poverty falls at low poverty lines, but reverses (or increases) at poverty lines above a particular threshold. In the latter period, the poverty rate increases for low poverty lines, but will show a decrease if very high consumption levels are chosen to describe poverty. (See Annex 1 for details)

Table 1.1: Change in the Level of Real Household Income & Consumption, 1990-96
(Monthly Per Adult Equivalent 1995 Denars)*

	1990	1996	% Change 1990-1996	Contribution By Components
Total Consumption	245,138	176,793	-28%	-28%
Food	113,362	82,385	-27%	-13%
Clothing	26,476	13,667	-48%	-5%
Housing	27,978	20,850	-25%	-3%
Health	9,738	9,291	-5%	0%
Education	13,134	5,681	-57%	-3%
Transportation	18,963	18,039	-5%	0%
Other	35,489	26,880	-24%	-4%
Total Income	270,367	175,916	-35%	-35%
Formal Job	181,313	99,985	-45%	-30%
Other Earnings	10,170	11,802	16%	1%
Social Transfers	32,726	30,971	-5%	-1%
Other	46,158	33,158	-28%	-5%

These numbers in this Table and Table 1.2 below are calculated on the basis of equivalent adult and not simple averages therefore may differ from those published by the Statistical Office. The categories of income and expenditure are also aggregated slightly differently than those used in the Statistical Office. [Other earnings includes income from self employment, agriculture, while other income includes income from gifts and private transfers, such as remittances].

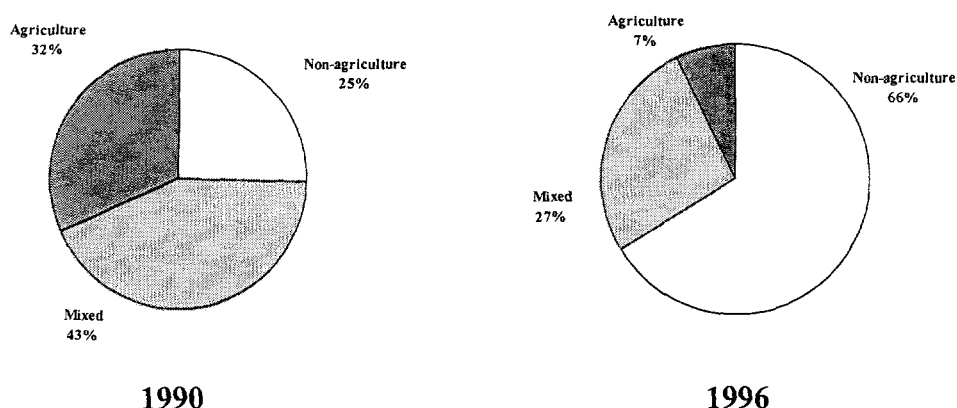
over the entire period, and increased sharply in 1995-96. Nevertheless, the distribution of consumption still remains fairly egalitarian by regional standards. The Gini coefficient, a measure of income inequality, was almost 30% in Macedonia (1996) compared to 45% in Russia (1993) and 54% in the Kyrgyz Republic (1993).

1.07 The sharp decline in real household income realized over the transition is mainly attributable to a fall in real wages, or earnings from a formal job (Table 1.1). The decline in social transfer income was far less dramatic. Other household earnings which include income from self-employment, or agriculture, actually increased over the transition. Households reduced real consumption to adjust to the fall in income. However, the fall in consumption, largely a result of curtailed spending on food, was somewhat less than the decline in real income, perhaps because households could draw on their savings. The decline in income was accompanied by a change in its *composition*. (Table 1.2).

Table 1.2: Change in the Composition of Income and Consumption, 1990-1996.

Consumption	1990	1996	Income	1990	1996
Food	46%	49%	Formal	67%	62%
Clothing	11%	8%	Other	4%	4%
Housing	11%	11%	Social	12%	20%
Health	4%	5%	Other	17%	14%
Education	5%	4%			
Transportation	8%	7%			
Other	14%	15%			
Total	100	100	Total	100	100

Figure 1.2: Changing Composition of the Poor, 1990-1996.



The share of income from a formal sector job declined, while the share of income from social transfers increased commensurately. The composition of consumption did not change greatly over this period. There was an increase in the share of a household's spending on food and health, matched by small declines in the budget shares of clothing, transportation and education. Food remains the important consumption item, with a typical household spending roughly half of all expenditures on food (Table 1.2).

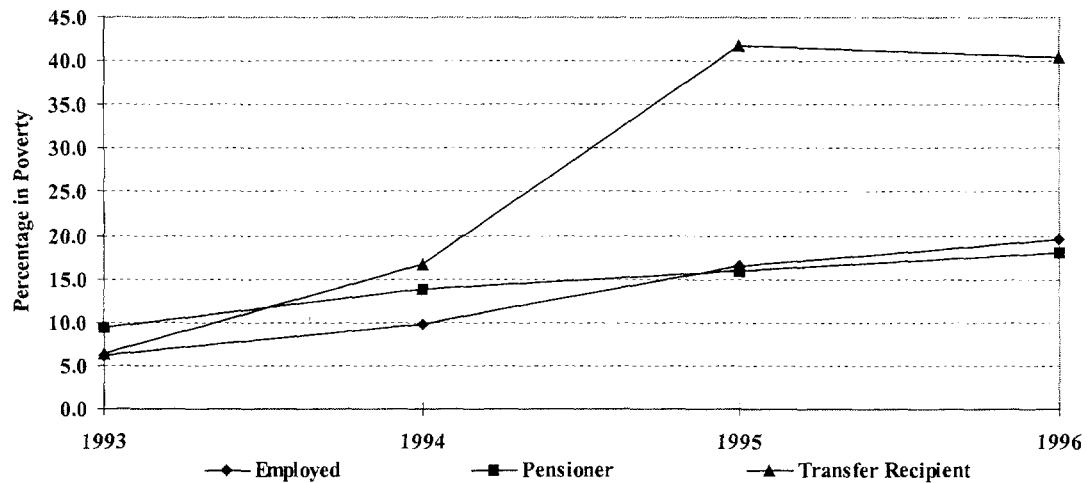
1.08 Longer Term and Newly Emerging Poor. The transition has increased poverty rates for all households, no matter their location, occupation, demographic composition, or major source of income.⁶ Four major trends merit attention. First, high poverty rates persist amongst rural agricultural households and in households with many children. Poverty amongst these households therefore represents a longer term aspect of poverty in the country. Second, there has been a major shift in the composition of poverty over the transition (Figure 1.2). In 1990, the majority of the poor resided in rural areas, in mixed or *agricultural* households.⁷ In 1996, poverty still remains a rural phenomenon, but the bulk of the poor are *non-agricultural* households. Thus, it is the source of income (agricultural vs. non-agricultural) rather than the location of the household (rural vs. urban) that explains the increase in poverty over the transition. Households with access to agricultural income have weathered the transition better than other groups.

1.09 Third, the socio-economic composition of poverty has also changed. A new group of poor has emerged, composed of households headed by the unemployed or those in receipt of cash transfers (social assistance). Over the 1993-1996 period these households have realized the sharpest increase in the incidence of poverty (Figure 1.3). The emergence of this new group of poor has been observed in many transition

⁶ There are discontinuities in poverty rate trends between 1990-19991 and 1993-1996 because of the 1992 hyper-inflation year.

⁷ The proportion of agricultural households is very small in 1996, therefore 1996 results should be interpreted with care.

Figure 1.3: Changes in Poverty Rates by Socio-Economic Group, 1993-1996.



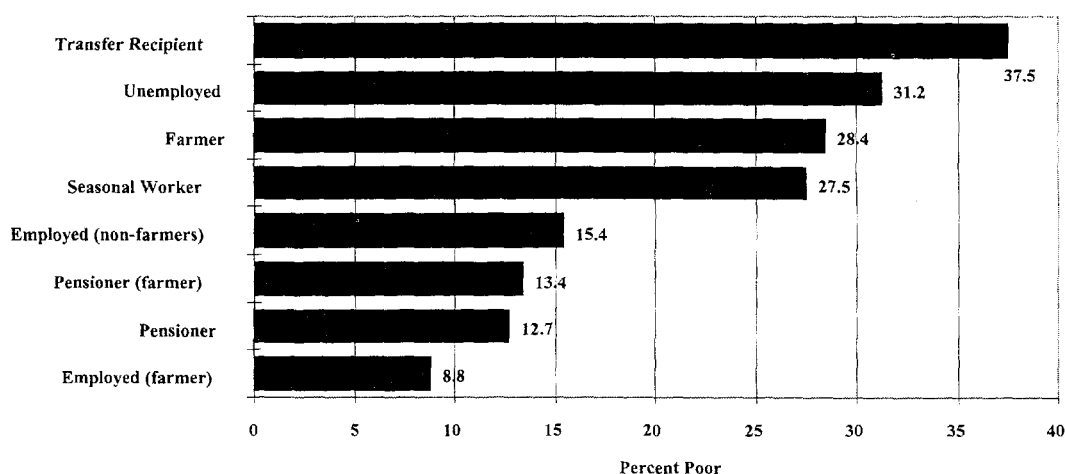
economies, due to loss of jobs. These households comprise an increasing share of the total population and particularly of the poor. Thus, the brunt of the poverty increase has been borne by new groups of poor. Poverty rates for pensioner headed and employed households has also increased over the period, but households headed by the employed have seen a greater increase in poverty rates than pensioner headed households. Finally, the *age* composition of poverty has changed over the transition. In 1990, poverty incidence was highest amongst older household heads. Over time, poverty rates amongst younger households heads have increased, perhaps because of the increased joblessness of their members (Box 1.2).

C. The Characteristics of the Poor, 1996

1.10 The poverty developments defined above created a new profile of poverty in 1996. How do the poor differ from the average household in that year? A snapshot of the socio-economic characteristics of the average household in the former Yugoslav Republic of Macedonia in 1996 indicates that a little less than half of all the population lives in rural areas. The average household size is 4.1 persons, and the head is on average 53 years old. Nearly two thirds of the population resides in an extended family. In 14% of households, the head is a woman. In about one out of four households, either the head or spouse is absent from the household at least part of the year. This may be a reflect seasonal or permanent migration of household members in search of jobs. The educational profile is fairly typical of the region: more than half of heads of households have primary education or less; one third have completed secondary education; and a little more than a tenth have university or other post-secondary education. Household association with the labor market is captured by three key statistics. The average Macedonian household derives 44% of its income from wages. Almost one in three households has an unemployed person in residence. Only 6% of the households own an enterprise (Annex 2, Table 1).

Table 1.3: Poverty and Inequality Indicators, 1996.

	Poverty Rate	Poverty Gap Index	Poverty Severity Index	Poverty Gap	Composition of Poor	Composition of Population
<i>Type of Settlement</i>						
Total	18.1	3.9	1.3			
Urban	10.2	1.9	0.6	18.6	32.1	54.5
Rural	25.7	5.8	2.0	22.6	67.9	45.5
<i>Region</i>						
Northwest	18.4	5.2	1.9	28.3	21.6	20.2
Northeast	23.5	5.2	1.8	22.1	36.7	26.9
Southwest	13.9	2.0	0.5	14.4	15.0	18.5
Southeast	6.8	1.2	0.3	17.6	4.6	11.5
<i>Socio-economic Category</i>						
Agricultural	25.3	4.1	1.0	16.2	10.8	7.3
Mixed	15.2	4.3	1.6	28.3	23.4	26.6
Non-agricultural	17.2	3.4	1.1	19.8	65.9	66.1
<i>Children < 18 years</i>						
0	9.1	2.0	0.7	22.0	14.1	26.6
1	11.7	2.3	0.6	19.7	13.5	20.0
2	14.6	2.5	0.8	17.1	28.6	33.8
>3	38.6	9.5	3.4	24.6	43.8	19.6
<i>Gender of Members</i>						
Male	17.7	3.9	1.3	22.0	51.6	50.2
Female	16.8	3.5	1.2	20.8	48.4	49.8
<i>Age of Members</i>						
0 to 5	22.3	4.7	1.6	21.2	10.0	7.8
6 to 18	20.9	4.5	1.5	21.5	26.8	22.1
19 to 29	20.6	4.8	1.7	23.3	20.0	16.7
30 to 39	17.0	3.5	1.2	20.6	14.3	14.5
40 to 49	12.4	2.7	0.8	21.8	9.9	13.8
50 to 59	11.0	2.5	1.0	22.7	6.7	10.6
>60	14.5	2.8	0.8	19.3	12.2	14.6
<i>Education of Head</i>						
Primary(<4years)	22.9	5.4	2.0	23.6	36.8	27.7
Primary(5-8 years)	25.1	5.7	1.9	22.7	44.4	30.5
Specialized Secondary	8.2	1.2	0.3	14.6	14.6	30.5
High School	8.5	1.1	0.2	12.9	2.6	5.3
University	4.9	0.7	0.1	14.3	1.6	5.5
<i>Socio-economic Status of Head</i>						
Employed (non-Farm)	15.4	3.1	1.0	20.1	33.9	37.9
Farmer	28.4	5.3	1.4	18.7	15.9	9.6
Unemployed	31.2	7.7	2.5	24.7	12.7	7.0
Pensioner	12.7	2.2	0.7	17.3	16.5	22.4
Employed(Farmer)	8.8	2.7	1.1	30.7	5.1	10.1
Pensioner(Farmer)	13.4	4.7	2.1	35.1	6.1	7.8
Seasonal Worker	27.5	3.9	1.0	14.2	4.0	2.5
Other	37.5	9.8	4.5	26.1	5.8	2.7

Figure 1.4: Poverty and Socio-Economic Status

1.11 Location and Socio-Economic Status. The 1996, at the official poverty line, about 20% of all households can be defined as poor.⁸ (Table 1.3)⁹. Nearly half of all the poor households are headed by those who work. Of these, the majority, or two thirds, are headed by wage earners and the remaining third are farmers. The remaining half, or non-working poor, are almost evenly divided between those headed by pensioners and unemployed/social assistance recipients. Poverty incidence varies greatly across socio-economic group. The two groups with a high incidence of poverty are households where the head is unemployed, or for whom *non-pension social transfers* are the main source of income.

1.12 Seasonal workers and farmers (with no fixed incomes) have the second highest poverty rates. (Figure 1.4), followed by wage earners and pensioners. Households headed by wage earners with access to farm income have the lowest poverty rates overall. Multivariate analysis indicates that a wage job has a very important and large negative impact on the likelihood that a household is poor. Ownership of an enterprise, also concentrated amongst wage earners, has a similar negative effect on the chances of being poor. The ability of a household to have a wage job either provides it with the ability to start up an enterprise (through greater accumulated wealth or improved ability to borrow, for example), or these households are better able (given a steady income source) to engage in entrepreneurial activities (Annex 2, Table 7).

1.13 There is a clear benefit to having more workers in the household. The rate of poverty incidence and the poverty gap and severity indices all decline as the number of workers increases.(Annex 2, Table 6).¹⁰ However, the *absence of a spouse -- for reasons*

⁸ The difference in the level of poverty at the official poverty line shown in Figure 1.1 and Table 1.3 is attributable to different price deflators. In Figure 1.1 the poverty trends are in poverty lines that are established as a proportion of 1995 median adult equivalent consumption; Table 1.1 provides poverty measures estimated in 1996 Denars.

⁹ The categories used in this table for education and socio-economic status are from the 1996 Household Budget Survey Additional Module.

¹⁰ The rate of poverty incidence only rises again for 3 or more workers.

Box 1.2 Poverty and Youth.

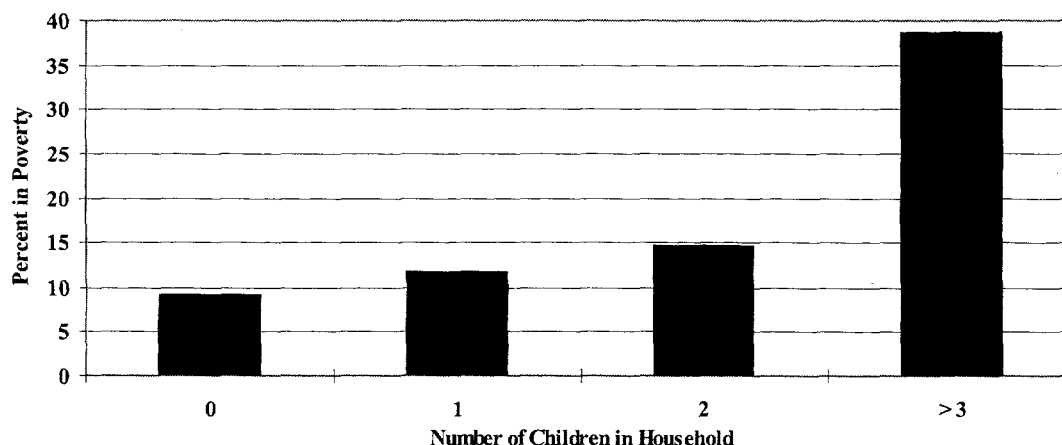
Poor respondents concurred that the economic situation is hardest on youth. Parents regretted that their children would never have the opportunities they had enjoyed. Most of the jobless youth interviewed expressed disappointment and pessimism about their future. Alen explained that he wondered "whether it's better to work or not to work. If I could get a job and receive the average Macedonian salary, I would only have enough money to eat a bit better, and a whole life would not be long enough for me to save enough money to buy myself an apartment or a car."

Young Macedonians feel socially isolated and saw their unemployment as the main reason. They avoid associating with people their own age because they could not afford to socialize (which in Macedonia means gathering in bars and cafes). Vasil, 20, told us, "I feel useless in this society. I am looking for a job and can't find one. I don't want to ask my parents for money because I know they don't have it. I avoid girls because I am ashamed of finding myself in a situation where I couldn't at least pay for my own drink."

of work -- actually increases household welfare and reduces the likelihood of being poor. At least 2/3 of the cases with this characteristic are female heads of household and in most cases the reason for absence is migrant labor. These households likely have access to remittances which may help explain their low rate of poverty. Finally, being a recent migrant also reduces the likelihood of poverty, but labor mobility appears limited -- there are only 2% of all households that report having migrated.

1.14 Household Size, Gender and Age. Consistent with other countries in the region, in 1996 the poor reside in larger households. However, it is the number of children, rather than the number of adults, that has a strong impact on the poverty status of a household. In particular, households with three or more children have the highest poverty rates relative to households of other family size and composition (Figure 1.5). These households comprise a large share -- almost half -- of all poor.

Figure 1.5: Children in Poverty 18 Years and Less.

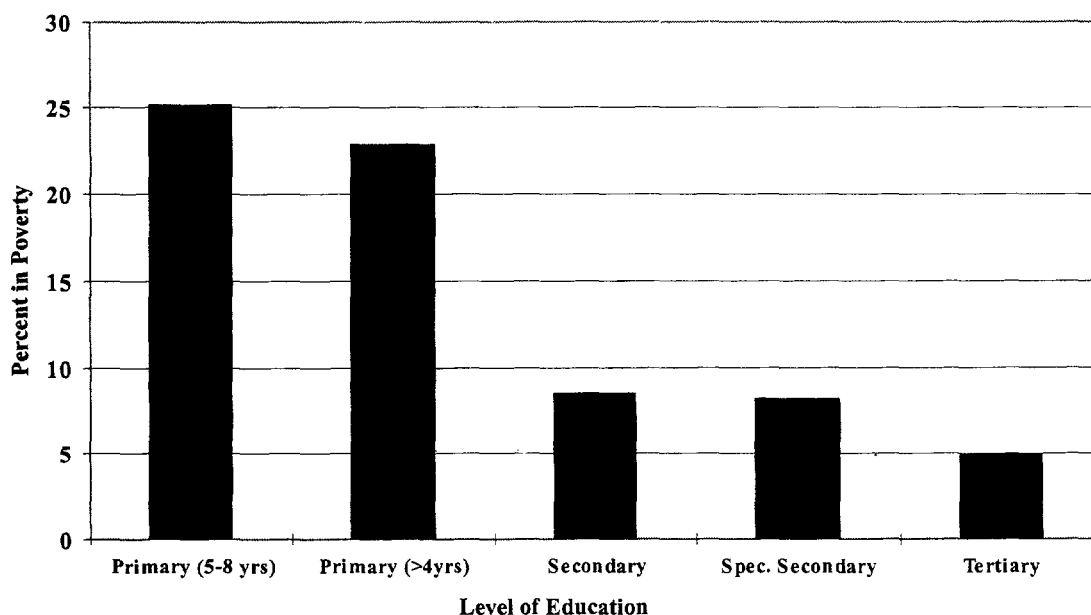


1.15 Poverty rates are lower for female vs. male headed households. Female heads of households are on average ten years older than male heads of household, and have less formal education. However, female headed households are smaller in size, have fewer unemployed members, are not agricultural, and derive their income mainly from pensions. The latter four factors mitigate the likelihood that a female-headed household is poor. Once these factors are accounted for however, there is no net effect of the gender of the household head on poverty.

1.16 A simple correlation of poverty with age indicates that the incidence of poverty remains somewhat higher at *lower ages and amongst the aged*. (Annex 2, Table 17). Children and individuals younger than 30 are more likely to be poor than older persons. However, the very aged are also poor. A pronounced *life cycle effect* is evident with welfare increasing until age 62 and declining thereafter. The probability of being poor increases sharply after age 67 (Annex 2, Table 7).

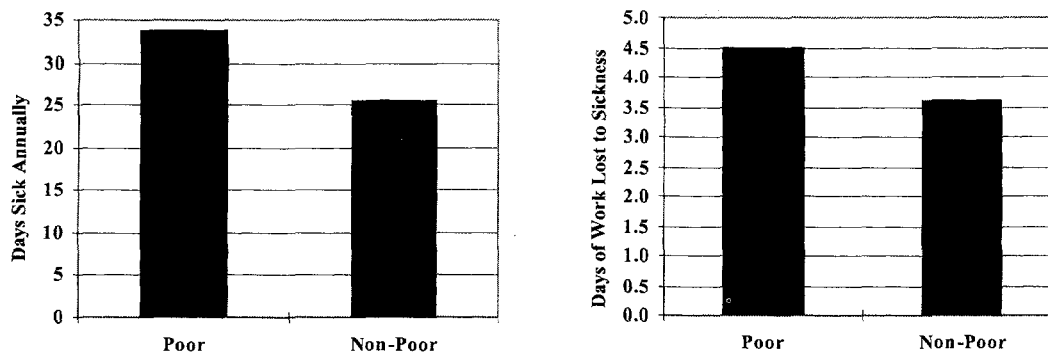
1.17 **Education and Health.** The education status of the household head plays a fundamental role in determining the household's poverty status (Figure 1.6). Households headed with individuals with primary education have the highest rates of poverty and account for a staggering 80% of the poor population. (Table 1.3). Households with less educated heads have greater poverty gaps as well. Multivariate analysis,¹¹ which assesses the relative importance of each particular characteristic (while controlling for other key factors) indicates that *education* has a very large positive impact on household welfare in

Figure 1.6: Poverty and Educational Status of Head of Household.



¹¹ These results remain the same even if the poverty line is maintained at 60% median consumption.

Figure 1.7: Health and Poverty.



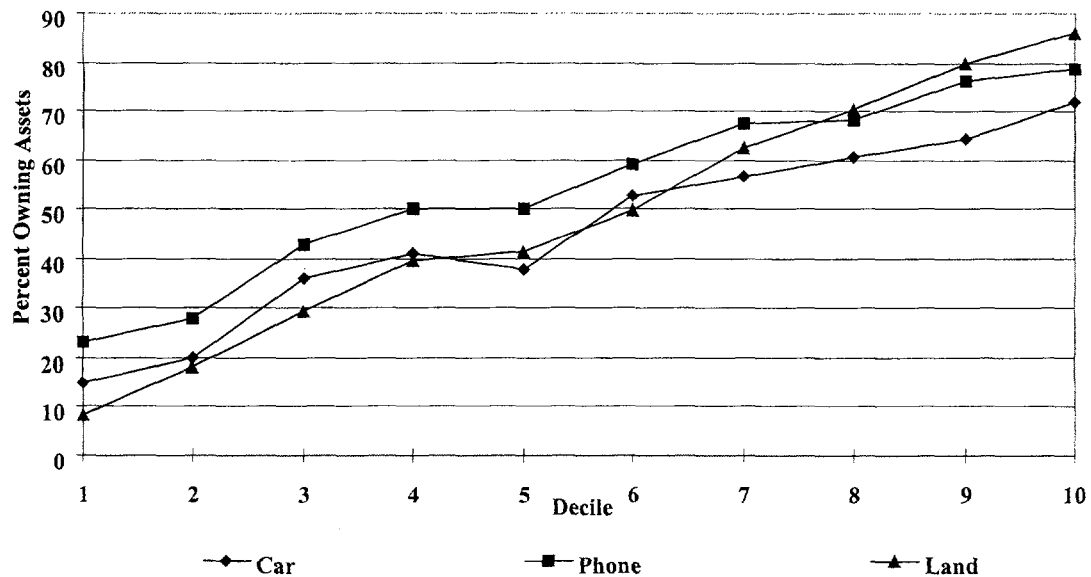
Macedonia. (Annex 2, Table 7). This is both good and bad news from the point of view of poverty alleviation. The good news is that younger people are better educated than current heads of household, so that over time this will lead to higher welfare and lower poverty. The bad news is that current poor households with heads who have primary education or less, and who form the bulk of the poor, have an average age of 53.5 years, and may not realize real gains in income to escape poverty in the near future. (Annex 2, Table 1).

1.18 Poor health status is also associated with low-income households. Slightly more poor vs. non-poor household members report having health problems. Poor households also report more sick days per year and more work days lost due to illness (Figure 1.7). However, these average tendencies do not appear to translate into a strong correlation between poverty and health problems. More days ill and more work days lost due to illness are not associated with greater poverty rates. In fact, the number of work days lost is *negatively* associated with poverty, suggesting that these households are coping in other ways, such as through social transfers. The exception is the presence of disabled members who contribute to higher incidence of poverty (Annex 2, Table 8).

1.19 **Consumption, Assets, and Living Conditions.** In 1996, the consumption of the poorest decile was less than one-sixth of the level of consumption of the richest households (Annex 2: Table 2). As in other countries, food comprises a greater share of expenditures of the poor (54%) relative to the non-poor (46%). (Annex 2, Table 25). The share of in-kind food in total food expenditures is also much higher for the poor. The ownership of assets, durable goods, and basic amenities, also increases with the level of household wealth¹². Most poor own far less land than the rich.

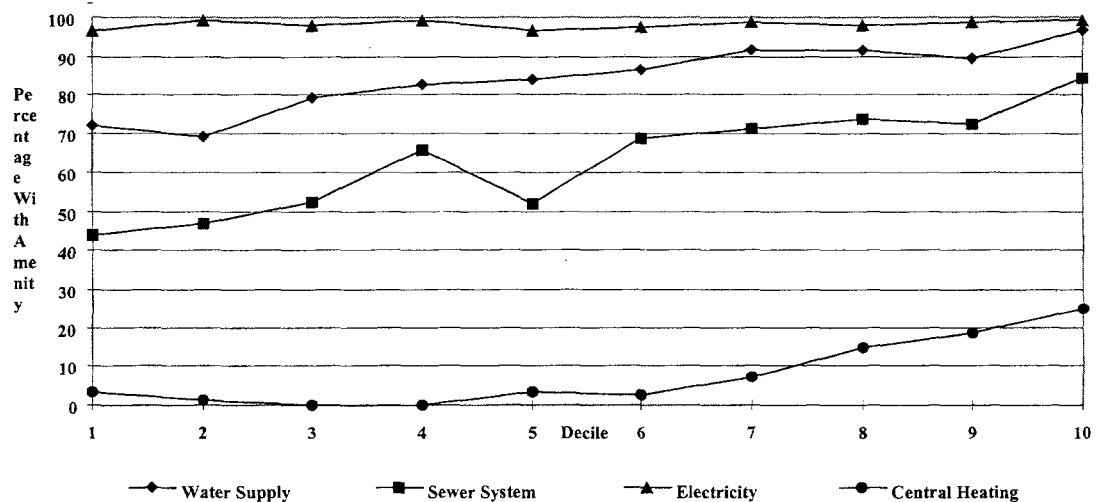
¹² The measure of consumption used does not include income flows from durables and housing. However, the consumption variable so constructed is closely correlated to ownership of land, durables and living conditions, and therefore paints an accurate picture of wealth.

Figure 1.8: Ownership of Assets



Moreover, the ownership of cars and phones are far more concentrated amongst the rich than the poor (Figure 1.8). The largest disparities amongst household amenities occur for indoor water supply, central heating, and sewage systems (Figure 1.9). The availability of electricity is almost universal amongst Macedonian households. However, poorer Macedonians have considerable difficulty in meeting electricity payments (Box 1.3). The living conditions of Gypsy families are particularly abysmal (Box 1.4).

Figure 1.9: Household Amenities.



Box 1.3 Living Conditions of the Poor.

Access to Water and Sanitation Facilities. In rural areas, but also in the many unplanned "spontaneous" settlements of poor households in urban peripheries, the biggest problem is drinking water and sewage disposal. In villages without piped water, households must fetch water from wells and village fountains which are often up to 300 meters from the house. They dispose of waste in septic holes which they dig, or they simply throw it in the fields or right onto the roads.

A sixteen-member Albanian family in Buzalkovo, in the Veles region, lives in a 60 square meter one-story house. Most of the family sleep on the dirt floor protected only by rugs. The house does not receive piped water. The women and children bring water from the public fountain located 125 meters from the house. The family uses an improvised outdoor latrine. The family economizes on electricity by heating with wood and using electricity only for lighting. In a period when their electricity was cut off they used candles.

Electricity. Poor urban and rural families find keeping up with electricity bills one of their biggest problems; some stated that after having their electricity cut they now pay their bills before they even purchase their food. Urban households rely mainly on electricity for heat. In the city areas heating with electricity is mostly used, but at the same time it is the largest monthly bill. Since the electric company states they will cut service after three months of nonpayment, most households stated they tried to pay with only a two month delay. Rural households rely more on wood, either paying in installments or cutting it illegally from nearby forests. The price of heating a single room (the usual practice in winter, when families shut off other rooms) ranges from 20-50 denars for a cubic meter, and families use from 3 to 10 cubic meters per year. Families try to conserve by using the wood only to cook a midday meal, often spending the rest of the day without heating. People experience having their electricity cut as shaming, and if they have no money at all, try to borrow from friends or relatives only to avoid being cut. Some households simply live without electricity. A young couple living in Sveti Nikole, near the city of Stip, live in an old house on the outskirts of town, where they don't receive electricity. Instead, they provide themselves with weak lighting by using a small car battery in one of the rooms.

Housing. In terms of living conditions, the greatest problems for poor households involve difficulties in paying for essential capital repairs and ongoing maintenance. The homes of many poor respondents were in a dangerous state of disrepair. For example, Gordana, 46, lives alone in the Veles region in central Macedonia in a house she inherited from her parents. A number of years ago the house was damaged in a fire, but has not been repaired since. Most of the roof and some of the walls have been destroyed, and the floor is disintegrating. Gordana sleeps in part of a former room which still has a roof. The windows were also destroyed in the fire, and the doors so damaged they barely function. Although the house is in an urban area, it has no heating, piped water, or electricity. Gordana gets water from a tap in the yard, and protects herself from the cold by placing cardboard boxes around her bed. In winter, she copes with the cold by staying in bed, covered with old blankets and papers.

Some houses have never been repaired from an earthquake 35 years ago. One household lives in a poorly built house near Skopje which 35 years ago was built as a temporary add-on to another home after the earthquake. The house is crooked because the walls are falling apart. The interior conditions are also extremely poor: the floor is cement, the furnishings consist of a single bed in which the mother sleeps with three small children, and a wooden bench, which by day serves as a table, at night the father's bed. The mother stated that she spent most of the winter in fear that the roof would collapse and kill one of the children.

Box 1.4: Gypsies.

In urban, semi-urban and rural communities, Gypsies occupy a special category of the poor, often living in slums or unplanned settlements which lack infrastructure such as asphalt roads and connections to municipal services such as electricity, piped water and sewage disposal. Gypsy households interviewed in Central and East Macedonia were very overcrowded and poorly furnished, with some household members sleeping on the floor. Their homes lacked kitchens or indoor toilets. Unable to afford even the septic pits which their neighbors used and had cleaned once a year, the Gypsies gathered their waste every day in buckets which they buried outside.

In the East Macedonian town of Vinica, for example, Agim and his family live in a two room house. The house, built of mud, reed, and stone, was built without a permit and lacks running water and electricity. The house is furnished with only one bed, a cupboard discarded by a neighbor, and an old stove. Most of the household sleeps on the floor, which is covered by several old rugs. Twice a day, Agim's wife walks twenty minutes to the town fountain, hauling back water in large buckets. Nevertheless, the family says that often it lacks drinking water. They get electricity from a cable they have attached to the house of their neighbor, with whom they share the bill. Agim and his neighbors appealed to the municipality to be hooked up to the electricity supply, but their appeal was denied because their homes were built without a permit. Just 100 meters from their house is the city dump, where most of Vinica's residents throw their garbage. Nearby households fear their children might become ill since they play near the dump.

D. Rural and Urban Poverty

1.20 As noted above, in 1996, poverty is disproportionately rural. Nearly two-thirds of all poor live in rural areas. Poverty is also nearly three times deeper and much more severe in rural areas (Table 1.3). There are several distinct characteristics of rural poverty. Rural households are larger in size, and have a higher average number of children compared to urban households (Annex 2: Table 9). The rural poor have average consumption levels that are much lower than poor households in urban areas. A larger share of rural (vs. urban) expenditures is allocated to food. Not surprisingly, the share of in-kind consumption of food in rural households is also much higher than for urban households. (Annex 2: Table 26). Rural households are also more isolated than urban households in terms of the distance to important categories of medical services (medical centers and hospitals), water supply (fountains or wells) and schools (primary and secondary). (Annex 2, Table 11).

1.21 Rural areas have higher maternal and infant mortality rates than urban centers (SAR Health Project). The latter may be attributable in part to low education status of rural (vs. urban) women but may also be the result of poor living conditions in rural areas. The differences in the availability of basic amenities in rural and urban areas is staggering. Nearly all urban households have running water (compared to two-thirds of rural) and a sewage disposal system (compared to one-quarter of rural households). (Figure 1.10)

Box 1.5: Rural Poverty.

Relatively few village households derived an income from agricultural production alone for a number of reasons. Many households do not have enough land to produce for subsistence and the market. Households which do have some arable land complained about the lack of irrigation, high price of inputs, uncertainty of sales and low prices they received, and the difficulty in obtaining credits.

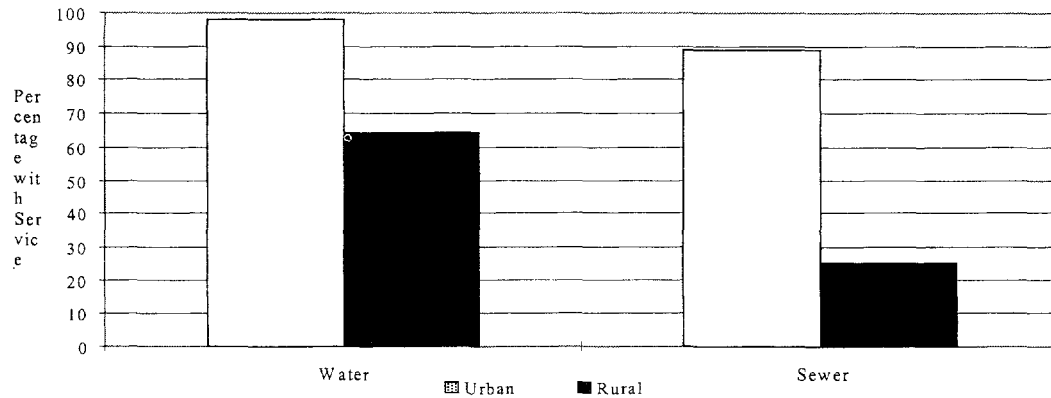
Many of the interviewed households owned no agricultural machinery. Unless they could afford to hire someone to carry out the mechanized work, they performed most farm tasks manually. This is particularly a problem in families without enough able-bodied members to farm productively. When there are many small children the women generally stay at home with them and do not perform farm work. For the most part, such families grow vegetables such as tomatoes, peppers, and onions in garden plots near their homes, sometimes not even producing enough to make winter preserves. Some rural households even reported periods of hunger. For example, two families interviewed in the village of Selce and Kamenjane, each in western Macedonia, reported periods when they and their children had survived only on bread.

A few interviewed households leased land at 50-100 denars per dekar in order to farm. Most paid for the lease in cash, although some paid with their own labor on the owner's land. The households use the leased land to grow tobacco, wheat, watermelons, grapes and other cash crops. Of the interviewed households in western Macedonia, one in Trebosh near Tetovo, and one in Vrutok near Gostivar, farm full-time. They now lease land, on which they grow wheat, beans, potatoes, onions, peppers and other vegetables, selling only the beans and peppers. They use their income to buy fertilizer and pay for the lease. However, the younger sons, 25-35 years of age, work off-farm for income which is used to pay for the children's schooling and other household expenses.

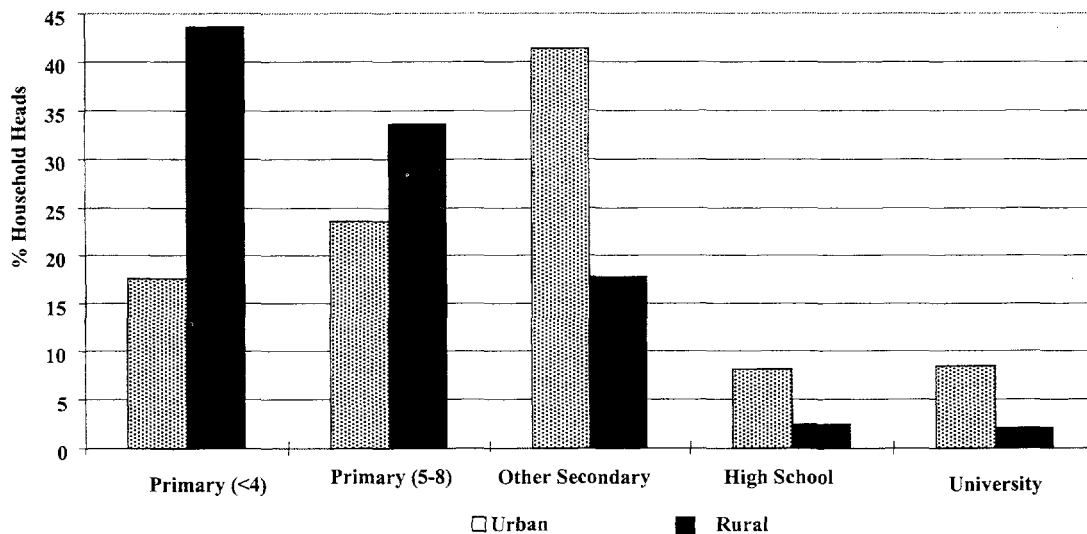
Case Study: Tobacco Farming. A household in the village of Vrapciste in western Macedonia leased 5 dekars of land for 300 denars to grow tobacco. They signed a contract with a monopoly in Tetovo guaranteeing purchase of the tobacco, but without an agreement regarding price or quality. The monopoly sold to the household needles, nylon, and other materials needed for the growing and drying processes. All household members were engaged in the cultivation, helped by their neighbors and relatives. Although they did not pay the latter, they will help them in turn later. The head of the household explained that he invested 600 denars for irrigation and plowing for a yield of 650 kilos of excellent tobacco and 70 kilos of poor quality tobacco. But the company classified the 650 kilos "third class." Although the respondent was not happy with the price offered, compared to other crops, this year's price for tobacco is higher and he still expects the income to be satisfactory.

A few village households breed livestock (horses, mules and donkeys) to aid in cultivating the land. A large number of households keep a cow or goat for their own dairy consumption; some keep a pig or a calf for meat; most village households keep a few chickens as well. Only a few respondents raised livestock as a source of income. One such family living in central Macedonia, consists of an elderly couple, each 60 years old. From their herd of 37 sheep they produce and sell cheese, once a year selling wool and the lambs.

In many cases the outflow of young people from rural areas has left an aging population in the countryside which is simply not capable of intensive physical labor. This is particularly the pattern in Central and Eastern Macedonia, which have traditionally had a high out-migration rate of young people to towns, transforming the age structure of village populations. For the most part, remaining households consist mainly of elderly members. Those who own land grow vegetable crops for their own needs only on part of their land, and they sell little or almost none of the products. When younger family members live far away they are unable to provide much support. The interviewers noted the extensive social needs of the elderly village population, and the need for more institutional and non-institutional care.

Figure 1.10: Living Conditions: Urban vs. Rural.

1.22 Education and the Labor Market. The key differences between rural and urban poverty are the education and labor force status of their residents. Households in rural areas have a much lower education status than those in urban centers. Over three quarters of rural household heads have primary education or less compared to half of all urban household heads. Figure (1.11). Multivariate analysis shows that *all education variables* have highly significant welfare and poverty reduction effects in urban areas (Annex 2: Table 10). In contrast, in rural areas, only higher secondary education is important in improving household welfare. This reflects the rural/urban distribution of education status. In rural areas, the vast majority of heads of households have primary education or less, so differences in education are less likely to explain poverty.

Figure 1.11: Education Status of the Head of Household by Location.

1.23 In rural and more so in urban areas, a low-wage share increases the chances that a household is poor. In urban areas, each unemployed household member reduces household welfare and increases the probability that a household is poor. However, unemployment is not a poverty or welfare maker in rural areas. *Owning a household enterprise* improves the welfare of both rural and urban household, but it reduces the chance of being poor by much more in rural areas than in urban areas (Box 1.5). *Remittances* are also very important for explaining household welfare in rural Macedonia, where an absent spouse (usually a male migrant worker), is associated with a significant increase in household welfare and a reduction in the probability of being poor.¹³ In contrast, in urban areas these effects are totally absent. (Annex 2, Table 10)

1.24 **Agricultural Households.** In 1996, agricultural households comprise only a small share (15%) of all rural households but they have the second highest incidence of poverty amongst all socio-economic groups. Agricultural households have virtually all of the characteristics that correlate positively with poverty. They are larger in size, have much lower levels of education for both men and women and have older household heads even compared to the average rural household (Annex 2 compare Tables, 19-20). Distinct from other rural households, the majority of household heads of agricultural households have no source of fixed income; only a small share are pensioners. Thus, agricultural income is the only source of income for these households, leaving them vulnerable to income shocks. Unfortunately, data limitations do not allow an in-depth analysis of the production and input constraints faced by agricultural households. A picture of poverty amongst these households is therefore developed from qualitative interviews of poor agricultural households. (See Box 1.5). This analysis indicates that farmers have difficulties in obtaining credit and a lack of capital as key constraints to improving agricultural incomes.

1.25 Summary

- As in other countries in the region, poverty increased over the transition, particularly in 1993-95; but has slowed down considerably in 1995-96. The main reason for the increase in poverty over the transition is the *decline in the level of real consumption*. The *increased inequality* in the distribution of consumption also explains the overall increase in poverty but much less so. However, a growing inequality of income has become increasingly important in explaining poverty growth over time.
- Poverty has diverse characteristics. There are three main groups of poor.

The traditional poor. Rural, agricultural, farm households with more than three children. These households formed the majority of the poor in pre-transition years, but currently represent only a small share. However, now as earlier, they continue to have amongst the highest *incidence* of poverty in the country.

¹³ It will therefore be interesting to understand further if changes in land ownership rights will have important impact on labor migration.

The new poor. Non-agricultural households have replaced agricultural households as the largest group of poor, yet poverty remains a rural phenomenon. These households are headed by wage earners, the unemployed, pensioners and other cash transfer recipients. The unemployed have the highest incidence of poverty in the country. Pensioners and wage earners have the lowest poverty rates overall

The chronic poor: Of all households, poor pensioners, elderly without pensions, the disabled, older farm households without pension or other fixed income, emerge as the most disadvantaged groups in society. These groups are not capable of work and are therefore the least likely to benefit directly from economic growth

- There are many *common* characteristics of poverty. The most important determinants of poverty are *low levels of education* and *labor force status* (unemployment, low-wage share, and lack of ownership of an enterprise). A striking fact is that nearly 80% of the poor live in households headed by individuals with primary education or less. Other common factors are unsatisfactory living conditions (sanitation, water supply), limited asset ownership, large household size and a large share of food in total consumption. Electricity is universally available but the poor have great difficulty in paying electricity bills.
- The differences in rural and urban poverty are mainly in education and employment status. Both rural and urban poverty is linked with *low paying jobs*, but only urban poverty is associated with *high unemployment*. While the average education status is low in rural vs. urban households, education has a stronger impact on welfare in urban than rural areas. *Remittances and growth in small enterprises* have been critical for improving household welfare in rural areas. Living conditions, such as the presence of running water and sewage systems, appear worse in rural areas, but are difficult for both rural and urban poor. Living conditions are even worse for Gypsy households.
- *Gender of household head* is not an indicator of poverty once other factors are taken into account.

II. THE LABOR MARKET AND POVERTY

2.01 The previous chapter has established a strong link between labor market status and poverty: the unemployed have a high poverty rate and the low-wage workers comprise a large share of the total poor population. This chapter evaluates recent labor market developments to inform measures for alleviating poverty amongst labor force participants. The Kosovo is likely to aggravate the depth of poverty amongst labor force participants, at least over the short term. However, the basic determinants of poverty in the labor market, low and unpaid wages, low levels of education and unemployment are likely to remain the same. The 'add on' 1996 Household Budget Survey is the main source for the conclusions.¹

A. The Labor Market: Background

2.02 Recent labor market developments in FYR of Macedonia have their roots in the worker management system practiced in former Yugoslavia. Under this system of "market socialism" the governance of enterprises was restricted to Worker's councils, giving workers (insiders) considerable incentives to restrict employment of new entrants to the labor force (outsiders) and push up earnings. As a result, registered unemployment rates (21%) were high in FYR of Macedonia even before the transition. Rigidities in the labor code such as hiring/firing restrictions, national collective bargaining, inflexible wage setting, and high minimum mandatory labor benefits, all served to increase labor costs. Not surprisingly, high labor costs contributed to high and sustained enterprise losses.

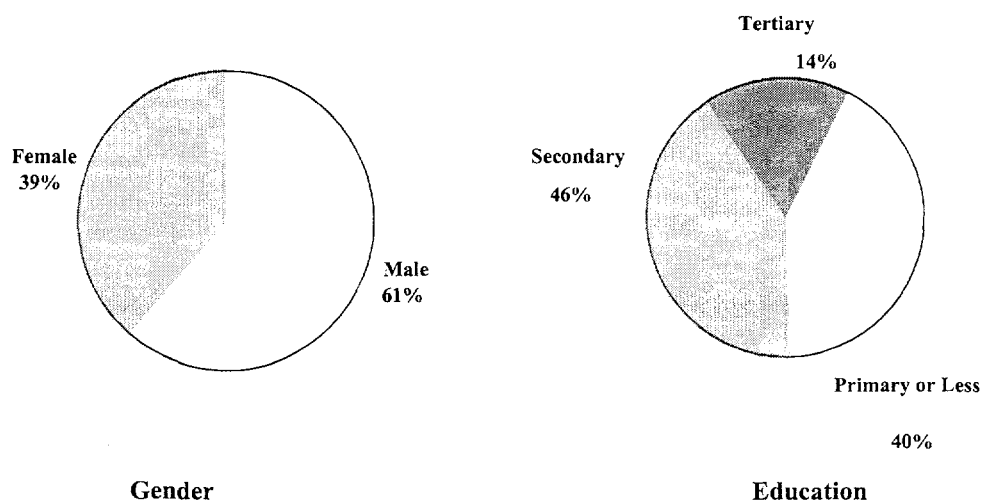
2.03 After independence and faced with a sharp decline in economic activity, the Government privatized a large number of loss-making enterprises and laidoff a significant number of workers. However, many privatized enterprises remain insolvent, supported by soft loans from banks; by the continued accumulation of wage arrears; and the payment of payroll taxes on their behalf by the state. Strong trade unions, restrictive hiring and firing provisions, and continued insider power continue to stave off reduction in employment. Despite the sharp declines in real wages realized over the past several years (see below), a recent study suggests that the share of gross wages to GDP in the country -- an indicator of labor costs -- remains amongst the highest in the region.² Thus, while the state has protected workers against open unemployment and therefore poverty by supporting unprofitable enterprises, it has done so at considerable fiscal and economic costs.

2.04 Unemployment rates have increased rapidly since independence. In 1996, over 32% of the labor force was unemployed.³ Unemployment rates are likely over-estimated given the presence of a large 'gray' economy thought to be driven underground by the

¹ The results of this chapter therefore vary from the results of the 1996 Labor Force Survey, carried out by the Statistical Office of FYR of Macedonia. The reasons may be the sample size of the add on module and the different classification of activities in this module. However, some conclusions of the chapter rely on the Labor Force Survey and are referenced.

² IMF, Mid term Review: Enhanced Structural Adjustment Facility, October, 1997.

³ There are several estimates of unemployment rates in FYR of Macedonia in 1996. Unemployment rates are 38% based on registered unemployment. A much lower rate -- 25% -- is found using the household survey data.

Figure 2.1: The Composition of the Labor Force

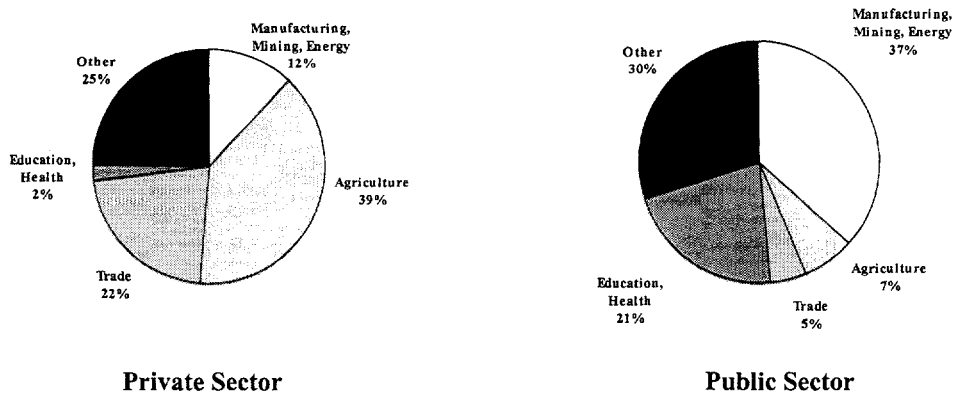
high labor costs prevailing the country. However, hidden unemployment in public enterprises noted above imposes a downward bias in unemployment rates. In any case, unemployment remains now, as before independence, a major economic and social problem for the country.

B. Recent Labor Market Developments

2.05 The labor force participation rate of the FYR of Macedonian active population is quite low (55%), particularly compared to European standards (70%), and even compared to other CEE countries (particularly for women). As in other countries, labor force participation rates have likely declined over the transition. High rates of unemployment have likely induced a discouraged worker effect. Individuals who participate in the labor force are young with education levels comparable to regional norms. Nearly 90% of the labor force is below fifty years of age and a sizable one third of the labor force is less than thirty years old. (Annex 2, Table 35). Nearly 40% of the *labor force* comprises workers with a primary education or less (Figure 2.1). Secondary school graduates constitute close to 46% labor force, while the remainder-- a relatively large share -- given the country's level of economic development -- has a post-secondary education. Individuals who do not participate in the labor market are mainly poorly educated and low skilled. Many of these are women, particularly of Albanian and Turkish descent.

2.06 As in other Central and Eastern European countries, the composition of employment has changed. Private sector employment has increased and there has been a shift from manufacturing towards agriculture and trade (Figure 2.2).⁴ However, the public sector remains the dominant employer, accounting for nearly 60% of all jobs.

⁴ This follows from the comparison of the industry structure of employment with that of new hires (using HBS 1996 data).

Figure 2.2: The Composition of Employment

And, despite private sector growth, labor turnover is low. The rigidities in the labor market, particularly restrictions on the hiring and firing of labor, continue to constrain employment.

2.07 *Real wages have declined* precipitously over the transition (Fig 2.3) The decline in wages has been steeper than in most Central and Eastern European countries. In 1996, the average wage was roughly half of 1989 levels (Annex 2, Table 28). The *inequality of wages* has increased albeit modestly, especially compared to other transition economies. Specifically, the inequality in wages, measured by the Gini coefficient, has increased from 22, indicating a low level of inequality, to 25-27, indicating a modest level of inequality (Figure 2.3) (Annex 2, Table 29). By way of comparison, in Poland and Bulgaria the Gini coefficient of wages exceeds 30 points.

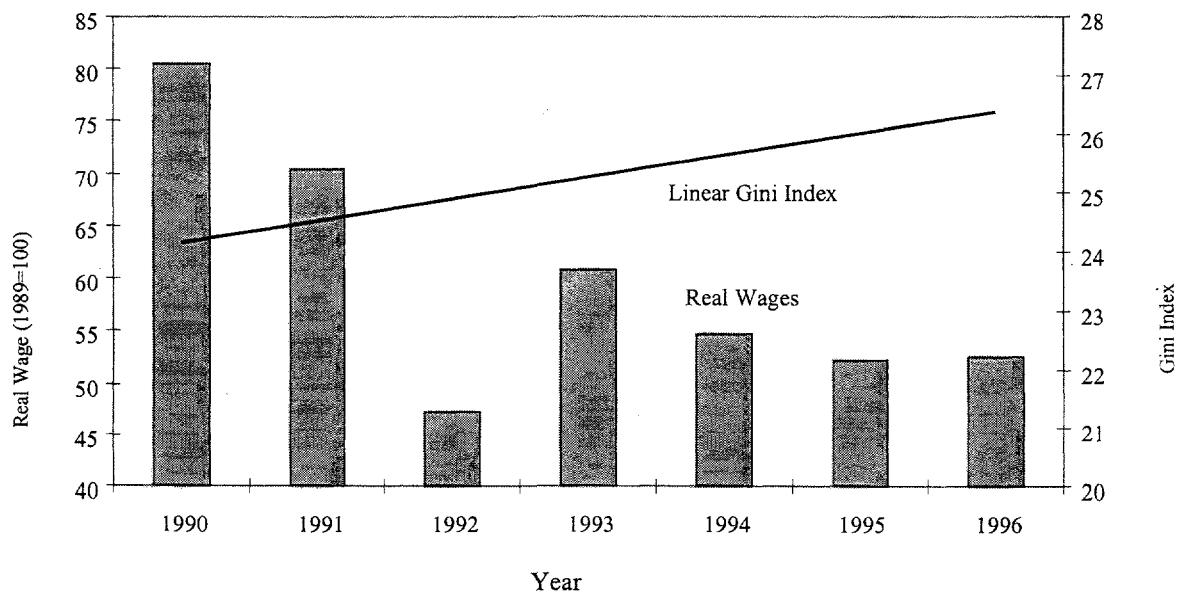
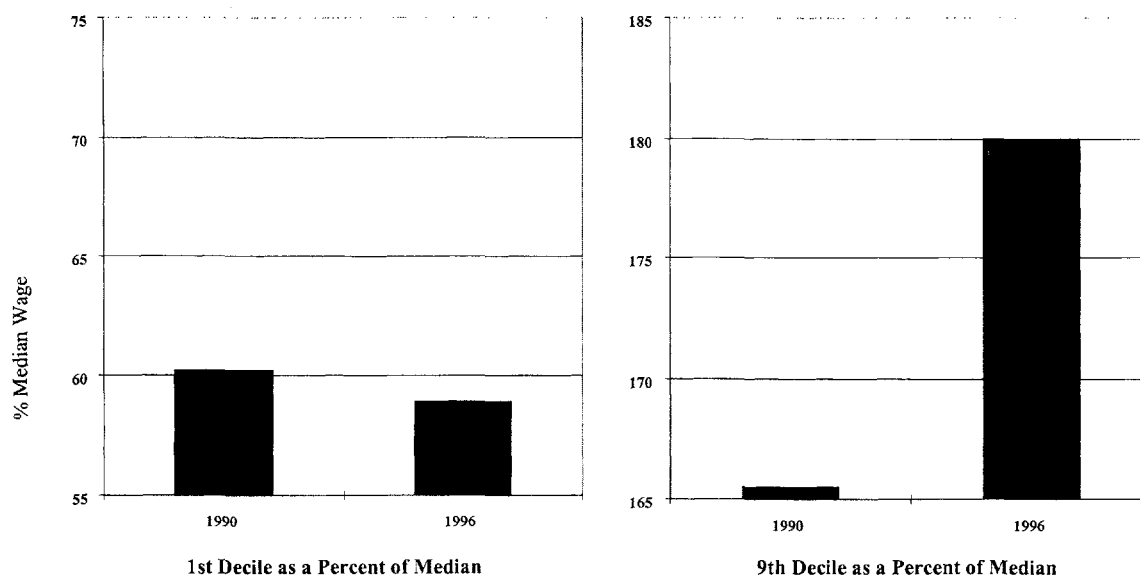
Figure 2.3. Trends in the Level and Distribution of Wages

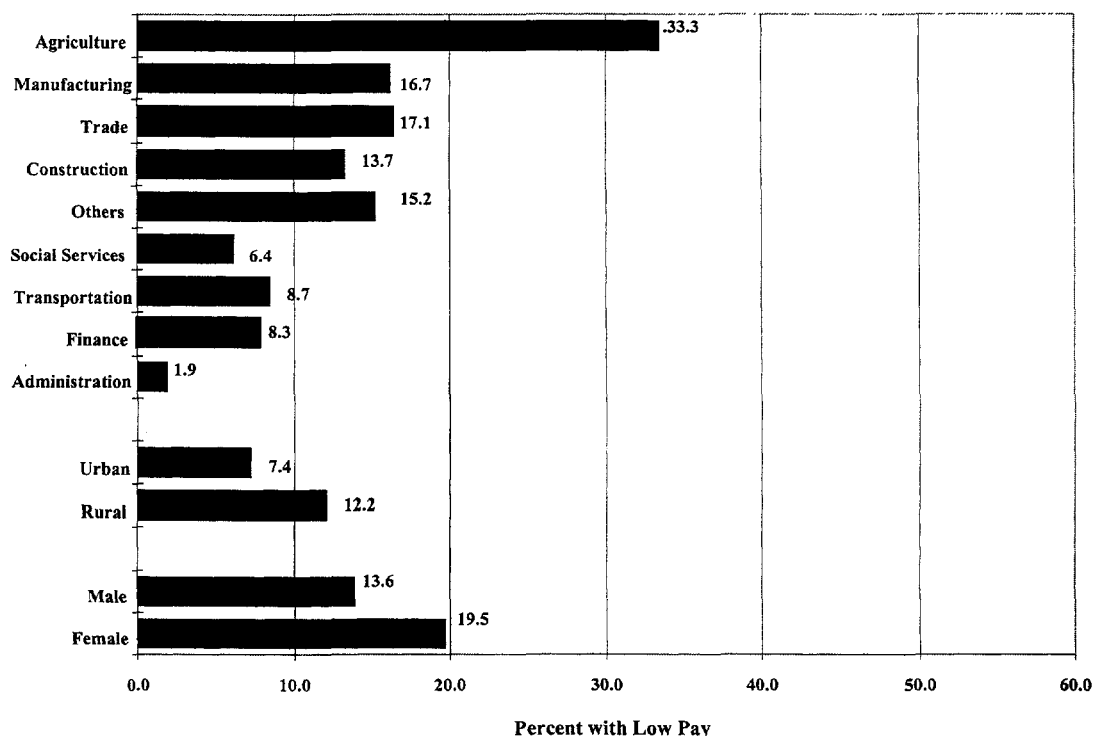
Figure 2.4: Changes in the Relative Position of Top/Low-paid Workers

C. The Working Poor

2.08 All workers have suffered from a fall in real wages. This development is the main factor behind increasing poverty amongst workers. The decline in wages has affected some workers more than others. In common with other transition economies, low-paid workers have suffered more in *absolute terms* from a decline in real wages relative to highly paid workers (Annex 2, Table 28). High paid workers have improved their *relative* position vis a vis median workers. By contrast with other transition countries, low-paid workers have largely maintained their *relative* wage position vis a vis the median worker (Figure 2.4). Thus, increasing inequality is largely a result of movements in the upper tail of the distribution of wages. The relative wage position of low-paid workers still remains quite favorable by regional standards and is more typical of OECD countries.

2.09 **Low-wages.** In 1996, the proportion of low-paid workers is much higher in the private than the public sector, and in rural than in urban areas. Household heads employed in agricultural, manufacturing and trade sectors are much more likely to be poor. Amongst workers, those with the highest incidence of low pay are women, young and older people, manual workers, workers with primary or lower education, and especially those working in agriculture (Figure 2.5). The incidence of low pay is higher amongst primary workers than spouses and working age children (secondary earners). (Annex 2, Table 32). Groups with a high incidence of poverty are not necessarily the most numerous amongst the working poor. The majority of low-paid jobs are held by men (60%), prime age workers (43%), with secondary education (36%). Slightly over

Figure 2.5 Incidence of Low Pay



half of all low-paid jobs are private sector jobs in manufacturing and trade, which means that the private sector has absorbed a large share of less skilled workers. Thus a typical low-wage job is a manual male job in the private sector, in agriculture, or in manufacturing outside the capital region (Annex 2, Table 32).

2.10 Determinants of Low-wages. The main factors explaining low-wages are low levels of education, gender, industry and location of employment. *Education has a high pay off for Macedonian workers.* The rate of return to an additional year of schooling is fairly high (about 7%), particularly in urban areas. It is well within the range of values characteristic of developed market economies as well as advanced transition economies (e.g. Poland, Czech Republic, Hungary). As in other CEE countries, men have a relatively lower rate of return to education than women. In contrast to most countries, the private sector rewards education less than the public sector. This somewhat surprising fact is attributed to private sector growth in low skilled industries. Once this is taken into account, the return to education is the same in both sectors (Annex 2, Table 33).

2.11 Wages also differ amongst individuals because of their sector or industry of employment.⁵ *Private sector workers earn more on average than public sector workers.*⁶ There are several caveats. The public sector wage does not capture the bonuses and other benefits received by public sector workers⁷. Moreover, the longer hours worked by

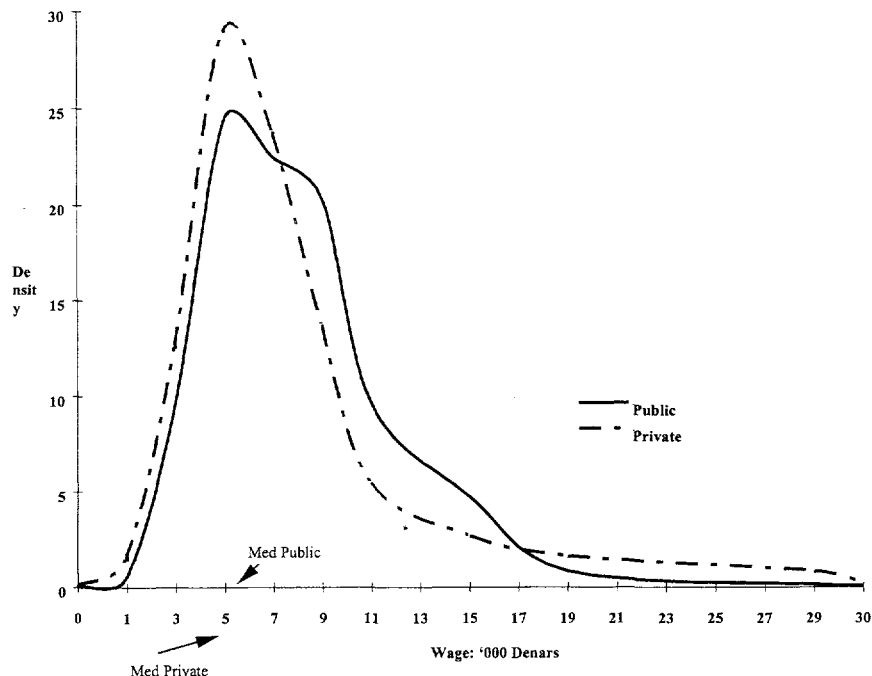
⁵ The discussion here focuses on the marginal effects of education, gender, occupation, and industry differences.

⁶ However, the private sector accounts for more low-paid jobs than the public sector.

private sector workers would also tend to lower apparent disparities amongst these workers. Agricultural workers earn less (all else equal) than in all other industries. In the private sector, inter-industry and gender differences are far more important than education in determining the level and distribution of earnings. That is, differences in manufacturing and agricultural wages, and the wages of men and women, are far higher in the private than public sector.

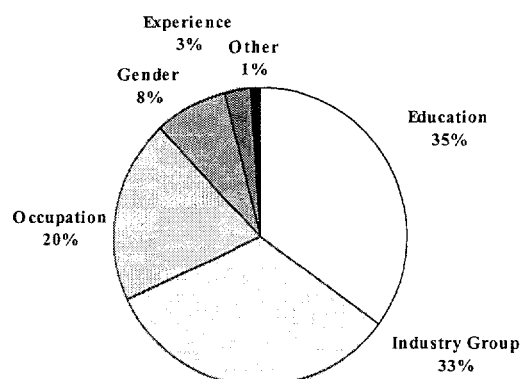
2.12 *Women earn much less than men in the private sector at similar levels of education, experience, occupation and industry*, particularly in rural areas. The gender wage gap is purely explained by discrimination, as women have on average much more favorable education levels than men (controlling for other characteristics such as industry, occupation and other factors).⁸ All else equal, women earn only 15% less than men in the public sector, but almost 40% less than men in the private sector (for comparable jobs).⁹ The lack of contract enforcement in the private sector, increasing informalization of the economy, the higher cost of hiring women (generous maternity benefits, etc.), and other discriminatory behavior towards women workers, are some reasons for lower wages of women vs. men. Private sector discrimination against women is not a pattern uniform to all transition countries. For example, in Poland the situation is reversed and women benefit from private sector employment more than men.

Figure 2.5A: Wage Distribution: Private vs. Public Sector



⁸ Interestingly, labor market experience seems to be of relatively little value overall. An additional year of tenure with the firm brings only a minimally higher wage.

⁹ The Labor Relations Law, however, guarantees equal work for equal pay.

Figure 2.7: Explaining Wage Inequality

2.13 Wage Dispersion. *The main reason behind growing wage inequality is the emergence of the private sector.* Wages are far more unequally distributed in the private than public sector (Figure 2.6). The difference is most pronounced in top paid workers. For example, in the private sector, a worker in the top decile earns more than twice as much as a median worker. In the public sector, the highest paid workers only earn 60% more than the median worker. In fact, most of the top paid and lowest paid jobs are found in the private sector.

2.14 Within each sector, education (though less so in the private sector) and inter-industry and occupational wage differences are also important in explaining the growing wage inequality. Education differences, mainly between post-secondary educated workers, are the main factor explaining wage inequality (Figure 2.7). Inter-industry wage differentials, between agriculture and manufacturing are the second most important factor causing wage inequality. Large inter-industry wage differentials, which are not accounted for by human capital factors, suggest the existence of barriers to inter-industrial mobility of labor. Occupational wage differentials, are the third most important factor in explaining wage inequality. The impact of occupation comes exclusively from professional and managerial occupations.¹⁰ That is, wage differentials between other occupations, for instance, service workers and manual workers, are on average negligible and do not contribute to inequality (Annex 2, Table 34)¹¹

2.15 Wage Uncertainty. Wage uncertainty, with adverse welfare effects on all employed, has become a regular feature of the Macedonian workforce. Irregularity of public sector wages, reduced volume of work, and prospects of plant closing, all create a considerable amount of income uncertainty for public sector workers. As related through in-depth interviews, the internal divisions and reorganizations within each company have added to this uncertainty. Many interviewed employed had not received wages for five

¹⁰ Workers were grouped into the following occupational categories: professional and managerial workers, service and clerical workers, manual workers outside agriculture, agricultural workers.

¹¹ Note that the unexplained inequality is quite high.

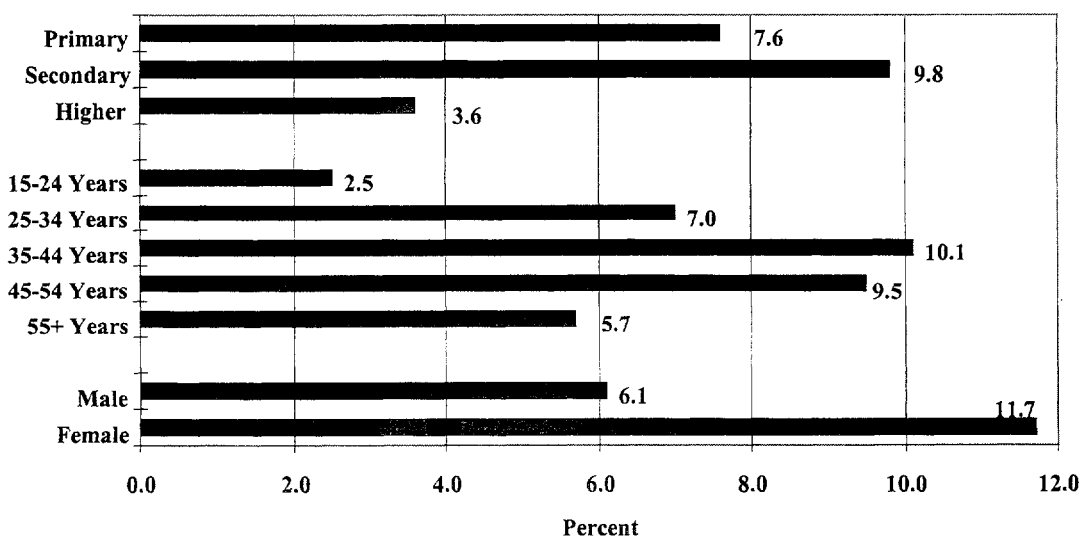
or six months, and many companies in which they work do not pay contributions for pension and health insurance on their behalf. Some of the interviewed have recently been sent on forced vacations of up to 7-8 months in a year. The most adversely affected by this phenomenon are workers with low pay and with limited savings and assets. The perceived difficulty of obtaining another job, ensuring and augmenting pension benefits, keeping information ties to the work force, and the expectation that they will receive their overdue wages if they continue to work, induces workers to go to work every day for several hours, even to register, when the company is liquidated.

2.16 The imposition of hard budget constraints and the subsequent restructuring of enterprises may well increase the pool of open unemployment, at least in the short run. While some older workers may withdraw from the labor force, others will have to attempt to find another job. Recent layoffs have hit mostly women, middle aged workers (35-54), and workers with a secondary education (Figure 2.8). The expectation that it will be difficult to find another job once laid-off is very real. A majority (60%) of laid-off workers do try to find a new job, although a substantial fraction of the laid-off (largely older workers) withdraw entirely from the labor force. Other, mainly younger workers, continue to search for work and join the ranks of the unemployed (Annex 2, Table 37).

D. Informal Sector Workers: Seasonal and Occasional Work¹²

2.17 Regardless of age or gender, most individuals who are not in regular formal sector jobs related in the qualitative assessment that they were engaged in some kind of informal personal contacts, usually friends and relatives. As noted in the previous chapter, seasonal workers have amongst the highest incidence of poverty in the country.

Figure 2.8: Incidence of Layoffs by Socio-Economic Factors



¹² This section is based on interviews of the poor and not on empirical data. As a result the conclusions cannot be generalized to the population.

2.18 Many *urban* individuals work as salespersons, bartenders, seamstresses, and taxi drivers. Men usually perform hard physical work. They are most frequently masons, painters, tile-layers, and loaders of goods. A small number of interviewed women were engaged in skilled work, knitting sweaters, weaving, or in making traditional garments (mostly in the western region) at home. Some women work in the informal sector as seamstresses. Women in urban areas most often work as cleaning ladies in buildings and apartments. In many households from the urban areas, prostitution was mentioned as a way of survival. In rural areas, poor people work as day laborers on other people's land (cutting, digging, sawing and similar) or mind cattle, mainly during the summer months. Some individuals supplement the family budget by collecting moss, mushrooms, various herbs, and wood during one or two months out of the year. Women in rural areas work mainly in agriculture. For example, they grow tobacco on rented land, after obtaining an advance payment to buy inputs from the tobacco combinats.

2.19 The informal work described in household interviews is arduous, seasonal or occasional in nature, requires a long search period, and is often available only during the summer months. Wages are low and even if close to the average wage, can only be obtained for a few months of the year. Households find it difficult to save for lean seasons. Winter months, when savings have been depleted and work is not easy to find were cited as particularly difficult. Competition from laid-off workers and, in the western region, illegal Albanian workers, were also often mentioned as having driven down wages and reduced the standard of living in recent years. Women selling traditional garments also cited reduced demand for their work as a result of increased competition from workers from Albania. Many women said that it was easier to find work a few years ago. They related that even seasonal work opportunities, for example, the extraction of sugar turnip, picking apples, sour cherries and other fruit in orchards, or work at hotels, are now few and far between.

2.20 Many households have tried to improve their living standards by working abroad. Working abroad, even temporarily, was considered by most poor households as an important source of income. Interviewed households narrated numerous instances of people who have tried to find employment abroad. Younger people (mostly Albanian) have frequently undertaken illegal work in Italy, Switzerland, and Slovenia. This work is arduous physical work and seasonal, lasting about 5-6 months. The reported pay is low relative to legal work of the same nature in these countries, but it still provides an important source of income for the household.

2.21 Starting a small business was cited by some households as a way to escape poverty. A small number of poor households related that they had attempted to, or would like to, start their own business. The main reason cited by individuals for not being

Box 2.1: A Private Enterprise

Informal Sector: Miki is a lawyer of fifty who previously worked in the construction industry. When his enterprise went bankrupt five years ago he registered as unemployed. His wife works as an administrator in a bank. After two years of looking for work Miki decided to use the severance pay from his firm (the equivalent of 2 years' salary, it came to about 7,000 denars), as well as some of the money he gained from the sale of a small apartment for 25,000 denars, to start a pizza restaurant. The restaurant did so badly Miki ended up closing it, selling what he could, and invested his remaining money in importing items, including furniture, from the Far East. The shop consists of a modestly equipped and relatively small space, 20 square meters, where Miki has displayed a range of handmade crafts, ranging from inexpensive items sold for 10-20 denars, to higher priced furniture which he sells for up to 1,000 denars. Miki had hoped that their high quality, and the fact that they would be considered "exotic" would attract buyers. After a year and a half, Miki found that his profits were much lower than expected. He blames the unfavorable government policies toward small businesses: "The new act on trading companies and the regulations concerning financial performance will cause all the smaller shops to close down in the next few months." He put forth as the example the requirement of paying a 10,000 denars deposit and 350 denars registration fee to register an enterprise, which many small businesses would find impossible. Moreover, he noted the prevalence of corruption: "You're expected to put money in the pocket of any inspector who comes to you. You just can't do anything without facing the need for bribery. Whenever an inspector appears, all the shops close immediately." According to Miki, it is much easier for small groceries shops to bribe inspectors. Several times, he has noticed grocery shop owners filling the trunks of the inspectors' cars with goods. "I cannot pay 100-200 denars each time they show their faces." The main reason he has decided to close down his business is that he is being required to pay tax on the inventory he keeps in his shop, even though, he claims, he is unlikely to sell much of it. "If they specified the total amount I should pay at the end of the year, in three or four installments, I would stop and think about it. But I cannot pay in cash an arbitrary amount for unsold merchandise, even if I wanted to. I've already invested the money; I could pay after earning something. Now, they are to come and confiscate my goods and even my car!" Miki has already received a list of his goods that will be confiscated, listing his car and registration number. He was terrified a few days earlier, when he witnessed tax inspectors arriving accompanied by 6 police officers and a dozen workers to confiscate goods from a nearby pharmacy. He feels that the official attitude treats business people like himself as criminals even when they try to meet their legal obligations. As a result, he hopes to sell all his property and emigrate from the country.

engaged in a private business is the lack of capital. Most of the interviewed households said that it is not possible for them to obtain loans to start a small business because they cannot obtain a mortgage at affordable rates given the poor condition of their property. Most unemployed do have a lot of ideas about what they would do (open cattle breeding farms, craft workshops, or in marketing products) if they could obtain credit on favorable terms.

2.22 A small number of interviewed households engage in illegal or semi-legal trade as a means to make ends meet. The activity is often the resale of agricultural, textile, or food products. A similar small share of interviewed households with a small amount of capital (savings from "better times," loans from friends or relatives), deal in smuggling goods. They buy goods, food, textile products, jewelry, alcohol, or cigarettes from the duty-free shops from Bulgaria and Turkey and sell them in the markets, on the streets, or to companies.

Figure 2.9: Unemployment and Poverty



E. The Unemployed

2.23 The Profile Of The Unemployed. In 1996, the *unemployment rate*, by gender, age, and educational attainment, is quite similar to that of OECD countries. The unemployment rate is higher for women, the young, and poorly educated and less skilled workers (Annex 2, Table 35). Unemployment rates for university educated individuals are less than half (15%) that of primary school graduates (40%). Secondary school graduates of all types of secondary school: vocational/3 year/4 year have the roughly the same (30%) unemployment rate. Single persons and secondary earners are much more likely to be unemployed than married workers or primary earners. The reason is not clear and could be a result of a number of factors: skills of female workers or the propensity of employers to layoff secondary earners first or to employ primary earners first, cultural bias, or other reasons. Unemployment is a bigger problem in urban than rural areas. Poverty rates for the unemployed are higher for men and for younger age groups (Fig 2.9)¹³.

2.24 A *typical* unemployed person is an urban married male secondary school graduate. Nearly three-quarters of all unemployed are not poor. However, unemployment and poverty are linked, because a large number of poor (41%) live in households with unemployed members. The *vast majority* of the unemployed in FYR of Macedonia are new entrants to the labor market, that is people with no previous work experience.¹⁴ The unemployed with previous work experience, mainly laidoff workers, account for only a quarter of all the unemployed.¹⁵ The predominance of new entrants is a very striking feature of labor market unemployment in FYR of Macedonia. In most Eastern and Central European countries the majority of the unemployed are persons with previous

¹³ However, unemployment in rural areas may be hidden and underemployment is probably also more pervasive.

¹⁴ The term "new entrants" is used for persons who have never worked in last 5 years.

¹⁵ FBS 1996 data.

work experience. For example, in Poland the unemployed with previous work experience account for over 80% of all the unemployed -- a proportion more than three times higher than in FYR of Macedonia.

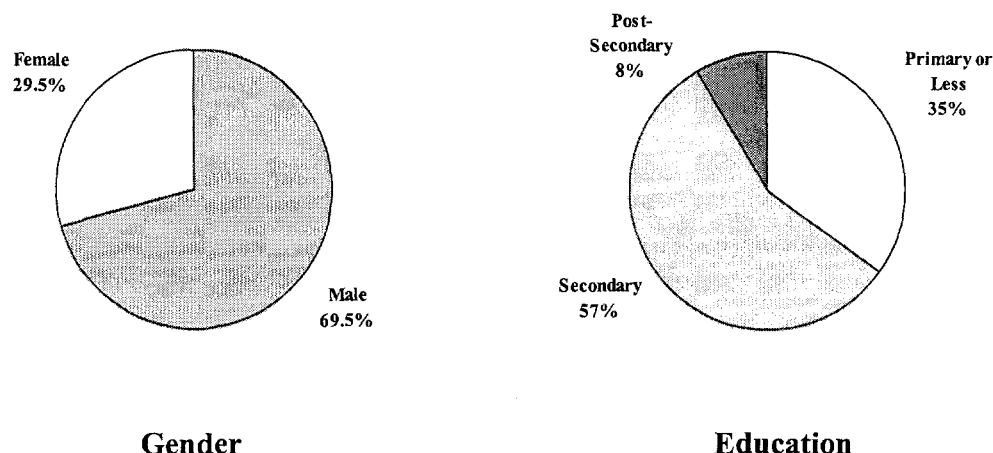
2.25 These results reinforce the earlier statement that the main reason for high unemployment and associated poverty in FYR of Macedonia is that of limited entry to the labor market, rather than layoffs.¹⁶ Thus, policies to reduce costs of hiring and firing, somewhat paradoxically, are likely to be critical for reducing unemployment in the country.

2.26 The Long Duration Of Unemployment. The flow into the pool of unemployment is quite low (1%). The main reason for high unemployment is the long duration of unemployment. As much as 80% of all unemployed are long-term unemployed. These values are far beyond the range observed in OECD countries and in other transition economies of Central and Eastern Europe. For instance, in Poland the unemployment rate peaked at 16% and the share of long-term unemployed has not exceeded 50%. The incidence of long-term unemployment is remarkably similar across socio-economic groups. In virtually each age group the share of long-term unemployed is around 80%, except very young workers in which case it accounts for 50%. This is in contrast to a typical situation whereby the incidence of long term unemployment increases with age (Annex 2, Table 35).

2.27 Long term unemployment has discouraged workers. A large number of workers indicate that they have ceased a job search when it has proved futile. While the average job search duration is long for virtually every socio-demographic category of workers, it varies notably between groups. (Annex 2, Table 36) Men tend to look for a job longer than women. Less educated workers have a longer search period compared to better educated workers. Workers with low education also have the lowest labor force participation rate. *Thus, the less educated seldom work.* This explains in part the high incidence of poverty amongst the less educated found in the previous chapter. In contrast, the majority of workers with a post-secondary education are a part of the labor force and are relatively seldom unemployed.

2.28 The capacity of the labor market to reintegrate a large number of the unemployed, into gainful and productive employment and thereby reduce poverty will be particularly difficult while unemployment is of such long duration. International experience demonstrates that unemployment tends to be more persistent when its rise is associated with the spread of long-term unemployment. Exit rates from unemployment fall as duration of unemployment increases. Re-employment rates are much lower for the long-term unemployed owing to the loss of skills and declining morale, and because employers tend to use the length of unemployment as a screening device (they equate long term

¹⁶ Labor Force Survey (1996). Unemployment may well be attributable to the limited supply of qualified workers, and unemployment rates amongst the less educated are quite high relative to university graduates. However, this assertion is difficult to prove. Data on education requirements and length of job vacancies would be required to address this issue.

Figure 2.10: New Hires in the Private Sector

unemployment with intrinsically low productivity). Thus, unemployment amongst the young could also have longer term poverty effects.

2.29 On a more hopeful front, given that younger cohorts have, on average, higher education status the proportion of household heads with low education status, both in rural and urban areas, should decline over time. On the positive side, unemployment hits largely secondary, not primary earners. This may well change however, as hard budget constraints on enterprises force further re-structuring, converting hidden unemployment to open unemployment. Another positive development is the average characteristics of a typical newly hired worker¹⁷ in the private sector: a young man (less than 35 years of age) with secondary or lower education living in a city and working in a trade, closely matches the profile of the unemployed (Annex 2, Table 38). Thus private sector hires are biased toward services, and towards urban and less educated workers (Figure 2.10). A notable exception is the large discrepancy between the share of female workers amongst the unemployed and new hires. *A woman is much more likely (1.4 times) to be found amongst the jobless than amongst new hires.*

F. Looking for Work

2.30 **Where?** Through in-depth interviews, virtually all of the unemployed indicated a wide preference for job location. Elderly males in urban areas indicated that they would accept work mainly in their own or a nearby municipality. Most women said that they would prefer to work in their own municipality. Accepting work in another municipality was considered difficult by most women because it would mean neglecting their children and home. Rural unemployed indicate that they are mainly looking for work in their own locality or in the nearest urban settlement. People with families are looking for work mainly in their own municipality. Because of their low level of education, it is difficult for them to find sufficiently well paid work that would compensate for the separation

¹⁷ New hires are defined as workers who held their current job for not more than 5 years. This somewhat broad definition was dictated by small sample size which did not make it possible to restrict the tenure to, say, one year.

from their family. Young people looking for work, regardless of their region of residence or ethnic status, are willing to accept work anywhere in the country. A large proportion of the young also indicate that they are amenable to working abroad.

2.31 How? The unemployed look for work through advertisements and through friends and relatives. Few people, if any, believe that they can find work through the Employment Bureau. Most of the interviewed regularly apply for advertised jobs and if called, present themselves for an interview. Some of the interviewed seek work directly in companies, regardless of whether there is an advertised job opening. Nevertheless, none of the persons interviewed had found work using these methods. The only successful method for finding jobs is considered to be “connections” with managers of companies. Very few of the interviewed had any such acquaintances. Some of the unemployed have tried to contact some influential people calling upon old friendships and neighborhood ties, but all these attempts have been unsuccessful. However, most unemployed, when questioned further, also believed that their low level of education and advanced age was the main reason for their inability to find work.

G. Labor Market Policies and Poverty Reduction

2.32 Private sector growth, by absorbing a large number of less skilled workers, has been critical to reducing poverty in the country. However, a considerable pool of less skilled individuals remains unemployed. This pool may expand, at least in the short run, as insolvent enterprises layoff workers, and because of the recent Kosovo crisis. Thus, it will take a considerable growth in employment to absorb the excess supply of less skilled labor. Further, private sector growth will be required to raise real wages of labor and to reduce poverty amongst workers. There is a caveat. The increasing disparity of wages may worsen poverty, dampening the positive effect on the working poor of any increase in the average level of wages. Moreover, private sector growth may increase the relative disparities between low-wage and top paid workers.¹⁸ A growing inequality of income in the initial phases of economic growth (to be followed by reduction in inequality and continuing growth) has been documented for many other countries in the world. Finally, the Kosovo crisis will have a major impact on the labor market, causing layoffs and unemployment and increasing poverty, at least in the short term, amongst workers as a result of growing wage arrears and an increasing number of workers on forced leave.

2.33 Ensuring a flexible labor market can have an important positive impact on stimulating economic growth. As noted earlier, the Macedonian labor market is characterized by high labor costs that constrain formal employment growth and contribute to a growing informalization of the economy. Labor market rigidities inherited from the socialist worker management system practiced in ex-Yugoslavia, particularly restrictive hiring and firing conditions and inflexible wage setting practices, continue to constrain the hiring of less skilled and poorer unemployed. Some of these rigidities embodied in the Labor Relations Law include i) excessive regulation of the

¹⁸ Low-wage worker could realize an increase in real wages, but much less relative to that realized by top paid, or even median workers. Low-wage workers could also realize a decline in their absolute wage inequality increases outpace the growth in the median wage.

hiring and termination processes; ii) extensive role of the court in reviewing termination decisions; iii) centralized collective bargaining system binding on all workers and employers that can impose restrictive wage setting practices and can establish benefits, or other (termination) conditions, higher than those established in the Labor Relations Law; iv) high minimum mandatory benefits including a generous sick pay provision (sixty days by employer). The result of these and other similar termination restrictions make it extremely difficult to fire workers and therefore also raise the cost of new hires.

2.34 High tax rates imposed to finance generous social insurance programs likely induce evasion, reduce formal sector growth, and contribute to a growing informalization of the economy. Moreover, rigidities in the land and credit markets, and other barriers to trade (high registration fees, etc.) constrain the development of small and medium enterprises, and reduce incentives for private sector development.

2.35 The Government has recently adopted several measures to improve labor market flexibility. In particular, reform of the Employment Law has eased regulations on the hiring process. However, it will be important to amend the Labor Relations Law to ease termination conditions and allow more flexibility in wage setting processes. These steps will have to be complemented by reforms in the credit and land markets to spur private sector development and employment growth.

2.36 Summary

- The increase in poverty amongst workers is mainly the result of a sharp decline in real wages. Wage disparity has increased but has contributed far less to the increase in poverty. Wage uncertainty has also increased and has an adverse impact on household welfare. The lack of major restructuring of enterprises has helped contain growth in open unemployment, but at high economic and fiscal costs.
- Low-paid and less educated workers have lost out in both relative and absolute terms in the transition to a market economy compared to well educated top paid (mainly urban professional) workers. The incidence of low pay is highest amongst individuals with primary education or less. The majority of low-paid workers are secondary educated male manual workers in agriculture jobs.
- Poverty is linked strongly to unemployment. Nearly half of all poor live in households with one or more unemployed worker. Poverty rates increase with the number of unemployed in a household. Unemployment affects mainly secondary earners and is a relatively greater problem in urban areas.
- The characteristics of the unemployed in FYR of Macedonia are similar to those found in OECD countries. However, quite atypically, the majority of the unemployed are new entrants to the labor force. Thus, unemployment is mainly a result of constraints to entry not exit, indicating high firing and therefore hiring costs in the country.
- The long duration of unemployment amongst the young is also worrisome. Unemployment of long duration discourages labor force participation, depreciates

labor force skills, and signals a “less productive worker” to the employer. Thus, even new entrants are vulnerable to poverty over the long term. As in other countries, this may be linked to the extensive duration of unemployment benefits (see Chapter 3).

- Private sector growth has helped absorb a large share of less skilled/less educated workers. The private sector is concentrated in less skill intensive agriculture and trade jobs, pays low-wages, and employs half of all low-paid workers. All else being equal, formal private sector growth in should help absorb the less skilled unemployed. There are three caveats. Given the large pool of unemployed workers that may well increase as restructuring resumes, it may take considerable employment growth in the private sector to (all else being equal) bid up wages and alleviate poverty amongst the low-wage employed. Second, a larger role for the private sector may well increase wage disparities between less educated and highly educated workers and contribute to increasing poverty. Third, the Kosovo situation may have an adverse impact on employment and poverty.
- Women are the more vulnerable labor force participants than men. Women are more likely to be unemployed, receive lower wages for the same work, and are less likely to be hired in the private sector. Greater formalization of the economy to encourage non-discrimination in the work force will be key to improving the welfare of female workers.
- Investment in human capital has a large pay off in FYR of Macedonia. Increasing the supply of well educated workers, along with other worker productivity increases (increase in the use of capital in production) should, all else being equal, raise real wages and reduce poverty over the long term. (The education system is discussed in the following chapter).

III. POVERTY ALLEVIATION PROGRAMS AND POLICIES

3.01 The previous chapters have highlighted the importance of investment in education and well targeted cash transfers as key elements of a poverty alleviation strategy. Accordingly, this chapter discusses the poverty aspects of two main public programs: (i) the education system, including pre-school, basic, secondary and tertiary education; and (ii) public transfers. The latter includes (a) the *pay-as-you-go pension system*, established to protect workers and their families against a drop in income from retirement, disability, or loss of an earning family member; two new programs established since independence, (b) the *unemployment insurance and active labor market programs*, to protect workers against temporary loss of income because of job loss and intended to help workers in escaping poverty by facilitating their re-entry to the labor force; and (c) the *mean-tested social assistance program*, which provides a cash transfer to all households falling below a minimum income threshold, and (d) the *child allowances program*, which provides means-tested benefits to all workers with children. The conclusions of this chapter are based on the 1996 'add on' Household Budget Survey.

3.02 Public spending on social programs has increased sharply as a share of total government outlays. In 1996, the Government spent roughly 70% of total budget on social programs, up from 50% in 1991. But real spending on social programs declined over the same period (Figure 3.1). The decline was not uniform across social programs. Real spending on health, education, and pensions fell sharply, but real spending on social assistance and unemployment benefits increased over the same period. An increase in real benefits and number of beneficiaries in both newly created programs explains this trend (Annex 2, Tables 60-61). The decline in real pension spending is the result of a real decline in the pension benefit; the number of pensioners in the country has actually increased as a result of the Government's early retirement provisions designated to facilitate the lay off of redundant workers.

Figure 3.1: Trends in Social Expenditures

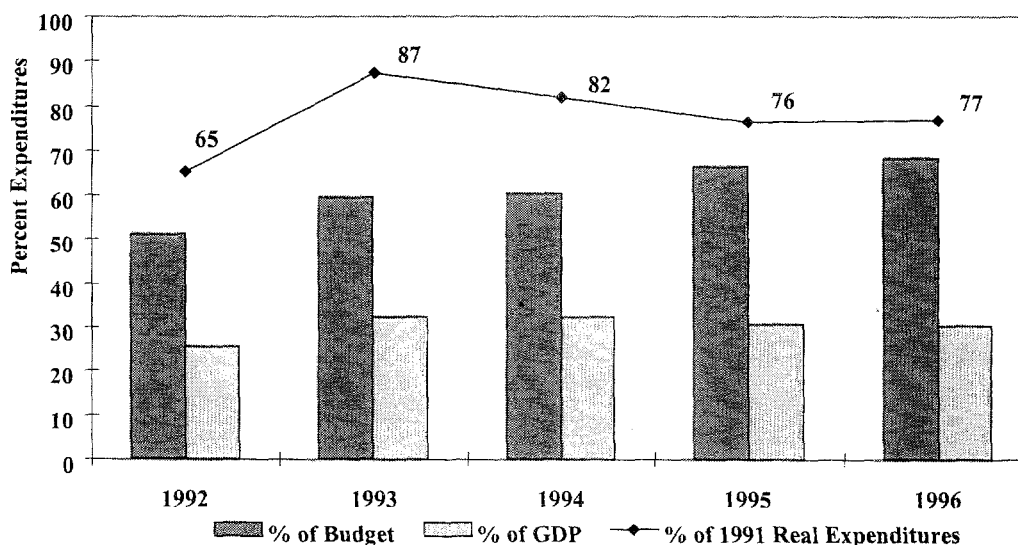
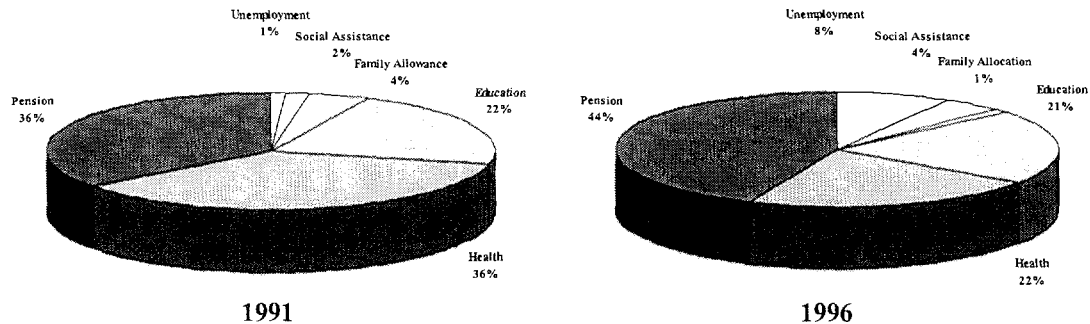


Figure 3.2: The Changing Composition of Social Expenditures, 1991-1996

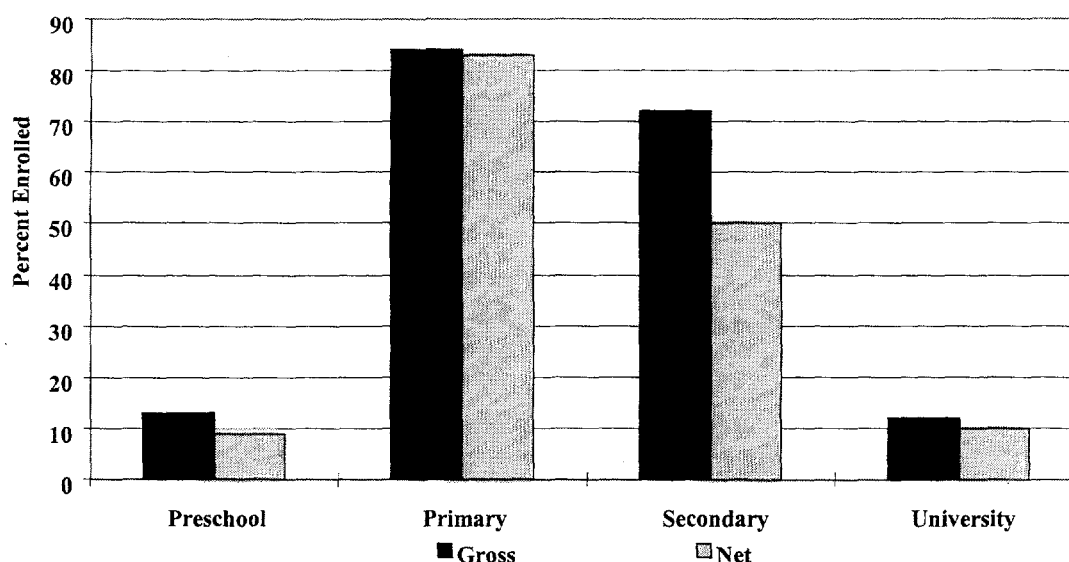


The decline in real resources has also resulted in benefit payment delays in all public transfers, compromising the poverty alleviation objectives of all cash transfer programs. *These pressures are likely to increase as layoffs and growing number of refugees from the Kosovo crisis strain social programs.*

3.03 The composition of social expenditures has also changed over the transition. The share of spending on *social protection*-- unemployment benefits, pensions, and social assistance programs increased while the share of spending on *social services* on (mainly) health and education declined. In 1996, the largest share of public outlays was consumed by pension benefits, followed by public health and education programs. Unemployment benefits, social assistance and child allowance programs comprise a very small share of total government outlays (Figure 3.2).

3.04 The main purpose of government spending on cash transfers, a short term poverty alleviation mechanism, is to improve equity and reduce poverty. Public spending on education is a longer-term investment in alleviating poverty, guided by both efficiency and equity concerns, that coincide in justifying better targeting of resources to the poor in areas that generate high economic returns where the private sector might under supply services that benefit the society at large. This chapter evaluates the poverty alleviation of each program based on its effectiveness and targeting efficiency. Specifically, the *effectiveness* of public spending is defined as the size of the per capita transfer received by the poor expressed as a proportion of per capita consumption. All else being equal, the higher this share the more effective the program in alleviating poverty. The *efficiency* of poverty alleviation programs is the share of total public spending on each program that is received by the poorest population groups. The targeting of programs is judged to be strongly pro-poor (progressive) if the share received by the poor is larger than their proportion of total population. It is considered weakly non-poor (regressive) if their share of public spending exceeds their share in total consumption, but is less than their share in total population. It is considered strongly non-poor (highly regressive) if the share of public transfer is less than their share of total consumption. In the case of public transfers, where possible, the discussion also focuses on the work incentive effects of particular transfer programs, as the lack of work incentives also compromises the efficiency of the program. As in the previous chapters of this report, consumption is used as a proxy for wealth.

Figure 3.3: Gross and Net Enrollment Rates, 1996



3.05 The analysis for the first section of this chapter, which discusses the education system, is based on the 'add on' 1996 Household Budget Survey (HBS). The second section of this chapter, which focuses on cash transfers, is based on first half year data from the 1997 Household Budget Survey. The 1996 data did not provide sufficient observations to undertake the required analysis. The only exception is the description of pensioner characteristics in this section, which was possible only through the use of the 1996 'add on' Household Budget Survey.

A. The Education System

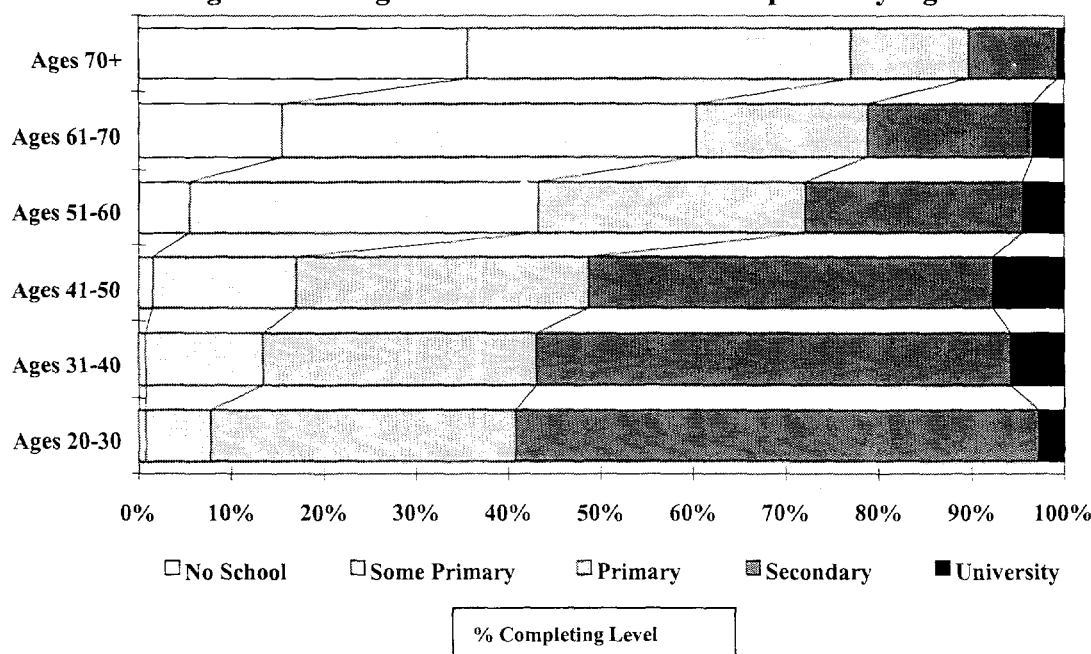
3.06 The Macedonian education system, funded and provided by the state, guarantees the constitutional right of all children to be educated in their own languages--Macedonian, Albanian, Serbian, Turk, or Gypsy -- through secondary education. The education system is comprised of pre-school (ages 3-6); *compulsory* basic or primary school (ages 7-14); and two streams of secondary education (ages 15-18); specialized vocational and general secondary; and tertiary education.

3.07 **Participation in Education: Past and Present** Macedonian gross enrollment rates are lower relative to regional norms at all levels of the education system.¹ The gross enrollment rate in primary education is roughly 84%, dropping to 72% in secondary school,² and 12% in post-secondary education. The gross enrollment is 13% for pre-school education. Net enrollment is roughly equal to gross enrollment for all levels of education except at the secondary school level (50% net enrollment) (Figure 3.3) (Annex 2, Table 45).

¹ Gross enrollment rate=[total enrollment /total population in relevant age group]

Net enrollment rate=[total enrollment of relevant age group /total population in relevant age group]

² Survey data shows a different gross secondary school enrollment rate (72%) than SCT data (58%).

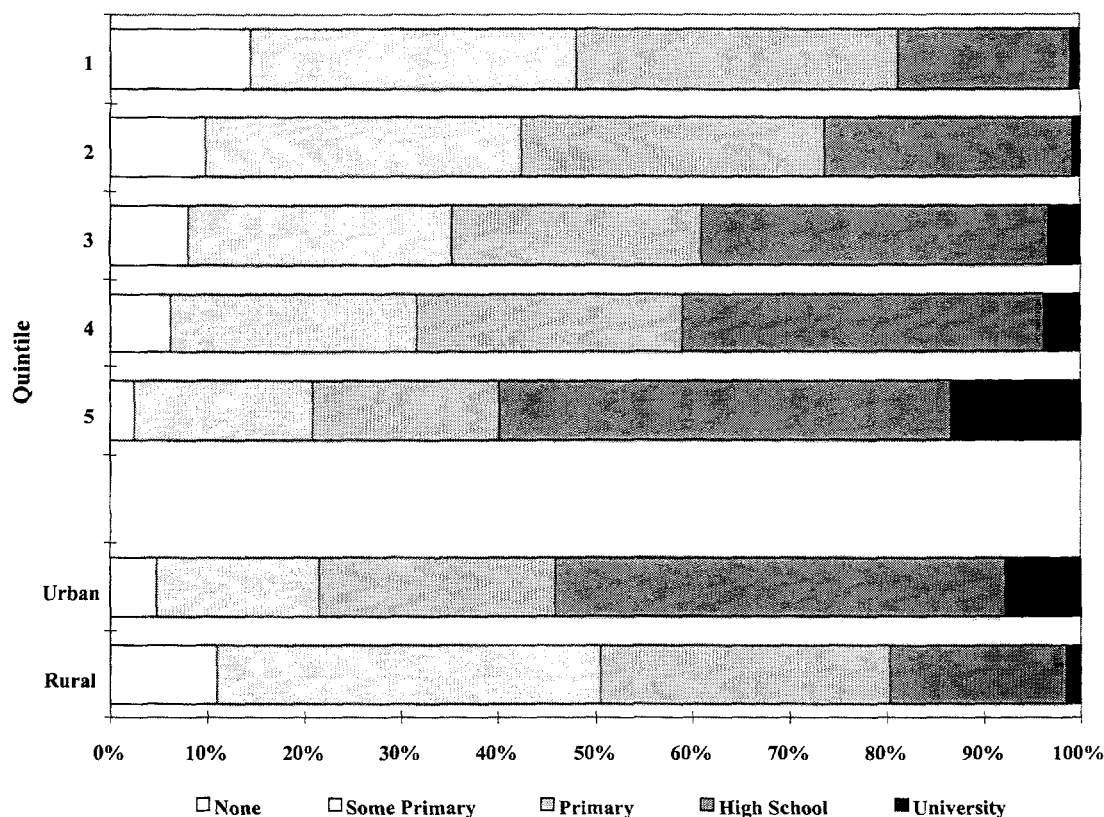
Figure 3.4: Highest Educational Level Completed by Age

3.08 The current levels of participation in the education system must be seen in an historical context. There have been major changes in the participation rate in the education system during the transition. As in most transition countries, gross enrollment rates have declined at all levels of the education system.³ The decline in enrollments overall likely reflects a decline in real household income, an increase in the indirect (in terms of foregone income for higher ages), and an increase in direct costs of obtaining an education, (as a result of the increased fees and reduced subsidies on textbooks (See below). Another important trend, common to the region, is the switch in enrollments from highly specialized vocational secondary schools towards general secondary education. This is generally attributed to growing dissonance between specialized vocational secondary education curricula and the market economy. However, despite this decline, the enrollment rate in vocational education still remains a very high share of total secondary enrollments compared to other countries in the region⁴.

3.09 The current participation rate also masks major gains made in the educational attainment of the population over time. The increasing level of average education status can be gauged by comparing the educational attainment of successive cohorts (Figure 3.4). Education status has increased overall for both men and women and for rural and urban areas. A most important development is the narrowing of the gap, over time, between the educational attainments of males and females and, to a lesser extent, of rural and urban residents. The country has also achieved a 95% literacy rate. These major

³ Laporte and Ringold, Trends in Education, SCT Paper.

⁴ ECA Education Sector Strategy.

Figure 3.5: Educational Attainment by Population Income Quintile and Region

achievements are likely attributable to changes in education policy (compulsory education); increased demand for education through greater awareness of its importance in determining income status; or simply from the greater availability of schools.

3.10 Nevertheless, despite these developments, there currently remains a significant gap in the educational attainment, across income groups, amongst men and women and rural and urban residents. The close correlation of education status with level of household consumption or wealth, bears repeating (Annex 2, Table 60). Nearly 80% of the poor (vs. 60% of the rich) have less than primary school education. Only 20% of the poor have completed secondary school. There are gender differences in educational attainment. Only half of all women, but nearly two thirds of all men in the top income bracket have an education level of secondary school or higher. This difference in education status is even more pronounced in lower income groups. Individuals living in rural areas, women in particular, have the lowest education status amongst poor households (Figure 3.5). And almost all university education graduates are from the top income quintile and from urban areas.

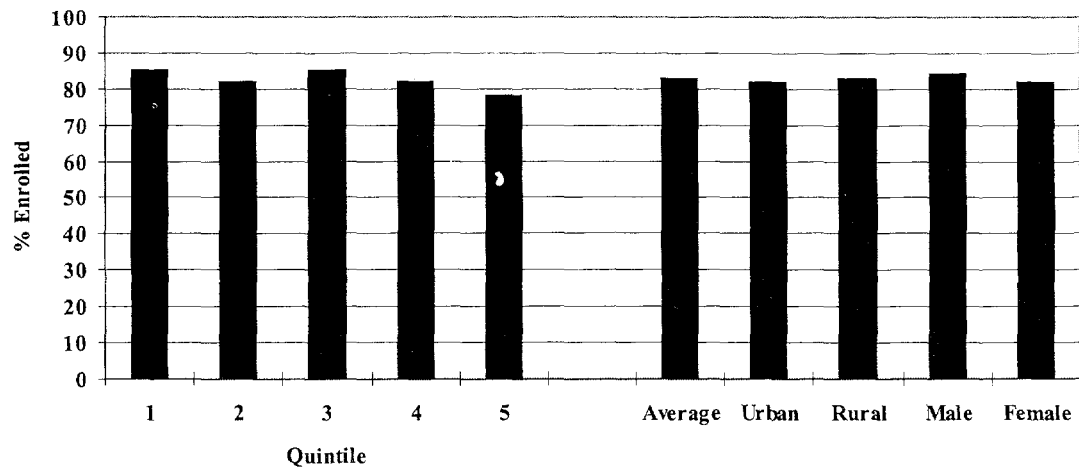
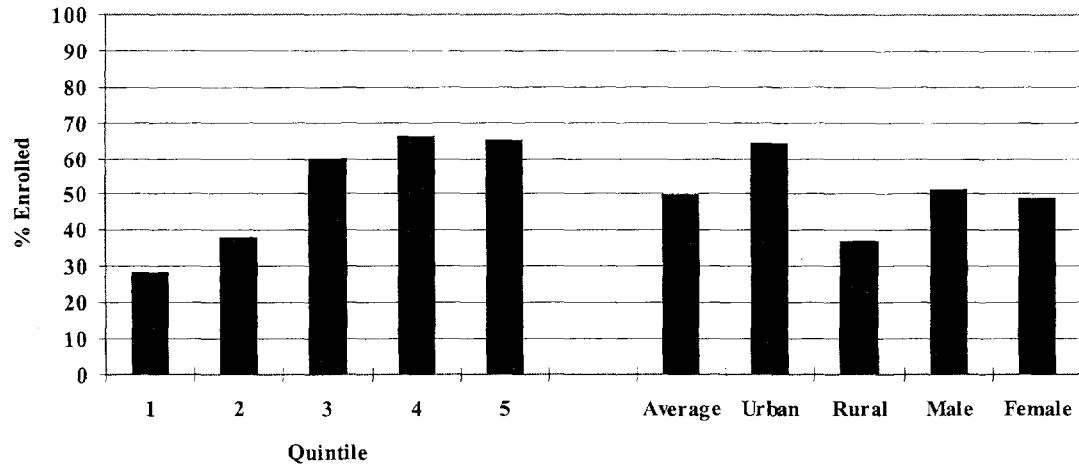
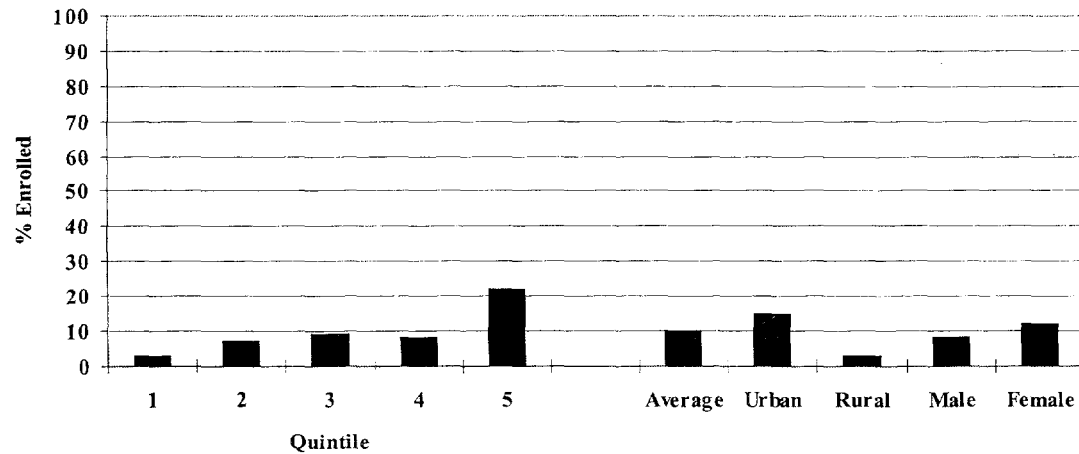
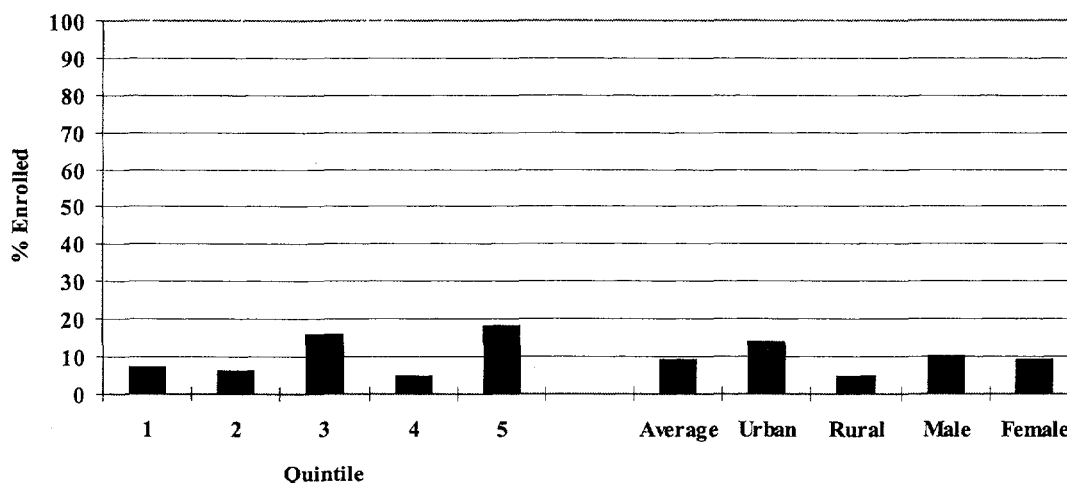
Figure 3.6A: Net Enrollment by Education Level - Primary School**Figure 3.6B: Net Enrollment by Education Level - Secondary School****Figure 3.6C: Net Enrollment by Education Level - Tertiary Education**

Figure 3.6D: Net Enrollment by Education Level - Pre-School

An evaluation of current enrollment rates shows that these differences may remain. While the gender gap has virtually disappeared from all levels of schooling in both urban and rural locations,⁵ net and gross secondary and tertiary enrollment rates vary considerably across income groups and regions. The net enrollment rates in secondary schools varies from a very low 28% (40% gross) in the poorest quintile to 65% (90% gross) in the richest quintile.⁶ At the tertiary level, enrollment rates are negligible at all but the richest quintile. There are substantial rural/urban differences in secondary and tertiary level enrollments as well. Urban enrollment rates are much higher than rural enrollment for both secondary and higher education⁷. Pre-school enrollments are roughly the same across income groups, but double in urban relative to rural areas (Figure 3.6A-D).

3.11 The basic enrollment rate of the children of the poor in the secondary and higher education system is worrisome and, as noted in previous chapters, suggests that poverty may be perpetuated amongst the poor. The most common reasons given for not being in school for school age children is the completion of compulsory minimum (21%),⁸ the high cost of schooling (15%), and failure (10%) (Annex 2, Table 44).⁹ The higher poverty rate of households with non-attending children (25%) relative to those with children in school (10%) suggests that poverty may perpetuate amongst these households.

⁵ There is a marginal tendency for male enrollments to be greater (than females) at primary and secondary levels, but a much more marked tendency for female enrollments to be greater (than males) at tertiary level.

⁶ Some puzzles remain that may well be a function of data limitations. These include the high female primary enrollment rates in rural areas (85%) compared with urban (79%).

⁷ This may reflect the fact that households residing in urban areas may board rural area students who are attending the University in Skopje.

⁸ The reason for expulsion etc. is not possible to ascertain in the survey.

⁹ Drop out and repetition rates reported by households are quite low.

Box 3.1 Education

Availability. Respondents describe numerous obstacles which make it difficult for their children to attend primary school (particularly in rural areas, where this is a greater problem than in Skopje and other urban areas) and pursue secondary education. These range from the breakdown in affordable transportation in rural areas to the cost of textbooks, school supplies, and clothing. In Skopje, interviewers noted that in poor families, one or two children sometimes dropped out of school so that a more motivated or gifted sibling could attend. Other reasons for non-attendance include young peoples' loss of confidence that completing school would result in work, and the feeling of young people from very poor families (particularly gypsies) that teachers and other pupils treat them with contempt.

Problems of transportation. In Zlokucani village, for example, the nearest elementary school is 4 km away, and many village children do not attend. Parents in such mountainous villages, where the nearest school is several kilometers away, often kept their children home during bad winter weather. In some cases, sudden changes of weather had prevented children from returning home, a cause of great anxiety to their parents. In eastern FYR of Macedonia, however, some village governments had organized transportation so that children could reach the school in town. In the Skopje region, one family described their son's route to his high school, located 20 km away. He travels part of the way by one of the new "private" buses, paying 10 denars for a ticket, and then walks the rest of the way because it would cost a further 30 denars on public transportation. As a result, it takes him two hours to reach a school that is about 30 minutes away by car.

The problem of textbooks and school supplies. Providing their children a full set of textbooks is a major problem for poor families of primary school children. A set may cost up to 1,200 denars, and it is difficult to buy used texts since they often double as notebooks in which the children write. Some children are able to borrow textbooks from relatives or friends. But they also face the problem that for some primary school subjects, the textbooks change almost every year. Parents complained that bookstores prefer to sell textbooks in sets and they cannot buy single books. Families with several school age children often borrow money to buy textbooks; sometimes they buy them on installments. Many families try to sell the used textbooks at the end of the year in order to raise money for the next year's textbooks. Because of the frequent changes in primary school textbooks, however, this is usually only possible for secondary school students. In Skopje, children sell their used textbooks in their school yards or in the City Square before the start of the new school year. Vaska, a high school student, described how she and her friend pooled their money to buy a single set, from which they studied together during the school year. In some cases, classroom instruction occurs entirely without textbooks. Thus, Ismet, who attends a vocational school for training mechanics, reported that no one in his class has textbooks. "All students take notes during class. We study from those and it's sufficient to pass."

The minority experience. A Gypsy family living on the outskirts of Stip in central FYR of Macedonia reported that they must force their children to attend school. The children are reluctant to attend because they lack textbooks. Their teacher characterized them as "guests" in the school, while the other children laugh at them. The parents applied to the Center for Social Assistance for help purchasing books, but were refused. Last year, their son failed the first grade and is now repeating it. But the situation remains the same—he and his sister, also in the first grade, still do not have any school supplies. The older siblings—a daughter of 18, and a son of 16—studied when the family lived in Germany, but refused to continue their education when the family returned because they would have been older than their classmates. While Gypsies are proficient in Macedonian, Albanian children usually attend Albanian language primary schools, and prefer to continue their education in Albanian, something which is not always possible at secondary level, unless their families have money to send them to schools in other towns. Especially in urban areas, Albanian girls tend to complete primary education, to the extent that the family has adequate resources. Yet even in urban regions, families may pull their girls out of school. In one interviewed family, the 90 year old grandfather, the head of the household, refused to allow the girls to be educated. Girls in two other Albanian families had to leave school rather than walk unescorted, or, in one case in western FYR of Macedonia, to ride the school bus with boys (a situation which elicited much unfavorable gossip in the Albanian community). Girls in yet another family were taken out of school to take care of the household because their mother was ill.

3.12 The proportion of children who state that *completion of the compulsory minimum* (vs. *completion* of their *desired level* of schooling) is their main reason for not being enrolled decreases with the income level of the household. Thus more poor than rich children do not obtain their *desired level* of schooling. This may reflect the low quality of schools in poorer areas, or the indirect or opportunity costs of forgone income of educating children faced by poorer households. This conjecture is supported by evidence from the labor force survey. According to the 1996 Household Budget Survey, some secondary school age students in rural, or poorer areas, work. The high poverty rate amongst households with non-attending school age children mentioned above suggests that withdrawal of children for work is not alleviating poverty. The employment of working age children, although it reduces its depth and severity of poverty in the short run, does not allow their families to escape poverty, and likely perpetuates it. Gypsy children are a particularly vulnerable group and some do not attend school (Box 3.1).

3.13 The main costs faced by households in educating their children are *books and supplies* and *transportation* costs. Books and supplies are relatively more important as a share of private spending for pre-school and primary school students. The share of transport costs dominates as a share of private spending only at secondary and post-secondary levels. Admission fees become a significant share of education costs only at the tertiary level (Annex 2 Table 46). Poor households spend more on educating each child as a share of household expenditures. The average enrollment cost as a share of household per capita expenditure decreases with income for all levels of the education system (Table 3.1).

3.14 **Public Spending on Education.** Recent fiscal problems have reduced real public spending on education. Education spending has been curtailed through a salary freeze, sharp reductions in non-salary budgets (teacher training, curriculum development, maintenance) and greater cost recovery. Students are now expected to pay for school supplies and textbooks at all levels of the education system. These measures have been coupled with some initiatives to improve the targeting of education resources towards the

Table 3.1: Ratio of Mean Per-Enrollment Cost and Expenditure Per Capita

Quintile/ Region	Preschool	Primary	Secondary	Tertiary
1	0.08	0.10	0.19	0.34
2	0.09	0.09	0.17	0.29
3	0.05	0.08	0.14	0.24
4	0.02	0.06	0.10	0.14
5	0.01	0.06	0.09	0.15
Total	0.03	0.06	0.11	0.21
Urban	0.03	0.06	0.10	0.20
Rural	0.04	0.06	0.13	0.17

Table 3.2: Household and Government Spending on Public Schooling

Quintile/ Region	Household Spending Denars per student	Per Capita Spending				Total Denars
		Household		Government		
		Denars	Percent of Total	Denars	Percent of Total	
1	2,333	396	10	3,664	90	4,061
2	3,233	602	13	4,001	87	4,603
3	4,131	721	15	3,968	85	4,688
4	3,807	572	13	3,677	87	4,249
5	7,758	1,202	21	4,512	79	5,713
Total	4,218	748	16	3,964	84	4,712
Urban	4,975	902	17	4,427	83	5,329
Rural	3,232	520	13	3,411	87	3,931

poor. Poor students in elementary school are exempt from these costs. Moreover, while students now pay nearly 70% of boarding costs (lodging and food) in secondary school (40% for university), school boarding is free for poor students from remote areas. University students (some 2,000 out of a total 18,000 students) are also now responsible for tuition payments.

3.15 Despite the wage freeze, salaries still remain a staggering 80% of total education spending. This wage share is amongst the highest in the region and reflects, in part, the constitutional right of all children to be educated in their native language, the specialized curriculum in higher primary and secondary school, and the low teaching load (by law and because of single subject teaching). This is reflected in student to teacher ratios that are very low in higher primary and secondary schools relative to OECD norms.¹⁰ The high share of wage costs has crowded out spending on other vital areas such as teacher training, educational materials, maintenance and capital renewal. Even the limited amounts allocated to non-salary spending are not fully realized as financing problems occur throughout the year. This has also resulted in severely dilapidated school structures, particularly in poor rural areas.

3.16 An important objective of public spending on education is to improve the education status of the poor. Given the changes outlined above, does public spending benefit the poor? The amount of per capita education subsidy is roughly the same (though marginally higher for the highest quintile) across income groups. However, public spending on education comprises a much greater share of *total* education spending compared to private spending on education. This is particularly the case for poorer households (Table 3.2).¹¹

¹⁰ UNESCO, 1995. Public Expenditures on Education in FYR of Macedonia. This does not capture the potentially lower teaching/hours per day.

¹¹ The incidence of public spending on education per capita by decile is derived by multiplying, in each decile i) enrolled/school age population; by ii) school age population/total population; and iii) average spending/enrolled. The average spending per student is assumed to be equal for all students (and may therefore over-estimate the proportion of education spending accruing to the poor). In secondary school, spending is skewed towards higher income groups because although the ratio of school age population/total population falls with income, this effect is dampened by the ratio of enrolled/school age population which increases with income.

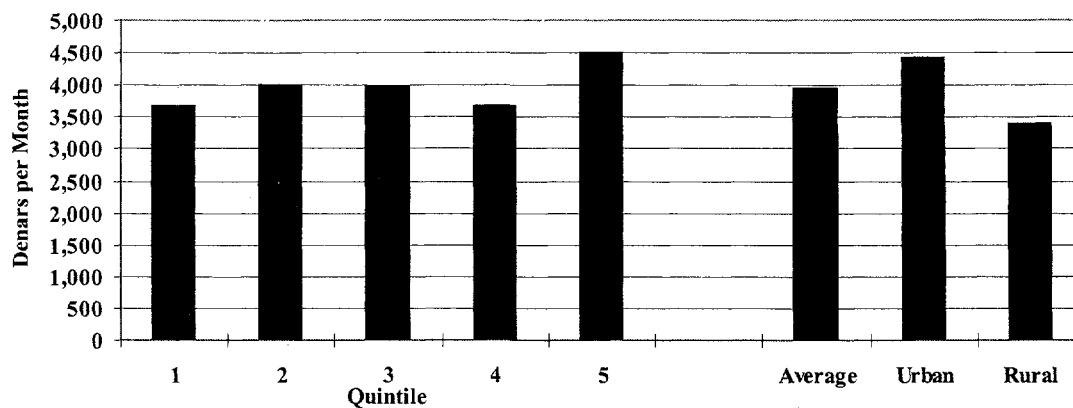
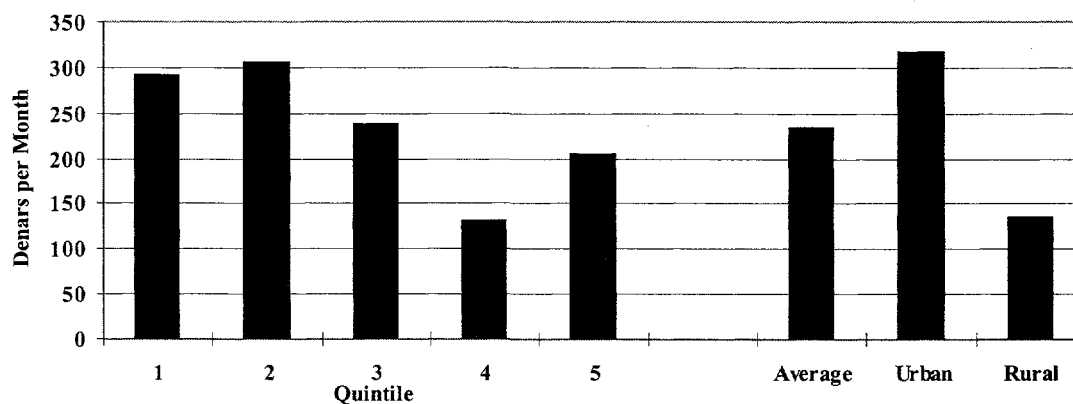
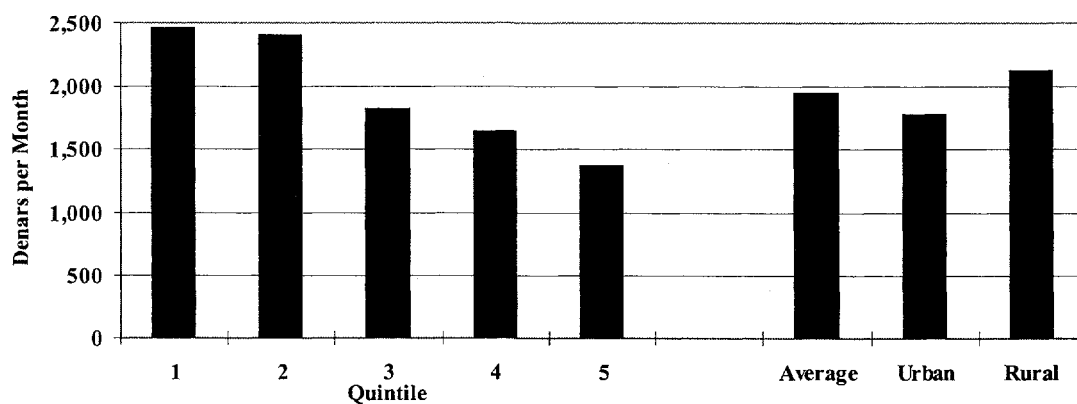
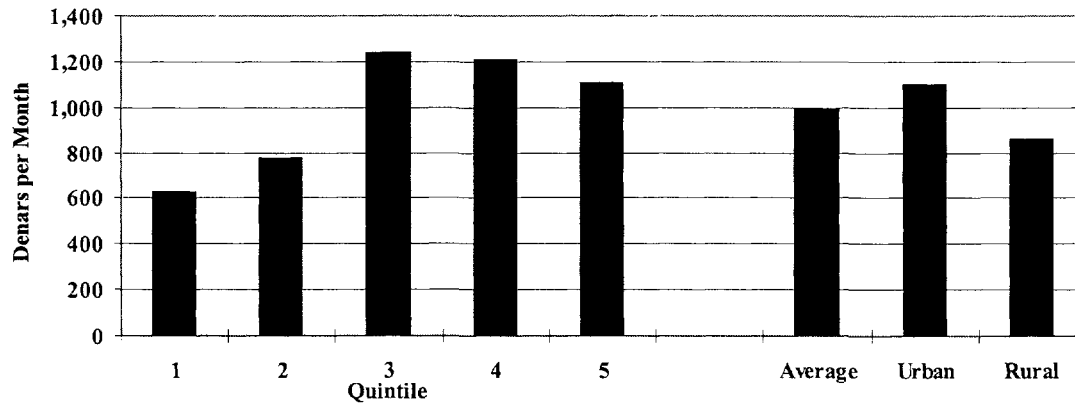
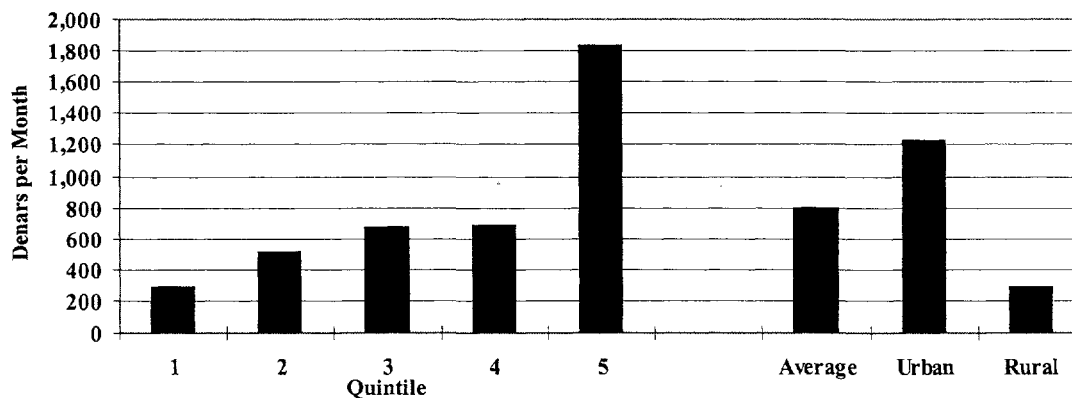
Figure 3.7A: Education Subsidy Per Capita - All**Figure 3.7B: Education Subsidy Per Capita - Pre-School****Figure 3.7C: Education Subsidy Per Capita - Primary School**

Figure 3.7D: Education Subsidy Per Capita - Secondary School

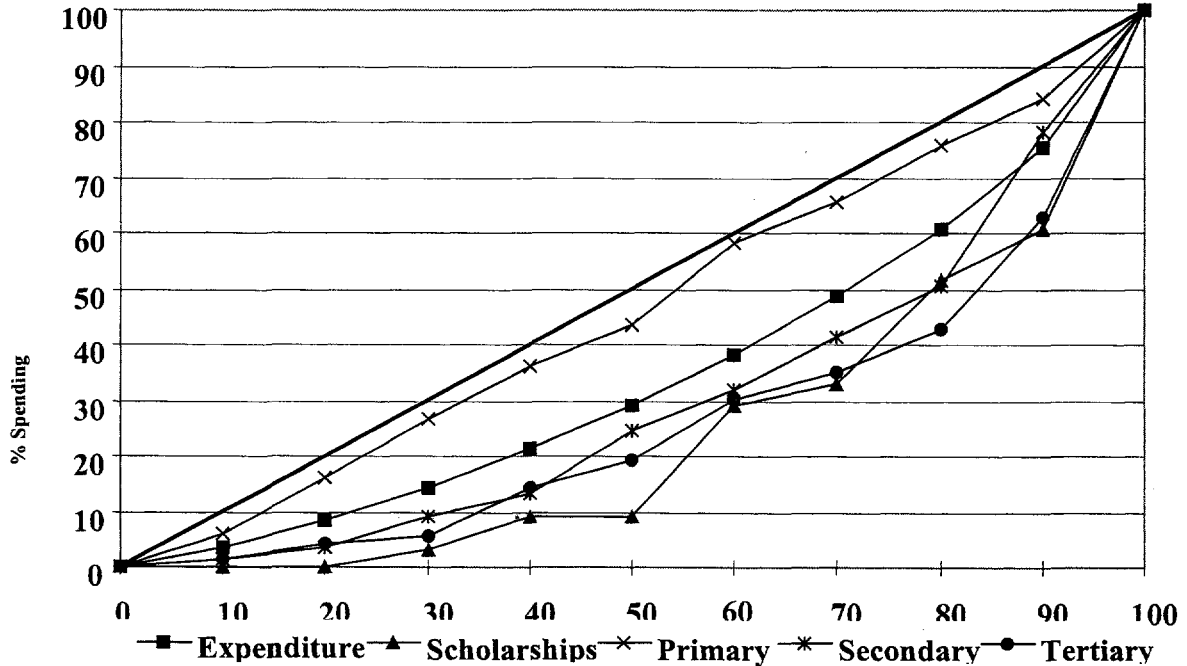
3.17 Public spending on education is also very *effective*. The per capita subsidy received by the bottom quintile comprises nearly 20% of their total consumption spending. This result masks important differences in distribution of the per capita subsidy by level of education. Although the per capita education subsidy declines with income for pre-school and primary education, richer households receive a much higher per capita subsidy for education in both tertiary and secondary education. The highest average per capita subsidy, however, is realized by primary education, followed by secondary school. The lowest per capita subsidy is received by tertiary school students. There is a rural/urban bias as well. The level of the per capita subsidy is much lower in rural than in urban areas. The only exception is primary education where rural areas receive a higher per capita subsidy than urban centers. Once again, there is no evidence of a gender bias against women (Figure 3.7A-E).

Figure 3.7E: Education Subsidy Per Capita - Tertiary Education

3.18 The share of public education spending received by the poor varies considerably by level of schooling. Education spending is strongly pro-poor in preschool education. However, primary school education is only weakly non-poor. The poor receive a smaller share of primary education spending relative to their share in total population (but a greater share than their share in consumption). However, education spending is strongly non-poor in both secondary and post-secondary education. The poor receive a smaller share of secondary and post-secondary education spending even compared to their share of total consumption. This is not surprising. Nearly 70% of all transfer spending (on fees, boarding, transportation) is received by higher education students.¹² Moreover, higher education scholarships are based only on academic merit and not on a need and merit basis. This restriction has skewed scholarship spending away from the poor towards children from richer households who attend better schools and can afford extra supplementary help. Thus, despite the overall egalitarian trend, education spending, with the exception of pre-school education, is not particularly well targeted to the poor (Figure 3.8).

3.19 This analysis suggests that there is some scope for improving the allocative efficiency of public spending on education. First, there is scope for targeting public spending on education towards the poor. This could potentially be achieved through greater cost recovery at secondary and higher education levels, through methods such as

Figure 3.8: The Distribution of Public Spending on Education



¹² UNESCO, 1995. Public Expenditures on Education in FYR of Macedonia

increased fees (with attention to the impact on the demand for education). These savings could be used to subsidize fees, textbooks, boarding, and transportation for poor rural students. To increase the participation of the poor in higher education, scholarships could be awarded on a need and merit basis, or set aside for a certain proportion for both.

3.20 Second, there may also be scope for improving the allocation of education spending from wage to non-wage costs. However, this re-allocation will have to be consistent with the phasing and content of the reforms in curriculum, teacher training, etc. to improve the quality of the education system.

3.21 Summary

- The country has made significant gains in raising the education status of the population at all levels of income, gender, and rural/urban location. Nevertheless, education status of the working age population is still lower for women than men, for the poor than the rich, and for rural than urban residents.
- The *gender gap* has been virtually eliminated at all levels of the education system, and income and rural/urban differences have been virtually overcome in compulsory basic education.
- The enrollment rates of the poor are much lower in secondary and higher education. The low participation rates of children of poorer rural areas (with less educated household heads) is particularly worrisome and indicates that poverty may be perpetuate amongst these groups.
- Private spending on education is *regressive*. Poorer households spend more on education relative to their income compared to the rich. *Books and supplies* are the most important components of private costs in primary and pre-school education. *Transportation costs* dominate private spending at the secondary and post-secondary levels.
- Public spending on pre-school education is strongly pro-poor, and primary education spending is roughly egalitarian while public spending on both secondary and higher education is strongly non-poor. Public education transfer spending on education is received by higher income tertiary education students. Scholarships are also received disproportionately by higher income groups.
- Real spending on education should be kept constant. However, there is scope for improving the *resource allocation* of education spending, from rich to poor and from wage costs to investment in the quality of the education system and educational facilities.
- Pro-poor education policies include greater cost recovery in secondary and higher education (with attention to demand) coupled with secondary and higher education scholarships that focus on both merit and need; reducing the costs of textbooks and books/supplies at primary education levels and transportation/boarding for the poor, particularly at secondary and higher education levels.

- The phasing and instruments for improving the overall efficiency and equity of education spending, should be determined as part of a comprehensive education sector reform program strategy. Increasing the participation of the poor at secondary, higher education levels, particularly in rural areas should be a particular focus of education reform efforts.

B. The Public Cash Transfer System

3.22 Apart from publicly provided health and education, individuals and families are protected from life cycle risks via four programs: (i) the pay-as-you-go pension system that protects workers and their families from old age (retirement), disability, or death of an earning member, (ii) a means-tested child allowance for workers employed in the public sector (enterprises), (iii) the unemployment insurance program that protects workers against temporary loss of income as a result of job loss, and (iv) a means-tested social assistance program for those who fall below a specified income level, whether employed or not. Private transfers, particularly remittances, are also an important source of income for households. In addition, the country provides institutional care for orphans and the elderly, and a one-off cash payment for households in emergency situations.

3.23 In 1996, the four major public cash transfer programs noted above consumed almost 18% of GDP, up from 13% of GDP in 1991. This is somewhat illusory. Real

Table 3.3: The Poverty Impact of the Public Cash Transfer System

	Poverty line is 60% of Median Adult Equivalent Expenditure					
	Total	Excludes Unemploy- ment Benefits	Excludes Social Assistance	Excludes Child Benefits	Excludes Old- Age Pensions	Excludes Social Transfers
	(1)	(2)	(3)	(4)	(5)	(6)
Total						
Gini	0.29	0.30	0.31	0.29	0.39	0.43
HC Ratio	17.00	18.00	19.16	17.36	34.70	38.98
Poverty Gap Index	4.48	5.21	6.70	4.55	16.66	21.21
Poverty Severity Index	1.70	2.25	3.68	1.73	14.43	18.88
Urban						
Gini	0.27	0.27	0.28	0.27	0.38	0.42
HC Ratio	7.80	9.10	9.74	8.34	27.15	32.25
Poverty Gap Index	1.48	2.30	3.21	1.55	14.00	18.53
Poverty Severity Index	0.42	1.00	1.91	0.43	13.72	18.03
Rural						
Gini	0.25	0.25	0.27	0.25	0.34	0.38
HC Ratio	30.09	30.60	32.47	30.10	45.47	48.50
Poverty Gap Index	8.74	9.32	11.64	8.78	20.42	24.98
Poverty Severity Index	3.53	4.00	6.17	3.56	15.43	20.08

1997 First half data (Household Budget Survey)

spending on cash transfers has declined over the same period. As noted above, this is mainly the result of a fall in real pension spending due to restrictive indexation of pension benefits. In contrast, real spending on unemployment benefits and social assistance programs has increased both because of an increase in program beneficiaries as well as an increase in real benefit (Annex 2, Table 60-61). The largest share of expenditures was consumed by pension payments, followed by unemployment benefits, social assistance, and child allowances. The current allocation reflects marked shifts in the relative emphasis within social protection programs. The relative share of child allowances has declined while that of social assistance and unemployment benefits has increased. Pension spending remains, then as now, the most important cash transfer program in the country. *The recent crisis in Kosovo and ensuing layoffs are likely to increase pressure on the unemployment benefit and social assistance programs.*

3.24 In the first half of 1997, these four programs taken together had an important poverty alleviation impact. All else being equal, in the absence of public transfer programs the incidence of poverty would have been more than double the current level (compare Column 1 with Column 6 in Table 3.3). The poverty gap would be almost five times as high and the severity of poverty would be even more greatly affected. The impact of each transfer program on poverty varies considerably however. The following sections discuss each public cash transfer and its poverty alleviation impact in greater detail. As noted above, this section is based on the first half 1997 Household Budget Survey data. The only exception is the description of the characteristics of pensioners which is based on 1996 HBS data. As in the case of all cash transfers, the level and incidence of pension spending is based on the first half 1997 Household Budget Survey data.

The Pension System

3.25 The public pension system is financed on a pay-as-you-go basis and provides protection against loss of income from disability, old age, and loss of a main earner in the family. In 1996, the coverage of the pension system was quite extensive, at least for men.

Figure 3.9: The Coverage of the Pension System by Gender and Age

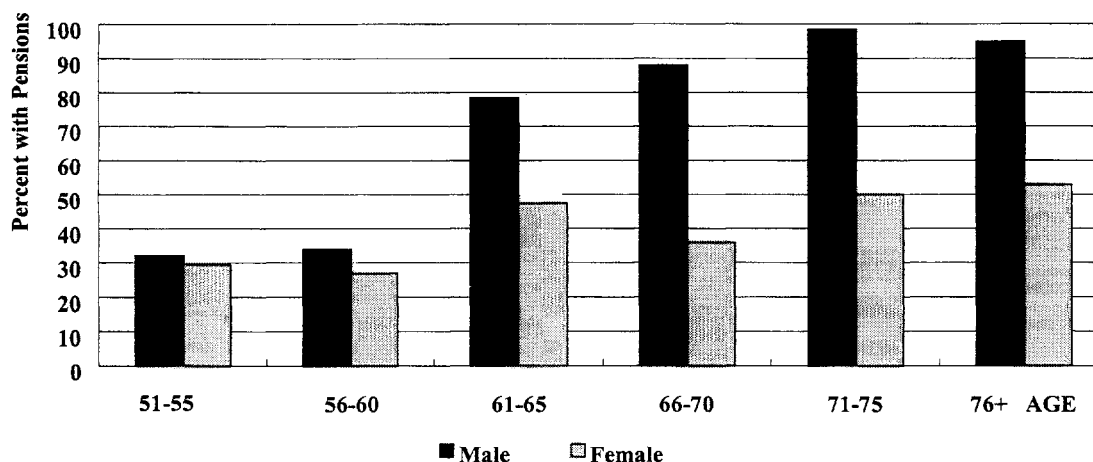
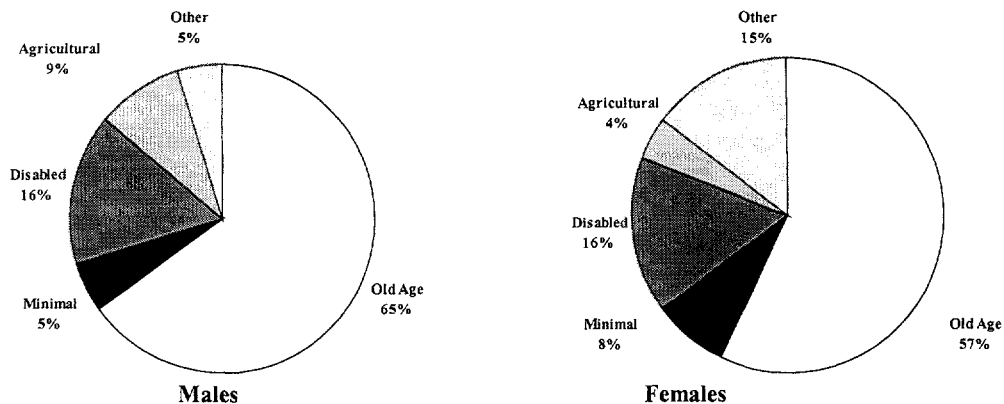


Figure 3.10: The Composition of Pensions by Type

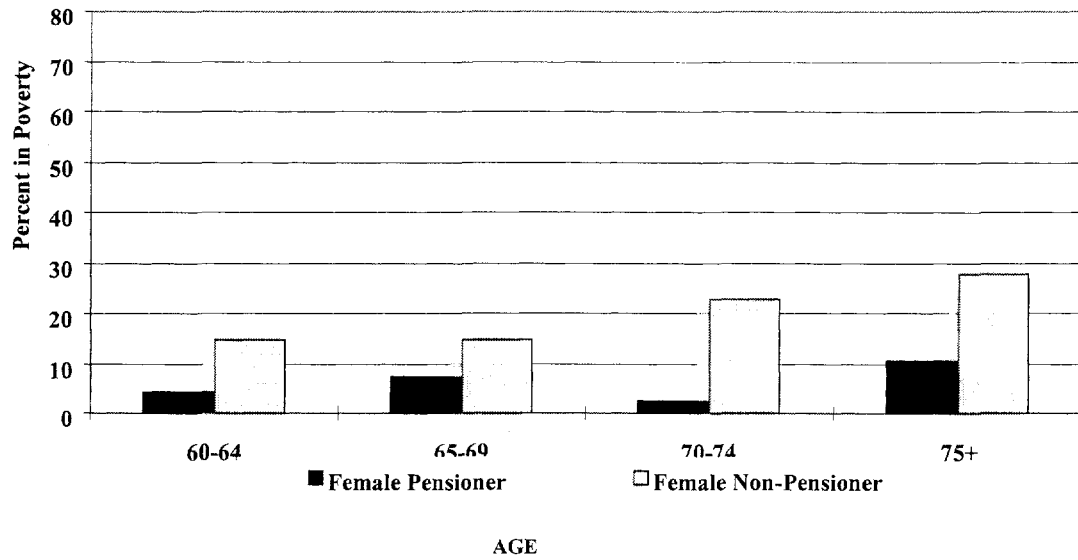
By age 66, 90% of all men receive a pension. In contrast, as a result of low past labor force participation, more than 50% of women over 66 receive a pension (Figure 3.9). The most common pension received by both men and women is an old age pension (Figure 3.10). Agricultural pensions are received by a small proportion of pensioners. There are some differences in distribution of pension type by gender of recipient. Women receive a higher share of minimal and survivor pensions than men, and a commensurately lower share of old age and agricultural pensions.¹³

3.26 The average amount of the pension varies by pension type (Table 3.4). The highest average pensions are old age pensions, followed by disability and other pensions (mainly survivor pensions for women). Agricultural pensions pay the lowest average amounts overall. Women receive lower pensions than men, reflecting lower paying jobs and/or lower survivor pensions for all but the minimal pension category. The average level of pension varies by rural and urban areas. The average old age pension is higher in urban areas while the average disability, minimum, and agricultural pension is higher in rural areas.

Table 3.4: The Average Amount of Pensions by Gender and Type, 1996

Type of Pension	Urban	Rural	Male	Female	Total
Old Age	6,461	4,970	6,389	5,387	6,024
Minimal	4,072	4,183	3,976	4,250	4,111
Disabled	5,144	7,354	6,728	4,387	5,789
Agricultural	3,033	3,736	3,719	3,570	3,682
Other	5,645	5,244	6,959	4,822	5,477
Total	5,990	5,024	6,093	4,974	5,649
N	472	259	342	289	731

¹³ The HBS data differs in some details from the Administrative Data of the Pension Fund. The other category includes survivor pensions. Agricultural pensions are farmer pensions, now being phased out; minimal pensions are minimum pensions for the state scheme.

Figure 3.11A: Poverty Amongst Female Pensioners and Non-Pensioners by Age

3.27 Despite low poverty rates, poor pensioners constitute over a fifth of all poor in the country. The most vulnerable group are older pensioners. The incidence of poverty increases with age (Figure 3. 11 A and B). This holds for both male and female pensioners. The increase in poverty with age can be linked, in part, to the decline in the average pension benefit by age of recipient. (See Figure 3.12 A and B).

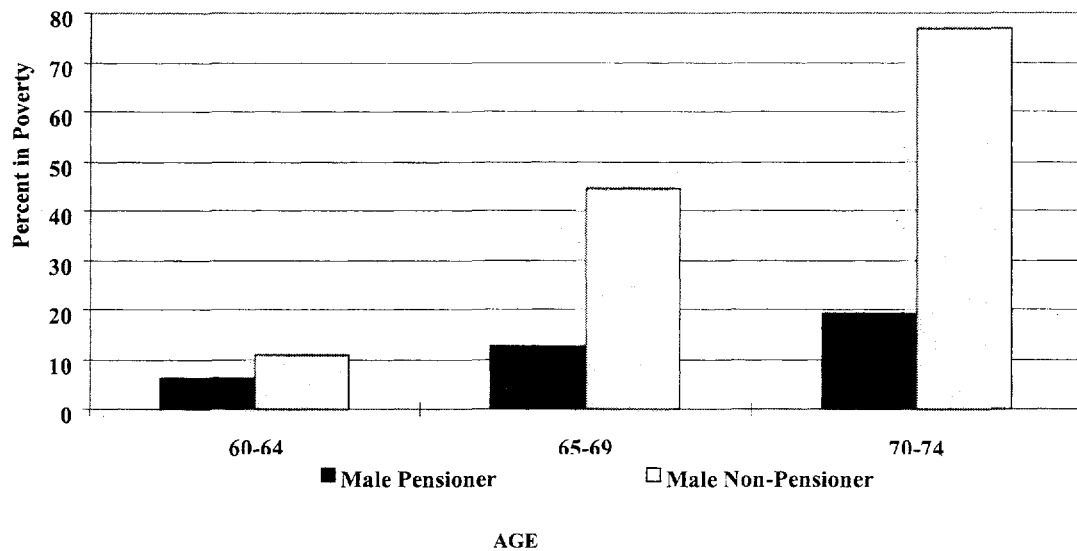
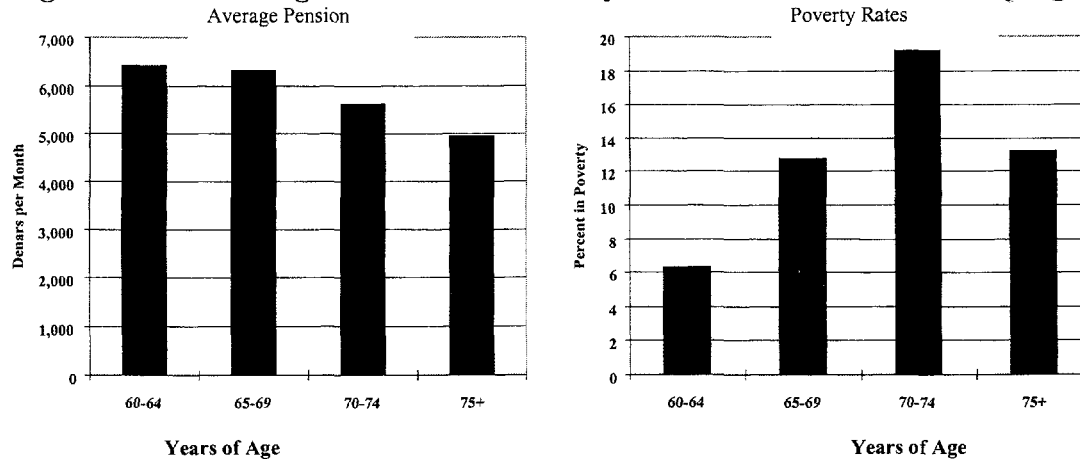
Figure 3.11B: Poverty Amongst Male Pensioners and Non-Pensioners by Age

Figure 3.12A: Average Pensions and Poverty Rates for Male Pensioners by Age

3.28 In contrast to OECD countries, the poverty rate is lowest in single pensioner households, perhaps because pensioners in larger households share pensions with other household members who do not have additional income. (Annex 2, Table 55). The poverty rate is higher amongst pensioners in rural as opposed to urban areas. This may be a result of low rural incomes that contribute to low rural pensions, but the under reporting of agricultural incomes may also account for this result. In contrast to other countries, poverty rates are higher amongst male headed as opposed to female-headed pensioner households (Annex 2, Table 55).

3.29 Nevertheless, pensioners have a much lower incidence of poverty compared to aged non-pensioners. The incidence of poverty is much lower amongst pensioners over

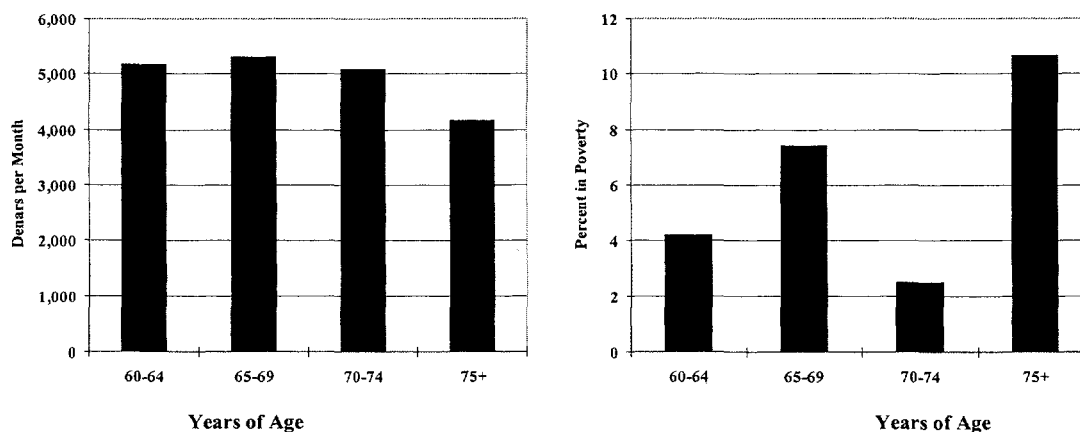
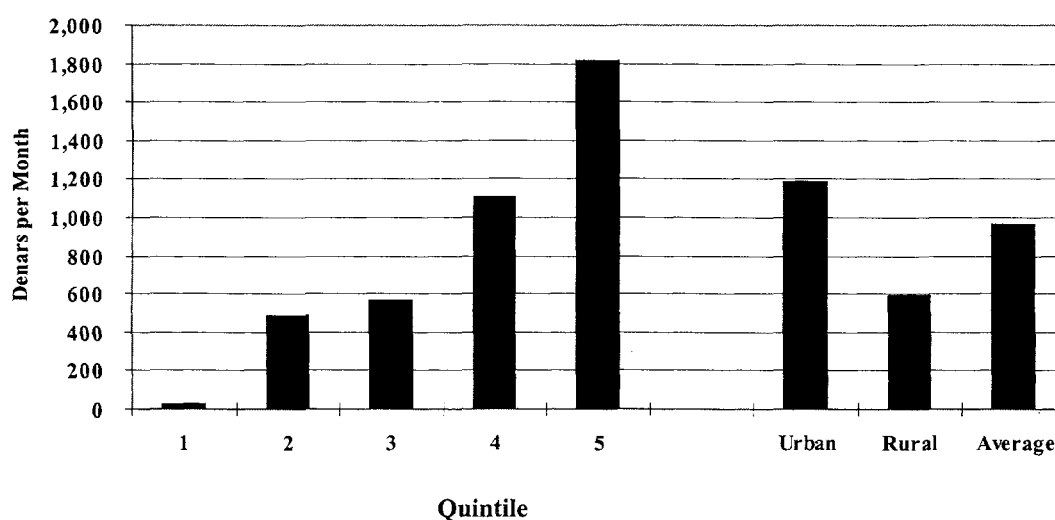
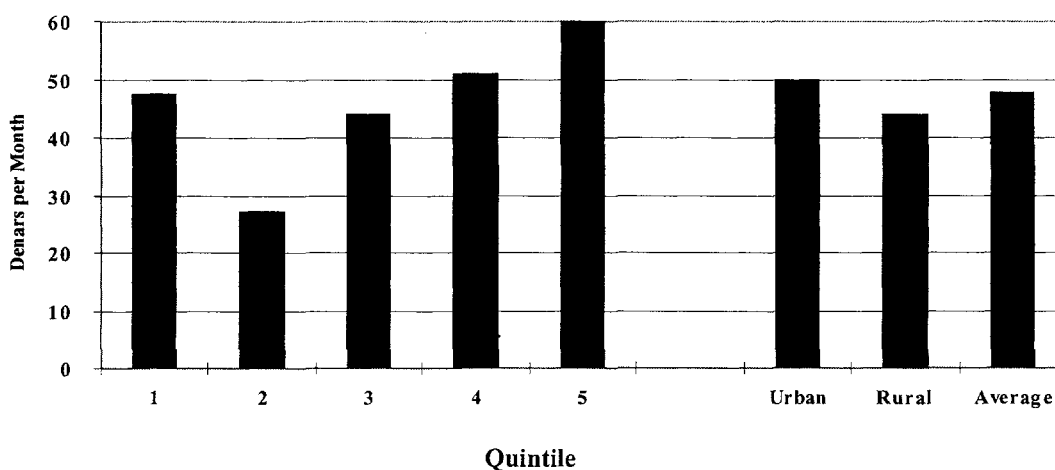
Figure 3.12B: Average Pensions and Poverty Rates for Female Pensioners by Age

Figure 3.13: Per Capita Old-Age Pension Benefits

60 and above, as opposed to non-pensioners of the same age (Figure 3. 11A and B).¹⁴ The poorest elderly live mainly in rural areas, have large families, and rely solely on agricultural income to make a living.

3.30 Incidence of Public Pension Spending. In the first half of 1997, the per capita old age pension benefit is greater (in amount) than all other cash benefits (Figure 3.13). The level of per capita pension benefit varies by income group and location. The level of per capita disability benefits, consistent with the smaller formulaic compensation or disability vs. retirement in the pension system, are lower than for old age pensions (Figure 3.14).

Figure 3.14: Per Capita Disability Pension Benefits

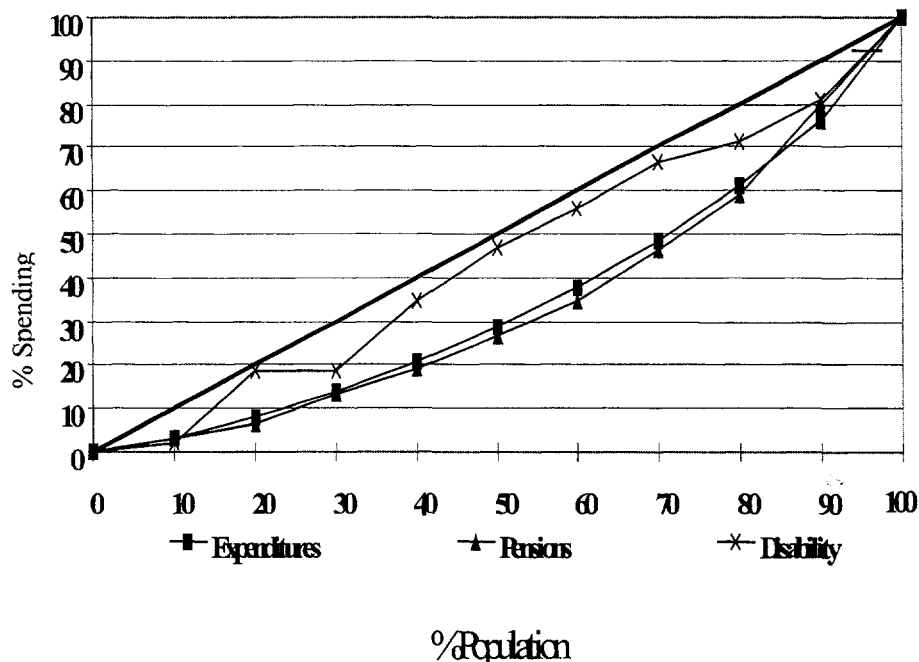
¹⁴ The poverty rates for men without pensions should be interpreted with care as the number of male non-pension is almost a negligible share of elderly males.

The level of per capita benefits for both disability and old age pensions are higher in rural and urban areas. This is not surprising. Pension and disability benefits are linked to an individual's past wages, and these are on average higher in urban areas. The distribution of pension spending is almost identical to the distribution of consumption disability benefits, consistent with the smaller formulaic compensation or disability vs. retirement in the pension system, are lower than for old age pensions. (Figure 3.14) The level of per capita benefits for both disability and old age pensions are higher in rural and urban areas. This is not surprising

The distribution of pension spending is almost identical to the distribution of consumption. That is, the poor receive the same share of total pension spending as their share of total consumption (8%), and far less than their share in total population (Figure 3.15). Once again, this is because pensions are not a targeted poverty benefit, and pension levels are linked to past wages. The distribution of disability pension spending is egalitarian, with the poor receiving a share of benefits that is almost equal to their share of total population.

3.31 Pension Reform. All in all, the pension system--despite some coverage gaps, plays a significant role in alleviating poverty amongst the aged. The incidence, depth, and

Figure 3.15: The Distribution of Public Spending in Pensions



severity of poverty would all increase significantly if there were no pension system at all. (See Table 3.3).¹⁵ However, this protection against poverty in old-age has come at considerable cost to society.

3.32 Confronted with these problems, the Government has undertaken major reforms of the pension system. The system replacement rate was reduced, minimum pensions were decreased, restrictive pension indexation policies are being pursued, and retirement ages--for both men and women--are slowly being increased over time. The sharp growth in pension costs has therefore been largely contained, but pension expenditures still remain a sizable share of GDP. As such, these transfers continue to impose a high tax rate on current workers with a potentially adverse impact on formal sector employment.

3.33 The growing financial problems over the transition reduced the level of protection offered by the system. As noted in chapter one, the incidence of poverty amongst pensioners has increased over time. The dissolution of pension contracts during times of financial difficulties are endemic to public pay-as-you go pension systems. The aging of the population will only strain this level of protection in the future. Financial problems could well emerge even earlier, as the restrictive pension indexation policy,--based on a wage freeze in the public sector--is unlikely to be sustained over the medium term. The recently revised savings contract between workers and the state could therefore not be sustained in the future.

3.34 In the long run, increasing the financial viability of the public pension system that would allow payroll taxes to fall from current levels, and increasing the contribution-savings link through a private funded scheme, will help avert poverty amongst current workers by increasing employment, and perhaps even net wage, with no adverse effect on pensioners. The reform proposals being considered by the Government includes a reform of the public pension system to improve its financial solvency and the introduction of private funded schemes that would allow individuals to save for old age using market instruments. Private life insurance and disability insurance provisions should help provide elderly left without a spouse or those with disabilities, to help smooth consumption against these contingencies.

¹⁵ This analysis views the counter-factual as the removal of the existing system. It does not address whether poverty reduction would have been greater had another more efficient (less costly) system been in place.

Box 3.2: The Elderly

The welfare of the elderly depends in large part on their relationship with their adult children. While some elderly respondents lived with an employed adult son who assisted them financially, pensioners living alone on the lowest pensions complain that they are the most affected by the economic crisis. A pensioner and his wife from Selce village expressed concern because they could not even provide for their own funerals: "They will not put you free of charge even in a grave." For this reason, poor pensioners still try to keep up with payments for sewage, since these include payments for burial costs, allowing them to assure themselves of a "decent" burial when they die.

What particularly distresses pensioners, however, is that they cannot help their children as much as they wish and that they must do so by going without themselves. Todor and Vesna, both 72 years old, exemplify these difficulties. They live in a single room in the Skopje region on Todor's pension of 5,000 denars. Their three children are married. Their daughter Anna, 36, lives in Skopje, another daughter lives in the Federal Republic of Yugoslavia. Their son, Victor, 40, lives in two rooms nearby with his wife and two children. Todor feels he and his wife could live well on his pension, but they cannot look at the way their children's families suffer without helping them in every way. Anna, for example, has worked for 10 years but has not received her salary for two years. Her husband, 37, was made redundant and has not received employment compensation for two years. They have two daughters of 10 and 13. Vesna explains, "Life has passed for us. I feel badly because of the children. My daughter, in order to feed her children, sometimes gets old bread intended for cattle from the Zito Luks bakery. I was never in such a situation. We never went without food, even though we were poor when we were young." They haven't seen their other daughter and her family for three years because of the war and because none of them can afford to travel.

By using much of their pension to help their children and grandchildren, the elderly couple themselves sometimes go without food. They also have health problems, but avoid the doctor and take only the essential medication. They say they do not care if they die because they find it so unbearable to see their children and grandchildren suffer, but they worry their death would cause a further burden since they no longer have any savings to leave to cover their funeral expenses.

An elderly couple living in Trsino village in Vinica municipality, each aged 70, have two married daughters and two married sons who live in nearby towns. Although the children visit their parents from time to time, they do not provide any assistance in working the land. The elderly couple has a cow and a few chickens. Although their land is suitable for growing wheat and tobacco, because of their age they no longer plant any crops, because, as they explained, "The children are not interested in working the land and we cannot." They receive social assistance which helps cover purchases of flour and other food.

3.35 Summary

- The coverage of the pension system is quite extensive in urban areas and for men, and has had a major poverty alleviation impact. The incidence, depth, and severity of poverty would all be higher in the absence of the pension system.
- Old age pensions are the largest transfer received by poor and rich households alike. But pension spending is skewed towards richer households; it is also regressive. This is because public pension benefits are linked to past wages of individuals.
- Pensioners are not as poor as non-pensioned elderly; but a sizable group of pensioners is poor. The poorest pensioners receive low agricultural and survivor pension; and are also older. The incidence of poverty is higher for non pensioners relative to pensioners.

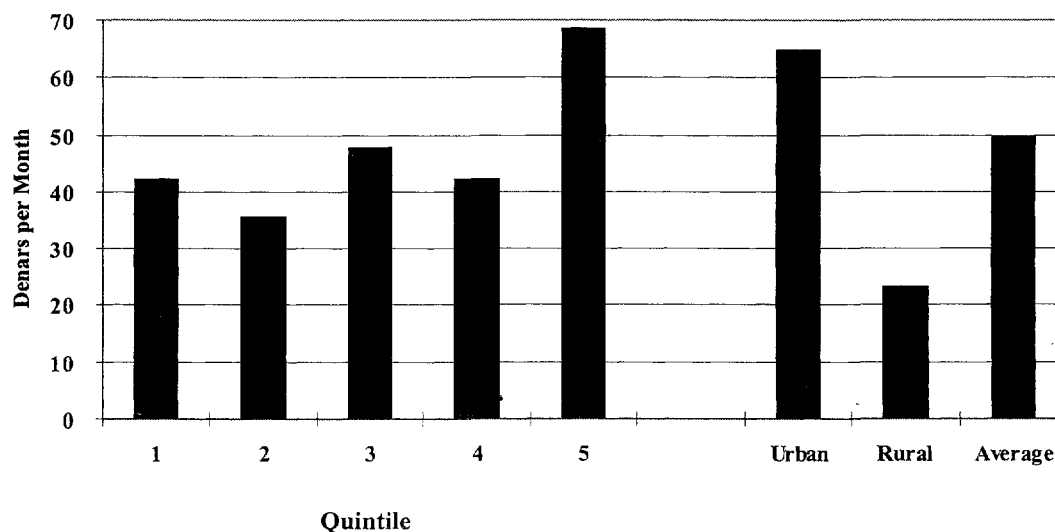
- The protection of pensioners against poverty has come at a very high fiscal cost which also imposes a large tax burden on current workers. Alleviating poverty in old age requires major pension reform that will reduce the scope of the public system, and allow individuals to save in well regulated, privately managed funds.

The Unemployment Insurance Program

3.36 The unemployment insurance program provides temporary support against the loss of income to individuals laid off from work. New entrants to the labor force, who form the majority of the unemployed, are not eligible for unemployment benefits. The number of benefit recipients is therefore only a small proportion of the total number of unemployed in the country. The average per capita benefit received by the unemployed is much lower than the old age pension program and closer in line with per capita disability payments. The level of the per capita unemployment benefit increases with income and is higher in urban than rural areas (Figure 3.16).

3.37 The distribution of public spending on unemployment spending is weakly pro-poor. The poor receive a greater proportion of public spending on unemployment benefit relative to their share in total consumption (8%), but less than their share of the population (20%) (Figure 3.17). The link between unemployment benefits and the level of household income is not surprising. Unemployment benefits are assessed on an

Figure 3.16: Per Capita Unemployment Benefits

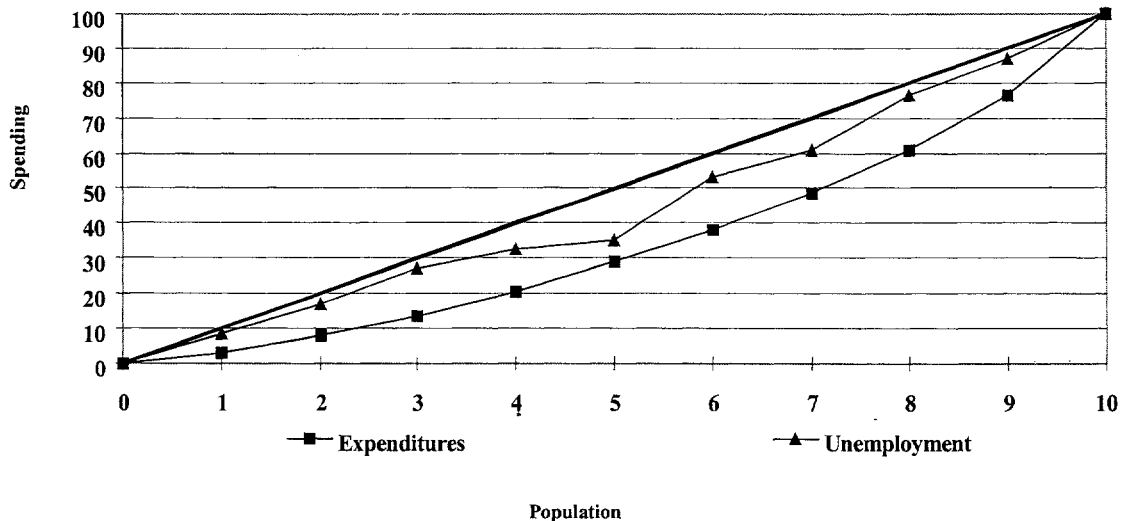


individual's past wages (Annex 2, Table 58). More specifically, eligible unemployed receive benefits equal to 50% of their average annual wage for the first 12 months which, falls to 40% of their average wage for the next 6 months. The duration and level of unemployment benefit ranges from 3 to 18 months, varying by the length of contribution period.

3.38 The current level and duration of the benefit are much reduced relative to those prevailing in early 1997. At that time, maximum benefit duration was 24 months, and the replacement rate was 50% over the entire duration of benefit. These changes were made to improve work incentives as well as to improve the solvency of the Unemployment Insurance Fund. Additional measures, such as provisions that unemployed report more frequently to the Bureau and "actively search for work" to register for unemployment benefits are also intended to improve incentives to work. The role of the Employment Bureau has also been changed, from channeling all hiring, to helping only the most difficult cases of unemployed re-enter the labor market. Private training programs have also been legalized. The Government has also initiated several programs offering assistance to laid off workers. A net impact evaluation of these programs is under preparation and will be used to identify and promote successful programs.

3.39 Despite these important reforms, for some categories of workers, the duration of the benefit has recently been increased. Individuals with over 25 years of contributions are now eligible for benefit until retirement. This measure provides work disincentives for workers, still in their prime working years, and is costly to finance.

Figure 3.17: Distribution of Public Spending on Unemployment Benefits



3.40 Summary

- Unemployment insurance benefits are progressive, weakly pro-poor, and do reduce poverty, though their impact is much smaller than that of pensions.
- Key distortions in the unemployment insurance program have been reduced: (i) the level and duration of benefit was reduced; (ii) hiring restrictions imposed by the Employment Bureau have been eliminated; (iii) the unemployed must actively search for a job and report frequently to the Bureau in order to remain on registered employment rolls; and (iii) private training programs have been legalized. A net impact evaluation of active programs is under preparation, should be used to identify successful programs.
- The Government program to provide special benefits to unemployed workers, with a long contribution history to retirement distorts incentives to work and is financially costly. At the very least, it should be restricted to workers near retirement age.

The Social Assistance System

3.41 Before Spring of 1998, the social assistance program guaranteed rural and urban households, subject to an income and asset test, a guaranteed minimum income approximately 50% of the respective official rural and urban poverty lines. Households eligible for social assistance received a transfer equal to the *difference* between their income and this minimum income guarantee. The minimum income guarantee provided by the program varied by household size, composition, and urban/rural location. Specifically, the minimum income guarantee was higher in urban than rural areas, and increased with household size. In 1996, the social assistance transfers comprised 1.3% of GDP (up from 1% in 1992), and provided cash transfers to roughly 54,000 households in the country.

Figure 3.18: The Distribution of Non-Pension Cash Benefits and Private Transfers

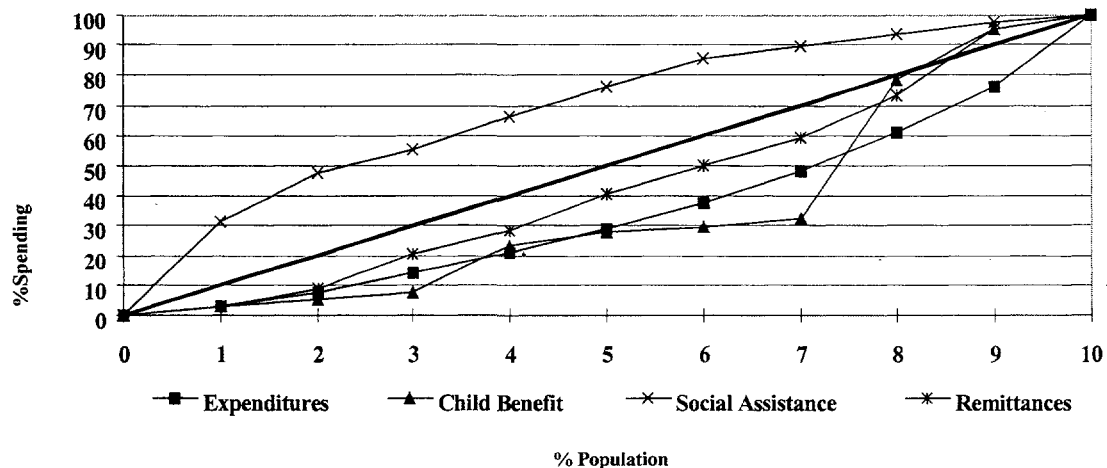
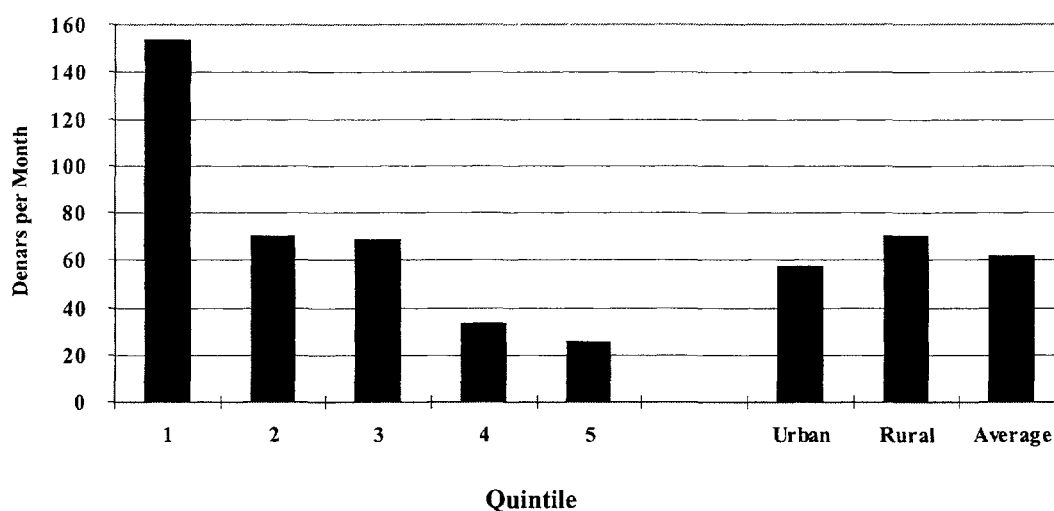


Figure 3.19: Per Capita Social Assistance Benefits

3.42 How effective and efficient are social assistance benefits? 1997 first half year household data reveals that social assistance benefits, are the most *efficiently targeted* cash transfers. (Figure 3.18). The bottom two deciles receive almost half of all public spending on social assistance. The level of the per capita cash transfer provided by the social assistance system is the second highest overall, after pensions. In contrast with

Table 3.5: Social Assistance: Inclusion and Exclusion Errors

	Eligible for Social Assistance		Not Eligible of Social Assistance	
	Receive	Do not Receive	Receive	Do not Receive
Per Adult Equivalent quarterly	3,753	2,671	8,850	16724
Per Adult Equivalent quarterly	5.079	5,452	9,491	14,663
Household Size	5	5	4	4
Children 0-15 years	2	1	1	1
Elderly*	0	1	0	1
Urban (%)	55	25	67	68
Capital (%)	92	17	62	32
Agricultural Households (%)	4	60	13	30
Female Headed (%)	13	4	18	16
Age of Head	38	51	43	54
Number Unemployed	1	0	0	0
Number of Pensioners	0	0	0	0
Number of Pensioner	168	77	114	877

*Elderly are males 60 and over and females 55 and over

pensions, the level of per capita social assistance benefit decreases with the level of income and is higher in rural than in urban areas (Figure 3.19). Not surprisingly, the social assistance program makes a contribution to the reduction of the incidence and severity of poverty. Without social assistance, the severity of poverty would be twice the current amount in rural areas (Table 3.3).¹⁶

3.43 Other measures of efficiency are the exclusion and inclusion errors of a system. *Exclusion errors* are measured by the share of ineligible households who receive benefit, while *inclusion errors* are gauged by the share of eligible households who do not receive benefit. Program *exclusion errors* are small. Nearly four out five household eligible for social assistance receive the benefit (Table 3.5). In both rural and urban areas, owning a car or house reduces the likelihood of receiving a social assistance transfer. Large families, families with more unemployed members, and low-income families have a greater chance of receiving a benefit. In contrast, program *inclusion errors* - are high. Nearly 40% of all recipients are ineligible for the program benefit. These households reside mainly in urban areas and predominantly in Skopje. In discussions, social welfare officers point out the difficulty of verifying claims in urban areas, particularly in large cities, where information about residents is less commonly available and individuals are relatively more mobile (Table 3.5).

3.44 Three other problems with the program have emerged over time. First, the enormously detailed scale structure was cumbersome to administer. Large households also had an incentive to split, falsely claiming that they were two separate households in order to receive more benefit. Second, rural/urban differences in income were not merited. The cost of living differential established between rural and urban areas was based on rural/urban poverty lines that did not accurately reflect these differences. The program therefore discriminated against the bulk of the poor who live in rural, non-agricultural households. The third major problem was that the scheme lacked work incentives. There was a 100% marginal taxation on incremental income that created serious disincentives to seek work. The lack of work incentives was more pertinent given that the earlier benefit scale provided fairly high replacement rates relative to average wage (50%) for an average size Macedonian family with four or five members. The current high unemployment rate may dampen the adverse effects on incentive of social assistance somewhat, but will not completely eliminate such effects. The right to register for such benefits may actually increase incentives to register and claim unemployment. Finally, the scheme encountered administrative problems. The random monitoring of households --in addition to document checks--was not institutionalized. Individuals all arrived to file claims on the same day, creating mobbing and violence in social welfare centers.

¹⁶ The analysis assumes that without social assistance transfers, households would not be earning any extra incomes. This is not an unrealistic assumption, given the current high unemployment rate of 30%. However, the impact may have been overestimated, to the extent the transfer encouraged a contraction of labor supply.

Box 3.3: Social Transfers: The Client's Perspective

Lack of information. Interviewers found in every region that respondents -- especially the poorest and least educated--were very ill-informed about the kind of assistance available. For example, most of them did not know that they could receive assistance if they were caring for another person, that there were special forms of assistance for children under 26, and material compensation as well for households whose main provider was serving in the army. They also lacked any information about the kinds of aid offered by humanitarian and/or religious organizations.

Criteria for receiving social assistance. Social assistance beneficiaries expressed a lot of anger because they felt that the social assistance offices were constantly checking on them to find a pretext to reduce their benefits. "All of them come to see whether they can cut something from what we get, but they are nowhere to be found when the assistance is late." A number of respondents felt criteria for receiving social assistance, or for being denied assistance, were arbitrary. A number of respondents complained that the appeal process took too long, creating enormous difficulties when social assistance was the only form of household income. In one case, social assistance of a divorced woman living in Bitola was suspended because someone had informed officials (according to her, not the case) at the Center for Social Work that she was again living with her husband. She submitted a request to the Center to reinstate her social assistance but was informed that the request should be sent to Skopje. Now she has been without social assistance for 6 months, and doubts that her request was ever forwarded. Each time she appeals to the Center in Bitola for information she has been told to wait, but she has finally decided to directly send a request to Skopje. In one case, however, a beneficiary living in central FYR of Macedonia whose assistance had been denied successfully appealed the decision. He had been cut off from assistance when the Center for Social Work found a new vehicle at his home. The beneficiary, however, managed to document the fact that it was his brother, who lived in a separate household, and owned the vehicle. In this case, his benefits were reinstated along with retroactive payments.

Complicated application procedures. Many respondents were irritated at what they considered the unnecessarily complicated procedures of applying for social assistance and the many documents they had to submit. These documents include: proof of citizenship; a document confirming their status as unemployed and without income (obtained from the Tax Office); and documents stating they did not have other sources of income such as land or business space. According to Blagoja, who spent a month just collecting documents, "You have to wait in line everywhere, and go from one counter to another. The clerks are very rude and do not inform you correctly." After submitting the documents, he received a number from the office and was told to return in a month to see how far they had gotten with the application procedure. He never returned, in part because of shame, in part because he was angry.

The problem of delayed payments. Late payments, whether of unemployment compensation or of social assistance, poses particular problems for poor families who are often given credit on a monthly basis from local shops. As Midat, head of a five member family explained, "The frequent delay of the money I receive from the Employment Bureau wouldn't worry me that much if I had other financial resources. I have to borrow from my relatives and friends, and then I have to pay them back with interest." A widower living with his daughter described a similar situation. "I buy bread and milk in a shop in the neighborhood. I pay the owner when I receive my assistance, but since it still hasn't arrived in three months, I owe a big amount to the shop which I won't be able to cover with it."

3.45 In early 1998, recognizing these issues, the Government adopted a revised social assistance decree. The decree provides a uniform scale rate for both rural and urban areas. The new scale rates vary only with household size. The distinction between children and adults has been eliminated. The new scale rates for each household size are (with the exception of single households) roughly a simple average of the different rural/urban scale rates. Thus, benefit levels in urban areas have been reduced and those in rural areas have increased. However, the new rate structure (with relatively high absolute magnitudes for two and three member families) continues to provide incentive for large families to split. In addition, the minimum income guarantee for large families has been reduced to roughly 40% of average wage. However, this level of benefit still remains well above the wages earned by a large proportion of workers, particularly in low paying agricultural jobs. As such, this benefit provides an effective minimum wage for the average Macedonian worker.

3.46 In order to introduce work incentives, the Government has decided to limit the duration of social assistance to four years. The income threshold will also be reduced over time. Individuals will get social assistance benefits at 100% of the current threshold for two years; benefits will be reduced to 70% and 50% in each following year. Households will not be eligible for benefits for two years after four years of continuous receipt of social assistance. This measure may be abused by individuals who may leave social assistance for a short period (say three months), only to come back to re-apply for another four year term of benefit. In order to minimize this problem, the following provision was introduced: households can re-claim another full four year benefit term only if they have not received benefit for at least nine months. Households who have left the social assistance rolls for less than nine months can, if they re-qualify, rejoin the system but with a benefit term reduced by the amount of the previous claim. Individuals who leave may still rejoin the system after nine months simply to qualify for another four year term of benefit. However, they will have to leave benefit for at least nine months to do so. This work incentive is particularly onerous to administer, however, as it is difficult to keep track of individual claims over time. Thus, the impact of this work incentive and its implementation will have to be closely watched in the future. Alternate work incentives, such as a 30% earnings disregard, or a lump sum earnings disregard, were considered by the Government and rejected because of the complexity of calculating benefit. These may well have to be reconsidered and re-evaluated if the term limit of benefit poses administrative problems or does not induce individuals to leave the system.

3.47 While these changes in the Decree and Program administration may help reduce the high inclusion errors of the program, the targeting of the program should be closely monitored, and eligibility tightened further if inclusion errors remain substantial. In any case, the new scheme should be carefully monitored and evaluated so that its targeting efficiency can be constantly evaluated and improved. *The crisis in Kosovo and the economic disruption which will likely cause an increase in social assistance expenditures*

means that efforts to improve targeting of the system will have to be redoubled to ensure that the poorest groups are protected from falling into abject poverty.

3.48 Proxy Means Testing. As in the Macedonian case, the administration of social assistance and other transfers in other countries in the region often relies on a mix of means testing and indicator targeting. An analysis of this approach in several transition economies has revealed that it usually does not work well, with leakage rates sometimes exceeding 50%, both in terms of households and amounts of money. In the Macedonian case, as noted above, social assistance is administered with an income test, and there are indications that many households receive social assistance who are not qualified to receive it. Part of the problem is the difficulty of ascertaining household income in the absence of a comprehensive tax or asset registration record data bank.

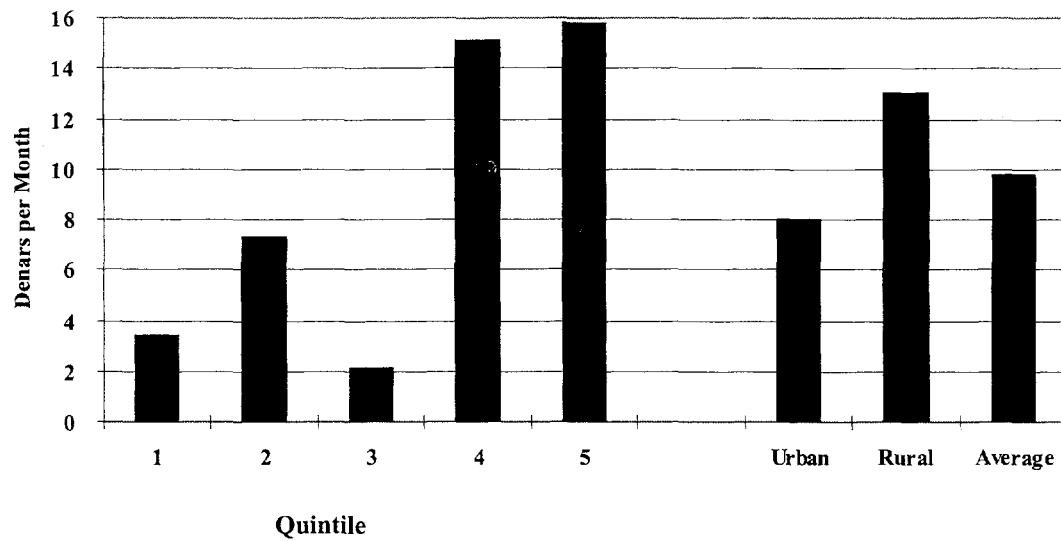
3.49 An alternate way to target the poor is to use proxy-means tests, based on easily observable household characteristics rather than household income, to identify social assistance claimants. The information required by social welfare administration can be observed directly by a social worker or can be obtained by simple questioning. Empirical estimates indicate that the wealthiest Macedonian households can be identified based on observable characteristics with nearly 90% accuracy (Annex 2, Table 57). Once these households are screened on the basis of the above indicators, the poorest Macedonian households can then be identified with nearly 70% accuracy, using indicators such as household size (the best indicator), durables (electric cooker, car, freezer or washing machine), the number of unemployed in the household, age and education of the head, receipt of private transfer from abroad (though difficult to document), and receipt of pension.

3.50 The results of this exercise suggest that indicator-based targeting is an option worth considering in order to further improve the targeting of social assistance and child allowance programs. The findings in the Macedonian case are not unique. Similar exercises for Poland, Hungary, and Bulgaria also reported that a set of initial screening variables could successfully identify over 90% of the non-poor, while a second set of variables could identify 60-80% of the poor in a second phase. While findings of this sort are indicative of the potential of indicator-based targeting, they are not a blueprint for practical application. There are three caveats. First, household may still be able to manipulate some indicators, such as the number of children, durables, and the number of unemployed. Second, the characteristics of the poor may change over time. Therefore indicators of poverty would have to be updated and re-evaluated periodically to test their continued relevance for targeting the poor. Third, the fiscal costs of this program would have to be estimated and evaluated against those of the current social assistance system.

The Child Allowances Program

3.51 The child allowance program provides child benefits to families with at least one employed member with an income of less than 1,700 denars per month. The benefit is 500 denars per month per child and is restricted to three children per family. The per capita benefit is almost negligible. The average per capita benefit is slightly higher in rural than in urban households. Rich households receive a higher per capita benefit than the poor (Figure 3.19). Child allowances are strongly non-poor. The poor receive a

Figure 3.20: Per Capita Child Allowance Benefits



much smaller share of spending on child allowances than their share of total consumption. The small amount of transfer and its restriction to the employed means that child benefits do not have a large impact on poverty reduction (Figure 3.21).

3.52 The small share of public spending allocated to the child allowances program is not well targeted to the poor. A key issue is the delayed payment of the benefit due to fiscal concerns. Reshaping this benefit to target the poorest families, those with three or more children the poverty impact would be negligible. The costs of targeting the program to families with three or more children would be roughly 300 million 1996 Denars higher than the 1997 child allowances budget (300 million Denars); the costs would be equal to the budget if only families with two or more children were targeted by the program.¹⁷ The child allowance program might well be phased out without any adverse impact on poverty. The social assistance program appears to be well targeted to large poor families with many children.

3.53 Summary

- The social assistance program is well targeted overall--the most well targeted of all cash transfer programs--and helps reduce the incidence, depth, and severity of poverty. The recent crisis in Kosovo is likely to raise pressures on the social assistance budget. Therefore it will be all the more important to ensure that program expenditures are well targeted to ensure the poorest households are protected from falling deeper into abject poverty.

¹⁷ Interestingly, given their large share of the population, targeting child allowances to families with less than three or less than two children would have a more dramatic impact on poverty reduction. However, such a program, even given current levels of benefit per child would be prohibitive, with costs roughly 4 (three or less children) to 10 times (four or less children) the current program.

- Groups with a high probability of receiving the transfer fit the profile of the poor: large, low-income households and individuals without assets (car, house). There are large inclusion errors mainly concentrated in urban areas.
- The program has been recently reformed. Based on the poverty line analysis recent reforms have eliminated unjustified rural/urban differences in benefit levels, simplified a complex benefit scale, introduced work incentives, and improved benefits administration.
- The fiscal costs and targeting efficiency of the reformed program should be carefully monitored. The work incentive chosen (term limit of benefit) is administratively complex and may well have to be redesigned in the future if it does not meet its intended objective. Social assistance payments will have to be adequately budgeted so that payment delays are avoided.
- Simulations find that indicator based targeting that identifies the poor might be successful for improving social assistance as it successfully screens the rich and identifies the poorest Macedonian households. However, any implementation would require a pilot test and an assessment of the fiscal implications of this exercise.
- Child allowances are not pro-poor and have very limited impact on alleviating poverty. Targeting child allowances to all households with two or three or more children will not have a large impact on poverty reduction.
- Benefit payments for both programs are not adequately budgeted resulting in delays of payment that compromise the poverty alleviation aspect of both programs.

C. Private Transfers

3.54 Private transfers, particularly in the form of remittances, are received mainly by rural households. Remittances constitute a larger share in total consumption of rural vs.

Figure 3.21: Per Capita Remittances

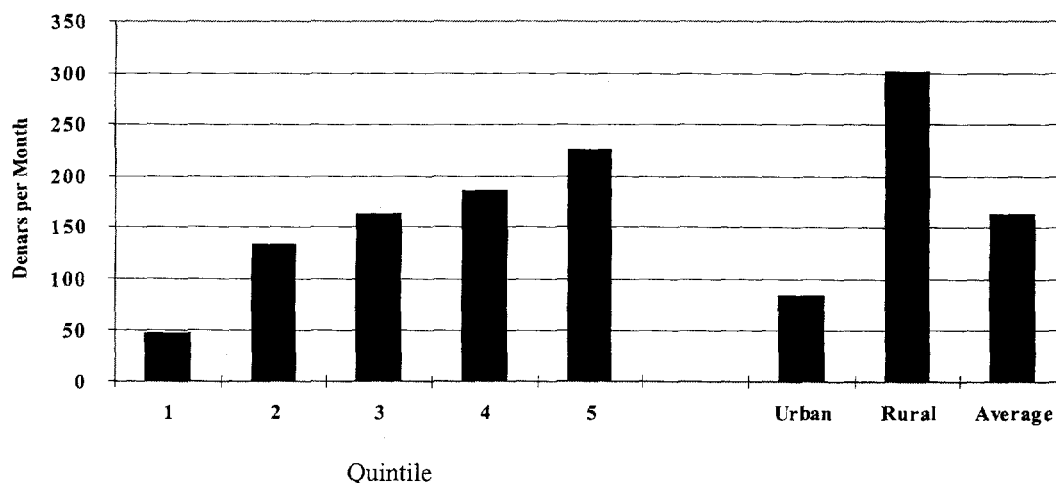


Table 3.6: The Distribution of Remittances by Share and Location

Per Capita Expenditure Quintile	Households Receiving Remittances (%)			Share in Total Expenditures		
	Total	Urban	Rural	Total	Urban	Rural
1	13.5	9.5	15.1	3.9	5.8	3.2
2	24.3	9.5	30.2	6.8	0.6	11.8
3	20.3	14.3	22.6	6.1	1.3	15.1
4	20.3	23.8	18.9	5.2	2.7	10.9
5	21.6	42.9	13.2	4.3	2.4	18.6
Total	100.0	100.0	100.0	100.0	100.0	100.0
N	74	21	53	1,015	645	370

urban households. After pensions, remittances are the largest per capita transfer received by households (Figure 3.21). The per capita level of remittances increases with the level of income. The distribution of private transfers is only weakly non-poor (Figure 3.18). The poor receive a larger share of private transfers relative to their share in total consumption, but a smaller share than their share of the population.

3.55 Remittance income has had a much larger welfare impact in rural areas. First, the average per capita private transfer is higher in rural than in urban areas. Second, a larger proportion of households receiving remittances are based in rural areas. Third, the share of private remittances in total income is much higher in rural than in urban areas. However, remittances are a much larger share of consumption for the poorest (first quintile) households in urban (vs. rural areas).¹⁸

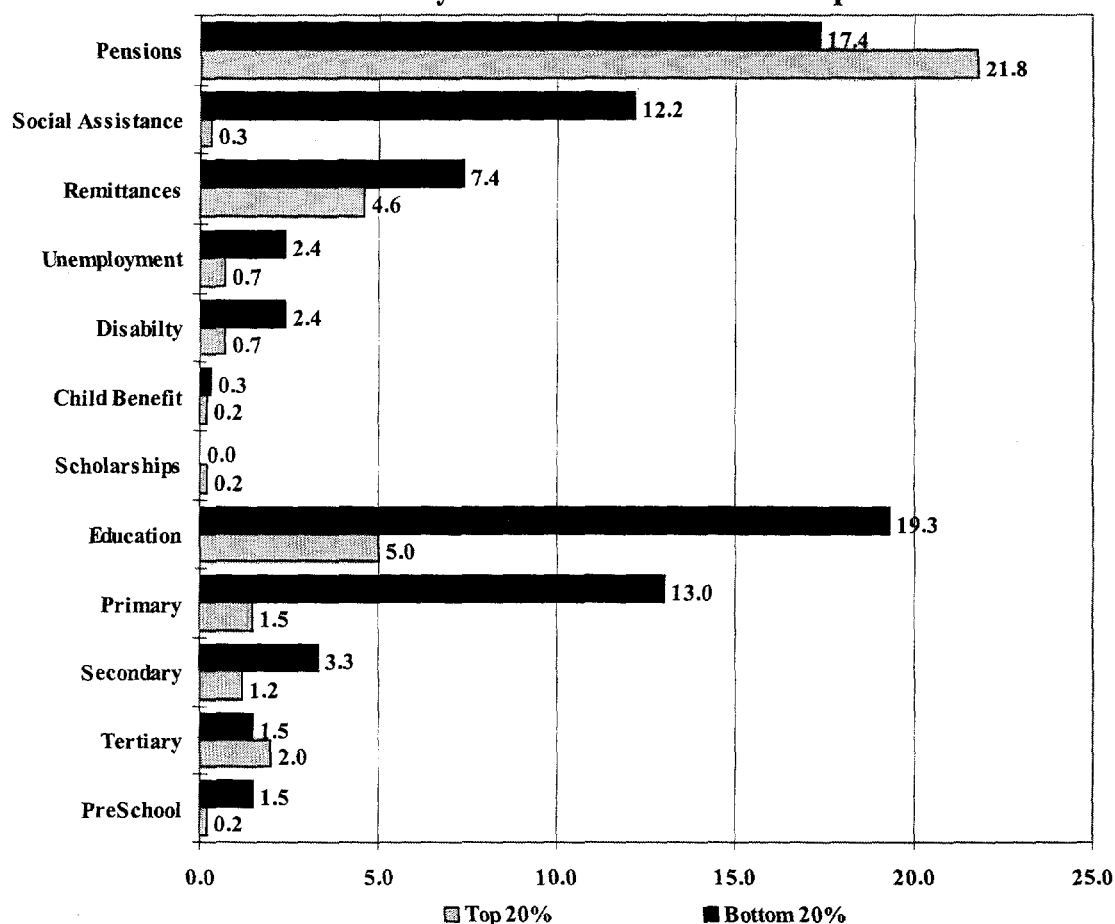
D. The Comparative Efficiency and Effectiveness of Poverty Alleviation Programs.

3.56 This section summarizes the comparative efficiency and effectiveness of the public programs discussed above. The *effectiveness* of public spending is measured as the ratio of per capita benefits to the per capita consumption of a household. The higher this ratio the more effective the program in raising the income levels of the poor. The *efficiency* of the program is the share of public spending on that program that reaches the poor (or the bottom quintile). This is not the stated objective of many programs, but is a way of measuring the distribution of program benefits that also allows a comparison of the poverty impact of diverse public programs. The comparison provided in the following sections should be interpreted with some care. The education data is based on the 1996 Household Budget Survey, while the information on cash transfers is from the Household Budget Survey in the first half of 1997.

3.57 **The Comparative Effectiveness of Public Programs.** Figure 3.22 compares the effectiveness of public programs. It gives the ratio of per capita transfer to household consumption for the top and bottom population quintile. Compared in this way, education

¹⁸ Poor households may have received private transfers and moved into richer income groups. But the magnitude of this effect is not possible to determine from a cross-sectional data set.

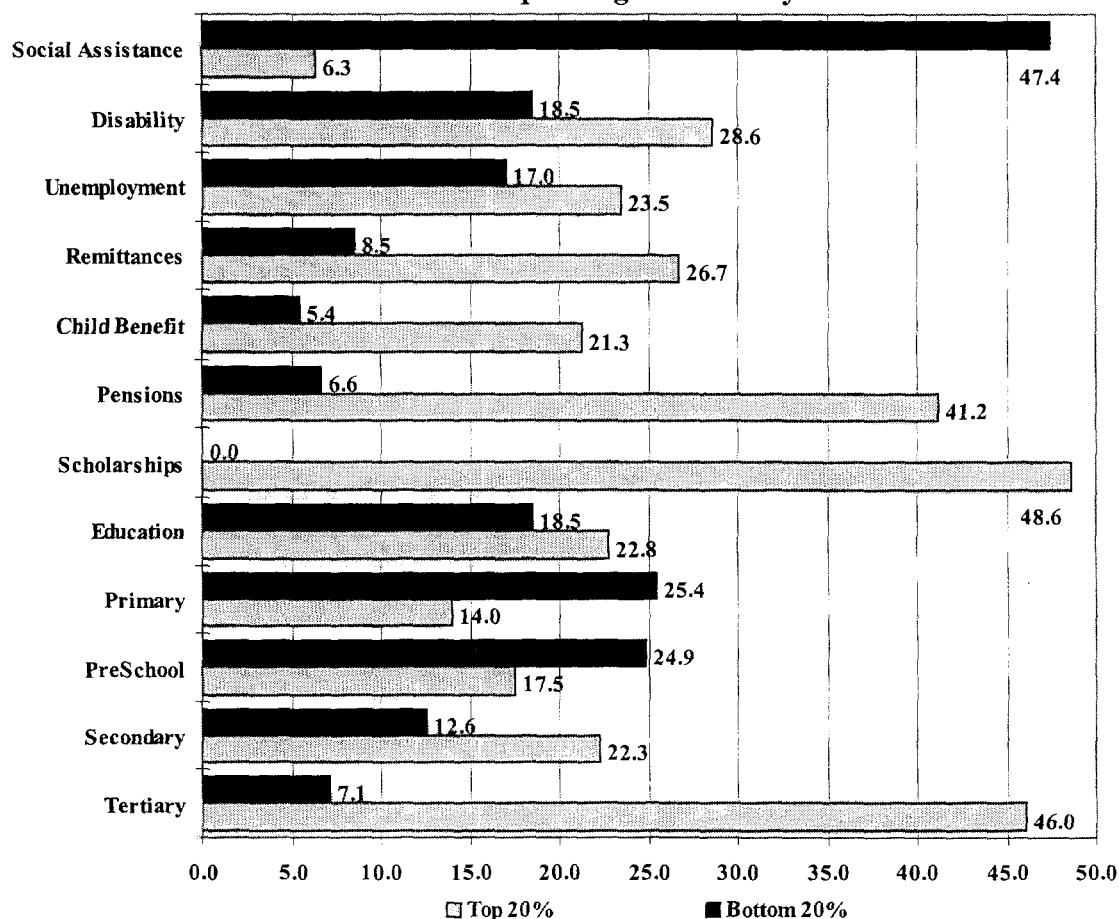
**Figure 3.22: Comparative Effectiveness in Reaching the Poor:
Transfer Subsidy Income as Share of Consumption.**



stands out as the most effective of all public spending programs. Education spending comprises nearly 19% of the budget of the poor. Not all education spending is equally effective in alleviating poverty, however. Primary education is the most effective program comprising nearly 13% of total consumption of the poor. Pre-school, secondary and higher education are not very *effective* at all. The poor receive subsidies for each program that comprise about 6% of total consumption. Among cash transfers, pensions are the second most effective cash transfer program, with pension benefits accounting for nearly 17% of the consumption of the bottom quintile. Social assistance is the third most effective program, with benefits comprising 12% of household consumption.

3.58 Most public spending and cash transfers is more important for the bottom than the top quintile. That is, most public transfers and education spending comprise a higher share of income of the bottom quintile relative to the top income group. The only exception is pension spending, spending on tertiary education and scholarships. Income from these programs forms a higher share of income of the rich relative to the poor (Figure 3.22).

**Figure 3.23: Comparative Efficiency of Targeting:
Share of Total Public Spending Received by the Poor**



3.59 The Comparative Efficiency of Public Programs. Efficiency is defined as the proportion of public spending on a program that is received by the poorest 20% of the population—those that fall below the poverty line. Transfers are considered efficiently targeted if the poor receive a share of total spending that is at least equal to their share in the population. It should be noted, once again, that education is a universal benefit and unemployment benefits and pensions are not targeted to the poor (Figure 3.23).

3.60 This analysis indicates that not all public spending is well targeted to the poor. As such, there is significant scope for better targeting public programs. First, there is considerable scope for reducing spending on current spending (mainly on pensions) and reorienting it towards investment spending--on education. Moreover, as noted above, there would be gains from improving the efficiency of targeting within programs by targeting scholarships and secondary and higher education spending relatively more towards the poor.

E. Institutional vs. Locally-Based Care

3.61 Thus far this chapter has discussed cash transfers to families. Yet many of the most vulnerable groups do not live in families, e.g. single, sick and elderly who live alone in rural areas abandoned by their families who have migrated to cities or orphans, and physically or mentally handicapped persons who live in institutions. These individuals have difficulty in taking care of themselves and can perhaps be considered the most disadvantaged in society.

3.62 Currently there are approximately 450 elderly living in institutions. There has been an increase in the demand for institutional care amongst the elderly population. The Gerontology Institute reports that this is because many families are no longer financially able to take care of their elderly parents or relatives and there is greater acceptance of sending the elderly to institutions. The elderly, who must be over age 65 to be eligible, have access to health care, meals, rooms in the institution. Elderly with a pension of less than 9,000 denars also receive a cash benefit equal to the difference between their pension and this amount. A recent report on institutional care in a home for the elderly (Mother Teresa) cites that the average age of residents is 75 years and most of the residents are women. The poor condition of elderly in rural areas and the large costs of building residential institutions means that day-care or in-home care for the elderly provided at the local level should be a major consideration.

3.63 There are two homes for orphaned children, one for children 0-3 years of age and the other for children 3-18 years of age. Together both institutions accommodate roughly 250 children. In 1997, the Government spent roughly 34 million denars on food and clothing for the children, salaries and utility bills. Financial and in kind assistance is also received from humanitarian institutions. However, in large part external donor agencies have replaced enterprises as the main donors for the upkeep of the institutions. All children are eligible for health insurance coupons. UNICEF has been particularly active in helping organize and improve the delivery of care to children within these institutions.

3.64 Social Welfare Officers consider institutionalization to be the worst possible outcome for children's welfare. Every effort is made by Social Welfare Officers to place the child in a family atmosphere. Once in an institution, the children encounter problems, such as those described in Box 4.5. Therefore, several options are explored for taking care of abandoned children before placing these children in an institution. These are a) placing the child with relatives; b) adoption; and c) foster family care. On the positive side, there is considerable demand for adoption by the population. In the Skopje alone, there are approximately 300 applications but only 50 children in the center. However, improvements could well be made in ensuring that foster parenting is encouraged, payments to foster parents are made on time; greater screening of potential foster and adoptive parents is undertaken; and there is more monitoring of adoptive and foster parents once the adoption/foster child placement has taken place.

Box 3.4: Institutional Care

The care of children without families is provided by two institutions, one in Bitola for infants (0-3), and one in Skopje for children (3-18). Local Centers for Social Care make the decision as to where to send a child when parental care is deemed inadequate. The Centers note particular problems in the case of Gypsy children, however. Their parents often send them to beg in the streets, on bridges, in apartment complexes, or in front of shops. In Skopje, the sight of a small infant in a box on the footbridge leading into the Old City, presumably with an adult nearby watching the infant and waiting for donations to be placed in the box, is not an uncommon sight. Many of these children do not attend school. The Centers, in cooperation with the police, often place such children in institutional care. The children, however, run away and start begging again. One such parent stated that her 3 children do not attend school because she cannot afford to send them. Her husband, who owned a horse cart and worked as a hauler, died three years ago. Even then, however, the children did not attend school. Now, every day, she takes her three-year old and goes to a particular place to beg, thereby earning about 150 denars a day. Although she travels there each day by bus, the drivers already know her and do not demand payment. Her other two children gather bread from garbage containers to sell as fodder to people who raise cattle. They earn around a 100 denars a day. The family also receives 4,000 denars in social assistance, but according to the woman, only once every 3 months. This pattern describes the family income for the past 6 months. Previously, until the organization left FYROM, the family had received monthly assistance in the form of 25 kilos of flour, oil, sugar, and firewood, from Caritas.

The most frequent reason for children under three to enter institutional care is that they have been born to single mothers. For children 3-18, of the present 135, 32 have no parents, 62 have only one parent, and 45 have two parents. Of the children with parents, the usual reasons for placement include a parent in prison or a psychiatric institution; rejection after divorce and remarriage; and parental inability (social or financial) to care for their children. The number of children placed for the last reason has increased in recent years. It is rare that such parents take their children back after placing them in institutional care. Ognena, one such parent, however, has placed her children three times in institutional care, but taken them home two times in the last two years, each time hoping that the higher amount of social assistance she receives when they are living at home would enable her to take care of them. The staff expects her to return the children a fourth time. These changes are extremely disruptive for the children, who have been forced to change back and forth between school environments each time.

In the home for older children, children have the right to stay six months after they turn 18, so that they have time to find a job and apartment after completing secondary school. Until seven years ago, the children usually managed to find employment based on recommendations from the Home or from the Centers for Social Care. When several youths had found jobs, the Center for Social Care sometimes provided apartments they could share. Today, finding a job has become so difficult the Home is allowing the children to remain longer, sometimes until they are 20. Some have found jobs through a youth organization, but only 3-6 months at a time. They no longer receive apartments. "The children are afraid to leave the home," commented an instructor. When they do leave the home, two or three of them may rent a small apartment together. Sometimes they find work in coffee bars or in warehouses, but not necessarily as formally registered employees. For example, a 19 year old boy now living in the Home works in a restaurant, but is not "officially" employed. When young people leave the Home now, they receive a blanket and bed sheets and 15,000 denars. The Center for Social Care in Skopje has proposed that the Ministry of Labor and Social Policy provide children leaving the Home with small apartments for a period of 5-10 years. They would not obtain in permanent ownership, but for five or ten years. At present, the children face a very abrupt transition. As a staff member noted, "These children have everything up to the age of 18, and after 18, they have nothing."

3.65 In addition to institutions for orphans and elderly there are several institutions for the care of children with disabilities. The main institution is Demir Kapija that houses nearly 485 beneficiaries. Several key issues regarding the care of disabled children were identified in a recent UN report. These include the very negative view of disability amongst the general population and by professionals that work in this area. This means that many households keep disabled children at home because it is considered shameful and an embarrassment to the family. Children sent to institutions receive services based on rigid categorization system that labels them according to a very narrow test of their intelligence (IQ). The basic educational and emotional needs of disabled populations are not met. Children and elderly are often left isolated without adequate stimulation, and with limited opportunities to learn and develop. Children often do not learn to sit or even crawl at one year, and many do not even learn to stand at two years of age. Living conditions in the institutions are also poor. Residential institutions are in need of upgrading and repair, staff are not adequately trained, resources are limited.¹⁹

3.66 Summary

- Improving care for chronic poor would reduce emphasis on the institutionalization of these populations and increase the provision of community-based care. The focus of the programs could potentially be the alleviation of poverty amongst children at risk, the disabled, and non-pensioned elderly. The financing of this program, and the mechanism for delivery of services, would have to be evaluated carefully to assess its financial and other economic implications.
- Promote fostering and adoption services, with adequate screening and monitoring of prospective providers. These services would also need to be evaluated in terms of their financial and other economic implications.
- Ensure timely payment of foster parents and child disability payments.

¹⁹ Benfield and Rothwell, Overview and Analysis of the Situation of Children with Disabilities in FYR of Macedonia, A report prepared for UNICEF, Skopje.

