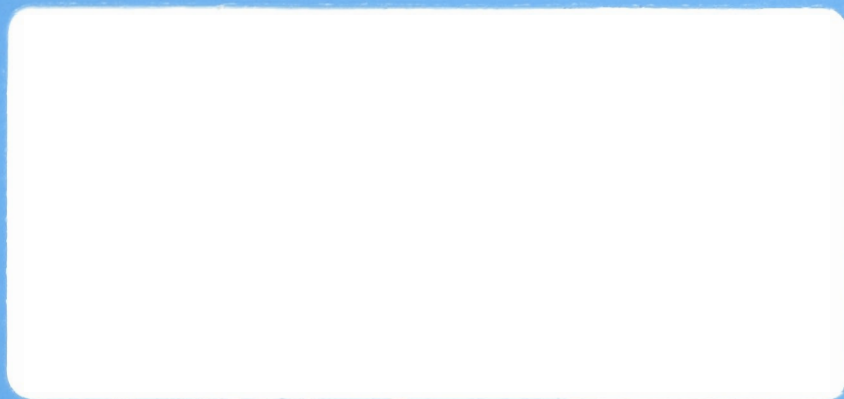




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**INCOME DISTRIBUTION, POVERTY AND WELFARE
IN TRANSITIONAL ECONOMIES:
A COMPARISON BETWEEN
EASTERN EUROPE AND CHINA**

Giovanni Andrea Cornia*

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* UNICEF International Child Development Centre, Florence.

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EXECUTIVE SUMMARY

Over the last 15 years most socialist economies have undergone radical economic, social and political changes. In China, the reform process began in 1978, while in Eastern Europe the first changes were introduced in 1989.

In the years immediately prior to the inception of the reforms, Eastern Europe and China shared a considerable number of common features in the fields of economic structures, international trade, pricing mechanisms, income distribution, human capital and state ownership, particularly if account is taken of differences in their overall level of development. In contrast, approaches to the transition have differed markedly. In most of Eastern Europe, economic reform was undertaken in the wake of the collapse of the socialist regimes and aimed at an immediate and wholesale replacement of the socialist model with a model based on private property and market prices. Transition policies were therefore mainly characterized—at least during the initial phase—by a radical "shock-therapy" entailing a massive dose of fiscal and monetary austerity, instant price and trade liberalization and rapid privatization.

In China, in contrast, the reform process emerged from within the socialist system, was spread over several years, gradually intensified over time and, during its initial phase, aimed at the creation of a "social market economy". However, though the initial scope of China's reforms was relatively narrow, by the early 1990s the reform process had spread to as many sectors as it had in Eastern Europe.

A comparison of the growth, income distribution, poverty and welfare impact of these two different approaches provides strikingly different results. On the whole, economic reforms in China have been highly successful, though rising regional income inequality, recurrent bouts of inflation and the stagnation in poverty rates (at low level) since 1990 might obfuscate a generally positive picture. In some welfare areas, the results are, in contrast, less positive, as indicated, for instance, by the trend toward reduced access to health services among low-income people. While economic reforms contributed to a rapid reduction of poverty and to generalized improvements in welfare, the greater fiscal decentralization, declining progressivity of social expenditure and massive recourse to user fees which have characterized the reform process have induced some avoidable social costs.

In contrast, the worsening of social conditions observed in recent years in most of Eastern Europe underscores a welfare crisis of untold dimensions. With few exceptions (such as the Czech Republic and, to a lesser extent, Slovakia), the countries of the region have been hit by a sharp increase in poverty rates (which has affected children and working adults more than proportionally), a severe health crisis, a drastic decline in preschool, primary and secondary enrolment rates, a radical jump in crime rates, an increasingly difficult socialization of children and youth and a sharp, and seldom observed, fall in nuptiality and fertility. While rising income inequality and a weak social policy have compounded these negative trends in Russia, Romania and a few other countries, the main source of worsening in human welfare is to be found in the negative economic impact of the overall "shock-therapy" approach which inspired the transition. While unfavourable initial conditions and exogenous factors have aggravated the situation and left little space for manoeuvre in several countries, such as Poland, it would appear that the impact of these factors would not have been the same had a more pragmatic and less doctrinaire approach been followed.

I. INTRODUCTION: "WESTERN" VERSUS "ASIAN" APPROACHES

In the debate on macroeconomic adjustment in developing market economies, a comparison has frequently been made between the "Western neoliberal approach" and the so-called "Asian model" which was implemented in countries such as South Korea and Taiwan in the 1960s and 1970s and in Japan in the early postwar years. While sharing several common features with the neoliberal approach in the field of stabilization, the "Asian model" has followed a more gradual and pragmatic approach in the other policy areas and has in principle entailed a greater involvement of the state in the economy, particularly in the fields of social safety nets, industrial policy and trade liberalization. A second contraposition between "Western-neoliberal" and "Asian" approaches to policy reform has recently emerged in the context of the transition to the market economy of China and the countries of Eastern and Central Europe and the former Soviet Union (ECESU). Since 1989, no less than 20 former socialist economies have introduced comprehensive reforms aiming to facilitate the transformation of their economies toward a market-based system. Though initiated at various points in time and characterized by several differences from one country to another, the policy packages introduced in Eastern and Central Europe share considerable similarities in terms of overall approach, priority sectors, time frame and main policy instruments used. Though the transformation is far from complete, it would appear that many of the problems and difficulties encountered thus far are shared by the countries undergoing the reform process.

A similarly profound transformation was initiated in 1978 in China and other Asian centrally-planned economies in the late 1980s (the latter are not discussed in this paper). Though the final objectives of such reforms were not necessarily those pursued by the countries of Eastern and Central Europe, "the Chinese road to the market" has also relied on several of the same policy measures adopted by the ECESU countries. Their intensity, speed, sequencing and choice of priority sectors were however substantially different. The results too appear to be quite different. On the one hand, the Chinese experiment has on the whole been quite successful throughout its 15 years of life, though problems of regional inequality, social welfare and recurring macroeconomic imbalance have at times obfuscated a generally positive picture. On the other hand, the initial hopes of the ECESU countries for rapid transformation and economic prosperity have quickly been tempered by an unprecedented decline in output, employment and incomes, by the further worsening of some social trends

which had already begun under socialist rule, a massive impoverishment and a severe health crisis.

While a number of excellent review articles and theoretical papers has appeared over the last few years on several aspects of the "Eastern European" or "Chinese" transition, particularly on issues of stabilization, privatization, taxation and labour market adjustment (see for instance Bruno 1992 and 1993, Svejnar 1993, Kolodko 1993), other aspects of the transition, such as agricultural, demographic, distributive and welfare issues have received less attention. Furthermore, as in the case of the adjustment efforts in developing countries of the 1980s—and despite the efforts of several international agencies—the focus of political concern in relation to the transition has remained narrowly economic. Even more surprisingly, the debate on the transition in China and Eastern Europe has proceeded on two separate tracks with little or no attempt to analyse these two different approaches within a comparative framework in order to draw policy lessons from one to the other. Only few papers on this topic have appeared (Nolan 1992, Yingyi and Xu 1993).

This paper tries to fill, however modestly, this gap by documenting in a comparative way the changes in distributive and welfare variables intervened over the respective time periods in China and in ECESU and by relating them to variations in initial conditions, differences in policy approaches and changes in exogenous factors. In particular, the paper asks a series of questions which illustrate its main focus: Has welfare improved or deteriorated during the transition? Which factors are responsible for the substantially different performance of China in relation to the Eastern European countries? To what extent is this "performance gap" due to differences in policy-making? Were the changes in living conditions primarily due to changes in economic or social policies? And, more specifically, what can be said about the welfare impact of the "Western" and "Asian" policy approaches?

II. THE INITIAL CONDITIONS

In the years immediately preceding the reforms, the Eastern European countries and China shared a considerable number of common structural features, particularly if account is taken of differences in their overall level of development. At the same time, they manifested marked variations in several other respects (Table 1).

Table 1: ECONOMIC CONDITIONS PRIOR TO THE TRANSITION^a

	Bulgaria	CSFR	Hungary	Poland	Romania	USSR	AMIC	China
<i>Economic Structure and Institutions</i>								
GDP/capita	2,320	3,450	2,590	1,790	2,290	--	--	330
Agricultural share	11	6	14	13	13	13	18	27
Exports to CMEA ^{b/} (%)	69	60	43	41	--	--	--	--
State ownership	100	100	90	70	100	100	--	100
Regulated prices (%)	100	100	15	100	80	100	--	100
<i>Human capital</i>								
Illiteracy (%)	--	1	<5	--	--	3.4	--	--
Secondary enrolment (%)	89	87	73	81	88	96	58	46
Tertiary enrolment (%)	26	18	15	20	9	25	--	1.3
Life expectancy at birth	72	71	70	71	70	64	67	66
<i>Income Distribution and Poverty</i>								
Gini coefficient	--	21.0	24.4	26.8	23.3	28.9	38.3/49.5 ^{c/}	21.0
Poverty incidence	--	8	14	15	29	14	38 ^{d/}	28
<i>Macroeconomic Balance</i>								
Deficit/GDP	4.5	1.5	1.0	4.5	0.0	--	-4.41	-0.6
Current account/GDP ^{e/}	-6.4	0.9	-4.9	-2.7	5.4	--	--	--
Debt/GDP	50.0	19.0	65.0	80.0	3.0	--	--	--
Inflation rate	6.3	1.3	18.0	640.0	2.5	2.0	1016	0.7
Monetary overhang (M2/GDP)	1.3	0.7	0.4	0.9	0.6	--	--	--

Sources: Bruno (1992), UNESCO (1991), Gelb and Gray (1991).

^a Data refer to 1978 or the late 1970s for China and to 1989 or the late 1980s for the countries of ECESU and for the average of the middle-income countries (AMIC). ^b Council for Mutual Economic Assistance. ^c The first data refer to the Asian newly industrializing countries (NICs), the second to Latin America. ^d Refers to Latin America.

^e Convertible currency only.

Economic Structure, Institutions and Human Capital

Striking similarities existed in this field among the ECESU countries. All of them belonged to the middle-income group of countries (with GDP per capita in the \$2,000-\$5,000 range) and with no exception suffered from "inefficient overindustrialization". As a whole, their shares of agriculture and industry in GDP were indeed respectively significantly lower and higher than the average of countries in this group. At the later stage, these pervasive micro-distortions, and an oversized public sector, represented a serious handicap in their move to the market economy. Though it had a relatively well-developed industrial system, China was instead a predominantly agricultural economy, with a level of participation of this sector in total output similar to the average found among the less industrialized countries (LICs).

In contrast, human resources in both China and Eastern Europe were notably more developed and better distributed among social classes than in their respective reference

country groups, clearly a considerable ex ante advantage in terms of potential for broad-based and "knowledge-led growth" in the post-reform years. For instance, despite the stagnation of the 1970s and 1980s, in 1989 life expectancy at birth in Eastern Europe was on average four to five years higher than in the middle-upper income group, while illiteracy rates were four-fifths lower and average gross enrolment rates in secondary education 20 points higher. Tertiary enrolment rates were instead below those of the most advanced newly industrializing countries (NICs) such as South Korea, Chile and Uruguay. Meanwhile, China boasted in 1978 substantially higher life expectancy at birth, enrolment rates and lower illiteracy rates than the other countries in the same income group.

With the exception of Hungary (where private ownership was notable) in several service branches and in agriculture and of Poland and Bulgaria (where part of agriculture was in private hands), the ownership of the means of production was firmly and fully vested in the state in all the countries under examination. Similarly, though again with some exceptions, the prices of goods and production factors were set by the state-run planning commissions. On the trade front, both China and the Eastern European countries were practically insulated from the international markets, while a very high proportion of Eastern European exports (between 40 and 70 percent, or higher in the case of manufactured products) was exchanged (using the "transferable roubles" as numeraire) with the other CMEA countries at planned prices which were substantially misaligned in relation to world prices. Energy and raw material prices in particular were below world market prices, giving rise in this way to a substantial *implicit subsidy* from the USSR to the importers of such commodities, estimated to equal in 1989 and 1990 \$8.1 billion and \$15.6 billion in current dollars, or between 5 and 12 percent of the GDP of the importing countries (Gelb and Gray 1991). The dissolution of the CMEA and the rapid elimination of these subsidies in 1990 and 1991 produced very large negative shocks on the importing countries (see later).

Income Distribution and Poverty

Perhaps the single most significant accomplishment of the socialist systems of Eastern Europe and China was the egalitarian income distribution they were able to institute, despite the efficiency and incentive costs incurred in reaching this objective. In the years immediately preceding the introduction of the economic reforms—and in spite of the worsening or stagnation of these indicators in Poland, Hungary and the USSR in the middle to late 1980s

and of the instability caused by the Cultural Revolution in China in the 1970s—these countries were indeed characterized by levels of income inequality and poverty rates substantially lower than those prevailing in the majority of the middle- and low-income countries. This conclusion holds true even if account is taken of the privileges of the *nomenklatura*, of the differential access by various social groups to the "official", "preferential" and "parallel" markets and of the opportunity cost of queuing (Atkinson and Micklewright 1992, Milanovic 1991).

While a typical Latin American or Southeast Asian middle-income country had Gini coefficients and interdecile ratios ranging respectively between 0.40 and 0.54 and between 10 and 16, in Eastern Europe the Gini coefficients oscillated between 0.20 for Czechoslovakia and 0.29 for the USSR, while the interdecile ratio varied between 2.4 and 3.6, i.e. values even lower than those prevailing in the Western market economies, with the exception of the Scandinavian countries. Poverty rates in turn were the lowest in Czechoslovakia (7.4 percent in 1988), around 14 percent in Hungary and the USSR and about 15 percent in Poland, as opposed to values about ten points higher for the average MIC.

Despite considerable regional differences in soil fertility and endowments of other natural resources, China too could boast an exceptionally egalitarian income distribution in 1978. The Gini index of income concentration for the whole rural sector was equal to 0.21 and to similar or lower values for the urban sector (Table 1; see also Hussain et al. 1991). In view of the country's substantially lower income per capita, the 1978 poverty rate of 28 percent (4.4 for the urban areas and 33 for the rural areas) was higher than that found in the countries of Eastern Europe. Nonetheless, it was still well below the rates recorded for other low-income countries: the Gini coefficient for these countries (such as India and the other South Asian nations) was twice as large (42.8), and poverty rates were also considerably higher.

It is important to stress therefore that, *ceteris paribus*, both China and Eastern Europe presented a major advantage over other countries which had to introduce major reforms under conditions of greater income inequality and higher poverty. As even the most successful reforms are likely to cause some dislocations and the impoverishment of some groups, more favourable initial conditions on these two fronts are likely to offer sounder guarantees of lower social costs and a greater political feasibility of the overall reform process.

Macroeconomic Balance

In the late 1980s, Poland and Yugoslavia and, to a lesser degree, Hungary and the USSR, started to suffer from growing macroeconomic instability. In fact, only Yugoslavia (not discussed in this paper) and Poland—where in 1989 inflation reached 640 percent, the budget and current account deficits amounted to 8 percent and 2.6 percent of GDP, and the debt/GDP ratio reached 80 percent—showed the symptoms of a severe macroeconomic crisis requiring urgent stabilization. Czechoslovakia, Romania and Bulgaria, in contrast, had not experienced major macroeconomic problems, though Bulgaria started facing a considerable international payments crisis in the late 1980s, and Romania, the USSR and Bulgaria felt the negative effects of a certain degree of "repressed inflation". In turn, prior to the inception of the reforms, China did not face any kind of macroeconomic imbalance, as indicated by its quasi-zero rate of inflation, balanced budget and extremely low foreign debt. While budget deficits are only one of the factors affecting macroeconomic instability (the others being the large subsidies provided through low-interest loans by the state-owned banking sector), with the exceptions mentioned above, neither the ECESU countries, nor China experienced *as a bloc* the massive macroeconomic dislocations which affected a large number of middle-income and low-income developing countries during the crisis of the 1980s. Only Poland and, to some extent, Bulgaria were suffering evident signs of macroeconomic collapse in the immediate pre-reform period. One could argue, in fact, that, with these two exceptions, the initial macroeconomic conditions in the countries under review were either favourable (as in China, Czechoslovakia and Romania), or not particularly adverse (as in Hungary and Russia). The subsequent wave of "shock-therapy" stabilization programmes in several of these countries has reflected more the preference for a given policy approach than an objective necessity.

III. ECONOMIC REFORMS COMPARED: SHOCK THERAPY VERSUS GRADUALISM

The Chinese Road to Reform

Economic reforms began in China in 1978 as a reaction to the excesses of the Cultural Revolution and as an attempt to move from the "extensive growth model" followed until then

to an "intensive growth path" which would lead to increases in productivity and personal consumption. The main elements of this approach can be summarized as follows.

1. *Household Responsibility System in Agriculture.* The reforms started with the introduction in 1978 of the household responsibility system in agriculture (HRSA). This programme entailed three main changes. Firstly, the commune system was replaced by an egalitarian family-based agriculture which guaranteed access to the land to all former commune members. They received an equal amount of land (corrected by quality) on a leasehold basis of 15-25 years, a duration which was subsequently extended. This land reform (which did not grant peasants full transfer rights) provided considerable incentives to the farmers, while at the same time avoiding the polarization in land distribution which might have followed after a few years from the devolution of full property and transfer rights. Secondly, procurement prices of the main staples were raised by 25 percent in real terms (with only a fraction of the price increase passed on to the consumers in the first years); further price reforms were introduced in 1988 and 1991 for non-staples so that all food prices are currently completely free. Thirdly, procurement quotas were gradually reduced, thus allowing the farmers to sell their over-quota production in the open market. This flourish of agricultural activities following the introduction of the HRSA, as well as the support and commitment of local governments, led to a phenomenal growth in rural industries.

2. *Enterprise Responsibility System.* In 1984 the enterprise responsibility system (ERS) was introduced for state-owned enterprises (SOEs). Also in this case, the reform entailed a two-tier price and commercialization system, by which state enterprises were allowed to sell at market prices the excess of output over the quota delivered to the state agency at predetermined procurement prices. In addition, a bankruptcy law was promulgated in 1987, while in 1983-4 the system of compulsory remittance of profits to the central Government was replaced by a corporate income tax of 55 percent, thus allowing enterprises to retain the after-tax profits and to respond in this way to price and profit inducements. Already by 1988, over 90 percent of state-owned enterprises were operating under this system (Harrold 1992), while by 1991 around 50 percent of industrial prices were determined by unregulated markets.

In addition to the rapid growth of rural industries and the introduction of the ERS for SOEs, the development of the industrial sector has been facilitated by the reforms introduced in the field of *foreign direct investment* and by the establishment of *special economic zones*. The law approving the establishment of joint ventures was passed in 1979, while the first four

special economic zones (benefiting from special taxation and profit remittance provisions) were inaugurated in the south of the country in 1980. In addition, since the mid-1980s private Chinese enterprises can also be established outside the rural sector and the joint venture context.

3. *Privatization of State-Owned Commercial and Service Enterprises.* Another area of profound, though gradual, reform concerned the privatization of state-owned commercial and service enterprises (somewhat similar to the "small privatization" in ECESU countries; see later). Reforms were initiated in 1982, and by 1985 75 percent of all state-owned units in this sector had been sold or leased to private owners, and "obstacles to entry" had been fully removed (Harrold 1992). Public enterprises continued to operate only in the wholesaling of some agricultural products, the retailing of commodities subject to rationing or price controls, and in department stores with a large number of employees.

4. *Fiscal and Social Sector Reforms.* In addition to the replacement of profit remittances by a corporate income tax, tax policy was modified by the introduction in 1985-6 of the *fiscal contract responsibility system*, through which the central Government further decentralized tax collection to local authorities while raising the proportion of central taxes to be retained locally. These reforms produced further fiscal decentralization and thus reduced the redistributive role of the central Government from rich to poor regions. At the same time, and until very recently, the Government increased the value of subsidies to loss-making state enterprises (which rose from 1 to 3 percent of GDP between 1978 and 1989) so as to avoid the potential social dislocations of the reforms (Hussain and Stern 1992). Indeed, these subsidies played the role of surrogate of budget-financed unemployment compensation schemes and other social transfers normally found in more developed economies.

The gradual reduction of consumer subsidies (starting from 1981), the decline in defence expenditure and the drop in investment expenditure (increasingly carried out by the enterprises on the basis of retained profits) allowed an increase in the share of public expenditure allocated to the social sector (Table 2).

However, the squeeze on central Government revenue which followed the tax reforms caused a stagnation in real expenditure per capita in these sectors (which remained mainly targeted to the urban sector), while the pattern of financing of these services was profoundly altered, as the total Government expenditure authority declined and as user charges and health insurance rose in importance. Indeed, though central Government expenditure in these sectors was dropping significantly, local governments tended not to take up the slack as they

Table 2: GOVERNMENT EXPENDITURE IN CHINA^a
(In Percentages, 1981-8)

Item	% of Public Expenditure				% of GNP			
	1981	1984	1986	1988	1981	1984	1986	1988
Social welfare	2.1	1.7	1.7	1.5	0.5	0.4	0.4	0.3
Debt service	5.8	1.7	2.1	3.0	1.4	0.4	0.5	0.6
Defence	14.9	11.7	8.6	8.2	3.6	2.7	2.1	1.6
Administration	6.2	8.2	7.3	8.2	1.5	1.9	1.8	1.6
Price subsidies	--	--	11.0	11.7	--	--	2.7	2.3
"Other"	7.5	10.4	10.2	11.7	1.8	2.4	2.5	2.3
Social sector ^b	15.4	17.0	16.2	17.9	3.7	3.9	4.0	3.5
Development	48.1	49.3	42.9	37.9	11.6	11.3	10.6	7.4
Total	100.0	100.0	100.0	100.0	24.1	22.9	24.7	19.5

Source: Yu (1992).

^a Figures may not sum owing to rounding. ^b Includes culture, education, scientific research and health.

usually focused their action on economic and infrastructural development rather than on the provision of health care and other social services. While local authorities in several counties were able to introduce alternative collective financing mechanisms (by, for instance, financing health care at the local level through the profits of local cooperatives), in others the main tax changes described above led de facto to the privatization of health and education services. In addition, the dismantling of the rural commune system unexpectedly caused the effective liquidation of the commune-financed health and education system in the countryside (Yu 1992). These trends are well illustrated by the data on the overall (public and private) financing of health care. Indeed, while total health expenditure remained broadly constant at around 3 percent of (a rapidly expanding) GDP, the share of Government resources in the total dropped from over 30 percent to 20 percent between 1980 and 1989 (Table 3). Between 1985 and 1989, furthermore, Government expenditure per capita in constant prices declined by about 10 percent.

5. *Exchange Rate and Foreign Trade Reforms.* Reforms in this area quickly modified an initial situation in which foreign trade was the exclusive concern of 15 state corporations operating within the context of a fairly rigid export plan. Four main measures can be singled

Table 3: TOTAL HEALTH EXPENDITURE BY SOURCE IN CHINA^a
(In Percentages And In Billions Of Yuan, 1980, 1985 And 1989)

	% Total Health Expenditure			Yuan (billions, 1980 prices)		
	1980	1985	1989	1980	1985	1989
Government health expenditure	31.1	30.0	20.2	4.1	7.0	6.2
Government health budget ^b	21.2	18.9	13.0	2.8	4.4	4.0
Traditional Chinese medicine ^c	0.8	1.3	1.0	0.1	0.3	0.3
Family planning ^d	2.3	3.0	2.0	0.3	0.7	0.6
Capital construction	2.3	3.4	1.6	0.3	0.8	0.5
Education and research ^e	4.5	3.9	2.2	0.6	0.9	0.7
Health insurance	45.5	43.3	43.6	6.0	10.1	13.4
Free medical care	5.3	6.0	6.8	0.7	1.4	2.1
Labour protection medical care	40.1	37.3	36.8	5.3	8.7	11.3
State-owned enterprises	30.3	25.3	26.1	4.0	5.9	8.0
Urban-collective enterprises	6.8	7.7	6.2	0.9	1.8	1.9
Rural-collective enterprises	3.0	4.7	4.6	0.4	1.1	1.4
User charges	23.5	26.6	36.2	3.1	6.2	11.1
Urban users	5.3	11.6	21.2	0.7	2.7	6.5
Rural users	18.2	15.0	15.0	2.4	3.5	4.6
"Other" ^f	--	0.4	0.3	--	0.1	0.1
Total health expenditure	100.0	100.0	100.0	13.2	23.3	30.7
Percent of GNP	--	--	--	3.0	3.2	3.1
Per capita (yuan)	--	--	--	13.4	22.2	27.6

Source: Yu (1992).

^a Columns may not sum due to rounding. ^b Including recurrent budgets and special budgets. ^c Became a separate item in the Ministry of Public Health budget in 1980. ^d Budget of the State Family Planning Commission and its affiliates. ^e Budgets of the State Education Commission and the State Science and Technology Commission and their affiliates. ^f Including the inputs from private practitioners, international organizations and foreign donations and loans.

out (Harrold 1992). First, the authority to create new foreign trade corporations was decentralized to local governments. Second, the scope of the trade plan was substantially reduced, so as to allow individual enterprises to seize new opportunities. Third, a greater retention of the foreign exchange was allowed at the local level. These three separate measures were followed by the introduction of the *export contract system*, which stipulated the sharing of foreign exchange between the central and the local governments and support measures, including tax rebates and export subsidies, to be provided from the centre. As a result, the number of foreign trade corporations climbed rapidly to 1,500 by 1987 and to over 5,000 by 1990, while the number of items exported also rose substantially. Fourth, a major additional boost to exports was provided by the large devaluation of the exchange rate

during the years 1978 through 1992. Between 1980 and June 1991, for instance, the real effective exchange rate declined by 65.4 percent (Harrold 1992).

6. *Macroeconomic Adjustment.* As mentioned earlier, at the beginning of the reform process China enjoyed broadly balanced macroeconomic conditions. However, two inflationary outbursts took place in 1988-9 and in 1993 (and to a lesser degree in 1980-1 and 1985-7) due to the overheating of the economy (see Table 6). On all these occasions the Government reacted quickly by means of the usual deflationary measures of credit tightening and wage control in the SOEs. As noted more in detail later in this paper, such policies did have a visibly negative effect on the growth of per capita incomes and the incidence of poverty. In more general terms, the macroeconomic policy of the Chinese Government during the transition could be defined as "prudent" or even "conservative"; the average budget deficit/GDP ratio was equal to 1.9 percent; external indebtedness reached only 15 percent of GDP in 1991, and the current account has tendentially remained balanced (see Table 6; see also Solimano 1992, Table 9).

The Reforms in Eastern Europe

With the exception of Hungary, which since 1968 has introduced some gradual but non-negligible modifications in its price and ownership system, "systemic" reforms began in ECESU only in the second part of 1989, when Poland launched some initial reforms. This was followed in January 1990 by the first comprehensive "big bang" programme which simultaneously combined a massive dose of fiscal and monetary austerity with price and trade liberalization and privatization of SOEs. Bulgaria and Romania also introduced some initial price liberalization and "small privatization" in 1990, though reforms accelerated massively in intensity and scope in February 1991 in Bulgaria and in July 1991 and May 1993 in Romania. In both cases, the later reforms entailed an almost total price liberalization, the flotation of the exchange rate and considerable fiscal and monetary austerity. Czechoslovakia (which broke into two constituents in January 1993) and, in particular, Hungary followed a better planned or more gradualistic approach to price liberalization, the first since 1990 and the latter since January 1991. Finally, in Russia and Ukraine the reforms followed a radical approach in 1992, but have since been slowed down by the large drop in output, persistently high inflation, rising budget deficits and loss of control over monetary policy which resulted from these initial reforms and by lack of domestic consensus.

Overall, the main features of these reforms can be summarized as follows, though it should be noted that the sequence with which they were introduced has varied from one country to another.

1. *Price Liberalization and Price Subsidies.* The aim of assigning a greater role to market prices in the allocation of resources has been pursued through the simultaneous and total dismantling of most price controls, an increase in public tariffs and the elimination of practically all consumer and most producer subsidies, including subsidies for drugs and basic foodstuffs (except for meat and milk in Hungary, or bread and a few other items in Russia). However, because of the disruptions caused by the shortage of essential items, the authorities are now reconsidering the introduction of targeted subsidies. In Romania, for instance, the Government decided in late 1992 fully to subsidize 68 vital medicaments to be distributed free of charge and a further 132 important drugs to be sold at one-quarter of their price. For the rest, the full economic cost is to be borne by the consumer (UNICEF 1994).

To avoid excessive welfare losses, part of the consumer subsidies was to be turned into income subsidies through simultaneous and theoretically equivalent increases in wages and benefits. The only cases of generalized staggered reduction of subsidies concerned housing, energy and transport services, while only in the case of Czechoslovakia did the initial wage increase granted to offset the expected price explosion prove adequate.

Price liberalization (and the inflationary effects of substantial devaluations) was expected to generate a large but short-lived bout of "corrective inflation", which would eliminate monetary overhang and price distortions. The decline in inflation, which was expected to drop to around 1 percent per month within 30 to 60 days, was to have been facilitated by means of restrictive wage, monetary and fiscal policies and (as in the Polish and Czech cases) by the stability of the exchange rate that, after an initial large devaluation, was supposed to remain constant as the "anchor" of the programme.

2. *Exchange Rate and Foreign Trade Reform.* As noted, all ECESU countries opted for a devaluation of the real effective exchange rate, though the extent of the devaluation and the exchange rate regime adopted since then have varied widely. Czechoslovakia and Poland opted for a fixed exchange rate (subject to realignment only after long periods), while Bulgaria, Russia and Romania adopted an interbank floating rate, and Hungary a managed rate. All countries quickly abandoned whatever form of two-tier exchange system they had. Bulgaria, Hungary, Poland and CSFR rapidly made their (devalued) currency convertible for current account transactions. Practically in all of these countries, quantitative restrictions to

international trade were rapidly eliminated, and low to moderate import tariffs were introduced, with the hope that import prices would de facto act as a lid on domestic prices. The biggest changes affecting the foreign trade of the ECESU countries were, however, the dismantling of the CMEA trade system, which started in 1990 and became fully effective in early 1991, and the move to a convertible currency basis for the former inter-CMEA trade, though barter and countertrade arrangements are still common.

3. *Privatization.* The modification of the property rights regime has moved in three directions. First, "small privatization" (of service units, restaurants, shops and so on) has advanced fairly rapidly in all countries, mostly through local auctions. In Poland, for instance, at least 20,000 outlets were sold in the first two post-reform years, while in CSFR and Hungary the divestiture of 100,000 small businesses and of 10,000 shops and medium-sized services was planned in the first year of the reform (Gelb and Gray 1991).

Second, the privatization of large SOEs has been the main focus of the privatization effort, though it has generated only modest results so far. While it has developed in quite different ways from country to country, four main avenues can be singled out. Public sales of a few SOEs have taken place in most countries, with purchases of large units often made by foreign capital. "Reprivatization" has instead entailed the return of some enterprises or land to their former owners (as in the case of Czechoslovakia and Hungary). "Spontaneous privatization" (often at very convenient terms) by the management and workers of the enterprises has been allowed in several countries (including Hungary and Poland). And finally, as in CSFR, privatization has primarily relied on some form of shares distribution.

The third direction remains relatively unexplored, namely, in removing barriers to entry and encouraging new investment and the autonomous development of new private enterprises. In contrast, this approach was actively pursued in China.

4. *Institutional Reforms.* The success of the efforts in the above three areas depends to a considerable extent on the existence of adequate "institutions" guaranteeing clear and enforceable property rights (of whatever nature they might be), free entry and competition, correction for "externalities" and other market failures, the establishment of social safety nets and the financing of the provision of these "public goods" through taxation. The absence of these institutions carries a number of negative consequences: property rights remain unclear, thus discouraging the purchase of SOEs by nationals and foreign investors, as well as the creation of new enterprises on which, in the end, future growth will depend; privatization

does not entail necessary competition; market prices cannot play their role as signals of relative scarcities, and the expected efficiency gains remain elusive.

Progress in drafting new legislation on property rights, bankruptcy, anti-trust, dispute resolution, wage indexation, unemployment and social policy, foreign investment, industrial relations, taxation, capital market and banking, and so on has, however, been carried out in an ad hoc manner and more slowly than required by the rapid moves in the fields of price and trade liberalization, though the situation has been somewhat more positive in Hungary (where some of these measures, such as tax reform, were introduced as early as 1988), CSFR and Poland.

5. *Labour Market and Social Sector Reforms and the Creation of "Safety Nets"*. Employment, wages and consumer subsidy policy have undergone radical changes, while eligibility for benefits and access to public services have so far been modified only moderately (Cornia and Sipos 1991).

The policy of artificial full employment has been abandoned, and unemployment has been allowed to increase sharply except in Russia and, in the first programme year, in Ukraine, though labour shedding due to company liquidations and dismissals has remained relatively rare. All countries have introduced some form of unemployment compensation (though eligibility has generally become increasingly more restrictive with time), and early retirement and extended child care leave for women have often been used to lighten the unemployment rolls. "Active labour market" policies, in contrast, have involved only less than 1 percent of the labour force and, even for these, have produced only limited results.

Wages are no longer set centrally, though wage increases in the public sector have been taxed heavily as part of the stabilization programme. All countries have introduced some kind of indexation of wages, pensions and benefits, though such indexation has always remained considerably below the increase in prices and has been granted on an ad hoc basis. This has caused large losses of income and the impoverishment of ample sections of the population, particularly during the periods of high inflation experienced in Poland, Bulgaria, Ukraine and Russia (only Poland and Bulgaria have since introduced a quarterly indexation ex ante). Furthermore, the extent of the indexation has varied considerably over time and by type of benefit. Pensioners, who represent between 30 and 40 percent of the voters in Bulgaria, Hungary and Poland (Bruno 1992), have generally enjoyed a more generous indexation, though the spread of pensions has increased as greater emphasis has been placed by the new pension systems on the relation between contributions and benefits. Child

allowances, instead, have been relatively penalized, particularly in Russia, Romania and Bulgaria (Table 4).

Several proposals have been put forward for the elimination or targeting of child and family allowances on poor families, but no decisions have as yet been made in this regard. Indeed, in several cases such benefits have been extended to the children of the unemployed. In addition, social assistance, practically nonexistent under the socialist regime, has been introduced.

No major structural changes have yet occurred regarding access to education, child care and other social amenities. The modifications introduced include: services provided in the past by state enterprises (such as child care, recreation and vocational training) have been discontinued; substantial user fees have been instituted for kindergarten and school meals, schoolbooks, drugs and most health services to compensate for the diminished government expenditure; several services, including child care and kindergartens, have been decentralized

Table 4: CHANGES IN AVERAGE PENSION/AVERAGE WAGE
AND CHILD ALLOWANCE/AVERAGE WAGE

	1989	1990	1991	1992	1993
<i>Average Pension/Average Wage Ratio</i>					
Bulgaria	57.3	48.2	53.5	43.5	44.1
Czech Republic	52.2	54.3	55.6	49.2	48.4
Hungary	63.1	62.6	64.3	60.9	59.7
Poland	53.3	65.0	76.2	67.2	69.1
Romania	54.9	53.3	48.4	47.7	44.1
Russia	35.7	33.7	48.5	27.8	34.3
Slovakia	49.2	51.0	53.6	49.1	48.1
<i>Child Allowance/Average Wage Ratio</i>					
Bulgaria	12.8	9.8	13.8	10.7	9.0
Czech Republic	10.4	11.9	13.2	11.7	--
Hungary	20.5	21.8	19.9	18.1	17.0
Poland	2.6	5.8	6.5	6.7	5.4
Romania	9.8	8.9	6.6	5.3	4.7
Russia	--	--	--	4.8	2.7
Slovakia	10.5	12.1	13.2	12.1	10.4

Source: MONEE Database, UNICEF-ICDC, Florence.

to local authorities, though—contrary to the Chinese case—an equivalent decentralization of tax power has not taken place; and finally, obstacles to private provision (particularly important in the case of education) have been removed.

In the health sector, in contrast, the situation is mixed. Some reforms have aimed at removing some of the problems inherited from the socialist era by assigning greater emphasis to primary care and introducing some financial incentives for the health personnel. New developments comprise, however, the introduction of health insurance, user fees for most services and—in Russia—the privatization of several health institutions by means of the creation of medical cooperatives. Most of these measures risk, however, reducing coverage among informal-sector people and the poor.

6. *Macroeconomic Stabilization.* Tight fiscal and monetary policies and considerable wage repression accompanied the liberalization of prices and foreign trade and devaluation, with the aim of stabilizing the macroeconomic imbalances inherited from the past or emanating from the inflationary and trade deficit effects generated by those same price and trade reforms. In some cases, the extent of the fiscal contraction and wage repression was quite extraordinary. In the most extreme case, Poland, the 1989 fiscal deficit (equal to 8 percent of GDP) was transformed into a 5 percent surplus in the first nine months of 1990 (Gelb and Gray 1991). A similar, though less pronounced, pattern was observed in Russia and Bulgaria. Even where initial conditions were more favourable, the recourse to stiff stabilization has been rendered necessary by *price overshooting*, which followed the liberalization of prices and foreign trade. Only in Hungary—where already in 1989 a considerable proportion of prices was determined by the market—and in CSFR, which followed a step-wise price liberalization, was the increase in price level similar to that expected. A "fragile fiscal balance" due to the delayed development of a new tax system and to recession has also contributed to this persistent fragility in state accounts. Despite subsidy cuts of the order of 8-10 percent of GDP, it appears that "the drop in enterprise profit taxes [still the main tax instrument in ECESU] is likely to continue to exceed the net drop in expenditure" (Bruno 1992, page 767).

Most Salient Differences between the Two Approaches

In Eastern Europe, the economic reforms were undertaken in the wake of the collapse of the socialist regimes. The shaping of reforms has been influenced, therefore, by a large "political rebound", i.e. the desire to replace rapidly and totally the model of social organization

imposed on these nations in the past. In 1990, this dominant, though—with hindsight—naive, perception led to the belief that all policy measures adopted by the past regime were inherently wrong, even in areas where positive results had been objectively achieved, as for instance in the field of human capital (see Section II). The neophyte-like faith in the model perceived to have opposite characteristics to "real socialism", i.e. the neoliberal model, as well as the lack of historical precedents from which to take inspiration, made the policy-makers in several ECESU countries consider the shortest transition to a full-fledged liberal market model as desirable and possible. From this followed their preference for a radical and instantaneous price liberalization, extraordinarily large and never before observed expenditure cuts, and rapid trade and import liberalization. As Bruno (1992, page 743) notes, "...unlike many past cases, IMF programmes in Eastern European economies thus far have typically been self-imposed, drastic adjustment programmes, to which the IMF has given its blessing rather than having been the primary initiator." The popular backlash against state intervention concerned even those areas in which state involvement is considerable even in the most liberal of the Western market economies, i.e. the regulatory framework of the economy and the social sector. As noted by a Polish observer, as "'socialist' is a discredited word, 'social' is also suspect, while [even] 'public' sounds dubious" (Wiktorow and Mierzewski 1991, page 223). In contrast, the reform process in China emerged from within the socialist regime. Particularly in the first years, the reforms were not envisaged to come up with a wholesale replacement of the socialist model by a market model based on private property and market prices. In addition, the reform process has been able to count on the considerable administrative strength typical of a command economy. As for the economic policies followed, five major differences can be distinguished when comparing the two approaches highlighted above.

1. *Choice of the "Target Model".* At the outset, the main objective of the Chinese reforms was to introduce greater decentralization in decision-making and more favourable incentives for economic agents. In a sense, these initial reforms shared some similarities with those instituted in Hungary (and suppressed in Czechoslovakia) in 1968 and which can be broadly considered as a move toward a "socialist market economy". It should be noted, however, that in subsequent years China has responded to the problems arising out of the initial reforms by intensifying the previous reforms and by introducing new ones, so that, at the present time, the role of market prices and non-state ownership is far more significant than was envisaged in the early phases of the reform. For instance, all consumer prices and more than

half of the prices of intermediate goods are now market determined, while the non-state sector accounts for the entire agricultural output, a very high proportion of service output and about half of the industrial production (Harrold 1992). Similar considerations apply to ownership (except for the financial sector and key industrial branches). The present situation is therefore more similar to that of a "mixed economy", with a strong participation of the state in the industrial sector and in the overall orientation of the economy.

With respect to ownership patterns, prices and the role of the state, the situation is de facto broadly similar or even less favourable in most of the countries of ECESU where, very differently to the case of China, the choice of a "full-fledged liberal model" as the target of reforms has been unequivocal, though progress toward this objective has been scant. It should be remembered, however, that only three to four years have elapsed since the inception of the reforms in these countries.

2. *Gradualism and Experimentation versus Shock Therapy.* In contrast to the radical and comprehensive changes prescribed by the dominant paradigm on policy reform—which has broadly been adhered to in all ECESU countries—the transition in China has "...been spread over time, often several years, and usually after experimentation" (Harrold 1992, page 5). This was the approach followed in the case of the HRSA, foreign investment and ownership, and special economic zones. Two are, in particular, the areas where differences are most evident: price reform and trade liberalization. The two opposing approaches to price liberalization are briefly discussed in this section.

In China, the increase in producer prices of 1978 was initially largely financed by the state budget and transferred onto consumer prices in steps by means of several rounds of price reforms. Consumer subsidies increased from 2.1 to 7.1 percent of GDP between 1978 and 1981, but subsequently declined to only 1.5 percent of GDP in 1991, and even further since the complete liberalization of food prices of 1992. Price increases averaged a low 5.8 percent per year between 1978 and 1991 and experienced only two relatively minor hikes of 15-18 percent per year in 1988-9 and in 1992-3. The inflationary and welfare effects of price liberalization have therefore been extremely modest and have not required the introduction of drastic deflationary measures as in the ECESU countries.

With the exception of CSFR and, particularly, of Hungary, price liberalization has instead been instantaneous and comprehensive (see above) in ECESU countries, thereby prompting price increases which were substantially greater than those—already very large—foreseen. In Poland, the projected price shock during the first year of reform was

estimated at less than 100 percent, while it ended up at about 250 percent (Bruno 1992). Romania, Bulgaria and Russia suffered from similar "price overshooting". Even in CSFR the 25 percent increase in prices projected for the first quarter of 1991 reached a disturbingly higher 40 percent. Only in Hungary, which had already gradually removed price controls over the 1968-88 period, did the further price liberalization of 1991 cause a low initial price shock of 10 percent (or about 25 percent on a yearly basis). Obviously, in all ECESU countries except Hungary, the economic and welfare costs of this "shock therapy" have been considerable (see later).

3. *Selective versus Universal Policies.* One of the main manifestations of the "gradualism versus shock therapy dichotomy" has been the adoption of two-tier systems in pricing, distribution, import protection, foreign exchange, and so on. While in China such two-tier systems have been frequently adopted (even if, in several cases, in a time-bound fashion), in Eastern Europe, by contrast, unified exchange rates, prices, protection rates, etc., have represented the general rule (with few exceptions such as Romania, in the first two programme years). It is often objected that dual pricing or other two-tier systems are inefficient, represent a potential source of arbitrage, corruption and rent-seeking and that they thus should be replaced, even over the short term, by a unified system (despite the economic and social costs and large adjustments that this approach may cause). While some of the above problems have surfaced in China since the introduction of the household and enterprise responsibility systems, it is however undeniable that such an approach has helped (together with other measures) avoid large price shocks while assuring the continuity of supply of critical inputs or consumer goods, thus allowing a gradual adjustment to new conditions and the development of market skills in a situation of overall growth. As such, these dual pricing or other selective policies have represented an effective instrument to smooth a difficult transition. Their adoption in China has been particularly reasonable in view of the administrative strength of the bureaucracy, and of their gradual phasing out, as occurred in the case of food.

4. *Marketization versus Privatization.* A third vital difference between China and the ECESU concerns their approaches to incentives and ownership patterns. In ECESU the main emphasis has been on the *privatization* of the SOEs and, in a few cases, of land; less emphasis has been placed on the growth of new non-state enterprises. This approach has met with numerous legal, accounting and economic problems, and it has therefore not yet been able to transfer to private or non-state owners any sizeable amount of the land and capital stock

nor to liquidate loss-making SOEs. At the same time, while many new, very small enterprises have been created in trade and services, few new industrial enterprises have started operating.

The accent in China has instead been on the *marketization* of state enterprises and on the growth of the non-state sector. The introduction of the HRSA, the spectacular development of rural enterprises and the introduction of the "enterprise responsibility system" of 1984 have de facto substantially "privatized" the economy, although SOEs still dominate the oil, steel, coal and electricity industries. (As noted, all agricultural, half of the industrial and a large proportion of service output originate from the non-state sector.) Growth in the non-state sector has also generated competitive pressures on state enterprises, bringing about changes in their behaviour (even though this process remains far from complete) and forcing a kind of "privatization from below". The other significant point of variance in the Chinese reform approach concerns the explicit recognition of a variety of property rights, including private, foreign, state and cooperative property rights, joint property rights and long-term leasehold rights.

5. *Scope and Sequencing of the Reforms.* The "gradualism" of the Chinese approach relates not only to the speed at which the single reforms were introduced but also to their scope. Initially, the scope of China's transformation was fairly narrow, though ten years later the reforms had practically spread to most sectors.

The sequencing of the various sectoral reforms was also very different to that carried out in ECESU countries. The Chinese reforms have been characterized in particular by their *self-reinforcing nature*. Indeed, the results of the initial reforms generated pressure for the subsequent introduction of other reforms. As noted by Harrold (1992), the success of the agricultural reforms generated surplus savings and labour, which in turn created the conditions and the constituency for the reforms leading to the massive development of rural enterprises. The latter, in turn, created the necessary pressure for the introduction of the reform of the SOEs of the mid-1980s, and so it continued.

In Eastern Europe, on the other hand, countries have attempted *simultaneously* to tackle price liberalization, stabilization and the privatization of SOEs and commercial establishments. They somewhat delayed the reform of the institutional framework (which has longer gestation periods) and attributed relatively less importance to the agricultural sector. This approach seems to have caused some significant *sequencing problems*. The first dilemma concerns the simultaneity of stabilization and price, trade and financial liberalization: in many

cases, liberalization has exacerbated either the internal, or external balance, thus calling for further stabilization. The second difficulty encountered relates to the choice of the optimal sequence between privatization and institutional reforms. Privatization, for instance, has been promoted and carried out before the necessary legislation on anti-trust and bankruptcy was in place, thus offering the opportunity for monopolistic behaviour (anti-trust legislation for instance was introduced in the Czech Republic as late as April 1993).

IV. ECONOMIC PERFORMANCE AND INCOME DISTRIBUTION IN THE POST-REFORM YEARS

This section discusses the changes in economic and social conditions which have taken place since the transition to the market economy of the Eastern European countries and China. In view of the focus of this paper, the analysis underlines mainly distributive issues. However, as changes in poverty and other welfare indicators were strongly influenced by economic factors, the discussion of distributive issues is preceded by a brief reference to the economic performance in the post-reform years.

Overall Economic Performance

Contrary to most expectations, the transition to the market economy in Eastern Europe has been characterized by an unprecedented and generalized decline in output and by persistent macroeconomic instability. Between 1989 and 1993, GDP declined from a maximum of 40 percent in Russia and Ukraine to a minimum of 15 percent in Poland (Table 5). Only Poland and Albania have so far given some sign of recovery, though in the latter the recovery has depended on a massive flow of foreign aid. While some have argued that the contraction of the economy in the region is overstated by official statistics, it is generally agreed that the recent performance has been characterized by a large output contraction which has involved practically all branches of industry and agriculture and affected not only the large, state-owned and mostly bankrupt "smokestack industries", but also the mostly private, light manufacturing enterprises. Except for the Czech Republic, Russia and Ukraine, the fall in output has been accompanied by a steep rise in "registered unemployment" which, in only four years, exceeded the 15 percent mark in Albania, Bulgaria and Poland. In Russia and

Table 5: MACROECONOMIC PERFORMANCE IN NINE EASTERN EUROPEAN COUNTRIES

	1980-4	1985-8	1989	1990	1991	1992	1993
<i>GDP Growth Rates (yearly change)</i>							
Albania	1.6	0.4	11.7	-13.1	-29.4	-6.0	11.0
Bulgaria	4.5	3.7	-0.3	-9.1	-11.7	-7.7	-6.0
Czech Republic	1.8 ^{a/}	2.5	2.4	-1.2	-14.2	-7.1	-0.5
Slovakia	--	--	1.1	-2.5	-14.5	-7.0	-4.7
Hungary	1.8	1.0	0.4	-3.3	-11.9	-5.0	-2.0
Poland	-2.4	3.8	0.2	-11.6	-7.6	1.5	4.0
Romania	3.8	5.3	-5.8	-8.2	-13.7	-15.4	1.0
Russia	--	2.5 ^{b/}	1.6	-2.0	-12.9	-18.5	-12.0
Ukraine	--	3.1	5.0	-3.6	-11.2	-16.0	-16.0
<i>Consumer Price Index (1989 = 100)</i>							
Albania	--	--	100.0	102.5	209.1	704.0	921.5
Bulgaria	--	--	100.0	123.8	542.7	973.7	1519.3
Czech Republic	--	--	100.0	109.9	172.2	191.3	231.1
Slovakia	--	--	100.0	110.4	178.0	195.8	241.2
Hungary	--	--	100.0	128.9	174.0	214.0	262.2
Poland	--	--	100.0	685.8	1167.9	1670.1	2259.6
Romania	--	--	100.0	105.1	288.5	896.9	3500.6
Russia	--	--	100.0	105.4	208.9	3399.7	33116.2
Ukraine	--	--	100.0	104.0	194.5	2620.0	119838.8
<i>Budget Deficit/GDP Ratio (%)</i>							
Albania	--	--	-5.9	-4.6	-25.8	-16.6	-11.7
Bulgaria	--	--	-0.6	-4.9	-3.6	-7.1	-12.3
Czech Republic	--	--	-0.3	0.9	-2.5	-0.2	-0.1
Slovakia	--	--	-0.2	0.0	-3.0	-2.8	-5.5
Hungary	--	--	-2.7	-0.1	-4.9	-7.0	-6.0
Poland	--	--	-7.4	0.4	-3.8	-6.1	-2.8
Romania	--	--	--	1.0	1.9	-4.8	-1.6
Russia	--	--	--	--	-10.0	-4.9	-7.6
Ukraine	--	--	--	0.1	-10.5	-32.0	-10.7
<i>Registered Unemployment Rate (%)</i>							
Albania	--	--	--	--	5.1	36.8	22.3
Bulgaria	--	--	--	1.7	7.5	13.2	15.9
Czech Republic	--	--	--	0.8	3.1	2.9	3.0
Slovakia	--	--	--	1.6	7.8	11.1	12.7
Hungary	--	--	--	0.8	4.1	10.3	12.9
Poland	--	--	0.4	6.1	9.6	12.9	15.0
Romania	--	--	0.1	--	1.8	6.2	9.2
Russia	--	--	--	--	0.1	0.8	1.2
Ukraine	--	--	--	--	0.0	0.3	--

Sources: UNECE (1994); MONEE Database, UNICEF-ICDC, Florence.

^a Data refer to Czechoslovakia. ^b Data refer to the USSR.

Ukraine also, however, "real unemployment" (i.e. that comprising also the workers employed at zero hours, working part-time or enrolled in retraining programmes) rose much faster than is revealed by official figures. Furthermore, in all countries, the inactivity rate has grown substantially more quickly than registered and real unemployment, owing to a massive increase in the number of early retirements and child care leaves and in the number of "discouraged workers".

There is still considerable disagreement on whether this phenomenal crisis has been primarily caused by supply or demand factors. As suggested previously, there are good reasons to believe that the Draconian stabilization policies pursued to reduce the inflationary outbursts which followed the introduction of radical price and trade liberalization and maintain a satisfactory external position adversely affected aggregate demand in these countries. This downward shift in aggregate demand was further compounded by the drop in export demand associated with a sudden and, with hindsight, excessively rapid dissolution of the CMEA and by the persistence of protectionist policies in Western Europe. At the same time, organizational shocks, increases in energy prices and financial constraints on enterprises likely had an adverse impact on aggregate supply.

In China, in contrast, the reforms were able to leverage investments in agriculture and industry made during the pre-reform years by means of appropriate price, subsidies, ownership and liberalization policies. These reforms helped China to sustain a phenomenal average output growth of more than 9 percent for the 12 years between 1978 and 1990 (Table 6) and of about 11 percent in the three subsequent years. As noted, in the initial years (up to 1984) this phenomenal growth acceleration was led by the agricultural sector, and particularly by crop production. The impact of industrial reforms, by comparison, was felt several years later. On average, industrial growth accelerated from 7.8 percent per year during 1978-83 to about 14 percent per year during 1983-8 (or from 9.7 to 11.2 percent if the periods considered are those indicated in Table 6). Contrary to the situation in Eastern Europe (where inflation and fiscal balance have represented an acute problem throughout the transition), the radical changes intervened in China have taken place in a substantially stable macroeconomic context, though rapid industrial growth (and the subsequent shortages of key industrial inputs) and considerable credit expansion caused a few inflationary outbursts in 1988-9 and in 1992-3 (Table 6). Even taking into account these episodes, however, budgetary, external and price stability were on the whole preserved by a fairly prudent macroeconomic

policy. This factor—as will appear clearly from the subsequent discussion—has avoided the large and negative impact on poverty which was observed instead in Eastern Europe.

Table 6: THE RESULTS OF THE MARKET REFORMS IN CHINA
(1978-90)

	1978	1980	1982	1985	1988	1989	1990
<i>Economic Performance</i>							
GDP growth rate ^a							
Agriculture		6.6			3.5		--
Industry		9.7			11.2		--
Total		9.1			8.9		--
Deficit/GDP ratio	-0.3	3.3	1.7	0.5	2.6	1.8	1.5
Inflation rate (%)	0.7	6.0	1.9	8.8	18.5	17.8	2.1
<i>Poverty and Income Inequality</i>							
Real income/capita							
Urban	--	--	467	557	632	632	685
Rural	134	180	241	324	336	313	319
Total	--	--	289	379	412	397	416
Income inequality (Gini coefficient)							
Urban	--	--	0.26	--	--	--	--
Rural (SSB)	0.21	0.24 ^b	0.26 ^c	0.26	--	0.31	0.31
Rural (corrected)	0.23	0.28	0.29	--	--	--	--
Regional inequality ^d	50.3	--	43.7 ^c	45.6	--	35.2	--
Poverty incidence (%)							
Urban	4.4	--	0.9	0.4	0.2	0.3	0.4
Rural	33.0	27.6	15.2	11.9	10.4	12.3	11.5
Total	28.0	--	13.9	9.2	7.8	9.2	8.6
People in poverty (mn)							
Urban	10	--	2	1	1	1	1
Rural	260	218	140	96	86	103	97
Total	270	--	142	97	87	104	98
<i>Human Welfare</i>							
Infant mortality rate ^e	41	39	36	31	31	30	--
Crude death rate ^f	6.3	6.3	6.6	6.8	6.6	6.5	6.7
School enrolment rate	124	112	101	114	126	128	129

Sources: World Bank (1992), Ahmad and Wang (1991), Yu (1992).

^a The first set of data refers to 1978-84, the second to 1985-9. ^b 1981. ^c 1984. ^d Ratio of the average per capita income of the five poorest provinces to that of the five richest provinces.

^e Per 1,000 live births. ^f Per 1,000 population.

Income Distribution, Poverty and Welfare

The large GDP declines of the last few years have been translated in Eastern Europe into a considerable deterioration of living conditions and into steep increases in poverty rates. Welfare losses measured in terms of capability-based welfare indicators appear to have increased, too. In China, by contrast, an excellent economic performance has generated a sharp decline in poverty rates, though the tumultuous growth of 1978 to 1991 did not benefit all regions and social groups to the same degree, and "functionings"-type indicators have shown more modest improvements.

At the aggregate level, the impact of changes in economic performance on the final distribution of income and on poverty rates depends on *changes* in three variables, i.e. the *level and distribution of primary incomes* and the extent and type of *redistributive measures*. As the new economic conditions have involved new types of risks unknown during the socialist era (as, for instance, in the case of unemployment, income instability and poverty), the establishment of appropriate social safety nets in Eastern Europe economies in transition did play an important poverty alleviation role. In predominantly agricultural economies like China the role of "formal" social safety nets—and, by implication, the decline in inequality associated to social transfers—were far less important. Though the commune system provided, and still partly provides, a considerable element of social insurance at the local level, altogether, transfer payments account for about 5-6 percent of national income and marginally grew during the 1980s (see next section). For this country, therefore, the impact of the reforms on income inequality will be discussed directly in the section on the final distribution of income.

For practically all ECESU countries, a considerable amount of data on income distribution can be derived for the period 1989-93 from household budget surveys (HBS), social security records (for pensions) and wage surveys which are routinely conducted at the enterprise level. For China, most of the same information for the period 1978-91 was obtained from secondary sources (World Bank 1992, Hussain et al. 1991, and a few others) which make use of the household survey data regularly undertaken by China's State Statistical Bureau. The quality and scope of this information are, however, rather different and, in some cases (that is, in Ukraine and Albania, for instance) do not allow any robust estimate of the change in inequality. For the other countries, prior analyses (Atkinson and Micklewright 1992) concluded that, altogether, the HBS data from Poland, Hungary and Czechoslovakia were of

comparable quality to those produced in Britain. The data from the USSR, however, were considered to be somewhat less reliable because of the systematic bias affecting the sampling framework of household surveys. In any case, the degree of representativeness of these surveys is likely to have deteriorated somewhat since 1989 due to the growing underrepresentation of the two tails of the distribution caused by increasingly significant underestimations of self-employment and property incomes and by possible declines in response rates in those countries which have introduced the income tax.

1. *Changes in the Level and Distribution of Primary Incomes.* Over the last four years, real average wages have fallen drastically and without exception in the Eastern European countries. The timing, extent and duration of the declines, however, have varied considerably. The largest fall occurred in Poland in 1990, while in most of the other countries it took place in 1991, and in Russia in 1992 (Table 7). In Romania, the May 1993 round of price increases markedly depressed real wages, which were already one-quarter lower than in 1989. In the same year, loss of monetary control, energy shortages and other supply disruptions caused in Ukraine a phenomenal 50 percent fall in real average wages.

Though most governments had hoped to contain the reduction in real wages to 10-15 percent, the extent of the recent fall has reached, and at times exceeded, the 30 percent mark in all the region, the only exception being Hungary, where the drop has been contained to about 18 percent (Table 7). In the case of Ukraine, real wages had dropped by the end of 1993 to only 45 percent of their 1989 level. Wage declines of 35-40 percent were recorded in Albania, Bulgaria and Russia, while reversals in this downward trend are evident only in the Czech Republic. Even in Poland—where GDP growth recovered, if only modestly, in 1992 and 1993—the four-year decline in wages does not seem to have bottomed out.

Except for Ukraine, the largest yearly contractions in wages have occurred in the periods immediately following the "big bang" price liberalizations which have generally marked the beginning of the reform process. As noted above, governments had anticipated the provision of compensation for the "corrective inflation" expected from price liberalization. However, the considerable and unexpected "price overshooting" which followed the liberalization of prices meant that wages were left to fall, as wage restraint represented one of the main anchors of stabilization. The excessively tight wage contraction which resulted from that decision caused, in turn, a large negative adjustment in the level of output through the reverse functioning of the Keynesian multiplier.

Table 7: WAGES, INCOME AND SOCIAL EXPENDITURE INDICATORS
IN NINE EASTERN EUROPEAN COUNTRIES

	1980	1985	1989	1990	1991	1992	1993
<i>Index of Real Wages (1989 = 100.0)</i>							
Albania	--	--	100.0	103.7	63.3	71.6	60.8
Bulgaria	76.1	85.8	100.0	105.3	63.7	72.7	73.8
Czech Republic	95.2 ^a	94.4 ^a	100.0	94.2	70.1	77.4	80.5
Slovakia	--	--	100.0	94.4	69.7	74.8	71.3
Hungary	108.7	113.9	100.0	94.3	87.7	85.9	82.5
Poland	95.8	81.1	100.0	75.6	75.4	73.3	72.6
Romania	103.4	98.8	100.0	105.1	90.2	82.5	69.5
Russia	78.3 ^b	83.9 ^b	100.0	108.6	98.9	63.4	67.4
Ukraine	--	--	100.0	107.9	110.0	90.0	45.8
<i>Index of per Capita Real Income (1989 = 100.0)</i>							
Bulgaria	--	--	100.0	98.3	58.5	60.8	--
Czech Republic	--	--	100.0	98.9	87.5	82.2	--
Slovakia	--	--	100.0	97.2	71.6	72.0	69.7
Hungary	--	--	100.0	98.2	96.5	92.4	87.2
Poland	--	--	100.0	71.5	72.3	71.0	61.7
Romania	--	--	100.0	126.1	97.0	79.3	--
Russia	--	--	100.0	99.7	105.3	61.7	--
Ukraine	--	--	100.0	--	108.8	96.3	--
<i>Public Social Expenditure (%)^c</i>							
Albania	--	--	13.4	15.8	28.9	--	20.3 ^d
Bulgaria	--	--	19.9	20.6	24.7	26.2	24.4 ^d
Czech Republic	--	--	22.2	22.9	22.5	26.3	--
Slovakia	--	--	24.4	25.5	27.3	28.4	26.0 ^d
Hungary	--	--	24.5	26.6	31.5	33.2	--
Romania	--	--	14.1	16.7	16.2	15.8	--
Ukraine	--	--	10.8	11.8	15.6	18.2	22.7

Source: MONEE Database, UNICEF-ICDC, Florence.

^a Data refer to Czechoslovakia. ^b Data refer to the USSR. ^c Includes expenditure on health, education and income transfers. ^d Preliminary.

Also in the field of wage inequality, the developments of the last four years have somewhat betrayed expectations. At the onset of the Eastern European transition, most analysts foresaw an increase in the dispersion of earnings. It was thought that this would be brought about by a rise in the share of self-employment and property incomes (whose

dispersion is generally greater than that of other earnings) in the total, and by an increase in the concentration of wage income. For instance, a long-time observer of Eastern European affairs noted not long ago:

"The introduction of a market economy is bound to affect the distribution of income in the countries of Eastern Europe. The extent and nature of economic inequality will also be affected by the longer-term structural changes to the labour force.... Such changes may well lead to an increase in poverty as well as rising levels of affluence" (McAuley 1991).

This study suggests that shifts in this direction have indeed occurred, but in a less intense and general manner than expected *ex ante*. Indeed, the Gini coefficients of gross wages (from administrative records) and wage income (from HBS) show a modest but consistent tendency to increase over the last three to four years for Bulgaria, Poland, Romania and Slovakia. While for these countries the increment is of the order of 3-4 points, Hungary and the Czech Republic display increases of just 1-2 points (see Table 8 and the Figure referring to Poland). Only for Russia is there evidence of a massive polarization in the distribution of wages starting in 1991 and continuing further in 1992. In this country, overall wage dispersion has risen mainly because of the persistence of a strongly bimodal distribution of earnings within the industrial sector and because of the fall of wages in the public administration vis-à-vis those of the industrial sector. Health sector wages, for instance, were equal to about 80 percent of the national average before the liberalization, but had fallen to 60 percent by 1993 (UNICEF 1994). Altogether, the increase in earnings disparity appears much less marked than expected, possibly suggesting that the extent to which "systemic" transformations have taken place remains limited. Progress on the privatization front has been modest, partly because of the recessionary conditions prevailing throughout the region and partly owing to the slow development of an adequate institutional framework. This has acted as a brake on new investments and on the establishment of new private enterprises characterized by a greater spread in the distribution of wages. In addition, the stiff income policy practised in the state sector in order to contain aggregate demand has certainly reduced the growth in wage dispersion.

Finally, the primary (pre-tax, pre-transfer) distribution of all earned and unearned incomes (see third column of Table 8) displays some decline in Romania, no change in Hungary and Poland, a modest increase in Slovakia and—consistently with the data on wage inequality—a sizeable increment in Russia and Ukraine.

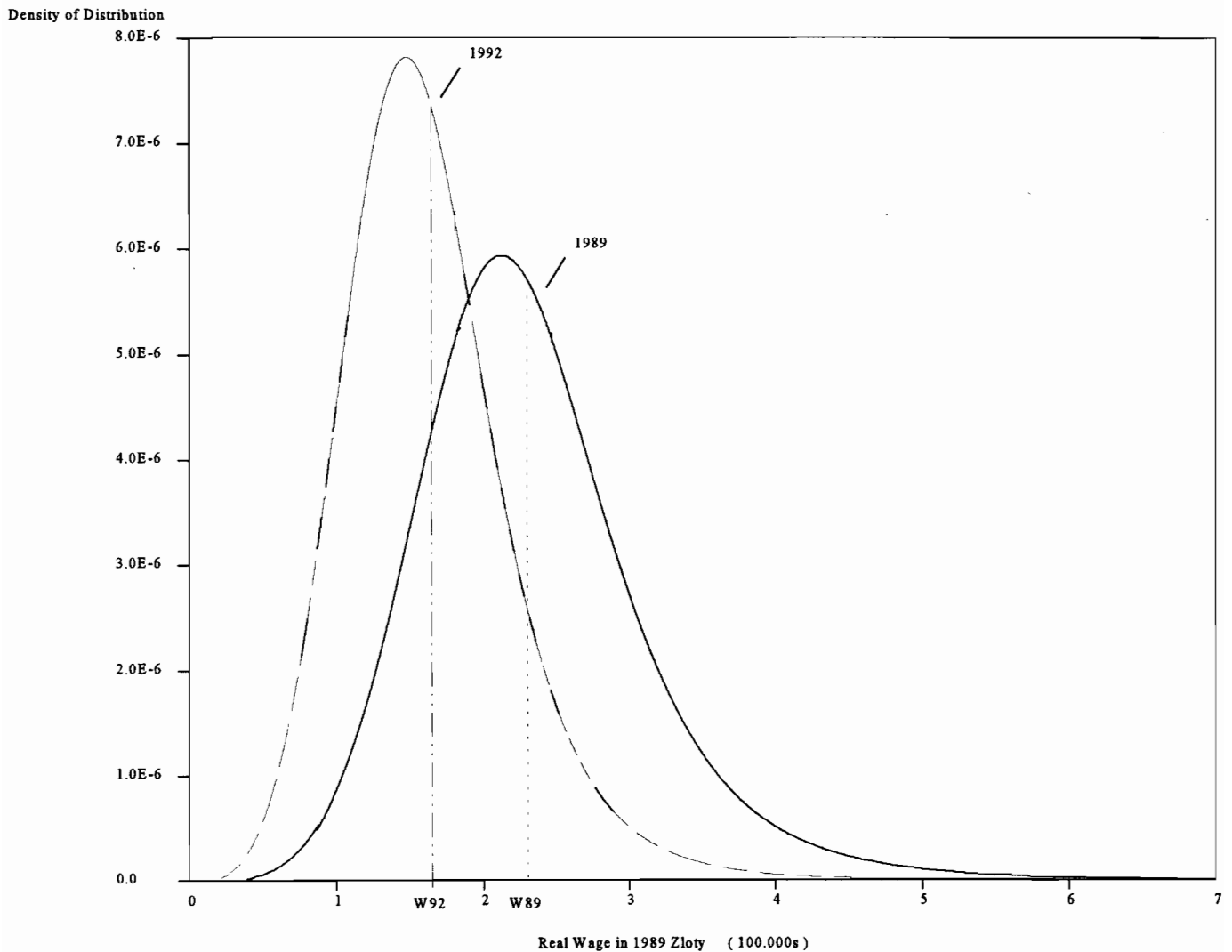
Table 8: CHANGES IN THE GINI COEFFICIENT OF THE WAGE DISTRIBUTION
AND OF THE HOUSEHOLD INCOME DISTRIBUTION IN EIGHT EASTERN EUROPEAN COUNTRIES

	Wages		Household Income Distribution		
	From Wage Surveys	From HBS	Before Tax & Transfers ^{a/}	After Tax & Transfers ^{b/}	Difference
Bulgaria					
1989	--	--	--	--	--
1990	21.0	--	--	--	--
1991	24.1	--	--	--	--
1992	--	31.7	32.1	28.9	3.2
Czech Lands					
1989	19.6	--	--	18.5	--
1990	--	--	--	20.1	--
1991	21.5	--	--	22.2	--
1992	21.4	--	--	18.1	--
Slovakia					
1989	--	20.5	22.1	18.3	3.8
1990	--	19.9	21.6	18.0	3.6
1991	--	23.5	23.3	18.0	5.3
1992	--	25.3	24.5	18.9	5.6
Hungary					
1989	--	31.8	26.9	21.4	5.5
1990	30.1	--	--	--	--
1991	--	33.0	27.3	20.5	6.8
1992	30.7	--	--	--	--
Poland					
1989	19.4	30.8	32.2	24.9	7.3
1990	--	29.6	31.0	19.1	11.9
1991	22.2	29.0	31.4	22.5	8.9
1992	24.1	32.0	32.4	23.9	8.5
Romania					
1989	16.2	31.3	31.2	23.3	7.9
1990	--	19.7	19.0	22.9	-3.9
1991	20.3	27.1	27.1	24.3	2.8
1992	--	27.2	27.1	25.1	2.0
Russia					
1989	24.2	--	--	--	--
1990	23.5	--	23.3	--	--
1991	29.9	--	26.0	--	--
1992	35.7	--	27.8	--	--
Ukraine					
1989	--	--	19.5	--	--
1990	--	--	--	--	--
1991	--	--	16.3	--	--
1992	--	--	24.1	--	--

Source: MONEE Database, UNICEF-ICDC, Florence.

^a For Russia and Ukraine, the data are before tax but after transfers. ^b Corresponds to net disposable income.

Figure: DENSITY DISTRIBUTION OF WAGE-EARNERS BY WAGE LEVEL IN POLAND
(1989 And 1992)



Source: MONEE Database, UNICEF-ICDC, Florence.

2. *Changes in the Level and Distribution of Final Incomes.* Tables 6 and 7 illustrate the dynamics of net per capita income over the two respective reference periods for China and Eastern Europe. In China, average rural per capita incomes expanded at a rate of 15 percent per year during the agricultural boom years of 1978-84, though the increase dropped back to a lower 3 percent in the subsequent 1985-90 period. Urban incomes also grew substantially (i.e. by over 50 percent during the 1980s), a less rapid growth—but with smaller deviations from the trend—than rural incomes. Average urban incomes also experienced a period of stagnation in 1988-9 when stabilization measures were introduced. It is important to note that

the growth of average incomes has differed substantially from that of output. For instance, while agricultural GDP grew between 1978 and 1984 at a rate of 6.6 percent (Table 6), real rural incomes increased at 15 percent (because of the terms of trade effect of the agricultural producer price hike of 1978-80). The opposite occurred during the subsequent period, which was characterized by the 1988-9 stabilization and the price reforms of the mid and late 1980s.

The situation in Eastern Europe is similar to that observed in China. As in the case of wages, real household net income per capita has declined steadily since 1990 (Table 7). The drop has been particularly marked in Bulgaria, Poland, Romania, Russia and, likely, Ukraine, all countries which have experienced very high inflation or hyperinflation. At the end of 1992 or 1993 average incomes in these countries were as low as 60 percent of their 1989 level. In Hungary, the drop in average net income per capita has been more contained than that of GDP, as stepped-up transfer payments by the Government have moderated the drop in primary incomes (see the next subsection). In contrast, in Russia and, likely, Ukraine, the fall in per capita incomes has exceeded that of GDP.

In a few countries, such as Poland, the deterioration in average incomes has been slower for pensioner households than for active households, as pensions have been better indexed for inflation than salaries and other benefits. High inflation indeed offers opportunities for considerable shifts in the hierarchy of various forms and types of remuneration, as confirmed by the considerable shifts in income structure that have accompanied the decline in net household income per capita. With growing unemployment and wage repression, the share of wages in total incomes contracted considerably (Table 9). The decline in the wage share was particularly pronounced in Bulgaria and Poland (the two countries with the highest unemployment rate), but all countries have been affected. Only Romania (where unemployment was allowed to rise until 1992 only marginally) seems to have moved in the opposite direction, though, on a numerical level, this phenomenon stems from the greater decline of transfer payments and other forms of income. The greater informalization of the economy has entailed rises in self-employment incomes which, in the definition adopted in Table 9, also includes incomes from self-employment in agriculture and from agricultural cooperatives. Four of the seven countries included in Table 9 indeed confirm this shift, and it is likely that Poland would also show an increase if agricultural incomes (which dropped markedly) could be separated out from the total.

Lack of detailed data does not allow us to verify whether the expected increase in property incomes has occurred. This information was (and still is) seldom collected as a

separate item in the HBS, though information on "other incomes" would suggest a shift in this direction (this hypothesis is indirectly confirmed by information on employment in private firms, growth in bank deposits and privatization of land). There is instead clear evidence of an increase in transfer payments, relative to total income, for all Eastern European countries, except Romania and Ukraine (where the extent of redistribution seems to have declined drastically) and, perhaps, Russia. In the other countries, the growth in the volume of total transfer payments can be explained primarily as the result of an increase in pensions and, to a lesser extent, "other transfers" (which include unemployment, social assistance and other benefits), while the relative importance of child allowances has declined everywhere but in Hungary. Such trends—a large decline in wages and child allowances accompanied by a rise in non-wage earnings and in pensions—would suggest that the burden of the income adjustment has been increasingly shifted from the elderly and autonomous workers to low-wage earners and to children.

Table 9: INCOME STRUCTURE BY INCOME SOURCE IN SEVEN EASTERN EUROPEAN COUNTRIES
(In Percentages)

	Wages	Self-employment	Pensions	Child Benefits	Other Transfers	Property Income	Other Incomes
Bulgaria							
1989	58.5	16.2	17.1	3.7	1.1	0.4	2.9
1993	45.3	22.6	17.2	2.8	1.6	0.3	9.8
Slovakia							
1989	75.9	5.1	6.5	6.8	1.6	--	0.4
1993	72.2	9.7	5.9	4.8	5.9	--	1.5
Hungary							
1989	62.8	8.9	16.0	7.9	2.2	0.2	1.9
1991	59.9	9.5	17.5	8.0	2.7	0.2	2.0
Poland							
1989	55.8	18.7	14.5	5.3	1.4	--	4.3
1992	50.2	12.1	25.7	4.4	3.2	--	4.4
Romania							
1989	67.7	8.8	6.4	4.5	1.6	--	10.8
1992	73.3	9.9	5.7	2.1	1.5	--	7.1
Russia							
1989	72.0	8.2	8.1	--	4.2	--	7.4
1992	66.7	12.1	6.7	--	5.7	--	8.8
Ukraine							
1989	63.5	10.1	16.3	--	--	--	10.1
1992	58.0	20.1	11.2	--	--	--	10.6

Source: MONEE Database, UNICEF-ICDC, Florence.

In China, the reforms led to a modification of the structure and dispersion of household incomes in both urban and rural areas, though the lack of detailed information does not allow a precise quantification of these changes. The growth of rural industries caused a phenomenal rise in industrial self-employment and wage incomes. In addition, although restrictions on permanent migration remain, there has been a massive increase in "temporary" migration to urban areas, which has in turn swelled the flow of migrant remittances to rural households (Hussain et al. 1991). In the urban sector, expansion of the non-state sector and the reintroduction of performance-linked bonuses in SOEs have also given rise to changes in income structure and variation. "Open" social security transfer payments (which only cover the employees of the "formal" sector of the economy) rose from 4.8 to 5.5 percent of national income between 1979 and 1985 (Ahmad and Hussain 1991), while welfare payments and social relief have traditionally accounted for a low percentage of GDP (Yu 1992) and declined from 0.5 to 0.3 percent of GDP over the 1980s. During the initial years of the reform, however, the welfare of (mostly urban) industrial workers was also safeguarded by an increase in consumer subsidies, which—as noted—came to represent a kind of "invisible transfer payment".

As for changes in the concentration of household net income per capita, the Gini coefficients show substantial stagnation in the case of Hungary, Slovakia and the Czech Republic (see Table 8, fourth column). In contrast, they show a steady and sizeable increase in Romania and Poland between 1990 and 1992 after an initial fall between 1989 and 1990. In Poland, a considerable decrease in income concentration took place in 1990, the year in which GDP dropped by 11.6 percent, average wages declined by 25 percent, and employment of high-income workers fell far more than the average (Milanovic 1993). Over the next two years, the decline in income disparity was followed by a clear rise which resulted from the greater informalization of the economy and the massive increase in the volume and dispersion of pensions (see later). In Romania income distribution improved marginally in 1990 following the introduction of populist measures, but worsened in the subsequent years because of the reduced weight of transfer payments in total income, their less progressive incidence and as the growth in the share of self-employment incomes.

In view of the increased earnings dispersion noted in the previous section, the decline of the Gini coefficient in Hungary, Slovakia (and the Czech Republic) instead appears more puzzling. A first factor to consider (dealt with in the next section) is the increasing weight of transfer payments in total income. Second, governments have sharply taxed the increments

in gross wages in the SOEs, thus effectively contributing to the preservation of a low level of overall income disparity in the still dominant public industrial sector. Third, the results presented above are influenced by the (presumably deteriorating) quality and adequacy of the household budget surveys, on the basis of which the data presented in the above tables were calculated. So, although inequality is growing, the statistical instruments available are becoming less precise in measuring the phenomenon.

There is no doubt that reporting and measurement problems are clouding the picture and that income inequality is likely to be growing more rapidly than is revealed by the HBS, wage surveys and the social security records. Yet, it needs to be recognized that several of the factors mentioned above (an adjustment to the recession mainly through wage reductions—particularly for the higher wage earners—rather than through employment reductions, a stiff wage policy aiming at containing wage increases even in healthy companies, limited privatization of the economy, and, in some countries, stepped-up transfer payments) are also exerting influences on income distribution which are contrary to those generated by an increase in informal sector and property incomes, the acceleration of unemployment and privatization. While Russia and Ukraine already give signs of a rapidly rising income inequality after relatively few years since the reforms began, escalations in income inequality do not yet seem to have occurred in Central Europe, though it is likely that such increases are only being postponed.

Income inequality instead clearly rose (from extremely low levels, particularly for a low-income country) in China following the introduction of economic reforms in 1978 (Table 6). However, while there is agreement about the increment of the Gini coefficient over the entire period and, particularly, for the 1985-90 period, there is conflicting evidence regarding inequality trends between 1978 and 1984, a period characterized by an extremely rapid and broad-based growth of agricultural incomes. The Gini coefficient calculated by the Chinese State Statistical Bureau shows an increase from 0.21 to 0.26 for this period. However, a number of measurement problems concerning changing sample size and stratification and valuation of self-consumption cast some doubts on the precision of such estimates. Using the same data set but correcting for some of these factors, other authors (see among others Selden 1985, quoted in World Bank 1992) have drawn the conclusion that, over the 1978-84 period, income inequality remained constant or even decreased slightly. This conclusion is supported by evidence showing that during the 1980-4 period the interprovincial income gap narrowed (see Table 6).

The rise in income disparity in the second part of the 1980s can instead be traced unambiguously to the rapid expansion of non-farm activities during that period. While the growth of agricultural output (which, it is useful to remember, originated from very egalitarian agrarian structures) was associated with a reduced inequality, increases in non-agricultural incomes—and particularly in rural enterprise incomes—were clearly correlated with rising income disparity (Hussain et al. 1991, Rozelle 1992, quoted in World Bank 1992). The introduction of various performance-related bonuses in state enterprises, in contrast, does not seem to have led to any visible growth in urban income disparity (Hussain et al. 1991). In view of the unequal spread of these new activities across provinces, regional inequality has become an important component of overall inequality. Indeed, while provincial Gini coefficients increased modestly over this period, the distance between mean incomes per capita of poor and rich provinces widened considerably. Until recently, furthermore, the rural Gini coefficient recorded in China was higher than in urban areas (Knight and Song 1990).

3. *Changes in the Redistributive Role of the Government.* From the above discussion it would appear that the *primary income distribution* (before tax and transfers) has shown a modest increase in inequality in Hungary and Slovakia. In Romania and Poland, on the contrary, it improved somewhat between 1989 and 1992 (though not between 1990 and 1992), despite the rise in disparity in the distribution of wages.

At the same time, the *final distribution* of net per capita household *income* (after tax and transfers) has remained stable at very low levels of concentration, or even declined, as in Hungary and Slovakia, while it worsened in Romania and, after the first year of reforms, in Poland. Therefore, in two cases (Hungary and Slovakia) the final distribution improved, while the primary income distribution deteriorated, though not substantially, whereas in the other two countries (Poland and Romania) a shift in the opposite direction has occurred since 1990 (Table 8).

These apparently contradictory trends may be explained by changes in the extent of redistribution of the tax and transfer systems in these two groups of countries. As shown in the last column of Table 8, the difference between the Gini coefficients of the primary and final distribution of income increases in Hungary and Slovakia and declines in Romania and Poland.

While the tax and transfer system exerts an equalizing effect (in all of these countries), the above data show that this effect seems to have increased, if moderately, in Hungary and Slovakia but to have decreased in Poland and Romania. In the first two countries, the share

of *transfer payments* (i.e. pensions, child and family allowances, sickness payments, unemployment compensation and social assistance benefits) *in total final household income per capita has increased* respectively from 26.1 to 28.2 percent and from 14.9 to 16.6 percent (Table 9). In addition, in both Hungary and Slovakia the incidence by decile of these transfers has retained a fairly progressive character and a far lower overall degree of concentration than that for primary income distribution. In addition, the incidence of child and family allowances, social assistance and sickness payments either became more progressive, or remained constant. In both countries, however, the increase in the share of pensions in total income has rendered their targeting less progressive.

In Romania, on the contrary, the share of transfer payments in total final household income per capita declined substantially (from 12.5 to 9.3 percent between 1989 and 1992), pointing in this way to an undesirable and sizeable weakening of the "social safety nets" (particularly pronounced in the case of child and family allowances) during a severe recession. In addition, the incidence of pensions (and of social assistance benefits) also became less progressive in Romania, while the other transfer payments remained constant.

Finally, Poland presents an anomalous picture: a sharp decline in the progressivity of pensions, accompanied by a large increment of their share in final net incomes, has caused from 1990 onward a deterioration in overall income inequality in spite of the stability of the primary distribution of income. Indeed, while the share of transfer payments in total final net household income per capita soared (perhaps unsustainably) from 21.2 to 33.3 percent, its incidence worsened substantially in the case of pensions (which represent three-quarters of overall transfers) and moderately in the case of social assistance benefits.

V. CHANGES IN POVERTY INCIDENCE AND SOCIAL WELFARE: EXTENT AND CAUSES

The post-reform years in China and Eastern Europe have been characterized by sharply divergent poverty and welfare trends. In spite of the limitations imposed by a scattered data set, there is ample evidence that poverty increased in all countries of Eastern Europe, while it declined massively in China. Similar conclusions are evident in terms of social indicators.

Sharply Rising Poverty in Eastern Europe

In Eastern Europe, the last four years have witnessed an unprecedented rise in the number of people whose income per capita has fallen below a conventional poverty line (roughly equal to 35-45 percent of their 1989 average wage), i.e. an income which would ensure the satisfaction of essential needs and a broader, though still basic, socialization. Living standards have also fallen much more sharply for a smaller number of households now living below an extreme poverty line (equal to 60 percent of the poverty line), i.e. an income allowing for the satisfaction—assuming a rational economic behaviour—of the essentials needed for survival.

Though measurement and interpretation problems are clouding the picture (because of shifts over time in the demographic composition of the poor, the varying quality of the HBS used for the computation of these rates and the changing meaning of "income per capita" when moving from rationed to open market economies), there is ample evidence that the proportion of the poor and, particularly, of the extremely poor increased significantly in the entire region over the 1989-93 period (Table 10). However, the initial year intensity and duration of such increases vary considerably among the countries. The steepest increases in the proportion of people living in extreme poverty have occurred in Bulgaria, Poland, Romania, Russia and, very likely, Ukraine (for which data problems do not allow unambiguous conclusions). In these countries, between 15 and 26 percent of the population could be considered as extremely poor in 1992-3, while an additional 28 to 38 percent was affected by less acute, but nonetheless debilitating, low incomes and poverty. These increases in the incidence of extreme poverty and poverty in these countries have initially taken place in parallel with sharp drops in net income per capita. As in Poland in 1992, for instance, poverty and extreme poverty rates have broadly stagnated, however, even during periods of recovery, as a result of rising income inequality.

In contrast, the spread of extreme poverty in the Czech Republic, Slovakia and Hungary was contained to less than 4 percent, while poverty rates rose much less than in the first group of countries. In Central Europe, inflationary explosions were more contained, drops in real wages more limited, the extensive safety nets created in the past broadly maintained and changes in income inequality extremely modest, all of which meant that the number of the poor was also kept down to more tolerable dimensions. In addition, while in 1992 and 1993 both poverty indicators adopted in this study were still edging upward in the

Table 10: ESTIMATES OF POVERTY AND EXTREME POVERTY
IN SEVEN EASTERN EUROPEAN COUNTRIES
(In Percentages Of Relevant Populations)

	Poverty					Extreme Poverty*				
	1989	1990	1991	1992	1993	1989	1990	1991	1992	1993
<i>Bulgaria (45% 1989 average wage)</i>										
Households	--	13.6	49.0	53.1	54.7	--	2.1	11.3	23.3	23.9
Children	--	17.7	61.7	59.9	64.4	--	2.0	16.8	26.6	32.2
Adults	--	11.0	49.2	48.7	53.7	--	1.3	12.0	20.1	24.9
Elderly	--	18.3	50.0	59.7	58.6	--	3.8	10.6	27.6	24.6
Population	--	13.8	52.1	53.6	57.0	--	2.0	12.7	23.4	26.2
<i>The Czech Republic (35% 1989 average wage)</i>										
Households	4.6	7.6	23.8	18.2	--	0.3	0.3	0.8	1.6	--
Children	4.2	12.5	43.2	38.3	--	0.3	0.3	0.2	1.1	--
Adults	4.4	7.6	26.8	22.6	--	0.2	0.1	0.5	1.8	--
Elderly	5.7	3.2	12.9	9.6	--	0.4	0.1	0.3	0.4	--
Population	4.2	8.6	29.8	25.3	--	0.2	0.2	0.2	1.3	--
<i>Hungary (40% 1989 average wage)</i>										
Households	12.3	--	13.9	--	--	0.5	--	1.5	--	--
Children	20.6	--	27.0	--	--	1.1	--	3.7	--	--
Adults	12.3	--	18.5	--	--	0.7	--	2.4	--	--
Elderly	11.8	--	10.6	--	--	0.3	--	0.4	--	--
Population	14.5	--	19.4	--	--	0.7	--	2.5	--	--
<i>Poland (40% 1989 average wage)</i>										
Households	22.9	38.3	33.9	35.7	--	5.1	11.3	8.1	10.4	--
Children	32.3	60.2	58.7	61.8	--	8.3	23.6	21.3	25.9	--
Adults	19.7	37.9	37.0	40.1	--	4.8	13.0	10.8	13.4	--
Elderly	29.5	39.5	29.2	29.5	--	5.2	7.8	3.8	5.2	--
Population	24.7	43.1	41.2	43.7	--	5.8	15.0	12.3	15.1	--
<i>Romania (45% 1989 average wage)</i>										
Households	29.9	17.6	25.1	44.3	--	7.7	2.4	6.8	15.2	--
Children	41.2	28.6	38.1	62.8	--	10.8	3.4	11.6	26.1	--
Adults	29.8	18.2	25.7	47.2	--	7.1	2.4	6.9	16.4	--
Elderly	43.9	21.0	32.1	45.9	--	14.4	3.6	8.4	15.3	--
Population	33.9	21.4	29.7	51.5	--	8.6	2.8	8.4	19.1	--
<i>Slovakia (40% 1989 average wage)</i>										
Households	5.7	6.2	24.9	30.3	34.5	0.2	0.2	2.4	2.9	--
Children	8.8	10.0	42.4	51.1	--	0.2	0.3	6.0	8.1	--
Adults	4.2	4.5	21.2	27.0	--	0.1	0.1	2.1	2.8	--
Elderly	6.2	6.7	25.4	29.0	--	0.2	0.2	2.5	2.4	--
Population	5.8	9.4	27.7	34.1	--	0.1	0.2	3.2	3.9	--
<i>Russia (40% 1989 average wage)</i>										
Households	--	--	--	--	--	--	--	--	--	--
Children	--	--	--	--	--	--	--	--	--	--
Adults	--	--	--	--	--	--	--	--	--	--
Elderly	--	--	--	--	--	--	--	--	--	--
Population	15.8	14.0	15.5	61.3	--	2.5	2.7	2.5	23.2	--

Source: MONEE Database, UNICEF-ICDC, Florence.

* The "extreme" poverty line is equal to 60 percent of the poverty line.

Eastern and Southeastern European countries, they experienced a small decline in the Czech Republic and broadly stabilized in the other two Central European countries.

The surge in poverty has differed significantly among the three main age groups, i.e. children below 16 years of age, adults below 60, and the elderly (Table 10). Where unemployment and the number of people hired at very low wages rose significantly and where pensions were better indexed than wages, child allowances and unemployment benefits, poverty grew considerably faster among children and members of the working-age population than among pensioners. Poland presents the most graphic illustration of this pattern (see Tables 8 and 10). Similar, though less pronounced, changes are observable in the Czech Republic, Slovakia, Romania and Hungary, where pensioners, who represent between 30 and 40 percent of the voters, have generally enjoyed a more adequate indexation than has been the case for other types of transfers and minimum wages. Greater surges of poverty among children should be linked in particular to unemployment and inadequate social transfers. In Hungary, the proportion of poor children in relation to adults and the elderly was about 1.5 and 2.7 times higher respectively in 1991 (Table 10), mainly because of the large increase in unemployment among middle-aged adults. In Russia, a survey carried out in July-September 1992 shows that the incidence of poverty among children of less than 15 years of age stood at 46 percent, while that for adults in the 31-60 age bracket was 35 percent, and for male pensioners it was only 22 percent. Poverty was found to reach a phenomenal 72 percent in families with three or more children (UNICEF 1994). In Russia (and Romania), these large increases in child poverty are also due to the massive erosion suffered by child allowances and other child-related income transfers. In Russia, for instance, child allowances for children of less than 18 months of age fell from 14.2 percent to 1.5 percent of the average wage between January 1992 and September 1993.

In view of the above discussion and in spite of the many measurement problems affecting income, income distribution and poverty data, it appears that in Central Europe (Poland, Hungary, Slovakia and the Czech Republic) the above described increases in poverty rates are to be attributed almost exclusively to declines in average wages and incomes per capita. The expected surge in primary income dispersion appears to have been very modest, or even negative, while the relative importance of redistribution has grown. In addition, the targeting of these transfers has generally improved or remained sufficiently progressive. The steepest increases in the number of the poor and extremely poor have thus occurred because of the recession induced by the macroeconomic, trade and other measures forming part of

the overall transition package. It was not, as many anticipated at the beginning of the transition, due to adverse shifts in income distribution and the rapid erosion of generous income transfers inherited from the socialist era. Income distribution appears to have begun to deteriorate in only some countries and only recently, while as noted—particularly in Central Europe and Bulgaria—the social transfer/GDP ratio increased significantly. While in Ukraine, the surge in poverty coincided with the loss of control over monetary and fiscal policy, in others it occurred concurrently with the introduction of simultaneous "big bang" price and trade liberalization, large currency devaluations and budgetary restrictions, namely in 1990 for Poland, 1991 for most of the other countries and January 1992 for Russia. The situation is more complex in Romania and even more so in Russia and, possibly, Ukraine. In these countries, the negative impact on poverty of truly unprecedented drops in wages and household incomes has been compounded by a rapidly escalating income inequality and by quickly eroding and poorly targeted social transfers.

The Decline of Poverty in China: Achievements and Remaining Problems

"Broad participation in reform-driven agriculture sector growth played the key role in the tremendous two-thirds reduction in absolute poverty during 1978-84" (World Bank 1992, page xi). Using a fixed absolute poverty line comprising a food basket of 2,150 kilocalories per day—and with an implicit food share varying over time between 0.60-0.63 for urban areas and 0.63-0.75 for rural areas—the poverty headcount ratio declined from 28 percent in 1978 to 8.6 percent in 1990 (Table 6). According to the same study by the World Bank (1992), the decline was particularly rapid in the rural sector, but important results were obtained also in urban areas, where already by the mid-1980s absolute poverty had been eradicated (thanks also to the restrictions imposed on rural-urban migration). Other assessments (see for instance Ahmad and Wang 1991) give similar estimates of the direction and speed of the poverty decline, though with consistently higher poverty headcount ratios.

The poverty decline of 1978-90 years was however far from uniform. Improvements in the agricultural sector were extremely rapid during the 1978-85 years but almost stopped during the following quinquennium. As noted in Section VI, during this period rural incomes per capita practically stagnated despite a 3.5 percent growth of agricultural production, much larger than the growth rate of the population. It is not entirely clear what has been the welfare effect of the price reforms of the second part of the 1980s (even in the rural areas a

considerable number of residents are net food buyers and, unlike their urban counterparts, are not sheltered from price shifts by food subsidies). Also, there is clear evidence that the restrictive macroeconomic policies applied in the 1988-9 period have affected both rural and urban residents. To some extent, and in a fashion completely symmetric to that observed in Eastern Europe, the observed fall in poverty is the result of a considerable increase (over 1978-85) or a non-decrease (over 1985-90) in average incomes, accompanied by a clear rise in income inequality (estimated between 5 and 10 points of the Gini coefficient). In urban areas, social policy played an important role in sheltering the registered population from the price and stabilization reforms of the 1980s. In rural areas such a role has been negligible or even negative. Fiscal decentralization, furthermore, has substantially reduced the possibility of the central Government controlling a growing regional inequality and facilitating the reduction in overall poverty by means of greater resource transfers for productive and welfare purposes to the poorer provinces. Though incomes have grown, if modestly, also in the poorest and less well-endowed provinces, the growing income gap between poor and rich counties and regions suggests an undesirable accentuation in regional disparities and in overall inequality.

Welfare Changes in Eastern Europe and China

The sharp rises in poverty discussed above have provoked a deterioration of untold proportions in human welfare throughout most of the region and particularly in Albania, Bulgaria, Romania, Russia and Ukraine, i.e. those countries where the increases in poverty rates were most pronounced. A summary presentation of these welfare changes is included in Table 11, which summarizes changes over the 1989-93 period for 29 welfare indicators relative to the nine ECESU countries. The indicators belong to three different classes of measures and include, in particular, four traditional income- and consumption-based welfare indicators, 20 "capabilities-based" welfare indicators (concerning mortality, health, education and social development) and five demographic indicators. For about 72 percent of the variables for which information is available, the 1993 level indicates a deterioration, often a serious one, in relation to the 1989 level. Of the 29 indicators considered, only three (maternal mortality, adoption rate and 1-4 year death rate) show improvements. In addition, in 56 percent of the cases (mostly in the hard-hit countries of Eastern and Southern Europe), the deterioration exceeds 10 percent, a level normally indicating acute deterioration. Only in 30

Table 11: SUMMARY OF WELFARE CHANGES IN NINE EASTERN EUROPEAN COUNTRIES, 1989-93

Indicator	Unit	Albania	Bulgaria	Czech R.	Slovakia	Hungary	Poland	Romania	Russia	Ukraine	Number of cases			% deteriorations	Rank	Average change in indicator
											decrease	increase	no data			
a) Income and consumption-based indicators																
Real income per capita	%	—	-39.2 ^a	-17.8 ^a	-30.3	-12.8	-38.3	-20.7 ^a	-38.3 ^a	-3.7 ^{a i}	8	—	1	100	1	-22.3
Poverty rate	% points	—	43.2 ^d	22.1 ^a	29.4 ^a	4.2 ^c	19.0 ^a	17.6 ^a	36.0 ^f	—	7	—	2	100	1	24.5
Food share	% points	—	4.1	0.1 ^a	1.0	0.3 ^b	-6.9	5.9 ^a	12.3 ^a	6.6	7	1	1	88	10	2.9
Calorie consumption per capita	%	—	-18.0	—	-3.3 ^a	-5.7 ^a	-5.1 ^a	-9.2	-2.0	-18.7	7	—	2	100	1	-8.9
b) Demographic indicators																
Crude marriage rate	%	-4.5	-33.8	-18.4	-19.1	-18.0	-19.8	-7.8	-27.8	-13.7	9	—	—	100	1	-19.8
Remarriage rate	%	—	-49.1	-9.9 ^b	-38.5	-28.3	-29.2	-13.8	—	—	6	—	3	100	1	-28.1
Crude divorce rate	%	-16.9 ^b	-22.0 ^a	-3.2	1.7	-13.5	-43.7	-17.1	11.1	11.6	3	6	—	33	27	-10.2
Crude birth rate	%	-22.3	-21.4	-5.9	-9.8	-3.6	-14.5	-31.7	-34.2	-20.0	9	—	—	100	1	-18.2
c) Mortality indicators																
Life expectancy, males	years	—	-0.9	0.4 ^a	-0.1 ^a	-0.9 ^a	0.6	ⁿ	-5.2	-2.0 ^a	5	2	2	71	17	-1.0
Life expectancy, females	years	—	-0.7	0.7 ^a	-0.1 ^a	-0.1 ^a	0.5	ⁿ	-1.8	-1.0 ^a	5	2	2	71	17	-0.3
Infant mortality rate	%	7.7	7.8	-14.8	-21.2	-15.5	-16.9	-13.4	12.9	15.6	4	5	—	44	26	-4.2
1-4 mortality rate	%	—	-5.2	0.0 ^b	-12.5 ^a	-27.3	-18.3	-29.1	-3.8	-4.9	—	8	1	0	29	-12.6
5-19 mortality rate	%	—	0.7	8.0 ^a	1.3 ^a	-1.5 ^a	-12.4	-14.6	19.2	6.9	5	3	1	63	19	1.0
20-39 mortality rate	%	—	10.0	5.2 ^b	3.7 ^a	10.6 ^a	-8.1	-3.1	65.8	28.0	6	2	1	75	13	14.0
40-59 mortality rate	%	—	4.1	-2.1 ^b	-9.2 ^a	8.7	-9.2	12.2	50.2	27.3	5	3	1	63	19	10.3
60+ mortality rate	%	—	-0.7	-4.5 ^b	-7.7 ^a	1.6	-1.3	1.5	17.0	16.6	4	4	1	50	24	2.8
Maternal mortality rate	%	-46.9 ^a	-24.1	-9.7 ^c	-74.0 ^a	-36.0 ^a	10.3	-64.4 ^a	3.7 ^a	-20.1	2	7	—	22	28	-29.0
d) Health indicators																
Abortion rate	%	60.1	7.7	-26.1	-8.3 ^a	-12.0	-84.5 ^a	488.7	10.3 ^a	0.8	5	4	—	56	23	48.5
Low birth weight rate	%	-3.2 ^c	33.7	13.9 ^c	13.6	-5.7	3.9	48.8	7.1	—	6	2	1	75	13	14.0
New tuberculosis cases	%	—	45.2	4.3 ^a	35.2	14.9	4.0	59.0	14.1	9.7 ^d	8	—	1	100	1	23.3
e) Social cohesion and protection indicators																
% of births to mothers < 20	% points	—	4.0	1.9 ^b	2.4 ^a	0.2 ^a	1.0	2.2 ^a	5.5 ^a	4.8	8	—	1	100	1	2.4
No. of adoptions	%	—	-12.5	-15.8 ^a	33.2	-6.0 ^a	-21.9 ^a	—	13.1 ^a	14.7 ^b	4	3	2	57	22	0.7
Crime rate	%	—	194.6 ^a	87.0 ^a	50.4 ^b	82.9	53.6	87.5 ^a	67.9 ^a	24.6 ^b	8	—	1	100	1	81.1
Youths sentenced	%	—	-68.8	-20.1 ^a	24.4	6.7	123.6	58.3 ^a	45.8 ^a	10.0 ^b	6	2	1	75	13	22.5
Homicide rate ^m	%	—	80.3	22.1 ^b	42.9	46.3 ^a	12.4 ^a	-51.5	141.1	—	6	1	2	86	12	—
f) Child education indicators																
Creche/parental leave coverage ^s	% points	—	-2.1 ^b	-11.6 ^{a g}	-3.5 ^{c i}	4.3	-18.2 ^a	0.4 ^{a i}	-10.4 ^{b i}	-9.5 ^{b i}	6	2	1	75	13	-6.3
Pre-primary enrolment rate	% points	—	-13.0 ^a	-16.0 ^b	-13.4 ^a	0.9	-6.0	-9.7 ^a	-12.7	-3.7 ^b	7	1	1	88	10	-9.2
Primary enrolment rate	% points	-4.0 ^a	-6.6 ^a	1.2 ^a	1.6	0.1	-0.9	-3.4 ^a	-0.6 ^a	—	4	4	1	50	24	-1.6
Secondary enrolment rate	% points	-12.0 ^a	-7.5 ^a	-0.1 ^a	0.3	3.3	1.7	-19.8 ^a	-4.8 ^a	—	5	3	1	63	19	-5.6
Total number of observations:		9	29	28	29	29	29	26	28	23	165	65	31	71.7	—	—
- number of deteriorations		6	24	17	20	18	17	18	25	20	—	—	—	—	—	—
- number of improvements		3	5	11	9	11	12	8	3	3	—	—	—	—	—	—
Percentage of deteriorations		67	83	61	69	62	59	69	89	87	—	—	—	—	—	—

Source: MONEE Database.

Notes: ^a 1992/1989; ^b 1991/1989; ^c 1990/1989; ^d 1990/1989; ^e 1993/1990; ^f 1992/1990; ^g Estimate; ^h The reported cases dropped by 66%, probably due to more frequent underreportings; ⁱ The CPI used for this calculation is suspect. Other indicators, such as industrial production and food consumption suggest a much sharper decline; ^j Only polio and measles; ^k Aggregation of child population aged 0-2 in creches and cared for by persons on parental leave; ^l Only creche enrolment rate included; ^m Per 100,000 population. Includes deaths due to homicides and purposefully inflicted injuries and other violence; ⁿ Although LEB data are available, they do not appear consistent with the mortality data and are therefore omitted.

percent of the cases are there signs of possible improvements in human welfare, though some of these may be somewhat misleading (see later). And last, as these data present a "point-to-point" comparison and do not include any information on improvements or deteriorations that have occurred during the intermediary period, the extent of the crisis as measured by these indicators is somehow understated.

In addition to the deteriorations in incomes per capita and poverty rates discussed above, the crisis has entailed a steep increase in overall mortality, which has particularly affected adult men but also adolescents, the elderly and in some cases even infants. As a result, life expectancy at birth, the most comprehensive health indicator, has deteriorated in seven countries out of nine since the onset of the transition. Health and education conditions have also shown a high frequency of deteriorations (though to a slightly lesser extent than for those indicators just discussed), as shown by a massive surge in new tuberculosis and low birthweight cases, which clearly confirm that poverty is on the rise. Finally there is evidence that primary and secondary education rates have moved downward in four and five countries respectively and that, with rising youth unemployment, skyrocketing costs of securing a living place and overall uncertainty about the future, marriage, remarriage and birth rates plummeted in all nine countries included in Table 11.

In China, in contrast, the "Asian" approach to the transition appears to have produced more positive effects than negative ones. The data on infant mortality and school enrolments included in Table 6 would support the view that human welfare has improved in line with the rise in income and rapid decline in poverty discussed above. In spite of the limited reliability of the data, this conclusion appears generally well grounded in the overall analysis conducted above. On the other hand, it would appear that the rising regional imbalances in the distribution of income and access to health care may have generated some adverse outcomes, at least in parts of the rural sector (Sen 1989, Yu 1992, Hussain and Stern 1990). In particular, while the overall effects of the reforms on poverty alleviation and overall welfare have undoubtedly been very positive, the dismantling of the commune-based health system, diminished central Government transfers to poorer regions and a less progressive incidence of public expenditure on health and education (see Table 12) seem to have caused likely welfare losses in those counties with inadequate growth in income per capita. While these problems are almost insignificant in relation to those faced in Eastern Europe, they still pose a serious policy problem that requires an urgent response.

Table 12: THE DISTRIBUTION OF GOVERNMENT EXPENDITURE FOR CURATIVE CARE IN CHINA
(In Rounded Percentages, 1980, 1985 And 1989)

	1980	1985	1989
Rural (township) health centres	32.3	27.2	26.8
County hospitals	26.3	22.8	21.3
City health centres	2.9	3.4	3.7
City hospitals	38.5	46.6	48.2
Total	100.0	100.0	100.0
% of total health budget	63.0	60.4	58.4*

Source: Yu (1992).

* Data for 1988.

VI. CONCLUDING REMARKS

In conclusion, there appears to be considerable evidence suggesting that, with some exceptions, the massive surge in poverty and loss of welfare observed in Eastern Europe over the last four years are, for a good part, due to macroeconomic factors and, in the end, to the choice of an accelerated "Western approach" to the transition. Indeed, there is little evidence that poverty and human welfare have suffered because of immediate and sharp increases in income inequality or because of a weak social policy, both factors which were generally anticipated by most observers. While these two factors have recently started to exert their negative influence, and are likely to do so in the future, the data presented in this paper suggest that, with few but important exceptions (e.g. Russia and, to some extent, Romania), social policy has generally had a moderating influence on the spread of poverty and that the much expected deterioration in income distribution has not yet taken place in any general and significant way. By implication, we have to conclude that the massive rise in the number of the poor and the worsening in key welfare indicators are to be attributed therefore to the macroeconomic management of the transition and, in particular, to the simultaneous implementation of drastic price and trade liberalization and currency devaluation measures. While unfavorable initial conditions and exogenous factors have aggravated the situation in two or three of the Eastern European countries (as in Poland), it does not appear that their influence would had been the same if a less drastic and more gradualistic approach had been followed.

Strangely, in the case of China, the conclusions appear somewhat symmetric. The overall "Asian approach" to policy reform has been far more efficient and equitable (in spite of some rises in income and regional inequality) than that followed in Eastern Europe and has contributed to a phenomenal reduction in poverty incidence in only 12 years. In contrast, the changes brought about by fiscal decentralization, declining progressivity of social expenditure, massive recourse to user fees even for basic "public goods" and hasty dismantling of the commune-based health and education system seem to have induced some avoidable social costs.

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Tel. 3955-234-5258 - Fax 3955-244817
Telex 572297 UNICEF I