Assessment of Rural Poverty

CENTRAL AND EASTERN EUROPE AND THE NEWLY INDEPENDENT STATES

IFAD
INTERNATIONAL FUND
FOR AGRICULTURAL
DEVELOPMENT
CENTRAL AND EASTERN EUROPE
AND THE NEWLY INDEPENDENT STATES
Since its founding in 1978, IFAD has focused its efforts on poverty reduction in rural areas of the developing world. At that time, and for a number of years thereafter, IFAD’s voice was a rather lonely one in the international community. To the extent that poverty reduction was on the international agenda, it was generally believed that general economic development and favourable policy frameworks would be sufficient to lift poor nations out of poverty. During much of the 1980s, in Africa and elsewhere, “getting prices right” became the overarching theme for advocates of structural adjustment. In the late 1980s and early 1990s, as adjustment efforts stalled in many countries – sometimes exacerbating social tensions – and researchers began to detect differential impacts of adjustment on social groups, poverty problems became more visible and calls for social safety nets became more pronounced.

Yet it remained largely unappreciated that the poor could respond to appropriate incentives and become agents of growth but that they would also need interventions specially tailored to their needs. Safety nets were frequently regarded as either charity or a means of buying political stability. That poverty reduction should be the central theme of the economic and social development efforts of governments and the international community, and that it was potentially a very wise investment, was not yet acknowledged.

This changed in the latter half of the 1990s. The 1995 World Social Summit placed poverty reduction squarely on the global development agenda. The development community called for a halving of global poverty by the year 2015. Poverty reduction is now an overarching goal for governments and international donors, and its centrality was reconfirmed at the Millennium Summit in 2000. It is now generally acknowledged that growth can only be truly sustainable (economically, politically and socially) when poverty is explicitly taken into account.

Yet in some ways, IFAD’s voice is still a lonely one. While fully 75% of the world’s 1.2 billion poor live in rural areas, official development assistance (ODA) patterns fail to acknowledge this simple fact. While agriculture is the primary livelihood source for the rural poor, international financing for agricultural development declined by nearly 40% from 1988 to 1998. Only about 12% of total ODA is devoted to agricultural development. In the absence of increased recognition of where the poor live and how they make their living, and greater commitment to investing in agricultural and rural development, the international development goal of halving poverty by 2015 will not be met.
While investing more in the rural poor is necessary, understanding how to do it better is crucial. It can no longer be a question of outside experts deciding what is best for the poor and imposing predefined solutions on them. In working with the rural poor, I believe we must approach them with respect for their knowledge, beliefs and practices. We must always remember that a key element of human dignity for any individual is gaining control over major decisions that affect his or her welfare. The poor need to have this first if they are ultimately to attain the more tangible things the non-poor possess.

This report follows the IFAD Rural Poverty Report 2001 launched last year. It is one of a series of regional poverty assessments prepared by the five regional divisions of IFAD’s Programme Management Department. The Rural Poverty Report 2001 and each of the regional studies provide overviews of the major characteristics and underlying causes of rural poverty and identify opportunities for reducing it through strengthening the asset base of the rural poor. It is my wish that this report stimulate discussion on appropriate and effective means of addressing the needs of the rural poor in the IFAD borrowing countries from Central and Eastern Europe and the Newly Independent States. More importantly, I hope the report serves to galvanize action for coordinated and sustained efforts on the part of governments, civil society and donors to make the dream of Central and Eastern Europe and the Newly Independent States without poverty a reality.

Lennart Båge
President of IFAD
EXECUTIVE SUMMARY

INTRODUCTION
This subregional poverty assessment has been undertaken as part of the identification of a multiyear strategic lending programme for the countries of Central and Eastern Europe and the Newly Independent States (CEN) presently borrowing from IFAD, that is Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, the Republic of Moldova, Romania and The Former Yugoslav Republic of Macedonia.

The poverty situation in the CEN region is unusual and represents a unique challenge for IFAD. Unlike many other parts of the world, widespread poverty is a relatively new phenomenon in the CEN region. Presently, most people in transition countries are literate, many are well educated and, until recently, enjoyed secure employment and guaranteed pension benefits. Despite expectations that the transition to a market-based economy would be rapid, it is now apparent that considerable effort is required to support the development of new market linkages, entrepreneurial skills and other services rural people need to succeed in the new economy.

This assessment aims to provide an improved understanding of the unique circumstances that shape the nature of rural poverty and opportunities to move out of poverty for people in the CEN region. Following the introduction, Chapter I gives an overview of recent macroeconomic performance and historical context; Chapter II looks at agriculture in transition; Chapter III examines the extent of rural poverty and characteristics of vulnerable groups; Chapter IV considers the strategic lessons from IFAD’s experience; and Chapter V outlines a medium-term strategy to support equitable growth and poverty reduction.

REGIONAL OVERVIEW
CEN economies are set in the framework of an abrupt termination of central planning and state services, including a sharp reduction in public-sector spending and the dissolution of production, marketing and distribution channels at the local, regional and national levels. Since the collapse of the former communist system, the magnitude of the increase in poverty has been unlike anything experienced elsewhere in recent times. According to recent data, nearly one in five people now lives on less than two dollars per day. Just over a decade ago, at the start of the transition to a free market economy, fewer than one in 25 people lived in such absolute poverty.
As dramatic as the economic collapse is, what truly sets poverty in the CEN region apart is that it has emerged in the context of profound and far-reaching systemic changes in political, economic and social life. On the political front, inhabitants of most CEN countries find themselves living within new state borders, in nations that are fundamentally redefining their identities and in political systems that have opened new avenues for freedom of expression and expanded civil rights. On the economic front, the transition to a market economy has created new opportunities for growth and private investment, but has also meant unknown material hardship and loss of security. From the social perspective, transition has brought the destruction of normal social patterns and the emergence of alarming new trends that complicate poverty reduction efforts.

Throughout the region rural people often have a higher risk of poverty than urban residents do. Since the beginning of the transition, the rural situation has deteriorated throughout the region with a large increase in inequality between rural and urban areas in most countries. In Albania, for example, almost 90% of the poor live in rural areas. Similarly, in Romania, rural poverty rates are considered to be more than double those in urban areas. Importantly, many of the region’s farmers turned to agriculture as a way of coping with the loss of employment following the collapse of former state industries. As CEN countries look to the future, therefore, one of the main challenges is to help rural people move beyond agriculture as a way of merely coping with poverty to agriculture as a route out of poverty.

**Agriculture in Transition**

Since the start of transition, significant progress has been achieved in all CEN countries with the liberalization of agricultural markets and trade, enterprise restructuring, commercialization of infrastructure and legislation to allow the expansion of private financial services. Despite these achievements, rural incomes have remained stagnant, mainly because of limited access to essential inputs and technologies, barriers to land consolidation, poor market access, scarcity of rural credit and limited off-farm earning opportunities.

In principle, the privatization of land is complete or nearly complete in all countries considered here. In practice, however, this process has resulted in extremely small and fragmented plots so that the poverty alleviating impact has been much less than anticipated. As farmers all across the region are discovering, access to land is only one part of the puzzle. Without access to credit, fertilizer, appropriate technologies, stable and remunerative markets and other productive assets, agricultural output has declined sharply and the yields of many crops now well below those achieved under the former system.
EXECUTIVE SUMMARY

Throughout the region, there has been a dramatic shift from large-scale rotational farming to the cultivation of subsistence crops for household food security. Only basic grains and potatoes are now grown in greater abundance than before with a sharp decline in the production of higher-value crops such as citrus fruits, tea, vegetables, wine grapes and tobacco that require specialized skills and dedicated processing equipment. Quite simply, with only a small area for cultivation, most family farmers have little choice but to plant the whole area to basic foods just to meet their subsistence requirements. Then, once their food security needs have been met, there is little incentive to intensify production because of poor market access. Livestock production has also had to adjust to new market conditions, and herd sizes have decreased significantly due to the lack of imported feed and forced sales by smallholders needing cash for subsistence purposes.

**DIMENSIONS OF RURAL POVERTY**

To measure the number of people living in absolute poverty, a recent World Bank study turns to the so-called two-dollar-a-day poverty line (actually USD 2.15 per person per day in 1996 purchasing power parity). Although the one-dollar-a-day line is used to measure absolute deprivation in many other parts of the world, the two-dollar-a-day line is more appropriate for the CEN region where the very cold climate demands additional expenditure on heat, winter clothing and food. This measure is also at the bottom end of the range of national poverty lines of the poorer countries in the region.

In terms of the IFAD target group, simple calculations based on poverty headcount indices and population data for each country suggest that around 4.0 million rural people in the CEN region (out of 23 million rural people in total) live on less than USD 2.15 per day, excluding Bosnia and Herzegovina for which data were not available. When a slightly higher poverty line of USD 4.30 per day is used (which is more appropriate for medium-income countries such as Romania and The Former Yugoslav Republic of Macedonia), the number of rural poor climbs to around 12.3 million, equal to roughly half of the total rural population. Although these are imprecise estimates, the large difference in the number of people living on USD 2.15 and USD 4.30 per day clearly indicates that while many people have not fallen into absolute poverty, large numbers still live at the margin and lack secure livelihoods. Unfortunately, more specific estimates of the number of rural poor in each country were unavailable and, at least from IFAD’s point of view, it is more helpful to focus on the number of beneficiaries covered by specific investment projects and the quality of outcome.

These estimates also overlook the significant differences that often exist in the severity and incidence of poverty between rural and urban areas. Moreover, poverty cannot be measured by income indicators alone and alarming trends are starting to emerge in the farm areas of all countries in terms of increased malnutrition, rising levels of disease and reduced standards of education. The situation is especially bad given that rural roads,
health centres, schools and clean water supplies were mainly developed to suit the needs of former state and collective farms and are no longer appropriate for today’s more dispersed population. In this respect, even the figure of 12.3 million rural poor is likely to understate the true extent of the poverty problem.

Rural poverty is found to be most severe and widespread for the following groups.

- **Farmers in upland and mountainous areas.** Often, entire mountain communities live in conditions of extreme poverty with insufficient food to meet their biological needs. Farmers in these areas have few opportunities to generate off-farm income and face severe marketing constraints because of their isolation.

- **Rural wage earners.** Due to the small size of farm holdings, most rural people must generate a large share of their income through off-farm activities. Depending on the assets they possess, families that rely on wage income are often poorer than farmers because they do not produce their own food.

- **Rural women.** Transition has had an especially high price for gender equality and women now make up a large percentage of the rural poor. Whereas men often migrate to the cities in search of employment, women are left to care for children on the farm and become trapped in subsistence production.

- **The elderly.** Elderly and retired people also account for a large share of the rural population in most countries. Although elderly people were often the prime beneficiaries of land restitution programmes, many are no longer capable of farming and find themselves in a particularly tragic situation.

- **Ethnic minorities.** New state borders, the creation of new majority-minority relations and sharp competition for reduced resources have together served to divide societies along ethnic lines. Especially for minorities who worked in collective agriculture, access to land was often lost through the reform process.

- **Internally displaced persons and refugees.** While not a traditional IFAD target group, the high number of refugees and internally displaced people in the CEN region calls for recognition of the special circumstances that leave them without assets or traditional social support networks, if only to maintain stability and prevent further conflict.

**IFAD Experience in the Region**

As of mid-2001, IFAD had supported a total of 17 investment projects in the region, of which 14 projects were still ongoing. Total IFAD lending amounts to USD 177.6 million thus far, with the total value of all projects, including cofinancing and government and beneficiary contributions, equaling USD 379.5 million. In other words, for every dollar IFAD has invested, an additional USD 1.14 in total project financing has been mobilized.
Several lessons with important implications for the subregional strategy stand out from this experience as follows.

- **The institutional vacuum** caused by the collapse of central planning contributes substantially to the problem of rural poverty. Successful projects must therefore be based on a long-term strategy for building and strengthening new institutions, and also designed with sufficient flexibility to cope with current weaknesses.

- **To address the challenge of mountain area development**, IFAD has found that a systemic approach, built on an awareness of how mountain communities interact with other parts of the national economy, is essential. This often demands close cooperation with other donors to help finance investments in rural roads, schools and health centres needed for sustainable, market led-growth.

- The development of **rural financial services** requires a long-term institutional focus and clear separation from government as a service provider. Considerable effort is also needed to strengthen local capacities to appraise individual loan applications. Bank officials in the region have almost no experience with the evaluation of small-scale investment loans, and this can be a serious constraint to the uptake of credit and its effective use by project beneficiaries.

- The lack of reliable **output markets** is proving to be an even greater constraint to agricultural development than the lack of crop inputs. An explicit recognition of the opportunities to involve private traders and other commercial investors in IFAD project strategies is therefore needed to support the transition process.

- Many of the rural poor in CEN countries do not depend on agriculture for their main source of livelihood. Support for agricultural services, agro-processing and other areas of the **non-farm rural economy** is critical for a sustainable reduction in the incidence of rural poverty.

- Despite many advantages, people of the CEN region are sometimes sceptical about the potential benefits of **group formation**, which has been difficult to separate from the legacy of communism. In this context, IFAD experience shows that groups formed with a clear financial objective and/or to manage a shared resource are often the most successful.

- Most governments of the region, and especially those borrowing on intermediate terms, are reluctant to use IFAD loan money for capacity-building and farmer training. Because these services are often essential to target the poorest social groups, priority must be given to mobilizing **grant cofinancing** for agricultural training and extension components.

### Subregional Strategy

IFAD’s overall strategic objective in the CEN region is to support the transition process with sustainable agricultural programmes that contribute to rural poverty reduction. IFAD is also guided by the need to contribute to the Millennium Development Goals, which set targets for reductions in poverty, improvements in
health and education, and protection of the environment. These goals are a formidable challenge, especially in the CEN region where the incidence of poverty has increased sharply since the start of the transition, with a corresponding deterioration in health status, education and gender equality.

To achieve these broad objectives, IFAD will focus on a few areas in each country where it has a distinct comparative advantage and can demonstrate replicable project strategies for broader application. At this level, success can be measured more by the impact of specific projects on targeted beneficiaries than by macroeconomic change and an overall reduction in the number of rural poor. Each country programme, therefore, will seek to address the underlying causes of poverty for the poorest and most vulnerable rural groups including mountain communities, rural wage earners and rural women. Success can also be measured by the uptake of project strategies by governments and other donors, thus enhancing impact and allowing for wider coverage.

In terms of specific areas for project intervention, future IFAD investments will focus on long-term institutional development and support for new market linkages. Although individual project strategies will vary from country to country, these two areas are of almost universal importance in that inadequate institutional support and poor market access both define and limit the opportunities to move out of poverty for the vast majority of rural people. Other strategic areas for IFAD support may include investments in improved on-farm productivity, development of the non-farm rural economy and creation of sustainable natural-resource management systems. Each priority area will be addressed, in part, through the development of rural financial services that channel resources directly to activities that benefit the rural poor and support other new areas of relevant trade and investment.

In addition to IFAD’s lending programme, individual country programmes will also focus on the following areas as mutually reinforcing elements of the subregional strategy. These areas correspond with IFAD’s corporate Plan of Action.

**Partnership-building.** IFAD has so far enjoyed considerable success in forging new partnerships with various donors in the CEN region and a major challenge now is to cement these relations and introduce a more programmatic approach. Especially in the poor mountain areas targeted by IFAD, project resources do not allow for major investments in heavy infrastructure needed to support market-led growth and development. IFAD will also continue to build partnerships through various Extended Cooperation Programme grants that enhance impact and strengthen civil society institutions.

**Policy dialogue.** IFAD’s strategy for policy dialogue will be to lead by example through the projects it supports and to share lessons from this experience on issues of
critical importance to the rural poor. Likewise, as part of the strategy for institution-building, IFAD will also seek to work in close cooperation with ministries of agriculture to strengthen their capacities to lobby other branches of government and the donor community on behalf of the rural poor for enabling legal reform and additional development resources.

**Knowledge management.** IFAD’s strategy for knowledge management in CEN countries will be to document proven strategies that can be adapted for wider application and to identify key lessons that help maximize impact. At the national level, country strategic opportunities papers (COSOPs) will continue to be one of the most important tools of knowledge management. Technical assistance grants will also be used to generate new knowledge on the opportunities for market development and to help channel existing knowledge to the benefit of ongoing and future projects.
This subregional poverty assessment has been undertaken as part of the identification of a multiyear strategic lending programme for IFAD’s Near East and North Africa Division (PN). It covers the countries of Central and Eastern Europe and the Newly Independent States (CEN) presently borrowing from IFAD, that is Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Georgia, the Republic of Moldova, Romania and The Former Yugoslav Republic of Macedonia.¹

The poverty situation in the CEN region is unusual and represents a unique challenge for IFAD. On the one hand, the poor in CEN countries, like the poor elsewhere in the world, lack assets and access to services; they have a low standard of living and they feel powerless and insecure.² Unlike many other parts of the world, however, widespread poverty is a relatively new phenomenon in the CEN region. Presently, most people in transition countries are literate, many are well educated and, until recently, enjoyed secure employment and guaranteed pension benefits. Since the collapse of the former communist system, the magnitude of the increase in poverty has been unlike anything experienced elsewhere in recent times. According to recent data, nearly one in five people in the region now lives on less than USD 2.15 per day. Just over a decade ago, at the start of the transition to a free market economy, fewer than one in 25 people lived in such absolute poverty.³

Importantly, rural people in the CEN region often have a higher risk of poverty than urban residents do. Since the beginning of the transition, the rural situation has deteriorated throughout the region and inequality between rural and urban areas has greatly increased in most countries. In Albania, for example, almost 90% of the poor live in rural areas, with 60% of the heads of poor households self-employed in agriculture.⁴ Similarly, in the Republic of Moldova more than 21% of the rural population now fall below the official poverty line compared with less than 7% in the capital city.⁵ Although rural people produce much of their own food, which keeps many out of extreme poverty, the depth of poverty (i.e. how far the average poor person’s income falls below the poverty line) and inequality among the poor are significantly worse in most rural areas.⁶

While rural poverty in the CEN region has many complex dimensions, a common underlying factor is the institutional vacuum created by the collapse of central planning and state socialism. Many heads of rural households are new farmers who turned to agricultural production to cope with the loss of employment after the collapse of the former economic system. Despite extensive land reform and other important policy
changes, rural incomes have remained stagnant, primarily because of limited access to essential inputs and technologies, barriers to land consolidation, poor market access, scarcity of rural credit and limited off-farm earning opportunities. As farmers across the region have come to realize, access to markets, credit, fertilizer, appropriate technologies and other productive assets are critical for success. These services were once provided by the state, but now simply no longer exist or are inappropriate to the needs of newly privatized smallholder agriculture. A fundamental challenge to the process of poverty reduction, therefore, is to build new institutions adapted to the current reality.

It should also be noted from the outset that conditions in CEN countries generally lag far behind those in other more industrialized transition states of the former Eastern block. A comparison of annual gross domestic product (GDP) growth rates, for example, shows that the effects of transition have been far more severe and long lasting in the CEN countries borrowing from IFAD than in the Czech Republic, Hungary, Lithuania, Poland and Slovakia. As this subregional assessment shows, the transition to a market-based agricultural economy is an unusual challenge and requires much more than the privatization of land and other assets. Despite expectations that the transition to a market-based economy would be rapid, it is now apparent that considerable effort is required to support the development of new market linkages, entrepreneurial skills and other services rural people need for success in the new economy.

Effective project lending strategies for CEN countries must be based on a good understanding of the economic, political and social transition. Towards this end, Chapter I of this assessment begins with an overview of the macroeconomic performance and historical context of the region. Chapter II looks in more detail at the current state of agriculture in transition and considers some of the challenges of moving from central planning to market-based production. Chapter III examines the extent of rural poverty and some of the characteristics of the region’s most vulnerable groups. Chapter IV provides an overview of IFAD experience and major lessons learned in CEN countries. Finally, Chapter V turns to the question of regional strategy and outlines what IFAD can do to help build effective institutions and market linkages needed for equitable development and poverty reduction.

Endnotes
1 This report was prepared by Mr John C. Keyser (consultant) in cooperation with Mr Abdelmajid Slama (PN Director) and country portfolio managers for the CEN region.
2 Narayan et al., 1999.
6 World Bank, 2000b.
<table>
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<tr>
<th>Abbreviation</th>
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<tr>
<td>CEN</td>
<td>Central and Eastern Europe and the Newly Independent States</td>
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<td>COSOP</td>
<td>Country Strategic Opportunities Paper</td>
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<tr>
<td>CPM</td>
<td>Country Portfolio Manager</td>
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<tr>
<td>ECP</td>
<td>Extended Cooperation Programme</td>
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<td>MAFF</td>
<td>Mountain Area Finance Fund</td>
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<tr>
<td>HDI</td>
<td>Human Development Index</td>
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<tr>
<td>MDGs</td>
<td>Millenium Development Goals</td>
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<tr>
<td>NGOs</td>
<td>Non-governmental organizations</td>
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<tr>
<td>PPMS</td>
<td>Project and Portfolio Management System</td>
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<tr>
<td>PPP</td>
<td>Purchasing power parity</td>
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<td>SIDA</td>
<td>Swedish International Development Agency</td>
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<td>SMEs</td>
<td>Small and medium-scale enterprises</td>
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<td>WHO</td>
<td>World Health Organization</td>
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<td>WUA</td>
<td>Water Users' Association</td>
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CEN countries are a relatively new addition to IFAD’s portfolio. They form a diversified region of about 53.3 million people, including an estimated 23.2 million rural inhabitants who derive their livelihoods mainly from agriculture. Although conditions vary greatly from country to country, transition economies are set in the context of an abrupt termination of central planning and state services, including a reduction in public-sector spending and the dissolution of production, marketing and distribution channels at the regional, national and local levels. A complete set of economic and human development indicators for each of the CEN countries covered by IFAD can be found in Appendix I.1

**Macroeconomic Considerations**

The scale of economic collapse alone distinguishes the experience of the CEN region from that of other parts of the world, with a decline in economic output and standard of living that rivals that of the Great Depression of the 1930s. As shown in Table 1, total gross national product (GNP) and per capita incomes are now well below the levels recorded at the outset of transition in most countries. The impact of transition has been especially severe in the Newly Independent States of the former Soviet Union (Armenia, Azerbaijan, Georgia and the Republic of Moldova), which were relatively more dependant than other Eastern block countries on the guaranteed markets provided by the former state system. Individual incomes have fallen by more than 60% in some countries, and total economic

<table>
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<th>Country</th>
<th>GNP at Market Prices (USD billion)</th>
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<tr>
<td></td>
<td>1990</td>
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</tr>
<tr>
<td>Albania</td>
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<td>Georgia</td>
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<td>Republic of Moldova</td>
<td>10.58</td>
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<td>Romania</td>
<td>38.46</td>
<td>34.14</td>
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<td>The Former Yugoslav</td>
<td></td>
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<td>Republic of Macedonia</td>
<td>2.56</td>
<td>3.30</td>
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Note: Data for 1999 are preliminary estimates; figures in italics are for years other than specified.

Source: World Bank, 2000c for 1990 figures except for Bosnia and Herzegovina where data are from EIU, 2000; and World Bank, 2001 for 1999 data.
output is now below pre-transition levels in all countries except Albania and The Former Yugoslav Republic of Macedonia.

Figure 1 looks at the evolution of economic performance in more detail and shows that CEN countries typically experienced a large drop in GNP at the start of transition and that recovery has been both slow and difficult to sustain. The only exceptions to this pattern are Albania where recent growth has been impressive, mainly a result of emerging from virtual autarky under the former regime; and Romania, which has had fairly steady growth since 1992 and has recovered to nearly 1990 levels. In The Former Yugoslav Republic of Macedonia, the large increase in GNP in 1999 mainly reflects increased spending on construction and services connected to the war in Kosovo and the influx of refugees.

One very important consequence of the economic collapse is that all countries of the CEN region experienced a sharp decline in the demand for labour. The jobs once guaranteed by the state simply ceased to exist, and new private-sector activities that could absorb these workers have been slow to emerge. Given the lack of alternatives, many families have turned to subsistence agriculture and other forms of small-scale self-employment for basic survival.

The structural nature of this transformation is illustrated in Table 2, which shows that agriculture and services now generally account for a much larger share of gross domestic
product (GDP) than at the start of the transition. Importantly, many of the region’s new farmers are former industrial workers or employees of large state farms who are unfamiliar with appropriate methods of agricultural production. As CEN countries look to the future, therefore, one of the main challenges in agriculture is to help farmers move beyond agriculture as a way of coping with poverty to agriculture as a route out of poverty.

Table 3 provides an additional view on the impact of transition and summarizes average growth rates by sector for CEN economies. Although agriculture has tended to do relatively better than other economic sectors, performance has still been extremely poor in all countries except Albania, which started from a very low base. This poor record is explained not only by dislocation from the break-up of former state and collective farms, but also by the lack of appropriate institutions needed to support smallholder production in a market economy. As farmers all across the region are discovering, access to land is only one part of the puzzle. Without access to credit, fertilizer, appropriate technologies, stable and remunerative markets and other productive assets, agricultural output has declined sharply and the yields of many crops are now well below those achieved under the former system.

In most CEN countries, the economic collapse has also been marked by a sharp increase in inequality. In the Republic of Moldova, for example, the Gini coefficient for income inequality increased from a pre-transition value of 24 in 1987-88 to 34 in 1992 and 36 in 1993. The 1999 household budget survey in the Republic of Moldova found the Gini coefficient for consumption to be around 41, with the richest 20% of

Figure 2: Index of Economic Performance Measured by GNP at Market Prices

Note: 1990 = 100 for all countries except Georgia (1991 = 100) and the Former Yugoslav Republic of Macedonia (1992 = 100). Data are not available for Bosnia and Herzegovina.

Source: Calculations based on World Bank, 2000c and 2001 data.
the population accounting for almost half of total consumption in the economy. In Armenia, the rise in inequality has been even greater. According to World Bank estimates, the income-based Gini coefficient was 27 prior to transition, but now stands at 59. In The Former Yugoslav Republic of Macedonia, the Gini rose from under 20 in 1993 to almost 30 in 1996; Romania experienced an increase in the expenditure-based Gini from 21 in 1989 to 30 in 1998.

Civil war and armed conflict have contributed to this poor macroeconomic performance and added to the challenge of transition in many CEN countries. The civil war in Bosnia and Herzegovina, which began soon after independence, led to the widespread destruction of housing and production facilities, the displacement of large segments of the population, a dramatic reduction in living standards and a drastic increase in poverty. Armed conflict in the contested Nagorno Karabakh area between Azerbaijan and Armenia has likewise disrupted traditional transportation routes and stifled the export and import capabilities of both countries, with a major impact on rural households and opportunities for agricultural growth. War has also had a direct impact on the rural poor in the northern areas of Albania immediately adjacent to Kosovo, and ethnic tensions in The Former Yugoslav Republic of Macedonia now threaten calamity on an equal scale.

**Historical Context**

To be effective, poverty reduction strategies require an understanding of the causes of economic collapse and the legacy of the former command economy. Specifically, as large as the collapse in economic output and living standards is, what truly sets poverty in the CEN region apart is that it has emerged in the context of profound and far-reaching systemic changes in political, economic and social life.

On the political front, inhabitants of most CEN countries find themselves living within new state borders, in nations that are fundamentally redefining their identities and in political systems that have opened new avenues for freedom of expression and expanded civil rights. On the economic front, the transition to a market economy has
created new opportunities for growth and private investment, but has also meant unknown material hardship and loss of security. Successive economic shocks, including the loss of jobs, prolonged non-payment of salaries, hyperinflation and the drastic erosion of accustomed supports (such as low-cost or free social services, subsidies and discounts on goods and services), have made people feel unusually vulnerable, powerless and unable to plan for the future.8

From the social perspective, transition has not only brought unaccustomed material hardship, but also the destruction of normal life and social patterns. In contrast to the majority of poor people in developing countries, most of the poor in transition countries are literate, many are well educated, and before the transition they had secure employment and anticipated receiving regular pensions and allowances from the state after retirement. As jobs are lost and unemployment grows, social cohesiveness is breaking down. Male suicide rates have increased by more than 50% in some countries; trafficking in young women is on the rise; and young men in poor rural areas are increasingly being recruited into the drug trade.9 These trends presage the emergence of major social problems that threaten to complicate future poverty reduction efforts.

Poverty under socialism. During the 1950s and 1960s, and in some countries up to the mid-1970s, socialism was remarkably successful in reducing income poverty and improving people’s health and education throughout the region. Rapid industrialization created jobs and accelerated the upward mobility of large social groups, including the rural poor, unskilled workers and the jobless. Illiteracy rates dropped to low single-digit figures, infant mortality was reduced by half, life expectancy increased by almost ten years for both men and women, and income poverty declined substantially.10 These early successes were linked with substantive investment in social infrastructure and the broad distribution of gains from industrialization. Full employment, consumer subsidies and a universal system of entitlement, including guaranteed access to social services and cash benefits, were an integral part of an ideological framework committed to an equal (if not politically open) society with high levels of social security.

Table 3: Annual Average Growth by Sector in CEN Economies (% Change 1989-99)

<table>
<thead>
<tr>
<th>Country</th>
<th>GNP</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>3.7</td>
<td>5.8</td>
<td>-5.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Armenia</td>
<td>-10.3</td>
<td>0.2</td>
<td>-18.1</td>
<td>-10.8</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>0.5</td>
<td>2.3</td>
<td>3.9</td>
<td>3.1</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Georgia</td>
<td>-15.3</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Republic of Moldova</td>
<td>-7.0</td>
<td>-16.0</td>
<td>-15.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Romania</td>
<td>-1.7</td>
<td>0.6</td>
<td>-1.9</td>
<td>-2.4</td>
</tr>
<tr>
<td>The Former Yugoslav Republic of Macedonia</td>
<td>1.1</td>
<td>-0.4</td>
<td>-5.9</td>
<td>0.8</td>
</tr>
</tbody>
</table>

Note: Armenia data based on change from 1990-98.
From roughly the mid-1970s, however, these positive trends stagnated and even reversed. Shortages of consumer goods, including food, housing and public services, became increasingly common and a source of deprivation. In this respect, it became increasingly apparent that the command economy lacked essential mechanisms needed to stimulate technological innovation, labour productivity and entrepreneurship. Although central planning proved very effective in promoting rapid development, the system could not generate the resources needed for a steady increase in material standards and maintenance of social provisions in the long run.

As living conditions worsened and remained below western standards, widespread dissatisfaction and popular pressure for change grew. Coupled with the dramatic developments of glasnost and perestroika in the Soviet Union, change in the eastern block became inevitable. Popular demands for greater political participation and economic change were buoyed by expectations that reform would improve the efficiency of resource allocation, revive economic growth and thus ensure a level of prosperity closer to that enjoyed in Western Europe. Ardent market reformers were so convinced of the massive inefficiencies of the old system that they expected changes in key incentives to trigger rapid improvement and better living conditions after only a brief disruption. These perceptions were to prove grossly over-optimistic.

**Agriculture in the command economy.** Government planning and control largely characterized agricultural production before transition. Ministries of agriculture, charged with fulfilling centrally planned targets, directed production and resource allocations on the basis of strategic and political considerations with little regard for efficiency. Financial costs and returns were largely irrelevant since the state was the sole supplier of inputs and all produce was marketed through official channels at predetermined prices. Low-cost agricultural credit was supplied to state farms for both working capital and investment purposes. Technical training and specialist inputs, including veterinary services and hybrid seed, were supplied by state-run research institutes or production units, generally controlled by a ministry of science. Most production units were furnished with their own highly specialized technicians.

This model of collective and state farms dominated the agriculture sectors in Albania, Armenia, Azerbaijan, Georgia, the Republic of Moldova and Romania. In Yugoslavia, the situation was slightly different since farmers who chose to remain in the rural areas were allowed to continue small-scale production on private land. Even here, however, the overwhelming majority of agricultural output was accounted for by state-owned agricultural agencies, the *agrokombinats*; and most family farms produced for subsistence along traditional lines, making only limited cash sales mainly to large state enterprises.

Throughout the region, agriculture on state farms was based on heavy mechanization, irrigation and the intensive use of chemical fertilizers and pesticides. This model of production came at a high environmental cost, however, and together with industrial waste and sewage from urban areas, contributed to making the region’s air, water and soils among the most polluted in the world. In the Caucuses, for example, there has been large-scale land degradation due to ill-conceived irrigation schemes with inadequate...
planning for drainage. In the Republic of Moldova, it is estimated that more than half of all arable land is eroded, and about one third to a medium to high degree.11 These environmental impacts not only hurt the poor disproportionately (the rich can buy filtered or bottled water, move off degraded land to better land or to the city, or move out of areas with intense air pollution), but are also a cause of increased poverty in their own right. Poor-quality soils, polluted water, poorly designed irrigation schemes, degraded forests and poor air quality all make agricultural production more difficult and contribute to the challenge of poverty reduction.

Endnotes

4 World Bank, 2000b.
5 IFAD, 2000b.
7 World Bank, 2000a.
8 Ibid.
9 Ibid.
10 Ibid.
11 IFAD, 1997b.