

Income distribution and price controls: Targeting a social safety net during economic transition

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Received 1 September 1996; accepted 1 April 2000

Abstract

During the ongoing post-communist economic transitions, the relative well-being of many people is changing rapidly, and governments are not well positioned to accurately measure individual living standards. Under such circumstances, continued price controls over basic consumer goods within the state sector, and the associated queuing, can form a serviceable device for targeting poor people for subsidies. With a fixed-price state sector and free-price parallel markets, rich people might choose to avoid queues and shop in the free markets, while poor people would prefer to pay low nominal prices and queue in the state sector. The targeting of subsidies through queues, therefore, can be accomplished even if the government has no information concerning individual income or living standards. When the alternative to price controls is a poorly targeted explicit social safety net, the resource cost of queues might be more than offset by an improvement in the targeting of subsidies. © 2001 Elsevier Science B.V. All rights reserved.

JEL classification: P2; H2

Keywords: Transition; Income distribution; Price controls; Social safety net

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1. Introduction

The provision of an adequate social safety net is a leading concern during economic transitions from socialism to capitalism. The safety net in socialist societies consists of explicit provisions such as pensions and disability payments, as well as other features inherent in the system of central planning. In particular, the policies of full employment and low fixed prices for most basic consumer goods within the state sector are major elements of the social safety net in socialist economies. During the transition, however, privatization (or the implementation of hard budget constraints) and price liberalization undermine these implicit social welfare protections. (Leitzel, 1995, p. 26.) Transitional economies, therefore, have enacted additional explicit provisions, such as unemployment benefits and minimum wages, to protect the welfare of some of their citizens.

A fundamental difficulty in providing subsidies to needy individuals is to distinguish those who are in need from others who can afford to be taxed. Many welfare programs in the West are means-tested, only available to those whose incomes fall below some threshold. Such targeting of benefits is by no means perfect, even in the absence of fraud, because official income is an imperfect indicator of welfare. The targeting of social safety provisions is even more problematic in transitional societies, however. First, the informal economy tends to be very large, so official income captures a smaller percentage of total monetary income.¹ Second, the in-kind provision of goods and services often is substantial and variable, diminishing the correlation between monetary income and welfare. Third, government authorities have had little experience with the implementation and enforcement of explicit social welfare policies. It has been claimed that many of those who receive unemployment benefits, for example, actually hold jobs.²

The difficulty of identifying poor people in transitional societies is matched by its importance. While there are many problems with the data and their interpretations, the socialist states tended to have distributions of income that were egalitarian relative to most Western market economies (see, e.g., Atkinson and Micklewright, 1992, p. 114). During the transitional years, these countries generally have seen a sharp increase in measured income inequality. The increasing (and increasingly visible) gap between the haves and have-nots frequently is cited as leading to an anti-reform backlash, and in promoting the electoral prospects of former communists or other opponents of transition.

¹ It was reported in mid-1995, for example, that the average Russian family received only 40% of its income from wages at officially reported jobs. OMRI Daily Digest, No. 132, Part I, 10 July 1995.

² Sachs (1993, p. 73), notes that the official unemployment rate in Poland was estimated to overstate actual unemployment by approximately one-third. Of course, the holding of informal jobs by those collecting unemployment benefits is not limited to transitional socialist societies.

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