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Conflict Between Horizontal Equity and Maximum Poverty Reduction, How Best to Allocate Funds to Regions:

An Empirical Analysis

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Abstract

If poor regions in a country are worse at targeting “their” poor, could it be optimal, from the point of view of nationwide poverty reduction, to transfer more funds to the richer regions, which are better at targeting? The paper develops the framework within which this crucial tradeoff between horizontal efficiency (regions with greater number of poor getting proportionately more funds), and maximum poverty reduction is studied. The analysis is applied to six East European countries with sufficiently detailed household-level data. In almost all cases, richer regions are better at targeting, and that targeting efficiency declines with increase in available funds. The paper also derives the conditions for the optimal interregional allocation of funds under the condition of given overall fiscal envelope and given level of regional efficiency in targeting. The difference between the current delivery of social assistance to the poor and the delivery under the optimal scenario shows how much is gained by reallocating funds between the regions. This amount is estimated at 2 percent in Hungary, 11 percent in Bulgaria and Latvia, and 17-19 percent in Slovakia and Poland.

Branko Milanovic is with the Policy Research Department of the World Bank. This paper is to be delivered at the *Asia and Pacific Forum on Poverty: Reforming Policies and Institutions for Poverty Reduction*, to be held at the Asian Development Bank, Manila, 5-9 February 2001. The work was in part funded by a grant from the World Bank Thematic group on Social Safety Nets headed by K. Subbarao and M. Grosh. The author is grateful to Prem Sangraula for research assistance.