

**Report No. 40864-KG**

# Kyrgyz Republic Poverty Assessment

*Executive Summary*

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**Poverty Reduction and Economic  
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## Introduction

1. This report attempts to answer three questions about the Kyrgyz Republic:

- What is the profile of poor?
- How has economic growth affected the level and composition of poverty?
- How has the labor market contributed to changes in poverty?

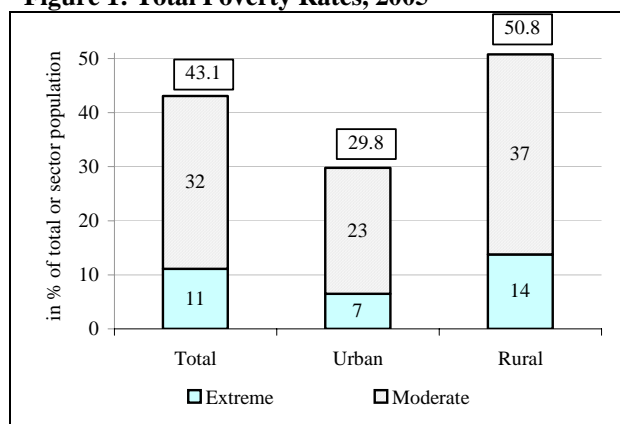
2. Answers to these questions carry significance especially at this time as the Government has started the implementation of its recently approved medium-term Country Development Strategy. However, the structure of Kyrgyz Republic's economy is in flux. The implementation of the reform agenda to expedite the transition from a centrally planned economy to a more market based one has yet to be completed, thus stymieing efforts to pursue policies that improve the welfare of the population and encourage business activity and competition. The political uncertainties of recent years combined with poor governance led to few investors – local or foreign – willing to risk their capital in medium to long-term projects in the Kyrgyz Republic during 2000-2005. Also, the external environment has changed significantly such that migration, remittances, and trade with Kazakhstan and China are affecting the development path of the economy.

3. The developments with regard to welfare and poverty in the first half of this decade can be summarized as follows. The Kyrgyz Republic saw a sharp decline in total and extreme poverty despite only modest growth. Remittances played a significant role in raising welfare and reducing poverty both directly and indirectly. Yet these remittances were mostly used to increase private consumption and the construction of housing rather than investment in the economy. Moreover, because private consumption of non-tradables increased significant, the poor benefited as they experienced an increase in their employment opportunities and wages. It is possible that after households have met certain needs that at least a portion of the additional remittances received will be invested, but much depends upon improving the business climate.

## Poverty Profile

4. The Kyrgyz Republic is a predominantly agrarian society with two-thirds of its population living in rural areas though the agriculture sector contributes only modestly to the national economy. The capital, Bishkek, and the surrounding Chui region, are magnets for workers leaving their farms to seek a better life either in Kyrgyz or abroad. The northern part of the country borders onto the middle income country of Kazakhstan where the economy is booming due to oil. The southern part of the country is more populous and it borders onto the lower income – and largely unreformed – economies of Uzbekistan and Tajikistan. The Kyrgyz Republic is mountainous with most regions at least moderately mountainous, the exception being Bishkek and Chui. This feature increases the cost of delivery of social services and infrastructure – which means that these services are not delivered to many and the population's welfare is adversely affected.

**Figure 1: Total Poverty Rates, 2005**



Source: KIHS 2005.

5. Estimated poverty in the Kyrgyz Republic in 2005 was 43.1 percent of the population. Extreme poverty – those whose consumption was inadequate to even meet food needs – was 11.1 percent of the population. The incidence of poverty is higher in rural areas (51 percent of the rural population) compared to urban areas (30 percent of the urban population). The majority of the poor live in rural areas – that is, about three out of every four persons below the poverty line reside in rural areas. Extreme poverty is twice as high in rural areas than in urban areas: 14 percent of rural residents live in extreme poverty compared to 7 percent of the urban population. Inequality as measured by the Gini coefficient was 0.28 which is better than seen in many parts of Europe and Central Asia (ECA). Regional level poverty rates are polarized with the

oblasts of Batken, Issykul, Jalal-Abad, Osh, and Naryn experiencing poverty rates in excess of 50 percent of their population while Bishkek and Chui's poverty rates are 11 percent and 22 percent of the oblast's population respectively (Talas falls in between at 44 percent).

6. Non-income dimensions of poverty differ markedly between urban and rural residents, possibly due to the mountainous terrain of the country, low population density in many districts, and the financial cost of service delivery. As in many countries of the Commonwealth of Independent States, electricity is available to all urban and rural residents. Mirroring experience in other countries, rural access rates to basic municipal services – such as running water, municipal solid waste collection, and sewerage facilities – are low for the poor and nonpoor alike due to the difficulty of providing network services to mountainous and/or low population density areas. In the urban sector, the more affluent have much greater access to basic infrastructure services such as a central heating, water supply, hot water, bath/shower, sewerage, central gas, and telephones than the poor. However, even there at least one-third of the urban non-poor do not have access to at least one basic service. Thus, in terms of non-income poverty, a much greater proportion of the population suffers from some aspect of deprivation than indicated by the income-based poverty line.

**Table 1: Access to services, 2005**  
% of households with access

	Urban		Rural	
	Non-poor	Poor	Non-poor	Poor
<b>Housing</b>				
Private ownership (%)	92	91	97	97
Living area per capita (m2)	13	9	16	12
<b>Location of water source (% of total)</b>				
Indoors	66	29	11	3
Outdoors (in the yard)	27	41	35	27
Outdoors (in the street)	7	30	54	70
<b>Access to sewerage network</b>				
	54	27	11	3
<b>Telephone</b>				
	61	28	23	12
<b>Power supply</b>				
	100	100	100	100

Source: KIHS 2005.

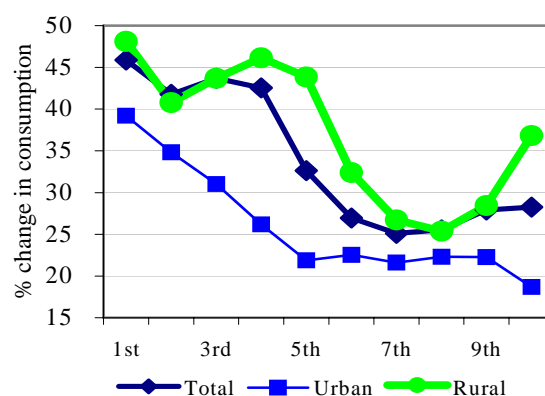
7. The individual characteristics of the poor are similar to those seen elsewhere in the ECA region. Households that are large with young children have a much higher probability of living below the poverty line. For example, persons living in households with two children have a one in two chance of living in poverty. Also, education is negatively correlated with poverty. However, the largest benefit in escaping poverty

accrues to those with a higher education degree where only 18 percent of people who live in households headed by a person holding a higher education degree live in poverty compared to 53 percent of those with general secondary degree.

### *Trends in Poverty and the Impact of Economic Growth, 2000-2005*

8. The Kyrgyz economy grew moderately by 3.7 percent per annum during 2000-2005. Concurrently, poverty fell from about 63 percent to 43 percent of the population and extreme poverty fell from about 33 percent to 11 percent of the population – indicating the strong responsiveness of poverty to growth. This high rate of poverty reduction was accompanied by improvements in inequality and the rise of average consumption per capita of the poor. On average during 2003-2005, consumption of the poorest 40 percent of the population grew by 10 percent per annum compared to about 4 percent per annum of the top 60 percent of the population surveyed. Urban and rural households benefited and poverty fell in both areas significantly. It also appears that poverty fell across the board in all oblasts, though since 2003 progress in poverty reduction has been more uneven at the regional level with Issykul, Jalal-Abad, and Osh seeing very little poverty reduction relative to other oblasts. However, the poorest regions in 2003 of Batken and Naryn saw major improvements by 2005 with poverty falling by 24 and 21 percentage points respectively.

**Figure 2: Consumption per capita growth, 2003-05**  
% growth among quintile groups



Source: NSC and authors' calculations

9. The responsiveness of poverty to economic growth is not surprising given that private consumption fueled economic growth during 2000-2005 rather than investment and

exports – the drivers of sustainable growth. Moreover, on the sectoral side, the main drivers of growth were agriculture and trade and tourism during 2000-2003. In 2003–2005, trade and tourism contributed the most to growth followed by construction, transport, and public administration. Accompanying the sectoral expansion were changes in employment. All sectors with the exception of agriculture saw employment growth. Trade and tourism and construction – both sectors that employ low wage labor – contributing the most to employment growth in Kyrgyz Republic. Yet, it was only the trade and tourism sector and agriculture which saw productivity growth during this period foreshadowing that rising wages would not be sustainable.

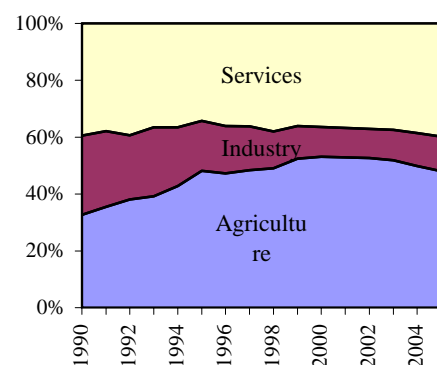
10. There are three main channels through which growth can translate into private consumption: wages, public transfers (such as pensions and social assistance) and private transfers such as remittances and gifts from friends and relatives. Labor income comprises 50 percent of total income for the households in the lowest quintile. In the Kyrgyz Republic, for the poorest 20 percent of the population, all forms of income rose with public and private transfers growing by about 80 percent (though from a small base) during 2003-2005 and labor income growing by over 50 percent. However, it appears that the second quintile (roughly equal to the moderately poor) benefited the most from the labor market as their wage income rose by 80 percent and social benefits fell significantly by about 25 percent during 2003-2005.

### ***Labor Market Developments and Poverty Reduction***

11. Since wages constitute the most important source of income for poor households, favorable labor market developments are key to the prosperity of low income groups. Labor market outcomes translate into higher living standards and poverty reduction through net job creation, an increase in compensated hours worked, and rising wages. In addition, for these developments to be sustainable and not reversed abruptly in the future, they must be accompanied by a growth in worker productivity – else why would any employer continue to pay more to a worker who does not produce more output?

12. In the Kyrgyz Republic, during 2000-2005, job creation occurred at an average rate of 1.8 percent per annum. However, since this was below the rate of growth of the labor force (1.9 percent), unemployment rose to 8.1 percent in 2005. But jobs were indeed created and as noted earlier, these jobs were in sectors which tend to employ unskilled, low-wage workers, consequently benefiting the poor proportionately more. The expansion of employment of the poor went hand in hand with rising real wages. Thus, according to aggregate data, there were more jobs and wages were rising. This would be an ideal combination if it were not for one problem – real wage growth exceeded productivity growth (11 percent versus 2 percent). That is, on average real wages were growing faster than the growth in output per worker – a feature that will ultimately discourage the creation of jobs by employers.

**Figure 3: Sectoral Distribution of Employed**  
In % to total, 1990-2005



Source: NSC

13. To complicate the situation, labor markets in the Kyrgyz Republic are highly segmented with starkly different structures. There is a divide between urban and rural markets, between formal and informal labor markets and between opportunities available to women and men. Thus, along each of these defining characteristics, key labor market indicators vary for the labor force as a whole but also for the poor versus the non-poor. In the Kyrgyz Republic, about two thirds of all jobs are in the rural sector (2003 data) and the vast majority of these (63 percent) are in agriculture. Rural non-farm activities include public services (e.g., education, health, and public administration) followed by commercial services, especially the trade sector, which provide 12 percent of jobs, and industry, mostly mining, which provides the remaining 8 percent of all rural employment. Only one-third of employed persons are self-employed, another

third are employees, and 20 percent are unpaid family workers. An estimated 8 percent of the rural labor force is unemployed.

14. In the rural sector, labor market indicators for the poor are worse than for the non-poor. Moreover, the rural working poor (of whom many are under-employed) have more people to support than the non-poor and work in less remunerative occupations. For example, unemployment rates are higher for the poor than the non-poor, 9 percent vs. 6 percent. The vast majority of the employed poor work in the farm sector – they comprise 60 percent of all farm workers – consequently, agricultural growth plays an important role in poverty alleviation in the country. Of those working in non-farm sectors, 60 percent are non-poor. In addition, the poor are under-employed and work 20 percent fewer hours (6.5 hours per week) than the non-poor. Finally, and very importantly, the rural poor workers have larger households with more dependents.

15. Urban labor markets are very different. Half of the Kyrgyz Republic's urban population resides in the capital city. The availability of higher paying jobs in urban areas, especially Bishkek, attracts migrants who comprise 29 percent of the urban working-age population. Unemployment is higher at 13 percent of the labor force. If we add in discouraged workers, unemployment rises to 16 percent (meaning that one out of every 8 people who wants a job will not get one). In the urban sector, 44 percent of employment is in the services sector followed by 19 percent in industry and 8 percent in construction. The vast majority (72 percent of all employed) are employees and 22 percent are self-employed. About one in three jobs is in the informal sector – that is, jobs that are outside the purview of the state's legal environment. And many workers are under-employed (working 34 hours per week).

16. The urban poor also have worse labor market indicators than the urban non-poor—their unemployment rates are higher (18 percent vs. 10 percent), employment rates are lower (51 percent versus 60 percent), and labor force participation rates are lower as well. Thus, despite having almost twice as many working age members per households than the non-poor, only half of them are employed. Moreover, each urban poor working person has to support on average three other persons compared to a non-poor employed person who has to support two other persons. An estimated 60 percent of the urban poor are in the

informal sector and an additional 11 percent work in farming. Only about one quarter of the urban working poor is in the formal sector. Poverty may also be exacerbated because of the lack of proximity to jobs or to public transportation: an estimated 17 percent of all households in the bottom 40 percent are relatively far from public transportation compared to 8 percent of non-poor households.

17. But one of the largest divides in the urban labor market is the gap between male and female working age adults. As in the difference between the poor and non-poor, the difference between women and men also exists. Women are less active in the labor market than men, at all ages in both rural and urban sectors. Poor women in particular have the lowest participation rates and gender gaps are the largest among the poor irrespective of their sector of residence. The impediments to women's labor force participation include the lack of child care and elder care services. Though gender segregation is not harsh in the Kyrgyz Republic, women still hold a relatively higher share of employment in low wage sectors. A large gender wage gap exists—women earn less than men per hour by about 25 – 30 percent. Though lower human capital endowments explain the differences in earnings in the public sector, in the private sector a large part of the earnings gap between male and female workers is unexplained.

### *The Bigger Picture—What Is Going On?*

18. The Kyrgyz Republic has seen impressive poverty reduction within a five year period despite moderate economic growth. This was achieved through the expansion of private consumption which was driven mostly through greater wage income resulting from the expansion of sectors employing mostly unskilled and low-wage labor. The fastest growing sectors were trade and tourism and construction – both in what is considered to be the “non-tradeables” sector. Concurrently, there was a sharp increase in foreign remittances as workers migrated to Russia and Kazakhstan.

19. It is unlikely that the growth in remittances and the expansion of the non-tradeables sectors were unrelated or coincidental. Rather the increase in money from abroad led to an expansion in the demand for services locally and an increase in imports. Real wage growth

outpaced productivity increases and undermined the competitiveness of the Kyrgyz economy. Because of the poor governance environment in the country and especially the unfavorable business climate, the funds were used for consumption and housing construction rather than longer term investment in the tradeables goods sector such as manufacturing. Thus, ultimately, without any significant change in the investment climate in the Kyrgyz Republic the economy will shift towards being less export oriented (with the exception of the export of labor) with time.

20. Is there anything wrong with this – especially if the jobs being created employ proportionately more persons from the unskilled and low income groups? The answer to this depends upon whether the leadership of the Kyrgyz Republic treats the current circumstances as a permanent engine of growth or one that is temporary yet buys the country time to implement reforms with less immediate short-term cost than would be the case in the absence of remittances. The biggest uncertainty of course lies in the continued demand for Kyrgyz labor by Russia and Kazakhstan – which is in no small way related to the price of oil. If remittances continue to flow in indefinitely then the growth in the non-tradeables goods sector and the decline in net exports accompanied by the growing disparity between productivity and real wages are viable for many years to come.

21. Yet, this also exposes the Kyrgyz Republic to potentially sharp economic downturns from a decline in remittances, lower internal demand for non-tradables goods and services, higher unemployment rates exacerbated by the return of workers, and lower revenues to the public sector. Moreover, if internal job growth is insufficient and reforms needed to promote job creation are delayed, then this may put an onerous burden on the social safety net in an already constrained fiscal environment.

22. What is also evident is that the economic expansion and the growth in private consumption is that it has not benefited all parts of the country evenly. Bishkek and surrounding areas have benefited more than Osh or Jalal-Abad. Many of the secondary towns are known to have been company towns whose economic viability was largely driven by one firm – many of which went bust in the early years of the transition. But other centers of business do not seem to have emerged and the Kyrgyz Republic suffers from a certain “uni-polar” development – with the capital being

the engine of growth for the country. Greater analysis is needed to determine why Bishkek is the main urban growth center and to what extent such factors as superior infrastructure, proximity to Kazakhstan which is both a destination as well as a transit country to Russia, or business networks unique to Bishkek.

### *Some Policy Directions*

23. The discussion above should be sufficient to show that tackling poverty is closely related to the growth agenda, economic policies, and possibly the regional distribution of resources pursued by the government. It is likely that poverty will continue to fall in the short-term with greater out-migration and remittance income. Yet, in the absence of vigilance, the Kyrgyz Republic could continue to grow without experiencing development and moving beyond transition.

24. What are the main areas to consider in the growth agenda from the poverty perspective:

- First, encouraging the channeling of a greater proportion of remittances to investment and job creation will lead to faster and more sustainable increases in the welfare of the low income groups.<sup>1</sup> In particular, poverty reduction based upon growth in the export sector is a much more likely to be sustainable than if it were based primarily on non-tradeables expansion. Hence, it is of critical importance to remove obstacles to investment in export-oriented industries, especially labor using ones. Thus, a general focus on improving the business climate combined with addressing the specific problems faced by enterprises trying to export (such as with transport, foreign exchange, and customs).
- Second, since the majority of the poor live in rural areas and work on farms, a rural anti-poverty strategy would include (i) improving the rural poor’s access to credit through formal channels, especially for working capital, (ii) providing technical assistance and better

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<sup>1</sup> See “Global Economic Prospects 2006: Economic Implications of Remittances and Migration”, World Bank 2006.

access to information for better crop selection, seed quality, and output marketing, (iii) increase farmers' access to machinery or other productivity enhancing inputs, and (iv) expansion of the unified monthly benefit to a greater portion of the rural poor.

significant as they will help to increase the sustainability of poverty reduction in the country.

- Third, regional investment climate surveys would be an important contribution to understanding the differential rates of economic development across the Kyrgyz Republic. Poverty has fallen more slowly in rural areas than in urban areas and in the oblasts of Issykul, Jalal-Abad, and Osh than in other parts of the country. An investment climate survey would help identify bottlenecks that are either imposed by local governments, uneven national government expenditures, and/or differing human and physical capital endowments.
- Fourth, as part of the growth agenda, reform of the education sector is important especially linking secondary and post-secondary education with labor market needs. Since effective vocational and technical education (VTE) is rarely well provided in developing countries, upgrading general secondary to impart skills to students to help them in the labor market as well as providing alternatives to the public provision of VTE need to be explored.
- Fifth, the social safety net could be improved to increase the coverage of the extreme poor, raise the benefit level to help the beneficiaries escape extreme poverty, and to decrease the leakage to the nonpoor. Safety nets are difficult to administer in economies where much of the income is derived from informal resources or from farming. However, through the use of strict selection criteria, leakage to the nonpoor can be minimized.

25. This report has focused on developments in 2000-2005. Since 2006, nascent but important changes are beginning to emerge. In particular, there has been progress in the expansion of the tradeables sector as demand from neighboring China and Kazakhstan for Kyrgyz products and services has grown. These new developments are