



# KYRGYZSTAN:

Economic Growth, Employment  
and Poverty Reduction





International  
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# Kyrgyzstan: Economic Growth, Employment and Poverty Reduction

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## Preface

Productive employment and decent work provide the key for translating the benefits of economic growth into poverty reduction. In recent years, this has been recognized in important global forums like the UN Summit of 2005 and the Ministerial Declaration of the ECO-SOC 2006. It has been agreed to include a new target in the Millennium Development goals which would be “to make the goals of full and productive employment and decent work for all, including women and young people, a central objective of our relevant national and international policies and our national development strategies”. Four indicators have been proposed under this new target, viz., employment-to-population ratio, vulnerable employment, the share of the working poor in total employment and labour productivity.

Since 2001, the ILO and the UNDP have been collaborating in the area of employment for poverty reduction with the objectives of building up a knowledge base on the nexus between economic growth, employment and poverty reduction, bringing out policy perspectives for achieving employment intensive pro-poor growth, and of carrying out advocacy and capacity building activities in this important field. That collaboration has been further strengthened with the preparation of a joint UNDP-ILO Action Plan in January 2007 when the heads of the two agencies and other senior officials met at the UNDP headquarters in New York.

The present study on Kyrgyzstan has been carried out within the framework of the above-mentioned programme of collaboration. It provides an analysis of the linkage between economic growth, employment and poverty reduction and brings out the policy implications of that analysis for pursuing a strategy of employment intensive growth for poverty reduction.

Since the introduction of economic reforms in 1991, Kyrgyzstan witnessed a period of economic decline till 1996. Growth has resumed since then, and a moderate growth of 4.7 per cent per annum has been achieved during 1996-2005. However, economic growth appears to have remained unstable and vulnerable to both external and internal shocks. The resumption of economic growth has been reflected in poverty reduction and an improvement in income distribution in the country. But the level of poverty remains high (about 40 per cent of the population in 2003), and the poverty reducing effect of economic growth needs to be strengthened. Employment and labour market effects of economic growth become important in that context.

The present report argues that annual GDP growth in Kyrgyzstan needs to rise to at least 7 per cent in order for employment growth to match the growth of labour force. But higher economic growth will not be sufficient; the pattern of growth will also need to change, especially from the point of view of the expansion of productive employment and decent work.


Despite moderate economic growth achieved by the economy of Kyrgyzstan since mid-1990s, employment situation in the country has not improved. Moreover, the sectoral composition of employment has not changed in a direction that is considered desirable for a developing country achieving economic growth. Instead of a shift away from agriculture towards manufacturing and other modern sectors which typically would have higher labour productivity compared to agriculture, the share of agriculture in total employment increased until 2000 and started declining only after that. Even in 2004, this share remained higher than in 1991. The share of manufacturing, on the other hand, has declined. The present study argues that the country needs to achieve faster growth in labour-intensive manufacturing industries and transform the composition of employment more towards that sector.

Economic policy should aim at raising the level of investment in the economy and channelling investment towards labour-intensive sectors, especially manufacturing. While encouraging the private sector, measures are needed to facilitate the growth of small and medium enterprises.

In the area of labour market policies, a number of reforms are aimed at making the labour market more flexible. But does greater flexibility in the labour market automatically lead to a higher growth of employment? Moreover, it remains to be seen how policies for bringing about flexibility can be combined with necessary protection for workers.

Simultaneously with policies for raising the rate of growth and its employment intensity, measures are needed to strengthen the capacity of the poor to integrate into and benefit from the growth process and higher productivity jobs that are created. Levels of education and skills, and access to productive assets would be important in that regard.

It is hoped that the findings and conclusions of the present report will be followed up with further work on the policy front to devise concrete policies and action that are needed to raise the rate of economic growth in Kyrgyzstan and make it more employment intensive and pro-poor.



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## Executive Summary

With the collapse of the Soviet Union, a number of CIS countries, including Kyrgyzstan, embarked on a process of transition from planned to market oriented economic systems. As a result of this process, Kyrgyzstan, like many of its neighbours, experienced an initial sharp decrease in economic growth, significant changes in the economic structure, rising unemployment, falling real wages and increasing levels of poverty and inequality. Despite resumption in economic growth since the mid-1990s, there was no immediate improvement in poverty and inequality levels, and only since 2000 has the incidence of poverty in Kyrgyzstan started to decline - despite fluctuations in economic growth.

A number of recent studies on developing countries have shown that while high rates of economic growth are necessary for poverty reduction, the pattern of growth - in particular in terms of employment and labour market outcomes - is critical in translating the benefits of economic growth into poverty reduction. Given existing empirical evidence and the recent experience of Kyrgyzstan, the present study provides an analysis of the linkages between growth, employment and poverty reduction with the objective of bringing out the role of productive employment in making economic growth pro-poor and the policy implications in this area.

The analytical and conceptual framework underlying the study is that in order for economic growth to result in poverty reduction, it must be accompanied by an increase in productive employment leading to higher returns to labour in the form of rising real wages or earnings of those in self-employment. In other words, economic growth must be concentrated in sectors that are employment intensive and the pattern of growth must allow for workers to move from sectors characterized by low productivity (e.g. agriculture) to sectors with higher levels of productivity (e.g., manufacturing). The study provides an analysis of the relationship between growth, employment and poverty reduction both at the macro- and micro level using various labour force surveys and household level data.

In terms of economic growth, the period from 1991 to 1995 was, as in many of the CIS countries, characterized by a significant decrease in output with a negative average annual growth rate of 9.5 per cent, resulting in a cumulative decline in GDP down to 50 per cent of the 1990 level. Although growth has resumed since 1996, it has remained unstable, with very low rates in 1998-99 and 2002, followed by strong growth in 2003-04. The latter (i.e., strong growth) was driven mainly by the agricultural and services sectors. Despite a further decline in 2005, due primarily to political instability, the average annual growth rate during 1996-2005 was a moderate 4.7 per cent. On the whole, it seems that economic growth in Kyrgyzstan remains vulnerable to internal as well as external shocks.

The rate of investment in the economy remains low even by standards of developing countries, and has declined in recent years (from 25% of GDP in 1996 to 14% in 2004). While public investment has declined, the increase in the share of private investment in GDP has not matched that decline.

The declining and uneven growth rates have had a significant impact on the living standards of the population as demonstrated by a rise in total poverty incidence from 43.5 per cent in 1996 to 55.3 per cent in 1999. Yet, the effects of positive and more stable growth rates in recent years are beginning to take hold with a continuous fall in poverty to 43.1 per cent in 2005 compared to 62.5 per cent in 2000 (according to the consumption measure). There has also been an improvement in inequality levels. Nevertheless, poverty and inequality remain issues of serious concern, particularly in rural areas of Kyrgyzstan where the vast majority of the country's poor are concentrated.

In identifying productive employment as a key link between economic growth and poverty, the present study provides a detailed examination of employment and labour market trends during the transition period. As a result of the shift from a planned to a market economy and the economic reforms which this entailed, the number of registered unemployed in Kyrgyzstan grew from 1.8 in 1992 to 58.2 thousand in 2004, representing an increase in the official unemployment rate from 0.1 to 2.8 per cent during this period (peaking at 4.3 per cent in 1996). However, according to the internationally accepted definition of unemployment, the rate of open unemployment was 9.9 per cent and 8.5 per cent respectively in 2003 and 2004. The rate of unemployment is higher in urban areas compared to rural areas (11.1 and 7 per cent respectively in 2004).

Growth of employment has been rather low compared to that of GDP as well as of labour force. During 1996-2004 (i.e., after economic growth resumed), employment growth was 2.2 per cent per annum, while GDP growth was 5.5 per cent per annum. During this period, labour force grew at about 2 per cent per annum. Clearly, a higher rate of employment growth is needed.

The structure of employment has not changed in the direction that is expected in a developing country. The share of industry in total employment declined during 1991-2004, and that of agriculture increased till 2000. Only recently has the share of agriculture in total employment started declining. In other words, economic growth has not resulted in a change in the sector composition of employment that is needed for poverty reduction at a higher rate.

The process of economic reforms has been associated with a decline in employment, particularly in the mining, processing, construction and transport sectors as well as in the manufacturing sector in general. On the other hand, employment in the financial sector has increased as a result of the development of markets and services. Moreover, reforms in agriculture have resulted in an increased number of people becoming engaged in this sector, absorbing some of the surplus labour force. In terms of providing employment, this may be perceived as a positive development, yet from a poverty reduction perspective one might question the desirability of this trend, given that labour productivity in the agricultural sector is lower than in manufacturing, which in turn means lower wages and underemployment, making it more difficult for people to improve their living standards.

An examination of the sectoral growth pattern in Kyrgyzstan shows that while growth in agriculture and services has been moderate and stable during the transition period, industrial activity has been dominated by a few large scale activities of a relatively capital-intensive nature and a narrow range of manufacturing industries - mainly textiles, food products and furniture. The country has the potential for increased growth in labour-intensive manufacturing. If the annual additions to the labour force, including the backlog of unemployed and underemployed, are to be absorbed, this potential has to be exploited.

More specifically, if the elasticity of employment with respect to output growth (i.e. the rate of employment growth relative to the rate of output growth) remains unchanged at the current level, a GDP growth of at least 7 per cent per annum would be required for employment growth to match the growth of labour force (2.4 per cent per annum). Moreover, as long as employment intensity is raised through higher growth of more labour intensive sectors and employment growth remains slightly lower than output growth, it should be feasible for existing unemployed and underemployed workers to be absorbed into the economy without adverse effects on labour productivity.

Findings from household surveys provide important insight into how poverty is linked to productive employment. First, unemployment level among the poorer household is higher (11 per cent for the poorest quintile compared to 6.5 per cent for the richest quintile in 2004). Second, the rate of underemployment (in terms of time measure) is higher for the poor. Third, the incidence of poverty is the highest among the self-employed and among those who are engaged in agriculture. These findings imply that productive employment and a shift of workers from employment characterized by low productivity to that with higher productivity is critical for poverty reduction.

The analysis using household level data shows the role of various asset- employment- and human capital related variables in influencing the probability of a household being poor. In this regard, the study finds that poverty is the highest for those with basic education and the lowest for those with university education. Likewise, remittances sent by migrant workers, play an important role in reducing poverty. Private transfers as percentage of income and consumption is higher for the poor compared to the non-poor in both rural and urban areas. Compared to the non-poor, a higher percentage of the poor are engaged in the informal sector. On the other hand, employment in the informal sector is inversely related to the level of education. Thus there is an interlinkage between education (and perhaps, skills as well), work in the informal economy and poverty.

The above implies that a reduction in unemployment and underemployment, a shift of workers away from agriculture to other sectors with higher productivity, from self-employment to wage-employment, and from the informal to the formal economy would reduce poverty. Education also contributes to poverty reduction. Moreover, the existence of gender inequalities in the labour market, as indicated by women being less economically active than men and being employed more in low-wage occupations, implies a greater risk of women being poor. This issue would need to be addressed.

Policies for poverty reduction through more employment-intensive growth have to start from a focus on achieving faster economic growth, although growth per se would not be enough. For achieving higher growth, the rate of investment has to increase. Given the low rate of investment and the macroeconomic stability that has been attained by the country, it should be possible to raise investment. Increase in public investment, especially in infrastructure would be desirable from the point of view of encouraging growth of private investment.

The pattern of economic growth will also need to change so that the structure of the economy changes in a way that will enhance the rate of poverty reduction. It is important for workers to be able to move from lower productivity sectors (e.g., agriculture and the informal economy) to higher productivity ones like manufacturing and services. Thus it would be necessary to achieve higher growth in manufacturing and services. Within manufacturing, a higher growth of more labour-intensive sub-sectors is needed. Simultaneously, measures are needed to promote improvement in labour productivity in activities where the poor are concentrated (primarily agriculture, rural non-farm activities, and the urban informal sector). Moreover, given the role of the private sector in creating employment, the government must seek to encourage further growth of this sector including measures to facilitate the development of small and medium sized enterprises (SMEs). While a number of reforms appear to have made the labour market significantly more flexible, both in terms of “hiring and firing” and wages, it would be important to ensure that flexibility in the labour market is combined with necessary protection for workers.

In addition to a favourable policy environment, an important factor is the ability of the poor to integrate into the growth process in terms of accessing the jobs that are created and benefit from these. That ability may be influenced by a variety of factors including the levels of education and skills of the workforce, their access to productive assets including microfinance, and labour market institutions and social norms (which, in turn, may have a bearing on discrimination and integration of the poor into the labour market), aspects which must all be part of the policy framework if successful and sustainable poverty reduction is to be achieved.



## Chapter 1. Introduction

With the collapse of the Soviet Union, a number of the CIS countries embarked on a process of transition from planned to market oriented economic system. Kyrgyzstan was one of them. While there were differences in experience between the countries, some common features of the transition were sharp decline in economic growth during the initial years of transition, changes in the structure of the economies, rising unemployment, falling real wages and increasing levels of poverty. Kyrgyzstan was no exception.

With the introduction of economic reforms in 1992, Kyrgyzstan adopted a strategy of rapid transition, moving simultaneously to a democratic system of governance and a market-based economy. On the economic side, reforms were undertaken on a wide front including privatization of state-owned enterprises, restructuring of enterprises, trade and exchange system, and reforms of financial institutions. The immediate impact of the changes was negative, with the GDP plummeting by about 60 per cent in four years (from 1992 to 1996), and the overall unemployment rate increasing sharply and wage rates (in manufacturing) falling. The incidence of poverty also rose. The sectoral composition of the economy changed significantly with a sharp decline in the contribution of manufacturing and an increase in the share of agriculture<sup>1</sup>.

However, the resumption of economic growth did not immediately result in an improvement in the poverty situation. Indeed, poverty continued to increase till 1999, and there was a sharp increase in inequality during the 1990s (Torm, 2003). The incidence of poverty started declining in 2000; and since then has maintained the trend despite the fluctuation in economic growth in some years (e.g., in 1998-99 and 2002).

Recent studies<sup>2</sup> on developing countries show that while a high rate of economic growth is a necessary condition for poverty reduction, it is not sufficient; the pattern of growth is critical. And in that respect, labour market outcomes (i.e., the growth of productive employment and real wages of workers) are found to be important in translating the benefits of economic growth into poverty reduction. A cross-country study (Islam, 2006a) found positive relation between poverty reduction and the employment intensity of growth in manufacturing (latter measured by the elasticity of employment with respect to output). Given the recent experience of Kyrgyzstan - first, the continuation of the rising trend in poverty despite the resumption of growth in the second half of the 1990s and then the reduction in poverty along with economic growth - it would be interesting to examine the linkage between economic growth, employment and poverty reduction in the country.

The purpose of the present study is to analyse the pattern of economic growth that has unfolded in Kyrgyzstan with a particular focus on the employment and labour market outcomes and on the linkage between growth, employment and poverty reduction. Such an analysis would bring out the role of productive employment in making economic growth pro-poor.

The report is organized as follows. Chapter 2 presents the analytical framework that is used to analyze the linkage between economic growth, employment and poverty reduction. Chapter 3 provides an overview of economic growth, poverty and inequality in the country since its independence. Chapter 4 presents a picture of the employment and labour market situation. While a macro level analysis of the linkage between economic growth, employment and poverty reduction is provided in Chapter 5, the linkage between employment and poverty is analysed in Chapter 6 with the use of household level data. Chapter 7 outlines a strategy for employment intensive growth as a route out of poverty.

<sup>1</sup> For details, see Torm (2003).

<sup>2</sup> See, for example, Islam (2006 b) for a number of country studies as well as cross-country studies.



## Chapter 2. Economic Growth, Employment and Poverty Reduction: A Framework of Analysis<sup>3</sup>

Conceptually, the linkage between output growth, employment and poverty can be analysed at both macro and micro levels. At the macro level, the linkage between poverty in its income dimension and output growth can be conceptualised in terms of the average productivity of the employed workforce which, in turn, gets reflected in low levels of real wages and low levels of earnings from self-employment. At the micro level of a household, the linkage between poverty and employment operates through the type and productivity of economic activities in which earning members of a household are engaged, the level of human capital of the members of the workforce, the dependency burden that limits participation in the workforce, and the availability of remunerative employment (the latter, in turn, is associated with the poverty reduction and growth strategy that is pursued by a country)<sup>4</sup>.

A low average productivity of the workforce can be due to deficiency of capital relative to labour and the use of backward technology. The role of productive employment in transforming economic growth into poverty reduction in that kind of situation can be conceptualised in terms of the following process. When high rates of economic growth lead to sustained increase in productive capacity, *productive* employment opportunities should be generated. That, in turn, would allow for a progressive absorption and integration of the unemployed and underemployed into expanding economic activities with higher levels of productivity<sup>5</sup>. In the process, the poor would be able to achieve higher labour productivity and increase their incomes in existing occupations or shift to new occupations involving higher levels of productivity, skills, and/or better technology. The results of the process described above could be reflected in: (i) improved productivity of various sectors and occupations, (ii) a shift in the structure of employment towards occupations with higher levels of productivity, and (iii) increases in real wages, earnings from self-employment, and earnings from wage-employment.

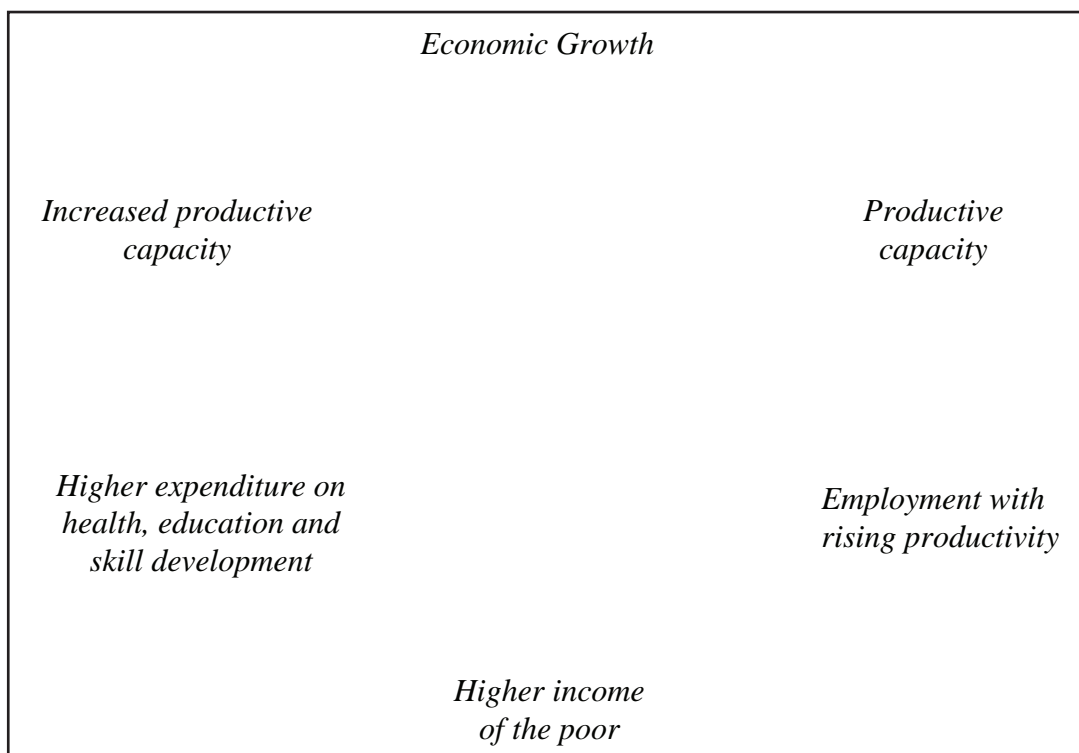
Higher levels of earnings resulting from the process mentioned above would enable workers to spend more on education and skill formation of their children, thus raising the productive capacity of the future workforce, and creating necessary conditions for achieving higher levels of economic growth. The process would thus complete the virtuous circle of economic growth leading to poverty reduction via growth of employment with rising productivity, and reduced poverty creating the possibility of further increases in productivity and higher rates of economic growth (see Figure 2.1).

<sup>3</sup> This chapter draws substantially on Islam (2006a).

<sup>4</sup> The processes described here have their roots in empirical evidence. See, for example, the country studies in Islam (2006).

<sup>5</sup> The emphasis is put on *productive* employment and the expansion of economic activities with *higher* levels of productivity because the expansion of any type of employment may not be effective in raising incomes and reducing poverty unless earnings can increase substantially simply through increased quantity of employment.



**Figure 2.1: Virtuous circle of links between growth, employment and poverty reduction**

The conceptual framework outlined above for analysing the linkage between economic growth, employment and poverty basically follows a demand-supply approach. The variables that are expected to influence incomes of the poor from the demand side include employment intensity of growth, shifts in the employment structure towards higher productivity sectors, technology, creation of assets for the poor, etc. From the supply side, an important factor is the ability of the poor to integrate into the process of economic growth and get access to the jobs that are created. Levels of education and skills of the workforce are amongst the key variables that determine the ability of the poor to integrate into and benefit from the growth process.<sup>6</sup>

A summary indicator of the employment growth that is associated with a given output growth is provided by the employment elasticity of output growth (for overall GDP, measured as the proportionate change in employment divided by the proportionate change in GDP during a given period). This implies that employment elasticity could be taken as a surrogate for employment intensity of growth. But employment elasticity reflects the inverse of labour productivity. While an elasticity higher than unity implies decline in productivity, a lower than unity elasticity means that employment expansion is taking place along with an increase in productivity. A rise in productivity would lead to a reduction in employment elasticity. Therefore, raising employment elasticity in individual activities cannot be the objective as that would mean a further lowering of productivity in economies that may already be characterized by widespread low-productivity employment.

Two further questions need to be raised in the context of levels as well as changes in employment elasticity. Regarding the level, the desirability of an elasticity of lower than unity has been mentioned above. How much lower than unity it should be (i.e., the right order of magnitude for the elasticity of employment) depends on the level of development and the relative factor endowment of the country concerned. The magnitude would also have a good deal of sectoral variation. The overall elasticity being a weighted average of sectoral elasticities, greater allocation of investment in more labour-intensive sectors and higher growth

<sup>6</sup> See, also, ILO (2003), for promoting such an approach to poverty reduction. There are, of course, other factors that influence the ability of the poor to participate in the growth process; access to capital and productive assets is important in that respect.

rates in such sectors could yield a situation where the overall employment elasticity increases (even with declining elasticities in some sectors). And the result could be higher employment growth with given GDP growth or employment-intensive growth.

The above discussion can be summed up as follows. While a high rate of economic growth is the starting off point of a process of poverty reduction on a sustained basis, the second factor that needs to accompany growth is a high degree of employment intensity (without of course compromising on increases in productivity in individual sectors/activities). Another important factor is the ability of the poor to integrate themselves into the process of economic growth and get access to the jobs that are created (Osmani, 2006); and that, in turn, may be influenced by a variety of factors, e.g., levels of education and skills of the workforce, their access to capital and other productive assets, labour market institutions and social norms (e.g., segregated labour markets, and discrimination), etc

Even after employment elasticity is estimated, its link to poverty remains to be examined. In a cross-section study with data from a reasonable number of countries, it may be possible to examine such linkage. Doing this for a single country would require appropriate time series data on the incidence of poverty as well as estimates of employment elasticity. When such data are not readily available, one should see if the level and direction of change in employment elasticity is appropriate from the point of view of its level of development, incidence of poverty and the existence of surplus labour. Such an analysis can be done by referring to the experience of countries that are regarded to have demonstrated success in achieving employment-intensive pro-poor growth and in either abolishing poverty altogether or in reducing it substantially.

The analysis of the summary indicator of the employment-intensity of economic growth as indicated above would need to be supplemented by a more detailed examination of whether and how growth has led to structural changes in an economy, which have (or have not) benefited the poor. In that regard, the first important thing to examine would be the sectors and occupations where the poor are concentrated and what the trends in productivity and earnings in various occupations are like. The second important task would be an examination of whether there are discernible shifts in the structure of employment towards occupations with higher productivity. The third important element in the channel of transmission of benefits of growth to the poor would be real wages and earnings of wage-paid workers and real earnings of the self-employed. An examination of the linkage between real wages and productivity would enable one to examine whether the benefit of growth has reached the poor.

The above discussion focused basically on a macro level analysis of how economic growth could contribute to poverty reduction through increases in employment in higher productivity sectors/occupations and a rise in real wages. A similar analysis could be carried out at the micro (household) level to examine the impact of employment and labour market related variables on poverty. Conceptually, it is possible to think of a number of such variables, which could influence the probability of a household being poor in terms of inadequate income. The variables could be asset-related (e.g., the possession of income-generating assets), human capital related (e.g., education and skill levels of the working members of a household) or employment related (e.g., the sector and quantity of employment of the workers, wages, productivity, etc.). Once necessary data are available for quantifying variables of the kind mentioned above and for identifying whether a particular household belongs to the poor or non-poor category, standard econometric methods (e.g., the estimation of a PROBIT model) can be applied to examine the influence of employment and labour market related variables on the probability of a household being poor. Although such methods have not been applied in the present report, some relevant data have been examined from the point of view of linkage between employment and poverty.



## Chapter 3. Economic Growth, Poverty and Inequality: An Overview

### 3.1 Track of Reforms

The Kyrgyz Republic was among the leading transition countries to promote rapid reforms in building a market economy. During the first stage of reforms (1993-1994), the Kyrgyz government ended most price controls, created a national currency, introduced a liberal trade regime, and eliminated most capital controls. The pace with which market reforms were promoted during the first decade of the transition was high compared to leading transition countries in Eastern Europe. But the speed of reforms slowed down later. The most critical reforms currently lie in the areas of governance, large-scale privatization and the development of the private sector.

#### *Trade, capital and exchange rate liberalization*

The Kyrgyz Republic was the first country among the former Soviet Union members to introduce a national currency, the *som*, in May 1993. With IMF program support, the country declared a liberal exchange rate regime and the abolishment of trade and capital controls. As a successful follow-on to the initial reforms, the Kyrgyz Republic was the first among the former Soviet countries to become a member of the WTO, although this membership did not provide substantial benefits in terms of expanding exports. Currently, the import tariff of the Kyrgyz Republic is one of the lowest among CIS countries, reflecting the liberal trade regime. According to a study<sup>7</sup> by the Asian Development Bank (ADB) on regional trade, the average import tariff rate was equal to 5.1 per cent, which is considerably lower than in neighbouring countries.

**Table 3.1: Custom Tariffs in Selected CIS Countries**

	Azerbaijan	Kazakhstan	Kyrgyz Republic	Tajikistan	Uzbekistan
Number of tariff bands	6	10	5	4	4
Maximum rate (%)	15.0	100.0	15.0	15.0	30.0
Non-weighted average rate (%)	5.7	7.4	5.1	7.5	14.5

**Source:** Adapted from ADB, Central Asia: Increasing Gains from Trade Through Regional Cooperation in Trade Policy, Transport, and Customs Transit, 2006

#### *Privatization*

The privatization of small-scale enterprises, mainly in the services sector, was one of the successful reforms in the early years of transition. Between 1991 and 1994, approximately 4,700 enterprises – including small trade outlets and retail and service establishments, were privatized. In the second phase (1994-95), approximately 1,300 medium- and large-scale enterprises, particularly in industry, transport, and construction, were privatized. In 1996-97, the government completed sale of the state shares of 600 enterprises. By the end of 2003, 97 per cent of all enterprises were in private hands. Kyrgyzstan has yet to privatize several key sectors of the economy, including mining, energy, gas, and telecommunications.

<sup>7</sup> ADB, Central Asia: Increasing Gains from Trade Through Regional Cooperation in Trade Policy, Transport, and Customs Transit, 2006

*Reforms in the agricultural sector*

Wide-ranging sectoral reforms occurred during the 1990s<sup>8</sup>. The land reform program was an important step and is considered as a success case among CIS countries. By 2002 the transfer of land from state farms to peasant farms had been largely completed with just 25 per cent of arable land still in the hands of the state. (Land was distributed based on a family size and was granted for 99 years). Land trading was allowed in 2001, although the land market was not active with sales/purchase transactions driven mostly by economic distress and migration. By the end of the 1990s, the incentive framework for agriculture was largely liberalized. Existing studies on the analysis of agricultural marketing chains suggest that markets are operating reasonably efficiently and freely in the Kyrgyz Republic, with the exception of some inputs\outputs. Small agricultural activities enjoy a low level of taxation paying only a unified land tax, however, medium and large agri-business and agro-processing enterprises are subject to enterprise taxation. Despite the progress made with reforms, some areas in the agricultural sector are still to be improved, mostly relating to improvements in agricultural infrastructure and support services, such as irrigation, rural finance and marketing.

*The financial market and the banking sector*

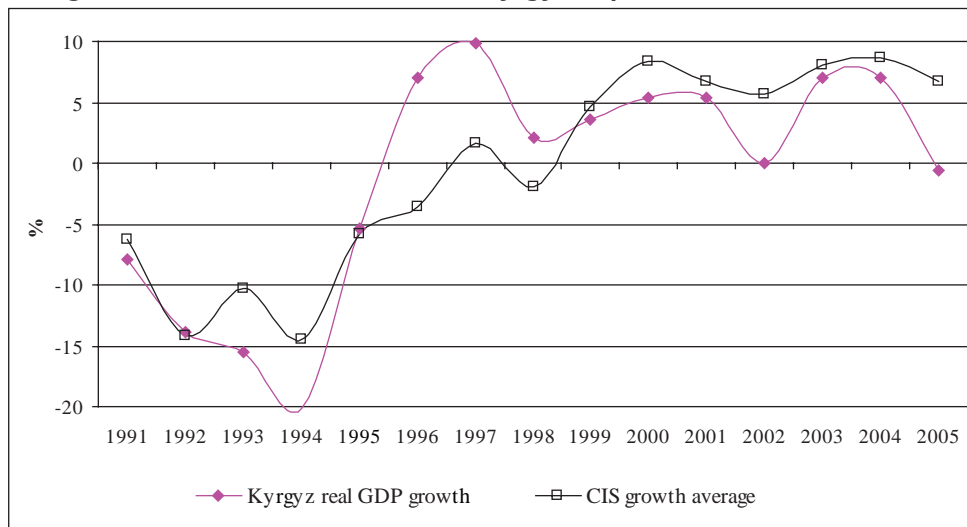
Banking reform was initiated in 1991 with the introduction of several laws. The independent National Bank of the Kyrgyz Republic (NBKR), the country's central bank, is responsible for monetary and exchange rate policies as well as for banking supervision. The Kyrgyz banking system has experienced several waves of collapses due to the inefficiency of new banks as well as and existing banks from the Soviet regime. Nevertheless, the banking system has undergone serious reforms aimed at building a two-tier system and these reforms have been termed "successful" by the European Bank for Reconstruction and Development (EBRD). By the end of 2004 nineteen commercial banks operated in the country, a substantial part of which are owned by foreign investors. Compared to neighbouring countries, such as Kazakhstan, the Kyrgyz banking system remains a weak player in promoting economic growth. According to a World Bank study in 2006, bank assets made up only 19 per cent of GDP compared to 49 and 38 per cent in Kazakhstan and Uzbekistan, respectively. Moreover in terms of interest rates, the difference between lending and deposit rates, was around 23 per cent compared to 9 and 3.5 per cent in Kazakhstan and Uzbekistan<sup>9</sup>. Non-banking institutions, such as micro-lending and credit institutions have been more successful in terms of the development and delivery of services to the large rural population. Other financial market institutions such as insurance and pension funds, have not experienced visible development.

**3.2 Economic Growth and the Structure of the Economy since Independence**

Kyrgyz transition growth replicates the economic growth pattern of the other former Soviet countries. From 1990 to 1995 there was a sharp reduction in output and income throughout all CIS economies coinciding in most countries with a rapid rise in inequality in the distribution of income. From 1995-1997 growth became positive in most CIS countries.

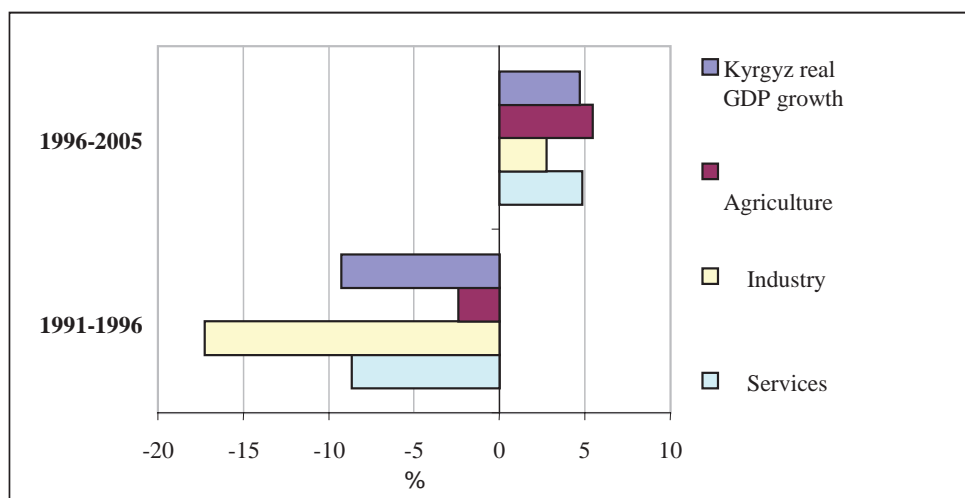
<sup>8</sup> World Bank (2004), Kyrgyz Republic: Agricultural Policy Update.

<sup>9</sup> World Bank (2006), Preliminary Banking and Finance Sector Note for the Joint Country Support Strategy 2007-2010.

**Figure 3.1: Real GDP Growth in the Kyrgyz Republic and CIS, 1991–2005**

Source: National Statistics Committee, statistical publications for various years; Statistical Committee of the CIS ([www.cisstat.com](http://www.cisstat.com))

For analytical purposes, the period since Kyrgyzstan's independence is divided into two sub-periods. The first period covers 1991 to 1996 during which the country experienced a strong contraction in output as in all CIS countries. The second sub-period covers the recovery period from 1996 to 2005, when economic growth resumed.

**Figure 3.2: Kyrgyz Republic: Two periods of Growth**

Source: National Statistics Committee, statistical publications for various years World Bank quarterly notes for various years ([www.worldbank.org.kg](http://www.worldbank.org.kg))

The beginning of the transition period was characterized by a strong contraction in output. Between 1991 and 1995 the cumulative decline in GDP amounted to 50 per cent of the 1990 level, due to economic restructuring and the loss of direct transfers from the central union budget<sup>10</sup>. The decline itself and the additional impact of reforms during the early years of transition resulted in hyperinflation, rising unemployment, falling real income and rising poverty. However, since 1996 GDP growth has resumed.

The pace of economic growth has been uneven since 1996. In 1996-97 growth was rapid, but concentrated mainly in agriculture and manufacturing. Growth in the following two years may be characterized as anaemic due to the effects of the financial crisis in Russia in 1998. The negative effects of this financial crisis were devastating for the Kyrgyz economy leading to a rise in inflation of up to 36 per cent in 1999, a twofold depreciation of the exchange rate

<sup>10</sup> World Bank (2003), Kyrgyz Republic: Enhancing Pro-Poor Growth.

and an increase in the current account deficit of up to 23 per cent of GDP. This, in turn, led to falling incomes and a decline in exports.

**Table 3.2: Kyrgyz Republic: Key Macroeconomic Indicators**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<u>GDP and prices</u>															
GDP real growth (%)	-7.9	-13.9	-15.5	-20.1	-5.4	7.1	9.9	2.1	3.7	5.4	5.3	0.0	7.0	7.0	-0.6
Agriculture	-8	-3	-9	-9	-2	15	12	3	8	3	7	3	3	4	-4
Industry	-7	-26	-23	-37	-12	3	20	-2	-4	10	5	-9	13	3	-11
Services	-2	-13	-15	-17	-4	0	1	4	3	5	4	4	7	12	8
GDP per capita dollar (at avg x-rates)	...	503	234	244	325	392	374	343	255	279	308	322	381	434	473
Gross domes.investments (% of GDP)	15	20	12	9	18	25	22	15	18	20	18	18	12	14	...
Public	...	...	9	10	8	4	4	6	10	8	5	6	5	5	...
Private	...	...	4	3	12	18	9	7	6	10	12	11	9	8	...
Inflation (%, end of period, CPI)	...	2 033	930	62	32	35	13	17	40	9.6	3.7	2.3	5.6	2.8	4.9
Exchange rate (som/\$, avg)	...	...	5	11	11	13	17	21	39	48	48	47	44	43	41
<u>External Sector</u>															
Current account balance (% of GDP)	...	-6	-9	-8	-16	-25	-8	-23	-15	-6	-1	-3	-4	-3	-8
Exports (mln US\$, f.o.b.)	...	285	340	340	409	531	631	535	463	511	480	498	588	733	676
Imports (mln US\$, c.i.f.)	...	396	495	462	595	894	725	870	614	559	472	640	716	941	1 108
External Debt (% GDP)	...	...	30	40	51	63	77	90	134	125	110	111	101	95	83
FDI (mln \$)	...	...	10	38	96	47	83	109	44	-2	5	5	46	175	60
<u>Government Budget (% of GDP)</u>															
Revenues and grants	40	21	24	26	22	21	20	22	20	18	20	23	23	23	25
Expenditures	35	38	38	38	38	30	29	33	32	28	26	28	28	27	29
Fiscal Balance (accrual)	5	-18	-14	-12	-16	-9	-9	-11	-12	-10	-6	-5	-5	-4	-4

Source: National Statistical Committee, National Bank, Ministry of Finance and Economy, World Bank quarterly notes for various years ([www.worldbank.org.kg](http://www.worldbank.org.kg))

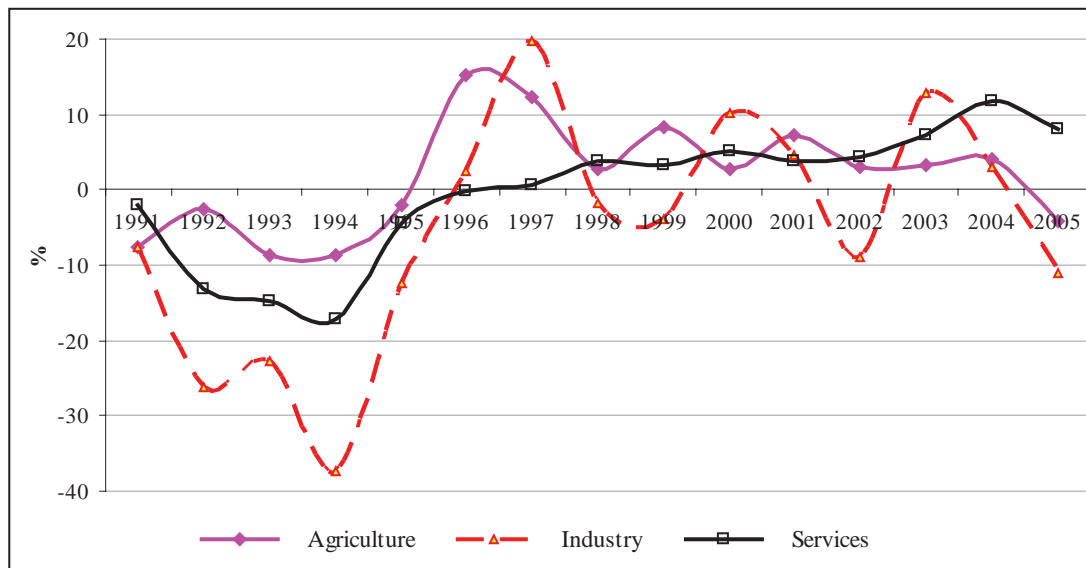
Compared to in the first period (1996-97) when GDP growth was accompanied by higher rates of investments, GDP growth in 2000-2001 was more stable and relatively broader taking place in traditional leading sectors such as agriculture and mining, as well as in construction, power, trade and catering. Moreover during the latter period, economic growth was supported by macroeconomic stability in terms of reduced fiscal deficits and low, single digit inflation.

In 2002 Kyrgyz GDP growth reached around zero due to negative growth in the mining and power sectors. Overall industry growth fell by 9 per cent due to a decline in gold production and low external demand for electricity. A solid growth rate and an increased importance of the services sector along with moderate growth in agriculture meant that GDP did not fall below its level in 2001.

In the two following years (2003-04), the Kyrgyz economy underwent a period of strong growth (7 per cent per annum) driven mainly by the services sector and the non-gold industry sectors<sup>11</sup>. Compared to agriculture and industry, services sector demonstrated sustainable growth pattern over several years and becomes more important sector for employment growth and poverty reduction.

<sup>11</sup> The non-gold industry is mainly represented by the energy sector, food production, construction materials, textile and electronics.



**Figure 3.3: Kyrgyz Republic: Composition of GDP Growth, 1991–2005**

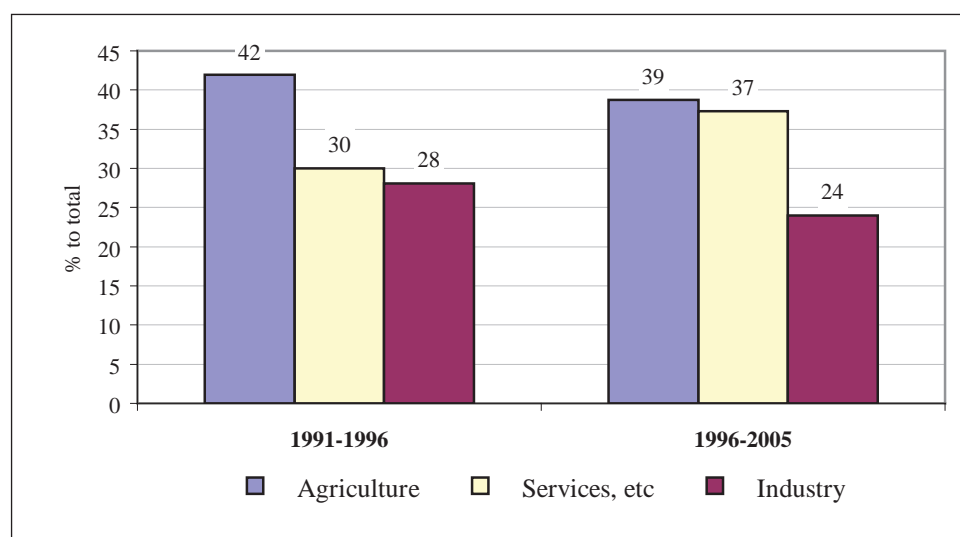
Source: National Statistics Committee, statistical publications for various years

In 2005 the country underwent serious political turmoil, which led to a change of President and Government. Despite the peaceful Presidential election, the political environment remained very fragile, with negative effects on the economy. The political instability, further aggravated by a decline in gold production and rising oil prices led to a fall in real GDP by 0.6 per cent. Economic performance in other production sectors was also sluggish. A positive sign of economic development was the continued strong growth in the service sector. Political uncertainties also led to higher price increases than anticipated, yet the authorities managed to keep the exchange rate stable.

Overall, the recovery pattern of the Kyrgyz economy in the last ten years has been uneven with an average growth rate of 4.7 per cent during the period 1996–2005. While agriculture and industry were the leading sectors in the initial years of this period, the importance of the services sector in driving economic growth is becoming more evident in recent years. Nevertheless, the economy has undergone several external and internal shocks and remains highly vulnerable.

As indicated in Figure 3.4, deindustrialization has led to the increased dominance of agriculture and services respectively making up 39 per cent and 37 per cent of GDP in 1996–2005. However, as a result of the transition and economic restructuring processes, these sectors remain vulnerable to natural and external shocks leading to the unsustainability of economic growth.



**Figure 3.4: Kyrgyz Republic: Composition of GDP**

Source: National Statistics Committee, statistical publications for various years;

### 3.3 The Poverty and Inequality Situation in the Kyrgyz Republic

During the early years of economic reforms, macroeconomic instability, declines in production and loss of jobs due to the structural reforms seriously affected the living standards of the population and led to an increase in poverty incidence. The situation started to improve after 1999. Table 3.3 demonstrates the trend in poverty during the period 1996-2004 as measured by two approaches: consumption per capita and expenditure per capita aggregates. The existence of two poverty measures is explained by the fact that from the beginning of poverty assessment in 1996, the National Statistics Committee applied expenditure aggregate as the official measure of poverty, while the World Bank used the consumption-based measurement of poverty (though both aggregates are calculated by NSC)<sup>12</sup>.

According to the expenditure aggregate the share of the population living below the poverty line was 43.5 per cent in 1996, peaking at 55.3 per cent in 1999, partly due to the negative effects of the Russian financial crisis. Then it started declining, and went down to 39.3 per cent in 2003. According to the consumption aggregate measure (see Box 3.1 for definition) there has been a continuous decline in the poverty incidence from 62.5 per cent in 2000 to 46 per cent in 2004 (equivalent to 2.3 million people). There has also been very good progress in the reduction of extreme poverty which declined from 20 per cent in 2000 to 13 per cent in 2004. According to a World Bank report in 2007 (see World Bank, 2007), the incidence of poverty based on the consumption measure went down further in 2005 to 43.1 per cent. It may, however, be noted that according to that report, between 2004 and 2005, the incidence of poverty increased in urban areas and declined in rural areas.

<sup>12</sup> An income based measurement of poverty is not applied by the NSC due to the low quality of data. However, some income based indicators, including the Gini index, can be calculated and used in the analysis.

**Box 3.1: Definition of the Poverty Line and Poverty Data Sources**

The *poverty line* in the Kyrgyz Republic is constructed using the cost-of-basic-needs approach and is composed of the *food poverty line* and the *non-food poverty line*. The *food poverty line* measures extreme poverty and, is set at the consumption level of the minimum caloric requirements, based on calculations of the cost of a food basket that provides sufficient daily caloric requirements, reflecting the actual dietary pattern of the population. For example, for 2004 food poverty line calculated using KIHS was equal to 15.04 soms per day, or around 5,490 soms per year.

Since objective standards for non-food needs do not exist, an allowance for non-food consumption is calculated from the household data, by calculating the share of non-food in total consumption for those households whose food consumption is close to the extreme poverty line. Since food consumption for these households are at minimum, it is assumed that any non-food expenditures made are critical as they are preferred over increased food consumption. Once the share of non-food consumption is estimated, the value of the food poverty line is increased so that the share of non-food in consumption is equal to that found among the reference households. The value of the second, complete or *absolute poverty line*, is the sum of the food poverty line and the non-food allowance. Based on the KIHS, the complete poverty line for 2003 is estimated as 23.92 soms per day, which includes 62.9 per cent of food component (15.04 som) and 37.1 per cent non-food component (8.88 som). (*World Bank, Poverty Profile Update 2003 (draft)*).

The first **data source for poverty analysis** in Kyrgyzstan goes back to 1993, when the World Bank conducted the Kyrgyz Poverty Monitoring Survey (**KPMS**) by rounds in 1993-98. This survey was conducted on an irregular basis covering between 2,000-2,700 households and in later rounds the survey represented the oblasts level. The Household Budget Survey (**HBS**) collected information on household expenditures and income on a monthly basis, initially from a 'quota' sampling of 1000 enterprise workers, farmers and pensioners, increased in 1997 to a more population-based sample of 2000 households, and further expanded to 3,000 households to include oblasts representative indicators. One of the benefits of HBS is the possibility to use panel data for poverty analysis.

The Kyrgyz Integrated Household Survey (**KIHS**) was introduced in 2003 and covers around 5,000 households based on a pure random sample of the population. KIHS collects data on a quarterly basis, thus imposing a smaller burden on participating households. The KIHS questionnaires include household characteristics, expenses on food and non-food items, housing conditions, and a section on the estimation of unemployment data. The survey presents not only quantitative indicators, but also qualitative ones (such as access to drinking water, services of health care). Due to the larger sample size and improved sample design, the KIHS has enhanced the quality of data for poverty monitoring and policy analysis.

Since poverty data for various years are based on different household surveys, interpretation of the trends must be carried out with caution. All the surveys (KPMS, HBS and KIHS), used their own methodology for building poverty lines and welfare aggregate. While the general approach in constructing poverty lines and poverty aggregate was comparable, due to the different sizes and features of the surveys, the poverty data may not be strictly comparable.

**Table 3.3: Poverty Incidence: Population below the Poverty Line (%)**

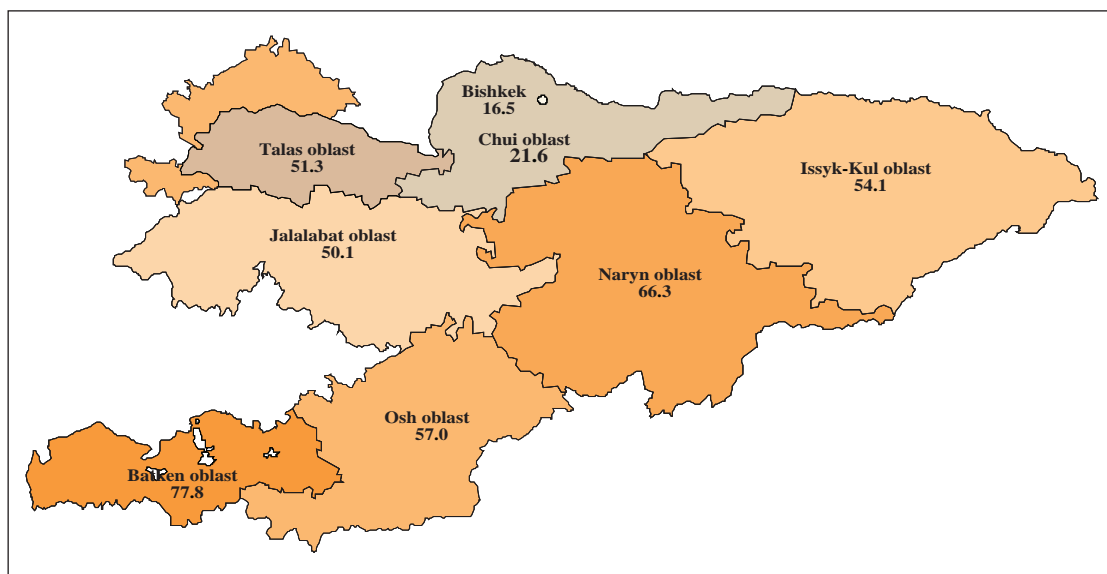
	Consumption aggregate			Expenditure aggregate		
	Total	Urban	Rural	Total	Urban	Rural
1996				43.5	30.3	49.6
1997				42.9	22.2	55.3
1998				54.9	42.2	62.4
1999				55.3	42.4	60
2000	62.5	53.3	67.4	52	43.9	56.4
2001	56.4	45.4	62.3	47.6	41.2	51
2002	54.8	44.5	60.3	44.4	39.6	47
2003	49.9	35.7	57.4	39.3	26.6	46.2
2004	45.9	28.3	55.5			

Source: KPMS (1996-1998), HBS (1999-2003), KIHS (2003-04).

The poverty line construction is explained in Box1.

Despite the decline in poverty, the level remains high, particularly in rural areas. Based on the consumption approach, it is estimated that over 75 per cent of the poor (1.8 million people) are living in rural areas. Moreover, by the same measurement, a rural/urban disaggregation of poverty shows that urban poverty declined faster than rural poverty in 2000-2004, by 25 per cent (from 53.3 to 28.3 per cent), compared to 12 per cent (from 67.4 to 55.5 per cent). This discrepancy in the trend also indicates that the concentration of poverty in the rural areas increased. Consequently, the number of the poor residing in rural areas increased from 71 per cent to 78 per cent of the total number of poor. The capital city of Bishkek and other urban areas have experienced particularly strong reductions in poverty mainly due to solid and sustainable growth in the service sector, which is more developed in urban areas.

**Map 3.1: Poverty incidence by Oblasts: Population below the poverty line in 2004 (%)**



Source: KIHs 2004

Where are the poor located? In 2004 about 78 per cent of the absolute poor and 75 per cent of the extreme poor<sup>13</sup> were residents of rural areas making these areas the principal focus of poverty reduction programs in the Kyrgyz Republic. Poverty also has a regional concentration: its incidence was highest in Batken oblast (77.8 per cent) followed by Naryn (66.3 per cent) (Map 3.1). The headcount rate of poverty in Batken oblast was more than 69 per cent higher than the national average in 2004. The least poor oblasts are the capital city (Bishkek) and Chui due to the highly developed services sector and an abundance of land. Although ownership of land is relatively equally distributed, in recent years land has become concentrated within wealthy households. The poor households generally have larger families than the non-poor and tend to be characterised by a lower level of education, although the difference is not significant. Moreover, the poor are more dependent on subsistence earnings as opposed to cash income.

According to international poverty lines, there also seems to be a general improvement in the poverty incidence. Table 1.4 presents poverty rates for 2003 and 2004 based on international PPP US dollars<sup>14</sup>. As it can be seen from the table, a relatively low percentage of households live below the 1\$ poverty line, however with a slight increase between 2003 and 2004. However, according to the 2\$ poverty line, the picture is more interesting showing a decline in the poverty level by almost 9 per cent from 2003 to 2004. Keeping in mind the figures from table 3.3 above, it seems that a high concentration of households have a consumption level slightly lower or equal to this poverty line. Progress may also be seen if we look at the 4\$ poverty line, by which the poverty incidence declined by 5 per cent from 2003 to 2004. Thus

<sup>13</sup> If measured by the consumption approach.

<sup>14</sup> Data for earlier years are not shown partly because of the incomparability of KIHs based welfare measures with the HBS based indicators. The second reason is the revision of the PPP conversion factor which was applied to international poverty lines starting 2003.

according to both national and international poverty lines, the Kyrgyz Republic has made significant progress in poverty reduction, yet the issue of equal distribution of growth remains important.

**Table 3.4: Poverty Incidence by International Poverty Lines, 2003–2004 (%)**

	2003	2004
\$1.075/day/capita	3.1	3.4
\$2.15/day/capita	40.1	31.3
\$4.30/day/capita	81.2	76.1

Source: NSC, KIHS for 2003-04 (consumption aggregate)

Generally, inequality as measured by the Gini coefficient saw small improvements during 2000-2004 as shown in Table 3.5, which presents three types of Gini coefficients. Whereas the consumption based measure of inequality shows a worsening situation from 2000 to 2004, driven primarily by increased inequality in rural areas. According to the other two measures of the Gini coefficient, there were improvements over this period, although judging by the consumption based Gini coefficient this trend is likely to have been reversed in 2004<sup>15</sup>.

**Table 3.5: Inequality Measured by the Gini Coefficient, 1999–2004**

	1999	2000	2001	2002	2003	2004
Consumption aggregate	...	0.30	0.29	...	0.31	0.33
Expenditure aggregate	0.37	0.33	0.32	0.33	0.30	...
Income aggregate	0.44	0.45	0.44	0.42	0.41	...

Source: NSC, HBS for 1999-2003; KIHS for 2003-04 (only for the consumption based Gini coefficient).

<sup>15</sup> With the introduction of the KIHS in 2003, NSC adopted the consumption based measurement of inequality as the official one. Although expenditure based welfare aggregate is also being calculated, NSC publishes only the consumption based inequality measure.



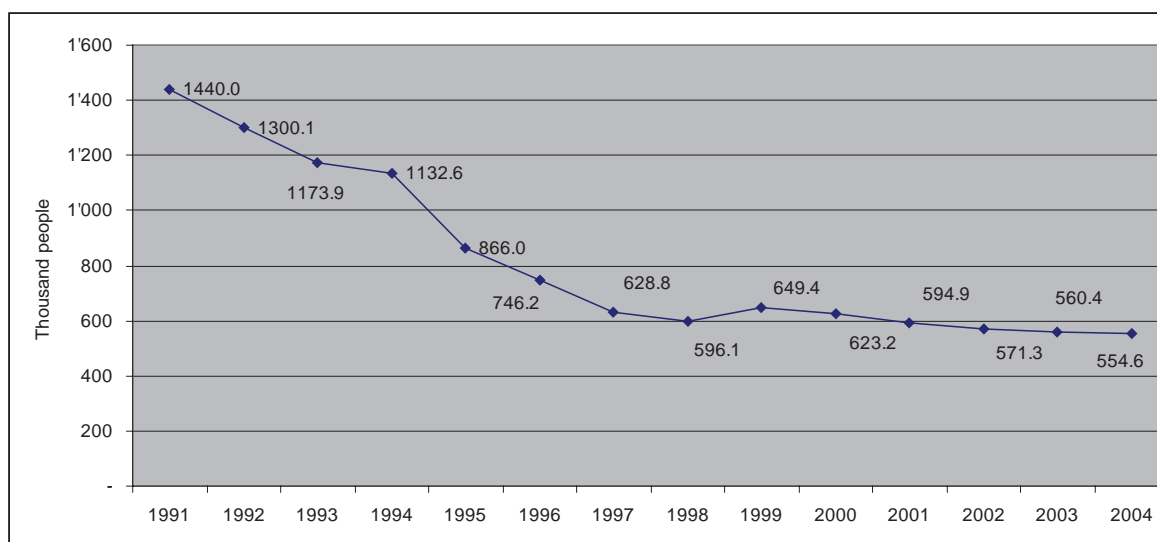
## Chapter 4. Employment and labour market

Employment and labour market outcomes constitute important components in analysing changes during Kyrgyzstan's transitory period. In this section, the analysis of the employed working age population and the labour market is based on data for the period from 1991 to 2004, produced by the National Statistical Committee of the Kyrgyz Republic. Moreover, data from the Kyrgyz Integrated Household Survey for 2004 (Labour Force Module - LFM<sup>16</sup>) has been used in order to assess the unemployment and underemployment situation in the country. The classification of underemployment is based on the number of hours of employment by working age population during one week.

### 4.1 General Overview of Unemployment in Kyrgyzstan

During the period of planned economy unemployment was a rare phenomenon, due primarily to the extensive methods of economic development which provided sufficient jobs to meet the demand. Naturally, frictional unemployment existed as individuals moved in between jobs, though the duration was short. However, during the transition to a new economic course, corresponding to the period under review (1991-2004), the employment situation has drastically changed. Since 1991, the number of jobs has declined steadily as a consequence of the desire of the owners of privatized enterprises to get rid of the surplus labour force. In view of the difficulties faced during the transitory period the Government has had to reduce the number of staff in administrative institutions as well as workers in the social sphere, causing massive dismissals. As Figure 4.1 shows, the number of staff of enterprises, organizations and institutions that had the status of a legal entity, fell from 1440 to 554.6 thousand from 1991 to 2004, representing a decline of 61.5 per cent.

**Figure 4.1: Number of staff in Enterprises, Organizations and Institutions, 1991–2004**



Source: NSC, estimate of balance of labour resources

Since the early 1990s the unemployed population in the Kyrgyz Republic began to grow, as the number of available jobs in the labour market fell short of requirements of an increasing active population. At the beginning of the transitory period the authorities began to officially register the amount of unemployed people.

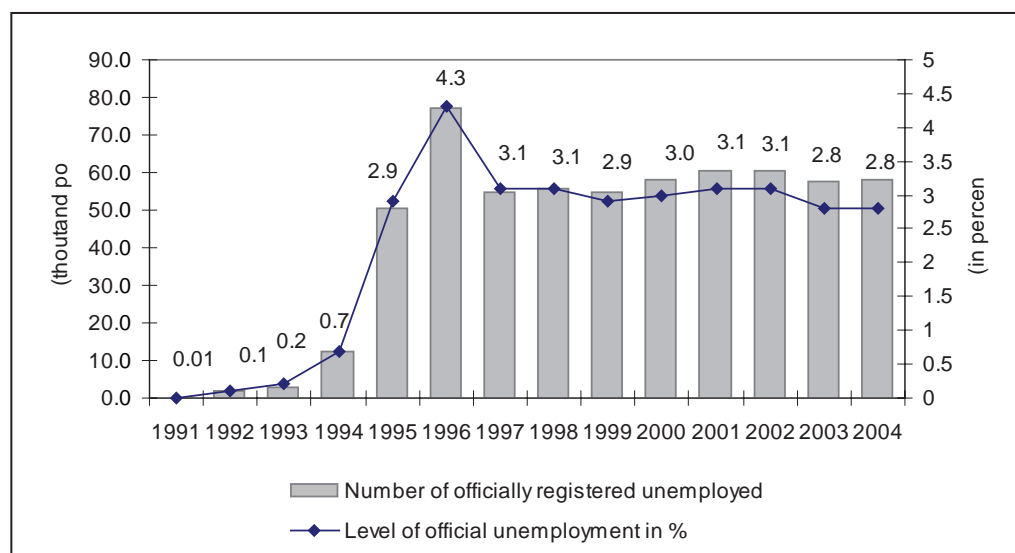
Two main indicators are available in order to measure unemployment. The first is "general unemployment", based on criteria developed by international statistical organizations, and referring to the share of the population who do not have a job, but are actively looking and

<sup>16</sup> For further detail on data contained in the LFM see Chapter 6 (section 6.1).

ready to start working. The second indicator is “registered unemployment”, measured by the number of people who apply to public employment agencies and therefore are considered unemployed. There has been and there is an enormous difference between these two indicators.

As illustrated in Figure 4.2 the number of registered unemployed in the Kyrgyz Republic has grown from 1.8 thousand in 1992 to 58.2 thousand in 2004 representing an increase in the official unemployment level from 0.1 per cent in 1992 to 2.8 per cent in 2004.

**Figure 4.2: Change in Official Unemployment**



Source: NSC, Estimate of balance of labour resources

Regarding the general unemployment level, calculated in accordance with the ILO standards, statistics are only available from 2002 when Labour Force Surveys (LFS) were introduced. Data in Table 4.1 shows that in 2002 the number of unemployed was 265.5 thousand and the unemployment level was 12.5 per cent, while in 2003 and 2004, these indicators were respectively 212.3 thousand and 9.9 per cent, and 185.7 thousand and 8.5 per cent.

**Table 4.1: Unemployment Level, 2002–2004**

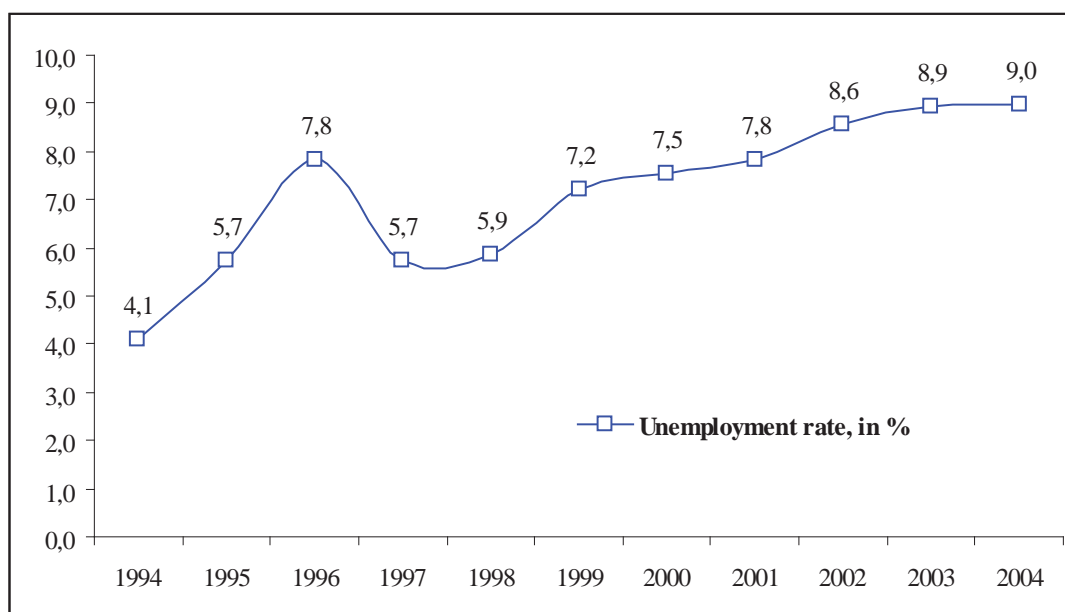
Unit of measurement		LFS, November 2002	KIHS, Employment and unemployment module, 2003	KIHS, Employment and unemployment module, 2004
Number of unemployed, total		265.496	212.280	185.721
Men	People	132.631	113.076	98.796
Women	//-	132.865	99.205	86.925
Urban	//-	155.494	105.223	89.159
population				
Rural	//-	110.002	107.057	96.562
population				
Level of unemployment, total		12.5	9.9	8.5
Men	per cent	11.2	9.4	8.0
Women	//-	14.3	10.5	9.3
Urban	//-	19.6	13.3	11.1
population				
Rural	//-	8.3	7.9	7.0
population				

Source: Author's calculations. Labour force survey 2002, KIHS, employment and unemployment module 2003–2004, NSC

More than 65 per cent of the population of the Kyrgyz Republic live in rural areas, and the total number of unemployed was higher in rural than in urban areas both in 2003 and 2004, although the actual rate of unemployment was higher in urban areas for the period 2002-2004 as indicated in Table 4.1.

The general level of unemployment before 2002 is indicated by the calculated balance of labour resources, which despite a number of assumptions, is the only source that can provide data for considerable period of time. According to this measurement, the general level of unemployment reached 5.7 per cent in 1995, increased to 7.8 per cent in 1996 declining slightly to 7.2 per cent in the period 1997-1999 and rising again to 9.0 per cent in 2004 (Figure 4.3).

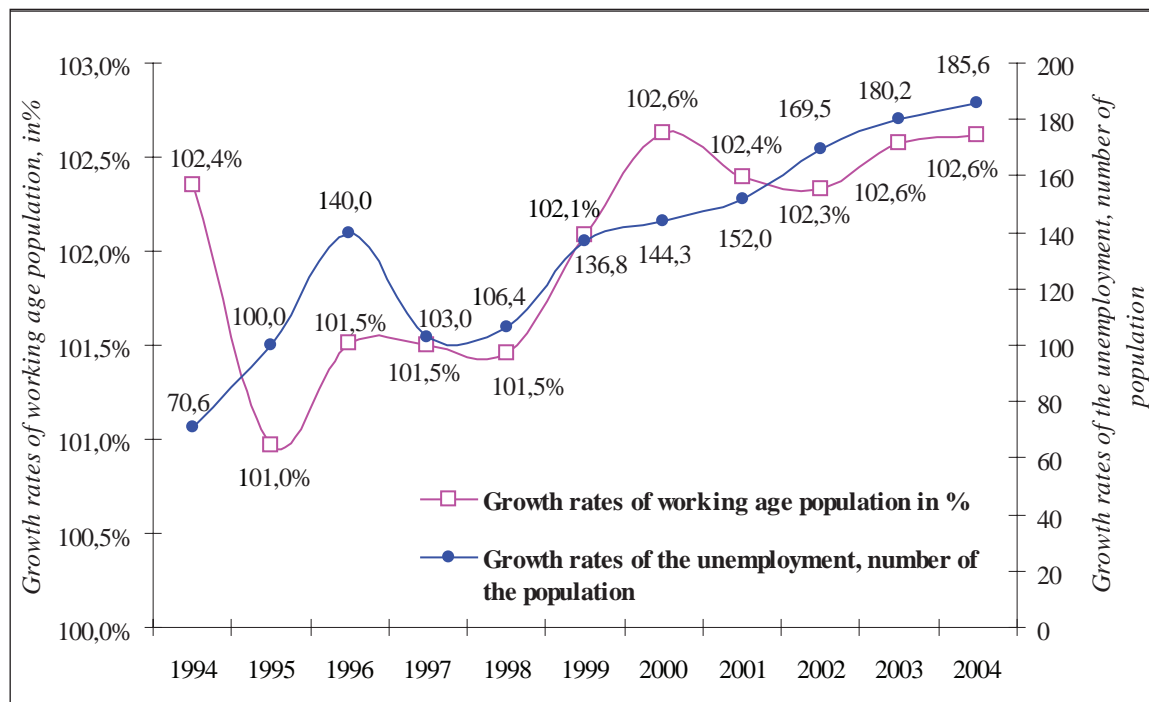
**Figure 4.3. The Unemployment rate in the Kyrgyz Republic, 1994-2004**



Source: NSC, estimates of balance of labour resources

During the period of 1994-2004, with the exceptions of 1997 and 2001, labour resources and the number of unemployed showed an accelerated growth: from 70.6 thousand in 1994 to 185.6 thousand in 2004 (Figure 4.4). Annual growth of the working age population was from 1 to 2.6 per cent per annum.



**Figure 4.4: Growth of the Labour Force and the Unemployment Level**

Source: NSC, estimates of balance of labour resources

The fluctuations of the unemployment level were not fully synchronized with the fluctuations in the rates of reduction of employment; this is seen in Figure 4.5. In other words, the decline in employment was not necessarily matched by a rise in unemployment.

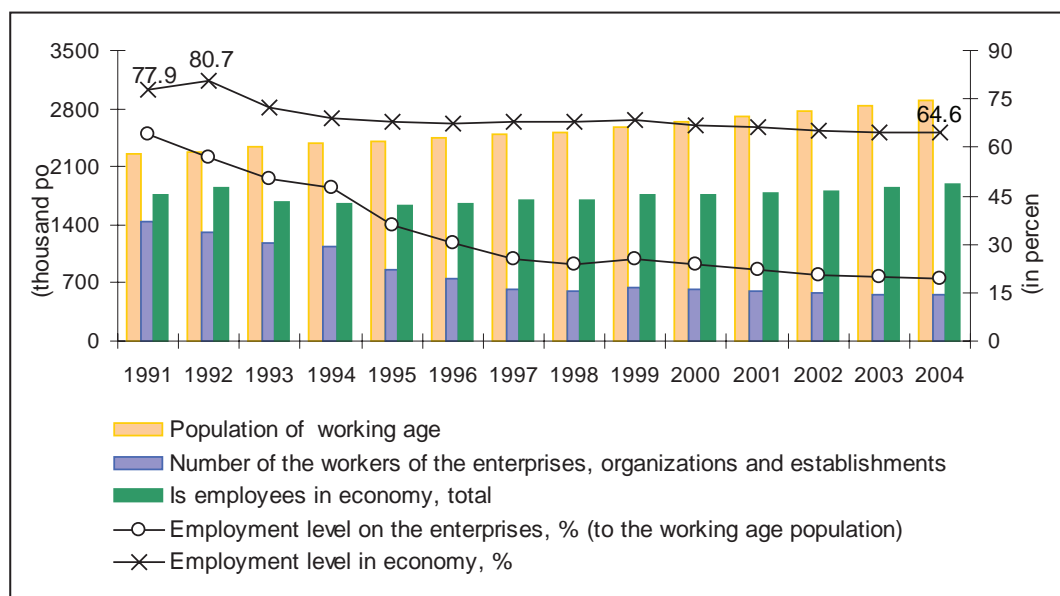
In order to obtain a more up-to-date picture of the level of unemployment, the Government of Kyrgyzstan carried out a 'one-time household survey' in July 2006 according to which the unemployment rate was 16.8 per cent for the country as a whole. This figure is almost double that of the unemployment rate found in recent Kyrgyz Integrated Household Survey (KIHS) (8.5 per cent and 8.1 per cent respectively in 2004 and 2005). Moreover, while data on unemployment during 2002-05 indicate a declining trend in unemployment, the figure for 2006 represents not only a break in that trend, but a sharp reversal. Such a difference would naturally raise questions about the comparability of the data from the KIHS with that of the one-time survey of 2006. A closer examination of the methodology and sample size adopted for the 2006 survey brings out a couple of points. First, the sample size for the 2006 survey was much smaller compared to the KIHS (1040 households in the 2006 survey compared to 5000 in the KIHS). Second, although the methodology adopted for identifying the unemployed appears to be the same in both surveys, in reality, it was applied differently - thus giving rise to the possibility of different results. For example, the enquiry on 'job search' (or 'looking for work' which is an important criterion for being identified as unemployed) contained nine questions in the KIHS, but was simplified into one question for the 2006 survey. As a result of this simplification, a higher number may have been identified as unemployed in the 2006 survey (compared to the KIHS). It could, of course be argued that the lower unemployment figures of the KIHS result from the stringent application of the definition of unemployment used in those surveys, and the real situation of unemployment is far worse as is indicated by the 2006 survey. Even if such a view is taken about the 2006 figure, it should not be used to draw any conclusions regarding the trend in recent years without being certain of the comparability of the data from the 2006 survey with the datasets of the KIHS surveys.

#### 4.2 Growth of the Labour Force and Employment of the Population

The number of people employed in the economy is one of the most important macroeconomic indicators and reflects the volume of aggregate demand for labour at a given time. In Kyrgyzstan, the working-age population grew by 658 thousand during the period of 1991-

2004, reaching 2909.5 thousand in 2004, equivalent to an increase of nearly 30 per cent. In such conditions of substantial demographic growth, a better picture of changes in the labour market during these 15 years can be obtained by looking at the level of employment. Despite a gradual reduction from 78 per cent in 1991 to 65 per cent in 2004 (see Figure 4.4), the level of employment remains relatively high. However, the structure of employment has undergone significant changes. While the absolute number of employed in the economy has increased slightly during the period under review, the number of paid workers at enterprises, organizations and institutions has decreased by 61.5 per cent from 1440 thousand people in 1991 to 554.6 in 2004. In other words, if in 1991, 6 out of 10 members of the working age population had jobs in enterprises with a guaranteed monthly salary, by 2004 this number had decreased to 2 out of 10. This perhaps reflects a shift from wage employment to self-employment (e.g., in privately owned agricultural land).

**Figure 4.5: The Level of Employment**



Source: NSC, estimates of balance of labour resources

### 4.3 The Structure of Employment

The structure of employment has undergone significant changes - both in terms of employment status as well as in terms of sectoral shifts in employment.

During the period preceding new market trends in the Kyrgyz Republic, the majority of the population was employed in the public and collective and cooperative farming (kolkhoz and sovkhoz) sectors amounting to as much as 85.2 per cent in 1991 according to the balance of labour resources dataset. Out of these 79.4 per cent worked at public enterprises, organizations and institutions, 14.8 per cent in commercial cooperatives (including kolkhozes and collective peasants' farms) and 12.8 per cent in peasants' farms of private subsidiary farms. Practically all employees of enterprises and organizations could be classified as wage workers as the private sector only started to emerge after 1991 and the number of owners was insignificant.

The establishment of a legal framework for the development of entrepreneurship and independent employment as well as private property in terms of land defined a new economic environment for the employed population. In the course of the transition to a market economy, the share of the private sector began to grow in and a variety of legal formats for economic activity gradually emerged.

According to the data on balance of labour resources from the NSC the number of people employed in enterprises and organizations, decreased from 1440.0 to 554.6 thousand during the period 1991-2004. The most dramatic component was the decline of those employed

in public enterprises and institutions – from 1149.4 to 359.8 thousand people equivalent to a decrease of 68.7 per cent. The share of the public sector as an employer was falling both because of the privatization of public enterprises as well as the appearance of new private enterprises. Thus, in 2004 the number of people employed in joint-stock companies, limited partnerships and joint ventures reached 190.3 thousand as compared to 104.8 thousand in 1991, in other words an increase of 81.6 per cent. During this period the number of people employed in individual labour activity, working at peasants' farms increased manyfold, new forms of labour relations appeared, in particular hiring by individual citizens.

Difficulties arising as a result of the transition to a market economy could not but cause negative impacts in the labour market. During the period under review (1991-2004) there was a significant change in the distribution of the employed population by type of activity resulting from the crisis in the productive sector, reforms of the agrarian sector and the social infrastructure. The economic recession was a blow to the industrial sector of the economy, mainly due to the collapse/decrease in economic ties, existing amongst the former Soviet Union republics. Most industrial enterprises were highly specialized and depended on external supplies while many resource and trade markets were lost in the new economic environment.

Thus, there was a decline in the number of employed in sectors such as mining and processing, construction, transport, as well as education, health and social services. On the other hand, there was a growth in employment in areas such as trade, repair of vehicles, household and private use appliances. The development of financial markets and services resulted in an increase in the number of people employed in the financial sector. Profound reforms in agriculture, with the land transferred for private use, resulted in the formation of individual peasants' farms leading to an increased number of people employed in agriculture, absorbing some of the surplus labour force.

The transition to a market based economy, accompanied by transformations in the labour market, as well as the issue of ensuring international compatibility, resulted in a number of changes in the methodology and organization of statistical surveys during the period 1991-2004.

Before 2002, the basic instrument which was used in examining employment was calculated balance of labour resources based on the compilation of data reported by enterprises, Unified State Registrar of Statistical Units (USRSU), household budget surveys, population census, data from the Ministry of Labor and Social Protection on the number of pensioners and recipients of the state benefits, Ministry of Education on the number of students etc.

The Labour Force Surveys (LFS) were introduced in 2002; and since then, they became the single source of information allowing assessing at the same time those engaged in economic activity, the unemployed as well as the economically inactive persons in accordance with the ILO criteria.

One further issue makes it difficult to ensure complete compatibility of data on the structure of employment for the given period, namely the classification of economic sectors. Before 1998 the Classifier of National Economy Branches was used, (which was a characteristic of a planned economy), whereas since 1998 the Classifier of Types of Economic Activity has been in use.

In 1991 out of the total number of the employed population 82.5 per cent (1447.1 thousand) worked in enterprises and organizations, whereas by 1994 their number had decreased to 68.7 per cent (1129.7 thousand). This reduction was mostly counterbalanced by those who became involved in individual labour activities increasing from 0.1 per cent (2.6 thousand) in 1991 to 8.8 per cent (141 thousand) in 1994 as well as by those employed in peasants' farms from 0.9 per cent (15.8 thousand) to 8.5 per cent (139.5 thousand) during the same period.

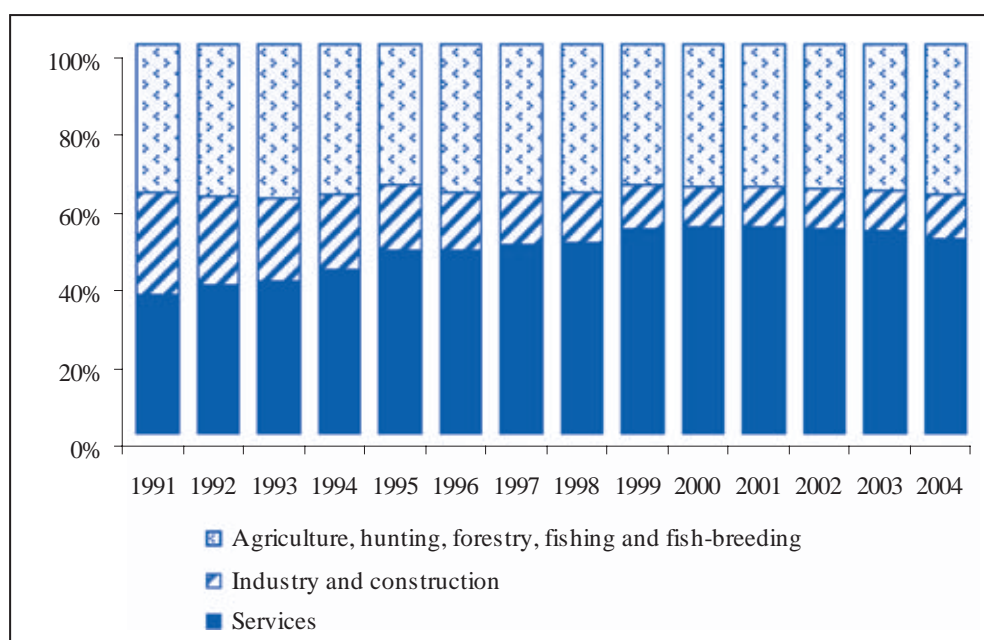
The growth of employment in agriculture can be attributed to several factors. During land reform almost each family received a land allotment, so that almost all capable family members became employed in peasants' farms. Moreover, the republic has a favourable climate

and soil for agrarian activity and alternative labour markets in rural areas are extremely limited. Furthermore after the loss of jobs in other types of activities, revenues from private land plots started to play an increasingly important role.

Starting from 1995, there was a substantial increase in farm employment, while there was a corresponding reduction of workers employed in enterprises and organizations. The share of those employed in farming reached 36.7 per cent (689.9 thousand) by 2004, while the number of workers in enterprises and organizations decreased to 32 per cent (601.9 thousand) of the total number of employed in economy. A substantial part of the population (around 10 per cent of those employed), were engaged in the production of goods and services in the private sector. . Starting from 1999 the number of wage workers employed by individuals started to increase reaching 8.1 per cent or 151.7 thousand of the total employed by 2004.

The sectoral composition of employment can be characterized by the increase in the number of those working in agriculture from 35.5 per cent in 1991 to 49.8 per cent in 2004 (i.e. from 622.7 to 936.2 thousand). In trade, repair of vehicles, household appliances and private utensils the number rose from 4.7 per cent to 11.4 per cent ( from 82.9 to 214.3 thousand) during the same period, while in industry and construction there were declines of 52.5 per cent (from 318.7 to 151.5 thousand) and 55.5 per cent (from 147 to 65.4 thousand) respectively .

**Figure 4.6: The Structure of Employment: 1991-2004**



Source: NSC, estimate of Balance of labour resources

#### 4.4. Gender and the Labour Market in Kyrgyzstan

Table 4.1 (see section 4.1 above) shows that unemployment rate for women was higher than that for men in 2002, and continued to remain so in 2004, although there was a slight narrowing of the gap. A recent World Bank report (World Bank, 2007) brings out a number of interesting features relating to women's situation in the Kyrgyz labour market; and it may be worthwhile briefly highlighting some of them. First, the labour force participation rate is lower for women. While there are a variety of reasons for that, it seems that the breakdown of social safety nets and the erosion of social services following economic reforms may have had an impact. As for reasons for not being in the labour market, a far higher proportion of women compared to men (24.8% as opposed to 1.5%) mention household work

including child care as a major reason. Second, women and men appear to work in different occupations. While there are certain occupations that are found to be “male-dominated” (e.g., agriculture, construction, etc.) there are those which are “female-dominated” (e.g., teaching, personal services, travel and tourism). Third, women account for higher shares of employment in activities and occupations involving lower wages. Fourth, there is a substantial earnings gap between women and men – some 30 and 25 per cent respectively in urban and rural areas, gaps which are not easily explained by human resource related factors. Given the above findings, it would be important to look more closely at factors that affect women’s participation in the labour market and keep them tied to jobs that are low paid. Whether there is discrimination in wage payment for the same job also needs to be examined carefully. Policy measures for closing the gender gaps in the labour market will have to be formulated on the basis of such analysis.

#### 4.5. The Informal Economy and Underemployment

Forced underemployment in the form of incomplete working hours and administrative leave became a widespread feature during 1997-2001, representing 3-4 per cent of total employment according to estimates of the NSC for various years (based on administrative reports from enterprises). The number of workers on leave at the initiative of the administration ranged from 52 to 69 thousand people according to various estimates and it should be noted that these figures are almost identical to the number of officially registered unemployed. In this context, it is important to point out that the state supported this type of underemployment by providing direct financial support through state employment agencies. These agencies in turn gave cash (either as grants or on a repayment basis) to the enterprises for the payment of wages to the workers who were transferred to administrative leave or incomplete working hours. Moreover, a lenient attitude was adopted towards the fact that many enterprises violated the existing legislation by not providing compensation to over half of those given forced leave. One important factor was the instructions received from the management who at times believed that they were being socially responsible by keeping jobs and not firing staff.

This practice ceased to exist in 2001, and according to data from the LFS of 2002 and 2003 only 0.4 per cent and 0.2 per cent were underemployed in these two years respectively. The most reliable information on underemployment calculated on the basis of hours worked per week, can be obtained from the Labour Force Survey. However, this data is available only for 3 years from 2002 to 2004. Two work time indicators are used to analyse the labour market: the first is normal work time<sup>17</sup> and the second measures the actual number of hours worked. The existence of a surplus of normal hours over the actual is an indication of underemployment in the economy.

The results of the 2002-2004 surveys show that the actual working hours of the employed population in their primary occupation are at least four hours less than a regular working week.

<sup>17</sup> According to the methodology used by the labour force survey, the normal duration of a working week represents the working hours set by legislation, rules and collective agreements for given types of work and categories of employees.



**Table 4.2: Average Working Hours per Week (primary occupation)**

	2002		2003		2004	
	Normal	Actual	Normal	Actual	Normal	Actual
Total	40.0	32.9	39.0	34.8	37.6	32.8
Men	41.4	34.7	40.1	36.3	38.6	34.1
Women	38.1	30.4	37.7	33.0	36.4	31.1
Urban population	43.1	42.0	42.3	40.6	41.6	40.3
Rural population	38.3	28.2	37.2	31.7	35.5	28.6

Source: Author's calculations. Labour Force Survey 2002, KIHS, employment and unemployment module 2003-2004, NSC

The deviation between normal and actual working hours depends on socio-demographic groups and the type of economic activity of the employed population with both the normal and actual working week being longer for men than for women. . This can be explained by the sectoral structure of women's employment and the prevalence of women in the types of activities that legally allow reduced working time (education and public health).

The amount of underemployment was substantially greater in rural than in urban areas, due to the seasonal characteristic of agricultural activity as well as an excess of the workforce in rural areas. . Based on LFSs, the difference between the normal and actual length of the working week in rural areas was over five hours, while in cities and towns this difference was just a little more than one hour. In 2004 in rural areas over 50 per cent of the employed population worked less than 30 hours per week, while in towns and cities this share was only 10.6 per cent. In the same year, a substantial share of the employed population (over 25 per cent of the working age group) worked for more than 40 hours per week as envisaged by the labour legislation, amounting to 28.2 per cent of employed men and 21.9 per cent of women. Thus, the results of the surveys indicate substantial underemployment in rural areas and quite a high level of over-employment in urban areas.

Overtime employment, defined as working more than 40 hours per week, is more typical for sectors of the economy where individual labour activity is predominant. Thus, the actual average length of the working week is highest in sectors such as trade, repair of vehicles and household appliances, transport and communication, hotels and restaurants, construction.

**Table 4.3: Average Number of Working hours by Type of Activity (primary occupation)**

	2002	2003	2004
Total	32.9	34.8	32.8
o/w:			
Agriculture, hunting and forestry	23.1	27.0	21.0
Fishing and fish-breeding	40.8	32.7	39.5
Mining	40.5	38.8	40.5
Processing industry	40.7	40.2	40.7
Production and distribution of electricity, gas and water	42.6	39.7	41.2
Construction	42.1	43.0	42.7
Trade, repair of vehicles, household appliances and utensils	47.5	44.8	43.0
Hotels and restaurants	46.8	44.1	44.0
Transport and communication	44.7	42.8	42.0
Financial activity	38.5	40.8	35.8
Operations with real estate, rent and consumer services	44.5	40.2	40.3
Public administration	43.7	40.8	40.7
Education	35.5	33.6	31.6
Health and social services	41.8	38	38.4
Communal, social and personal services	41.3	40.2	40.7
Household services	27.4	33.3	36.1

Source: Author's calculations. Labour Force Survey 2002, KIHS, Employment and unemployment module 2003-2004, NSC

The data from labour force surveys allows for making an assessment of the employment in the informal sectors of the economy indicating quite a high level of informality in the Kyrgyz economy.

Principal approaches towards the definition and measurement of employment in the informal sector for national statistical bodies were formulated in the recommendations of the International Conference of Labour Statisticians in 1993. The conference defined the informal sector in broad terms as "the aggregate of units employed in the production of goods and services with the basic objective to provide occupation and revenues for those who are related to those units. These units are characterized by low organizational level, low intensity of capital and small size. Labour relations, if any, are based primarily upon attracting random workers, kinship and personal relations and not on agreements that provide formal guarantees». Employment in the informal sector constitutes the main element of informal employment, which may also include informal employment in formal enterprises<sup>18</sup>.

<sup>18</sup> A further distinction that needs to be made is between informal workers who are self-employed and informally employed wage workers, as well as family workers (who often are non-remunerated). However this kind of classification is difficult given the current state of data availability.

**Table 4.4: Employment in the Kyrgyz Republic: 2002–2004 (thousand)**

Type of enterprises	2002			2003			2004		
	Total	Informal	Formal	Total	Informal	Formal	Total	Informal	Formal
Total	1,850	...		1,930	1,293		1,991	1,364	
Primary occupation		1,114	737		1,229	701		1,310	677
At formal enterprises	988	251	737	1,011	309	701	964	287	677
At informal enterprises	541	541		742	742		879	879	
Households	322	322		178	178		149	149	
Additional jobs	...	...	...		64			54	
Share of informal employment in %		60.2			67.0			68.5	
Share of employed in informal sector, in %	46.6			47.6			51.6		

Source: Author's calculations. Labour Force Survey 2002, KIHS, Employment and unemployment module 2003-2004, NSC

The average annual number of those engaged in the informal sector as their principal occupation amounted to 47.6 per cent of the total employment level (920 thousand) in 2003 and 51.6 per cent (1028 thousand) in 2004. In 2003 and 2004 respective amounts of 1229 and 1310 thousand people were engaged in informal employment in formal enterprises. Their share represented more than 67 per cent of the total number of those employed. In addition, more than 64 thousand people in 2003 and 54 thousand in 2004 were engaged both in the formal and informal sectors, i.e. had two or more additional occupations.

The informal sector (including informal employment in the formal sector) includes primarily those involved in individual labour activities (around 53 per cent of the total informal sector), including family workers constituting 21-22 per cent and wage workers hired by individuals making up 22-23 per cent.

The sectoral composition of the informal sector consists of five large types of activities: agriculture, trade, hotels and restaurants, transport and communication and industry. The role played by other types of economic activity is insignificant in the structure of the informal sector.



**Table 4.5: Informal Employment as a Primary Occupation**

	2002	2003	2004	2002	2003	2004
	Persons			% of the total		
Total	1,113,589	1,229,129	1,314,597	100.0	100.0	100.0
Agriculture, forestry and fishing	762,170	751,473	749,470	68.4	61.1	57.0
Industry	41,087	67,423	76,525	3.7	5.5	5.8
Construction	33,296	66,720	97,949	3.0	5.4	7.5
Trade, hotels and restaurants	210,074	255,716	290,690	18.9	20.8	22.1
Transport and communication	41,501	51,060	59,501	3.7	4.2	4.5
Education, health and social insurance	2,563	3,784	2,412	0.2	0.3	0.2
Other services	22,898	32,953	38,050	2.1	2.7	2.9

Source: Author's calculations. Labour Force Survey 2002, KIHS, Employment and unemployment module 2003-2004, NSC

The share of the informal sector in the total number of employed by sector provides an interesting picture, with the share of informal sector in agriculture reaching over 96 per cent in 2004 primarily explained by farming and production at private subsidiary farms. The share of informality is also quite high in trade (over 89 per cent) and construction (68 per cent), which can be explained mainly by individual labour activity and employment by individuals. Over half of those employed in transportation are involved in informal employment, as self-employment is predominant in this sector.

**Table 4.6: Share of Employment in the Informal Sector by Economic Sector (%)**

	2002	2003	2004
Agriculture, forestry and fishing	83.9	90.0	96.8
Industry	25.4	35.9	37.1
Construction	55.3	65.3	68.0
Trade, hotels and restaurants	85.7	87.6	89.1
Transport and communication	45.8	52.3	52.7
Education, public health, social insurance	1.2	1.6	1.0
Other services	14.1	18.4	19.8

Source: Author's calculations. Labour Force Survey 2002, KIHS, employment and unemployment module 2003-2004, NSC

## 4.6 Labour Migration

The predominance of non-wage employment (traditional self-employment, unpaid family workers, employment at private subsidiary farms), high levels of informal employment and underemployment, in other words – low utilization of the labour potential in the economy of the Kyrgyz Republic serve as an evident explanation for the motives of labour migrants leaving the country in search of better jobs.

According to the mass media<sup>19</sup> between 300 and 500 thousand of the economically ac-

<sup>19</sup> Migration in mountain regions in Central Asia (Tajikistan, Kyrgyzstan), S.Olimova and M.Olimov. ([http://www.eawarn.ru/pub/AnnualReport/AnnualReportWebHome2005/32\\_Anrep2005\\_Migration\\_CA.pdf](http://www.eawarn.ru/pub/AnnualReport/AnnualReportWebHome2005/32_Anrep2005_Migration_CA.pdf))

tive Kyrgyz population are labour migrants in Russia and Kazakhstan. The difference in revenues in the larger former USSR republics of Russia and Kazakhstan, on the one hand, and in smaller economies of former USSR (such as Kyrgyzstan, Moldova, Tajikistan etc.), on the other, is continuously increasing. Many economists believe that the reduced pressure on the domestic labour market and remittances from labour migrants, which, according to some estimates, are equal to the state budget of the Kyrgyz Republic, are beneficial to the economy through ensuring consumer demand, providing occupation for many traders and other producers of goods and services. However, the reduced pressure of unemployment may have serious implications in the long-term given that the educational background of labour force deteriorates.

Given the structure of employment in the economy of the Kyrgyz Republic, as well as the types of labour activity in which Kyrgyz migrants are involved, (performing simple operations of transporting the goods from one country to another, being street cleaners and performing unskilled labour at construction sites), it is unlikely that the migrants would be able to maintain their skills for use in the domestic economy. On the other hand, evidence shows that with time, the inflow of private remittances from labour migrants has a tendency to decrease while the most advanced migrants assimilate to new places and bring their families with them. Thus, the quality of labour resources and the level of skills seem to no longer remain the competitive advantage of the Kyrgyz economy. From a long-term strategic perspective there is a need to pay increased attention to the level of education and professional training of labour resources.

There are other important questions relating to international migration of workers. First, from the point of view of maximizing the returns in terms of remittances, it may be worthwhile raising the level of skills and competencies of prospective migrants. And that would involve investment in skill development. That, however, would raise a related question as to whether spending public money to develop skills for outside use would be justifiable from a strict cost-benefit point of view. Moreover, migration of skilled workers could lead to a shortage of skilled workers in the domestic economy and the emergence (or widening) of skill gaps in the country. A related issue is the appropriate wages/salary for creating necessary incentives for workers to stay in the country, and how that compares with the prevailing wages/salaries. Hence, the issues relating to the skill level of migrants, skill gaps within the economy, and costs and benefits associated with migration should be dealt with in an integrated framework.

Second, there are issue relating to the conditions in which workers work in the receiving countries and more generally, the rights of migrant workers. A related issue is that of abuse of migrant workers in both the sending and receiving countries. There is clearly a case of better monitoring of the situations in this regard and put in place appropriate mechanisms for redress.

The third set of issues relates to the development role of international migration through the utilization of remittances in the receiving countries and of the skills of the returning migrants. This links more to the poverty reducing effects of remittances and is taken up in the next chapter. It may, however, be mentioned here that Kyrgyzstan would benefit from putting together a more pro-active strategy to deal with the issues relating to international migration and the productive use of remittances

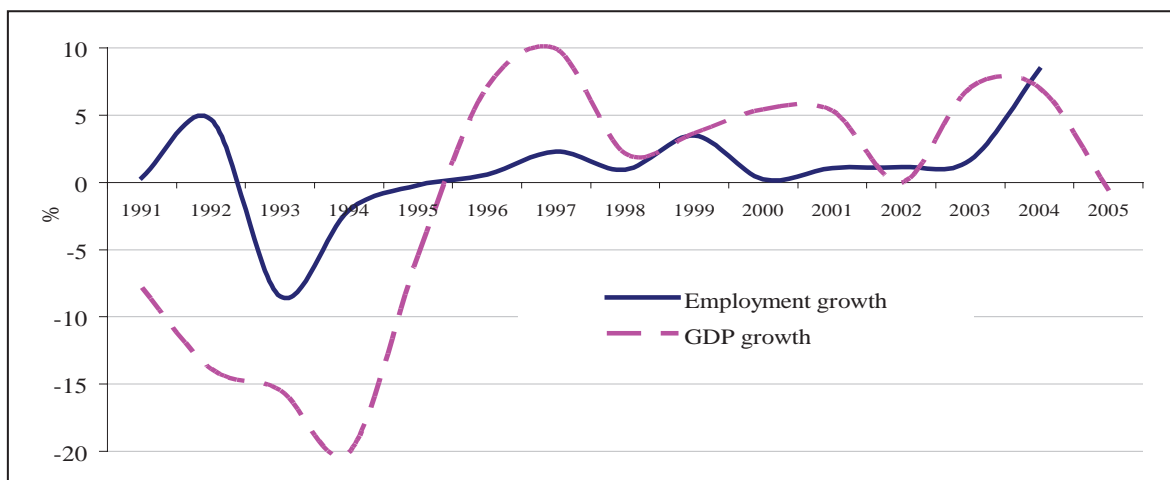


## Chapter 5. Economic Growth, Employment and Poverty Reduction: A Macro Level Analysis

### 5.1 Employment Intensity of Economic Growth

The main mechanism through which economic growth is conducive to well-being of the poor is through an increase in employment, given the fact that, often labour is the only resource the poor have. A rise in unemployment, resulting from loss of jobs, is certainly correlated with an increased incidence of poverty. The Pattern of growth in the Kyrgyz Republic was very similar to what other CIS countries faced – a sharp decline in output in the first 5-7 years after the collapse of the Soviet Union, as a result of broken economic links and widespread closures of industry and collective enterprises (Figure 5.1). During more than a decade this process resulted in considerable change in the structure of employment and GDP with most of the traditional industries declining both in terms of their contribution to output and employment. On the other hand, the commercial services sector, notably trade, transport and communication, are becoming leading growth sectors creating more employment opportunities.

**Figure 5.1: Employment and Economic Growth, 1991–2005**



Source: NSC

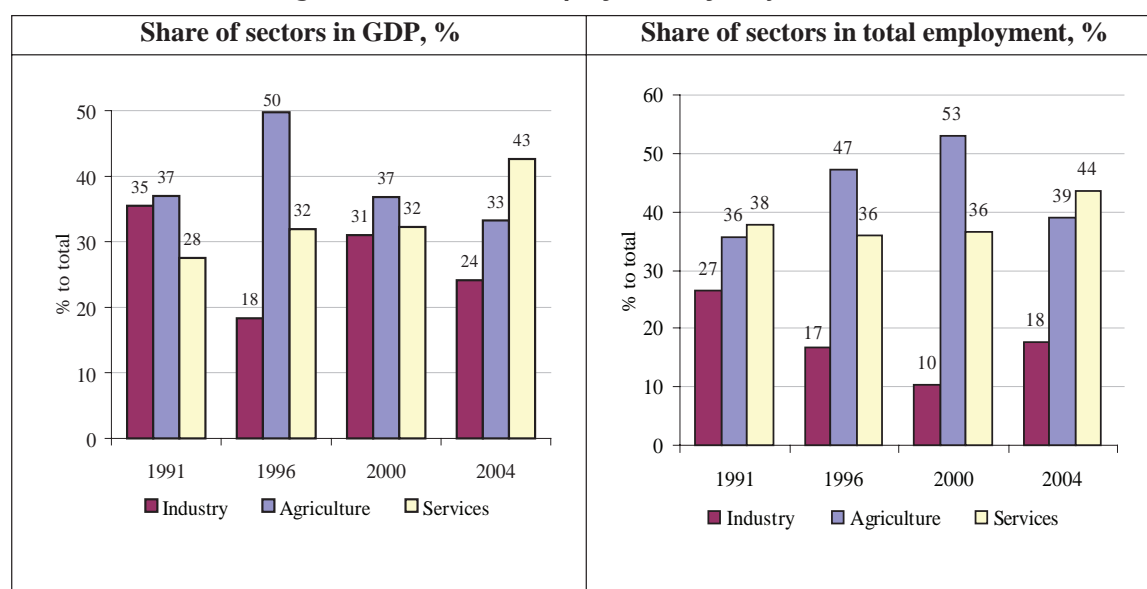
Economic growth has been uneven in the Kyrgyz Republic since 1996, when the recovery of the economy started. From the job creation perspective, the employment development pattern was conservative, showing modest growth since 1996, following some decline in the early years of independence. Part of the decrease in employment during the period from 1989 to 1994 can be explained by a mass emigration of the Kyrgyz population equivalent to half a million people. In the recovery period (from 1996 to 2004) average economic growth was about 5.5 per cent, while employment grew by an average rate of about 2.2 per cent. Thus, overall, economic growth was not associated with increased employment, though the changed structure in the composition of Kyrgyzstan's GDP led to considerable shifts of the labour force between sectors.

**Table 5.1: Selected Indicators on Growth and Employment, 1991–2004**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
GDP real growth, %	-7.9	-13.9	-15.5	-20.1	-5.4	7.1	9.9	2.1	3.7	5.4	5.3	0.0	7.0	7.0
Total employment growth, %	0.3	4.7	-8.5	-2.1	-0.2	0.6	2.3	0.9	3.5	0.2	1.1	1.1	1.7	8.4
Labor force growth, %	0.3	4.7	-6.9	0.4	1.5	2.9	0.0	1.1	5.0	0.6	1.4	1.9	2.1	7.9
Unemployment rate, %														
ILO	...	...	1.7	4.1	5.7	7.8	5.7	5.9	7.4	7.5	7.8	12.5	9.9	8.5
Registered	...	...	...	...	...	...	3.1	3.1	2.9	3.0	3.1	3.1	2.8	...

Source: NSC

An analysis of the contribution of the three sectors of the economy (agriculture, industry and services) to GDP and employment reveals that industry is becoming less important in both dimensions while the services sector is gaining increased importance. As illustrated in Figure 5.2, in 1991 industry contributed to 35 per cent of GDP, a ratio comparable with that of the share of agriculture, and provided employment for just over a quarter of the labour force. However, in 2004 industry contributed to only about 24 per cent of GDP (including gold production which was insignificant before 1997) and employed 18 per cent of the labour force. Agriculture really became a locomotive of growth and a source of employment in the mid-90s, when the sector contributed to around 50 per cent of both GDP and employment. It is a well known fact that this was the result of land reform and privatization, however, growth in the agricultural sector has become sluggish in recent years due to slow progress in productivity. In contrast to industry and agriculture, dynamic growth in the labour-intensive services sector is drawing labour from these two sectors. Compared to the early years of independence when services was not a leading sector, data from 2004 indicate that the sector has become a major provider of jobs, accounting for 44 per cent of the total employed.

**Figure 5.2: GDP and Employment by Major Sectors**

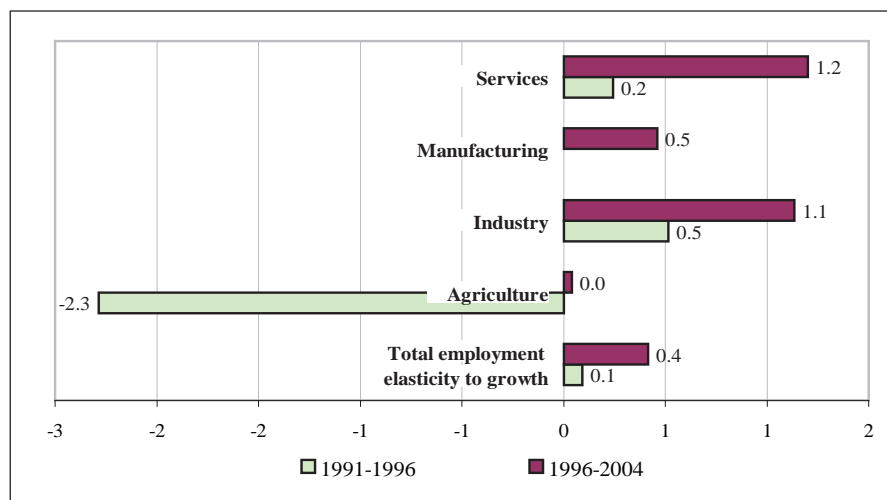
Source: NSC

An indicator that shows how growth is associated with employment is given by the employment elasticity of output growth (measured by the proportionate change in employment divided by the proportionate change in GDP during a given period). In other words, this indicator measures the employment intensity of economic growth, yet, is inversely related to labour productivity. An elasticity higher than unity implies a decline in productivity, while a lower than unity elasticity could mean that employment expansion is taking place along with increased productivity. Therefore, an increased employment-to-growth elasticity does not nec-

essarily imply a positive outcome, given that it may be associated with lowered productivity<sup>20</sup>.

Data from the National Statistics Committee can be used to estimate employment elasticity in the Kyrgyz Republic. The employment data for 1991-2004 is available by sectors of the economy (agriculture, industry, and services), however there is some inconsistency in the data for the three sub-periods as follows. The data available from the first sub-period from 1991 to 1997 is based on the Soviet classification system of economic sectors. The data from the second period 1998-2001 comes from when international classification of economic sectors was introduced. Finally, employment data from 2002-2004 is based on National labour force surveys. Given this, the calculated employment elasticities will inevitably vary, in particular around the years when the classification systems changed. It is a common problem to obtain reliable and consistent estimates of aggregate employment in many developing countries - particularly where there are large informal sectors. In such situations, it may be practical to focus on sectors (e.g., manufacturing industries) for which estimates of output and employment would be more reliable and more easily available. The analysis of employment elasticities below will concentrate on all three major sectors of the Kyrgyz economy.

**Figure 5.3: Elasticity of Employment to Growth**



Source: NSC

As in Chapter 3, the analyzed period has been divided into two sub-periods the first one covering the years from 1991 to 1996 when the economy experienced a fall in growth, and the second comprising the years from 1996 to 2004, when growth resumed. In general, in both sub-periods economic growth in the Kyrgyz Republic was not employment-hostile (see Figure 5.3). During the first period both economic and employment growth were negative, and the employment elasticity was equal to only 0.1. More specifically, the cumulative decline in real GDP accounted for 56 per cent, while employment declined by 5 per cent (mostly explained by emigration). The second sub-period saw a rebound in output and employment and the employment elasticity increased slightly to 0.4. The sectoral analysis of the employment elasticity provides better and more detailed insights.

Agriculture, the main economic sector of the Kyrgyz economy, provides a very interesting case in terms of employment trends. In the first sub-period (1991-1996), cumulative growth fell by more than 14 per cent, yet by 1996 the number of people employed in agricultural activities had increased by 1.3 times as compared to 1990. These reverse trends in agricultural growth and employment (as illustrated by the negative sign of the employment elasticity in Figure 5.3) are explained by the two parallel processes of a decline in output due to mass dissolution and privatization of collective agriculture enterprises and an increase in employment due to the inflow of workers as a result of the lack of jobs in non-agricultural sectors.

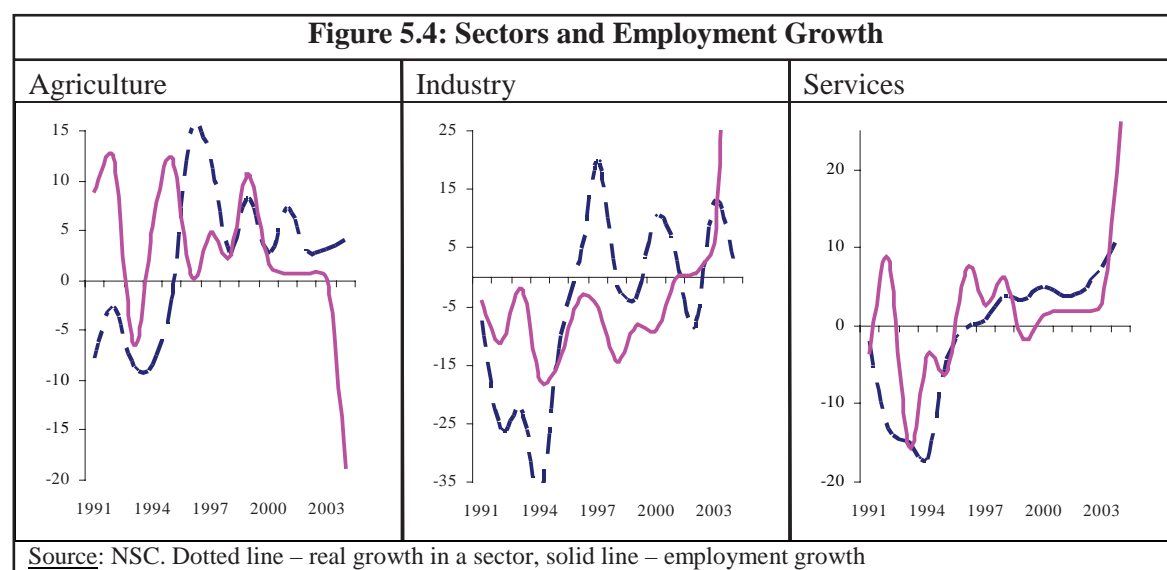
<sup>20</sup> From Rizwanul Islam 'The Nexus of Economic Growth, Employment and Poverty Reduction: An Empirical Analysis', ILO 2004 (draft).

Further detail on the agricultural reforms and policies are provided in the next section of this chapter.

Industry, a leading sector of the Kyrgyz economy in Soviet times, has undergone dramatic changes in the post-Soviet period including in its structure. With regard to growth industry experienced a two-fold decline in the first sub-period of which only about 40 per cent was compensated for in the second period, when growth resumed. Similarly, employment in industry decreased significantly (by 53 per cent) in the first sub-period, however in the second period employment grew on average by 5 per cent annually. The decline in industrial output and employment during the first period resulted in an employment elasticity of 0.5, while during the second period employment elasticity exceeded unity, thus leading to the conclusion that in this period growth in industry was a job-friendly one, although at the cost of declined productivity. This is not surprising given that industry is mostly composed of small and medium size enterprises that are dominantly labour- as opposed to technology intensive.

Given the importance of manufacturing within the industrial sector, an attempt was made to calculate its employment elasticity. However, this was possible only for the period from 1998 to 2004, due to a lack of detailed employment data. Employment elasticity in manufacturing was equal to 0.5 per cent during 1998-2004, showing a positive result in terms of the productivity of the sector. In terms of growth, manufacturing followed the trend of the whole industry and declined two-fold in the first sub-period. However, in contrast to the slow recovery of the whole industry, manufacturing demonstrated solid growth in the second sub-period (10 per cent on average). This may be primarily due to the beginning of mass production of gold at Kumtor mine in 1997, when manufacture grew by 60 per cent.

**Figure 5.4: Sectors and Employment Growth**



The services sector, in contrast to the uneven development of agriculture and industry, has in recent years, demonstrated steady progress both in terms of growth and employment. From 1991 to 1996 the services sector declined by 2 per cent per annum, yet the resumed growth rate in the second period was equal to 4.5 per cent per annum, following agriculture in terms of the level of growth. As for job creation, the number of employed in the services sector declined substantially in the first period (2.1 per cent per annum), while the second period saw the highest job creation rate (5.4 per cent) among all sectors of the economy. Employment elasticity in the services sector was negligible (0.2) during the first period while during the second period the elasticity was 1.1 indicating employment generation. However, given the fact that the service sector is quite labour-intensive, and that employment growth was mainly associated with an inflow rate of labour force exceeding the level of output, an employment elasticity exceeding unity points to relatively low productivity.



## 5.2 Policies Pursued with Regard to the Agricultural Sector

Agriculture was a main engine of economic growth in the early period of recovery and a source for employment<sup>21</sup>. As a result of the large inflow of labour displaced in the collapsing industrial and service sectors and by the need of the rural population to ensure food security and physical survival, the initial growth in agriculture was characterized by a strong emphasis on food crop production, much of it for home consumption and barter. In the beginning of the economy's recovery (1996), agriculture contributed to 50 per cent of GDP and accounted for nearly the same percentage of the labour force (Figure 5.2). While output increased, labour productivity declined, due to the large increase in agricultural employment, the shift to low-value staple food crops, the widespread lack of farming know-how among the newly privatized farmers, the virtual absence of critical inputs, and the de-capitalization of farming as physical assets deteriorated. Thus, the role of agriculture in recent years has been declining both in terms of value added and employment share. In 2004 agriculture contributed to only 30 per cent of GDP employing 39 per cent of the labour force. This development is mainly due to the unsustainable nature of on-farm incomes and the solid growth of the service sector increasingly attracting the labour force.

**Table 5.2: The Role of Agriculture in GDP, Employment and Consumption**

	1991	1991	2000	2004
Share of agriculture in GDP, %	37	50	37	33
Share of agriculture in employment, %	33	47	53	39
Share of family budget spent on food, %	30	57	...	68

Source: NSC, KIHS for 2004; Earlier data adapted from Mudahar (1998).

Nevertheless, the role of agriculture is crucial both for household consumption and export. The importance of agriculture is shown by the share of the family budget allocated for food, which has doubled since the early years of transition representing about two third of the consumption basket in 2004. This increased share of food in household expenditure is significantly related to rising inflation over the 15-year period, especially in the early years of transition when price liberalization led to inflation exceeding 1000 per cent in some years.

Rural poverty shows less improvement compared to urban poverty. Although agricultural growth was one of the main drivers in reducing poverty, the rural poverty level remains high compared to urban poverty. In 2004, three-fourths of the poor lived in rural areas. Agricultural growth was particularly conducive to the reduction of extreme rural poverty showing impressive progress with a 12 per cent annual reduction in the period between 2001 and 2004. However, compared to urban poverty, progress in rural poverty reduction has been modest, and what is particularly worrying is the increase in rural consumption inequality as measured by the Gini coefficient which rose to 34 per cent compared to less than 30 per cent in preceding years (Table 5.3).

<sup>21</sup> See the background paper on Agricultural and Rural Development for Kyrgyz Joint Country Support Strategy, 2006.



**Table 5.3: Agricultural Growth and Rural Poverty Development, 2001-04**

	2001	2002	2003	2004	2001-04 (average)
Absolute poverty rate	67	62	60	57	
Extreme poverty	28	27	26	21	
Gini index	29	29	30	34	
Agriculture growth	7.3	3.	3.2	4.1	4.0
Change in rural poverty rate	-7.5	-3.3	-4.8	-3.4	4.7
Change in extreme rural poverty rate	-5.0	-3.0	-19.7	-19.5	-11.8
Elasticity of absolute poverty	1.0	1.1	1.5	0.8	1.2
Elasticity of extreme poverty	0.7	1.0	6.2	4.7	2.9

Source: NSC. Poverty and inequality measures are based on consumption per capita aggregate.

Since the productivity of labour in industry is expected to be higher than in agriculture, how would one explain a reduction in poverty in recent years despite the observed shift in employment? One view is that the data does not reflect the actual situation as the number of people counted as engaged in agriculture may overestimate those who are truly dependent on that sector. Although this view may be plausible, as will be discussed in Chapter 6, the main issue in rural areas is underemployment, due to the seasonal nature of agricultural activities. As evident from the household survey in 2004, the average number of hours worked in agriculture is 23 hours per week, compared to 42 hours in manufacturing and 44 hours in trade. Working members of the poorer rural households tend to work less than the richer ones, and this is closely related to access to land, inventories and agricultural inputs. Other issues associated with low progress in rural poverty reduction include higher dependency ratio, less reliance on labour incomes, and low level of education.

How are the agricultural reforms conducive to increased incomes of rural households? Agricultural policy reforms fall into the following broad categories<sup>22</sup>: land and farm restructuring; price, trade and market liberalization, privatization and enterprise restructuring; reform of the rural credit system. Key elements of the current agricultural strategy include completion of the land reform (mainly in the North of Kyrgyzstan), restructuring of public agricultural services, and a shift in public expenditures towards support for private commodity markets. Continued productivity growth in farming is essential for the sustainability of future agricultural growth<sup>23</sup>.

distribution and privatization of state farms served as core elements of agricultural reforms. In the early stages of transition, 49-year land use rights were distributed to private farmers, but in 1995 the rights were extended to 99 years. These developments effectively dismantled the state farms and reduced state control over agricultural activity. During these reforms about 286 thousand individual farms, cooperatives, and various unions were established. More than 77 per cent of the land was transferred to private ownership and land became an object of market transactions (sales, exchange, or use as collateral for loans). Despite numerous initial obstacles facing the system and the farmers (practice of the old management system, problems in splitting up efficiently, disruption in the supply of inputs and services, lack of access to credit, unsuitability of agro-equipment targeted to work at large farms), in 1996 the reforms showed a positive effect on output, as economic growth resumed. Regarding the assessment of the Kyrgyz Government, "the first phase of the land

<sup>22</sup> Mudahar (1998).

<sup>23</sup> World Bank (2004).

and agrarian reform has been successfully completed. As a result land obtained its owner, became an object for transactions, market relations were introduced in agriculture"<sup>24</sup>. Although the sale of land has been permitted since 2001, some transactions held in regions were related to economic distress and migration. However, the Kyrgyz Government recognizes that "further development of the agrarian reform requires new approaches. Therefore elaboration and implementation of a new agrarian policy is required, which would logically carry on main ideas of the first phase of land and agrarian reform, and identify priorities and directions of the agro-industrial complex development, structural, financial-credit policy and normative-legal basis of the reforms for the forthcoming period".

In terms of market liberalization, marketing and taxes, the reforms in the agricultural sector were conducted in the context of liberalization of the whole economy. Price regulation was abolished in the beginning of the major reforms, the external trade regime was liberalized to a significant extent and the Kyrgyz Republic became a WTO member in 1998. Some distortions in the sector still remain, mostly related to subsidies of the irrigation water price and light taxation of farming entities that pay only unified land tax.

The Government introduced reforms in the rural credit system in order to move from a directed and subsidized rural credit system to a commercial one. These reforms included the abolishment of credit write-offs, liquidation of the special bank, recovery of old debts, and an increase in interest rates. A large number of non-bank financial institutions have emerged since 1997. These provide most of the credit to agriculture, and their agricultural portfolios continue to expand following the enactment of defining legislation in 1999 and 2002. Many of these institutions are regarded as success stories in the region<sup>25</sup>. Among them are the Financial Fund "Bai Tushum" and the Kyrgyz Agricultural Finance Corporation, which primarily lend for agricultural activities, yet their ability to expand operations will depend on their ability to access additional capital. The banking sector is represented weakly by a few commercial banks, and in general, banks do not provide loans to the agricultural sector due to high loan losses in the past in this sector and the weaknesses in legislation to use land as collateral. The fact that finance is not reaching rural households is demonstrated by the fact that only 27 per cent of rural households are engaged in some form of borrowing, of which only 8 per cent comes from formal lending institutions (KIHS 2003). Thus, access to credit at a reasonable cost (to finance working capital and investments) remains a critical constraint in rural areas.

Commercialization of farming and yield improvements were among notable determinants of the decline in rural poverty. What are the agricultural reform outcomes that have been conducive to a sustained decline in rural poverty in recent years? As the Agricultural Policy Update of the World Bank states "the defining characteristic of the recent growth experience has been the reduction in subsistence food orientation and the emergence of commercially minded peasant farms. By 2002, small family farms operated 71 per cent of arable land and produced about one half of the value of production and the majority of the agricultural marketed surplus. They managed to improve crop yields (and to a lesser extent livestock yields) with relatively low input use levels through better management of the resources at their disposal than the previous landowners. They were also able to take advantage of regional price increases for crops and livestock by increasing commercial sales".

The increase in livestock and crop prices was another factor contributing to the decline in poverty. Rising prices was the dominant growth contributor to agricultural production driven mostly by external demand. By 2003-04 prices for key agricultural products (vegetables and

<sup>24</sup> Agrarian Policy Concept of the Kyrgyz Republic till 2010, Approved by the Kyrgyz Government Resolution in June 2004.

<sup>25</sup> World Bank (2004).

fruits, meat and milk) had risen by at least 30 per cent since 2000. A price comparison made by a World Bank study revealed that price dynamics in oblasts (regions) were closely correlated with the prices in the neighbouring regions of Kazakhstan and Uzbekistan. Livestock has proven to be an important income source for rural households: A simple regression of poverty versus its determinants has demonstrated positive and notable impacts on the poverty situation.

Thus, the experience of Kyrgyzstan with respect to economic growth and poverty reduction points out the important role that can be played by growth in agriculture. Although it has been argued (in Chapter 2) that for poverty reduction to take place on a sustained basis, economic growth needs to be associated with a shift of people away from low-productivity sectors like agriculture to sectors characterized by higher productivity and returns, e.g., industry and services, during the initial stages of development when large numbers of the poor are concentrated in agriculture and the growth of other sectors remains sluggish, growth and improvements in productivity in agriculture can be very useful in reducing poverty, especially in the rural areas<sup>26</sup>. From that point of view, policies aimed at boosting productivity in agriculture can be extremely valuable. However, it needs to be mentioned at the same time that from the point of view of poverty reduction, the participation of small and marginal farmers in the yield raising programmes in agriculture and the distribution of the benefits of increases in productivity in agriculture would be critical.

### 5.3 Informal Type Manufacturing Activity in Urban Areas

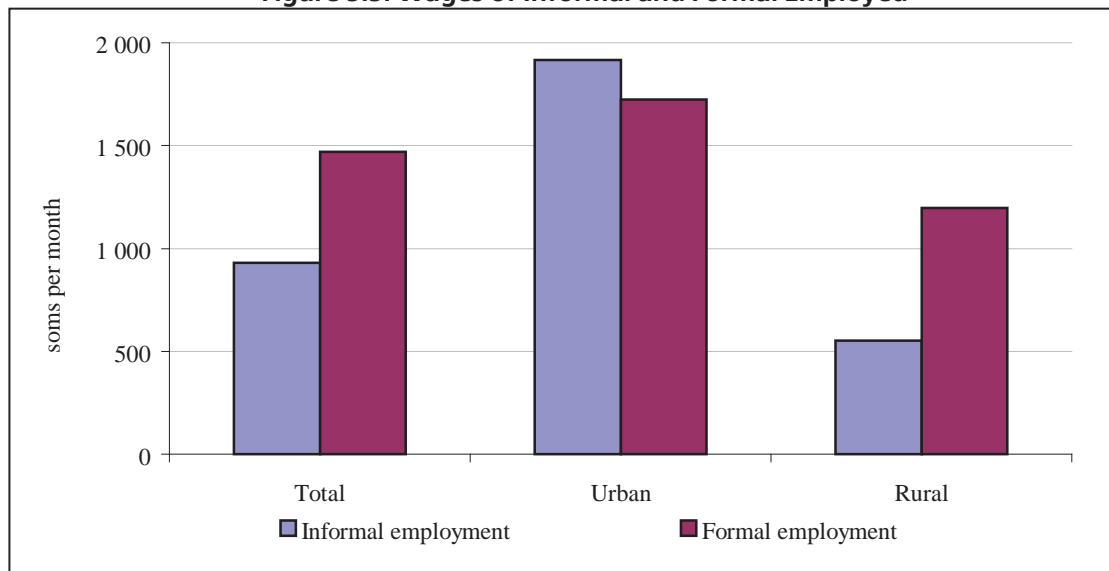
The informal sector<sup>27</sup> represents an important part of the economy in the Kyrgyz Republic and thus plays a major role in employment creation, production and income generation. According to NSC estimates, the total value added of informal and hidden activities has in some years reached up to 50 per cent of GDP<sup>28</sup>. Most of this value added comes from informal legal activities, mainly from the agricultural sector. Given the level of 'rural-urban' internal migration, the informal sector also tends to absorb most of the growing labour force in the urban areas serving as a survival mechanism in coping with unemployment, low wages and pensions.

Nominal wages of informal sector workers are higher in urban as opposed to rural areas. The informal economy clearly plays a major role in generating economic growth and employment. Data from household surveys can be used to compare wages in the informal sector with those of the formal sector. As illustrated in Figure 5.5, wages in the informal sector are generally lower than in the formal sector, and this is driven mostly by the feature of the employed in rural areas. What is surprising is that wages of urban households employed in the informal sector are higher than of those who work formally. One explanation for this may be that most of the employed in the formal sector work for the public sector, where wages are lower compared to the private sector. As for the rural areas, the wages in the formal sector are more than the double of those in the informal sector, implying the existence of few formal out-of-farm job opportunities.

<sup>26</sup> Vietnam's experience with poverty reduction in the 1990s provides a similar example. See Islam (2006a) and Huong, et al. (2006).

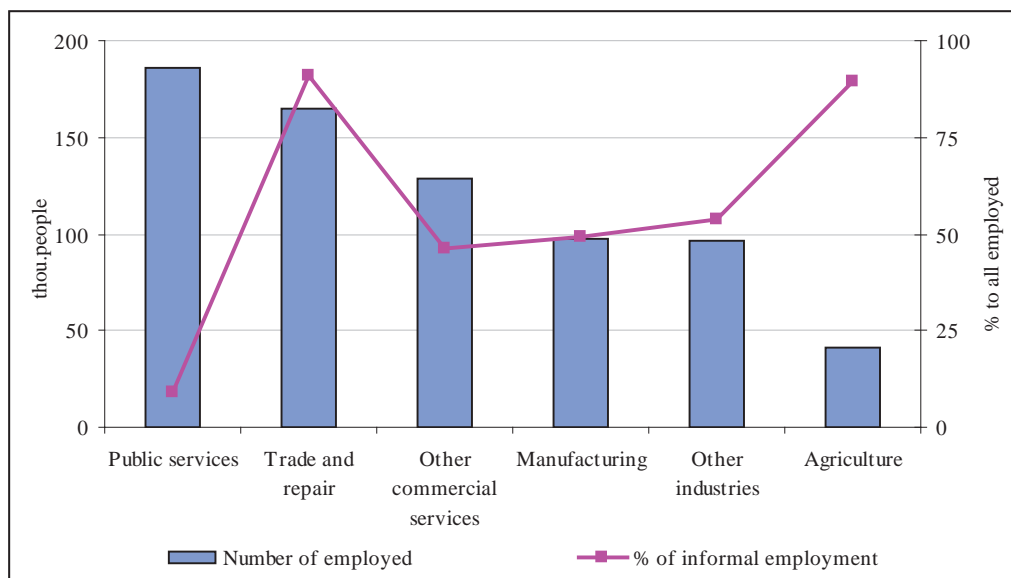
<sup>27</sup> For the definition and measurement of the informal economy, see section 4.4 in Chapter 4.

<sup>28</sup> NSC report on shadow economy for the Joint EuroStat, OECD and Russia seminar on problems of statistical estimation of unobserved economy, Sochi, October 2000.

**Figure 5.5: Wages of Informal and Formal Employed**

Source: KIHS 2004

Based on NSC assessment, informal activity in the Kyrgyz Republic is mostly concentrated in agriculture and trade. As for informal and hidden production in urban areas, such activities are mainly concentrated in food, textile and furniture production of small and medium enterprises. The Labour force survey for 2004 allows for an analysis of the composition of employment in urban areas by economic sectors. About 716 thousand people residing in urban areas are classified as employed, with 50 per cent being involved in informal sector activity. As mentioned earlier, commercial services sector represents the highest concentration of informal employment. For example, 91 per cent of the employed in the trade sector are classified as informal workers. As for the manufacturing sector, 49 per cent of the employed are classified as involved in informal activity.

**Figure 5.6: Informal Employment in Urban Areas, 2004**

Source: KIHS 2004

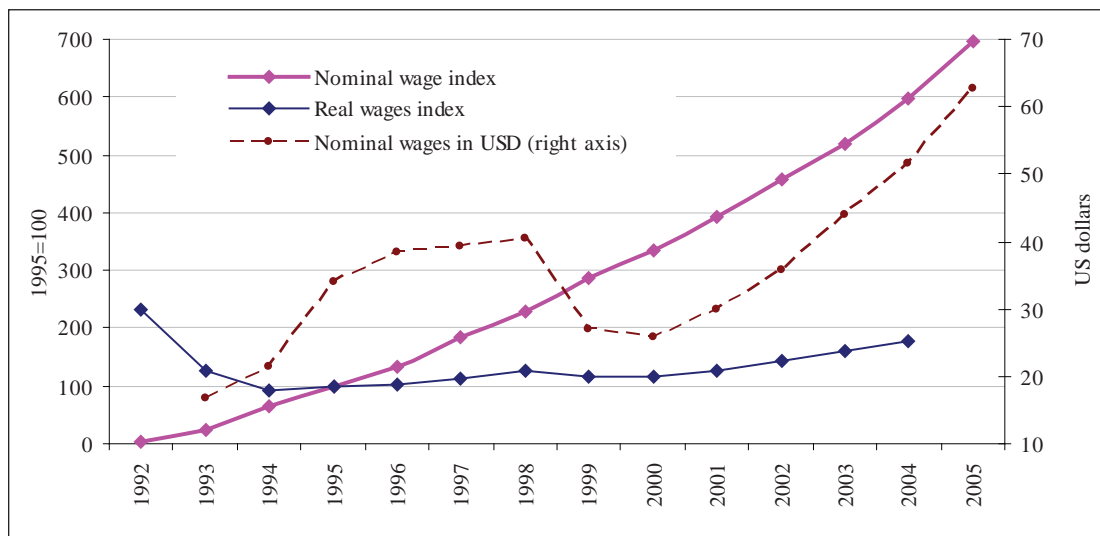
Textile production remains one of the most competitive sectors of the Kyrgyz economy. This industry was successfully developed in the Soviet times, with both wool and cotton being produced on a large scale. It used provide employment for about 300 thousand people. Disruption of the production chain led to the closing of large factories, and after some years of stagnation, textile production became one of the largest employment and export sectors.

According to some estimates, the production of the textile industry could be up to 20 billion soms equivalent to about 500 million US dollars. Largely operating in the informal economy, this sector provides about 150 thousand working places<sup>29</sup> (both in terms of production and trade) and its export share is equal to 10 per cent of total exports. Given the successful development of this sector, in 2006 the Government undertook a series of measures to formalize this activity and to ease regulation and taxes.

#### 5.4 Trends in Labour Productivity and Real Wages by the Different Sectors

It is important to note that the data on wages used in this analysis is based on administratively collected information that does not provide a perfect picture of the extent and evolution of labour income. Taking into account the large informal sector, information on wages is subject to measurement errors and therefore, wages represent only a portion of total cash incomes. For example, as the household survey for 2004 reveals, in rural areas labour income represents only 48 per cent of all incomes.

Figure 5.7: Nominal and Real Wages, 1992–2004



Source: NSC

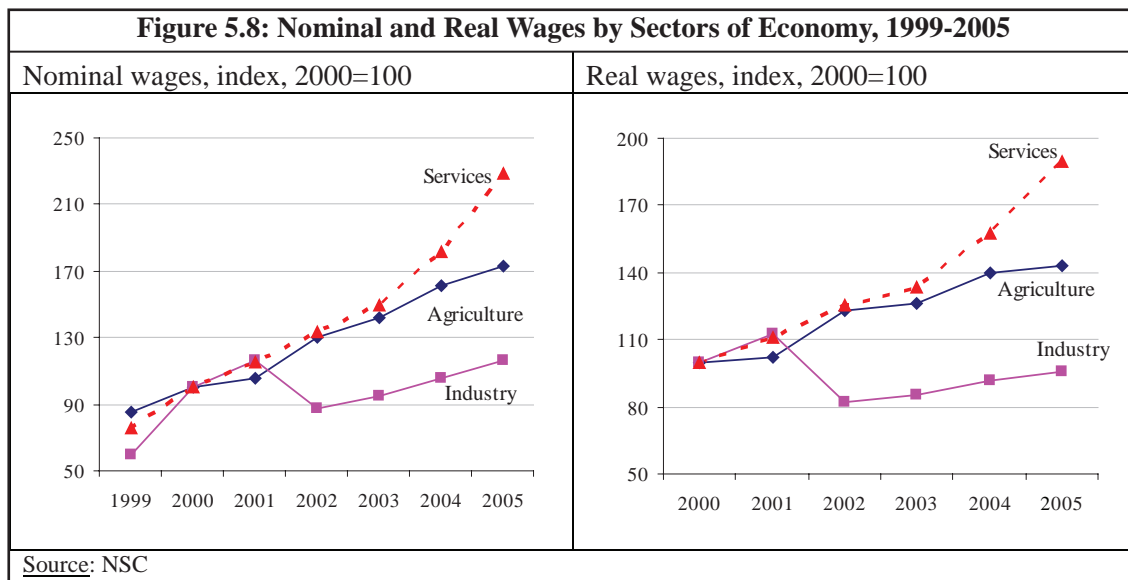
As shown in Figure 5.7, nominal wages have been rising by a considerable rate. During the period 1995–99 the annual increase of nominal wages was around 36 per cent (almost three-fold cumulative increase); from 2000–2004 the growth rate averaged 17 per cent (two-fold growth in cumulative terms). The sectors that experienced the highest growth in wages were commercial services and industry. In terms of US dollars, average wages rose from 17 dollars in 1993 to 40 dollars in 1998. The sharp depreciation of the som as a result of the regional currency crises led to a decline in wages after 1998 down to 26 US dollars in 2000. In recent years, there has been a steady increase in wage and in 2004 average wages were equal to 63 US dollars. The obligatory, yet low minimum wage of 100 soms per month has played no role in securing the living standards of the employed, as this amount was equivalent to only 13 per cent of the absolute poverty line and only 21 per cent of the extreme poverty line in 2004.

Unlike nominal wages, real wages grew less rapidly. Taking into account the hyperinflation that took place during 1992–1994, it is not surprising that real wages declined to a minimum level in 1994. Since then real wages have been rising, and were in 2004 76 per cent higher than in 1995 according to the index of real wages. It should be noted that low inflation rates in recent years has allowed real wages to grow at a faster pace (on average 11 per cent during 2001–04), and this is one of the reasons for the overall decline in poverty.

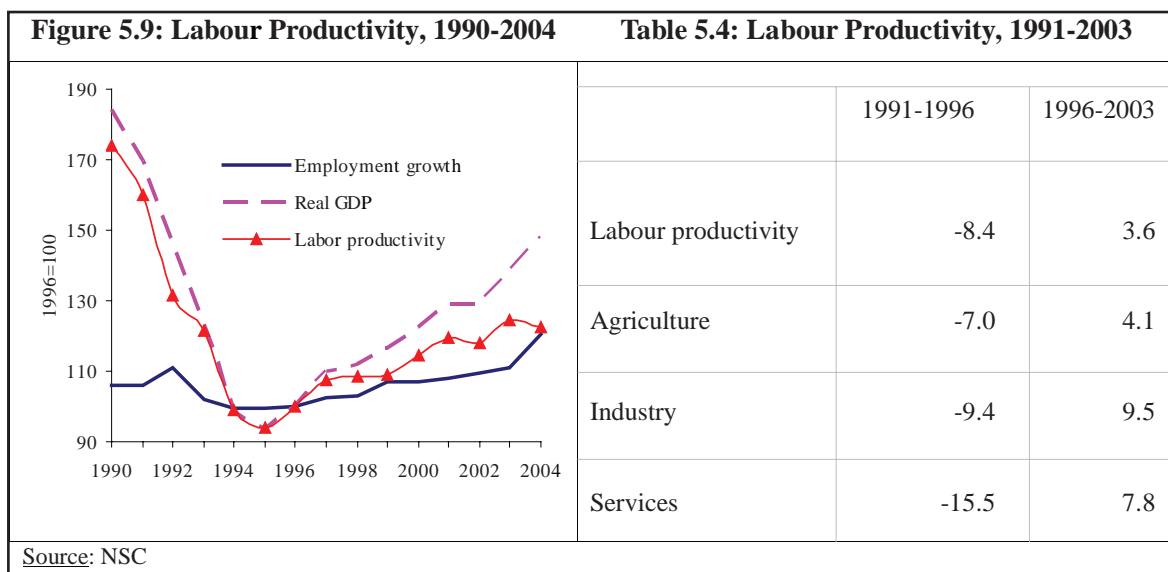
There is no complete comparable time series data for wages by sectors. Sectoral wage data starts from 1999 and in examining the development of both nominal and real wages in the period since then, it is clear that the services sector has experienced the highest wage growth followed by agriculture, while real wages in industry have been almost stagnant. It should be noted that in monetary terms industry sector still pays a higher salary than the ser-

<sup>29</sup> Newspaper Slovo Kyrgyzstana, # 85, 2006 (<http://www.sk.kg/2005/n85/obch9.html>).

vices and agricultural sector (by several times in the case of the latter). For instance, in 2000 wages in agriculture and services represented one-fifth (618 soms) and a half (1571 soms) of industry wage (2947 soms), respectively. By 2005 the situation had changed notably: wages in agriculture were only three times less than in industry, while wages in services were slightly higher than in industry.



What has been the overall progress in labour productivity in recent years? After a sharp decline during the initial years of transition, labour productivity started increasing since 1995. But it is clear from Figure 5.9 that the level of 1990 has not yet been reached. With positive GDP growth and employment growth, overall labour productivity has increased since the mid-1990s and the contribution of increased labour productivity to growth has been higher than that of the contribution of increased employment. For example, out of the 5.1 per cent average growth rate during 1996-2003, 3.6 per cent was due to improved labour productivity. As expected, productivity growth in agriculture has been lower compared to in services and industry. However, labour productivity growth has not only been due to the reallocation of people to more productive activities, such as industry.





Agriculture, which is usually considered a low-productivity sector, showed less reduction in labour productivity during the early transition period (1991-1996), although also less progress after the mid-1990s compared to other sectors. Labour productivity in industry has seen the highest progress among the three sectors, but it has barely recovered to its level in 1990. Services were the single sector experiencing dynamic growth in employment, but at the cost of a lower than potential increase in labour productivity.

How did real wages do in relation to changes in labour productivity? It appears that since 2000, real wages moved favourably in relation to the growth of labour productivity. But there is some asymmetry in this respect between the sectors. While the growth of labour productivity was the highest in industry, real wage growth in that sector was the lowest.

### 5.5 Remittances and Poverty Reduction

International migration has become a notable economic phenomenon in the Kyrgyz Republic in recent years. Having started from shuttle trade in the first years of transition, when individual traders discovered the benefits of re-exporting goods to the Russian Federation, it became a permanent activity for many entrepreneurial individuals and a means of escaping from poverty. This process, obviously, was driven by far higher growth rates in neighbouring countries, like Kazakhstan and Russia. There is no accurate estimate of the actual number of Kyrgyz labour migrants working abroad, but existing estimates are around 300,000 people, which is equivalent to 14 per cent of the national labour force<sup>30</sup>, or comparable to the number of employed in the industrial sector. A forthcoming remittances study carried out by the ADB could shed some light on this issue and provide a better estimation of labour migration.

Empirical evidence suggests that international migration might be conducive to poverty reduction in developing countries. Based on an analysis of 74 low and middle-income countries, Adams and Page (2003) found that 'a 10 per cent increase in the share of international migrants in a country's population will lead to a 1.9 per cent decline in the share of people living in poverty (\$1.00/person/day)'. They found that 'international remittances, defined as the share of remittances in country GDP, have a strong, statistical impact on reducing poverty. On average, a 10 per cent increase in the share of international remittances in a country's GDP will lead to a 1.6 per cent decline in the share of people living in poverty.' In the Kyrgyz Republic, the impact of labour migration through remittances sent from abroad has had a notable effect on various spheres of economic life in recent years.

As Adams and Page noted, existing data on remittances in most countries does not capture all inflows of remittances, due partly to the share of illegal labour migrants who send money back using non-official channels. In the case of the Kyrgyz Republic, the relatively close distance to labour recipient countries, namely Kazakhstan and Russia, determines the large share of remittances sent back using non-official channels. However, as the National Bank of the Kyrgyz Republic reports, the use of banking systems and other means of non-cash transfer systems by labour migrants is becoming increasingly widespread. According to estimates by the Kyrgyz Central Bank, workers' remittances are growing very rapidly, with the net inflow in 2005 being about US\$280 million, (representing more than 12 per cent of GDP), which is ten times higher than in 2002 when the amount was estimated to be US\$28 million. The actual growth rate of remittances may not be as dramatic, and it is plausible that these figures reflect improvements in statistical recording. Based on the survey of migrants undertaken by the Economic Policy Institute in Bishkek, in 2003 inflows were estimated to be about US\$520 million, equivalent to 27 per cent of GDP.

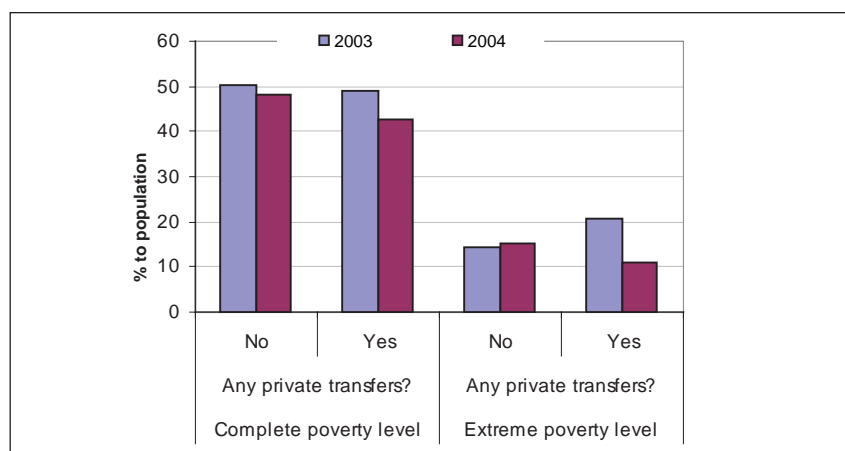
<sup>30</sup> This estimation includes only those migrants who do not change citizenship and who travel to other countries solely for economic reasons.

**Table 5.5: Kyrgyz Republic: Workers' remittances, 2001-05 (million US dollars)**

	2001	2002	2003	2004	2005	2006p
Workers' remittances, net	1.5	28.2	65.1	163.7	280.5	
Inflows	4.5	30.3	70.3	179.1	313.3	492.4
Outflows	3.0	2.1	5.2	15.4	32.8	
Remittances inflows as:						
% to GDP	0	2	4	8	13	17
% to exports	1	5	9	19	33	42
% to international reserves	2	10	18	32	51	60

Source: NBKR, Quarterly BOP publication; includes estimates from official sources

Figure 5.9 indicates that the households having some private transfers as a source of income were better off in terms of poverty outcomes, although it is not obvious how significant private transfers were in poverty reduction. Households-recipients of private transfers demonstrated increased progress in reducing the poverty level in 2004 compared to those that had no private transfers. As existing studies have shown, increased consumption is the main channel through which remittances affect poverty. Data on private transfers as percentage of consumption (presented in Table 6.3 in Chapter 6) also indicates the role played by remittances in reducing poverty. Private transfers account for a higher share of consumption in the lower consumption groups compared to the higher consumption groups. The difference appears sharper in the urban area.

**Figure 5.9: Private Transfers by Poverty Status of Households**

Source: KIHS 2003 and 2004.

Remittances are mainly used for consumption. What are the main usages of remittances by households-recipients? The migrants' survey conducted by the Economic Policy Institute in 2005 revealed that these transfers mainly led to an increase in consumption. Around 56 per cent of the remittances were spent on everyday consumption (food and clothing) of the receiving households, while 13 per cent of funds were spent on higher value items such as cars or home appliances. This is basically explained by the fact that most migrants represent major breadwinners of these households and points to the anti-poverty nature of the remittances. Only 10 per cent of remittances were directed towards investment purposes (opening business, real estate), and the improvement of human capital (training, medical services).

Most returned migrants intend to go abroad again. The second labour migrants' survey and analysis was conducted by the World Bank as part of its regional study examining mainly returning migrants. The survey was undertaken during the period of June-July 2005 in various



locations throughout the country<sup>31</sup>. According to the report, more than 70 per cent of migrants intended to leave only temporarily and then return to Kyrgyzstan, which is not surprising, considering that most migrants worked abroad to resolve pressing financial problems. More than 45 per cent of the migrants interviewed intended to return abroad, indicating that migration from Kyrgyzstan is mostly circular in nature. It is likely that migrants return to work abroad because they have not yet fulfilled the goals for which they migrated in the first place (buying a house, saving for children's education, etc.).

Seasonal workers earn less than migrants with stable jobs. The same World Bank study has found that those who have permanent jobs send back larger size remittances than those who work on a seasonal basis. For example, migrants with permanent jobs sent back 2000 US\$ annually, while those who were engaged in seasonal work sent back around 1270 US\$ annually. Given that most migrants who come from urban areas have a better educational background, there is also a significant difference in the size of remittances originating from rural and urban migrants. Existing studies contain no explicit analysis of the correlation between educational background and size of incomes in terms of remittances. However, the World Bank survey demonstrated that labour migrants from the Kyrgyz Republic are generally fairly well educated with 24 per cent having university degrees, and another 9 per cent having attended university at some point. Women-migrants on average tend to be better educated with 30 per cent having university degrees compared to 20 per cent of male-migrants. Migrants with technical vocational education make up 31.5 per cent of the sample, while 33 per cent of migrants have high school diplomas.

Economic migration probably has more benefits than drawbacks in the Kyrgyz Republic. The fact that workers are able to find employment abroad relieves pressure on the domestic labour market as characterized by high unemployment and underemployment level. The remittances that the migrants send back/ bring back home allow for increased household consumption and, in macro term, has the potential to contribute to further economic growth and reduction of poverty. However, in order to transform the development potential into reality, it would be necessary to put in place incentives for the productive use of remittances and also for the returning migrants (or the diaspora) to make productive investments in the economy. The likely negative consequences of this phenomenon are mostly long-term. As existing studies have shown, the bulk of labour migrants are young and this may lead to a potential shortfall of the labour force in the medium term as well as to an imbalance in the demographic structure of the population. The efforts of the Russian Federation in providing a favourable regime for former Soviet country migrant workers to obtain citizenship is attracting young labour migrants to remain permanently in the receiving country. Thus, brain drain could be a potential problem if the sending country would like to focus on the development of technology and a knowledge based economy.

<sup>31</sup> This is from the first draft report that based on this survey and prepared by World Bank. The sample size of the survey was 1,424 individuals selected via snowball sampling method from 9 primary sampling units representing 7 regions of the Kyrgyz Republic, the capital Bishkek city and the second largest city Osh. Interviews were proportionately allocated according to the share of urban/rural population in each primary sampling unit to ensure that the research sample was representative of the country (see Appendix 1). The structure of the questionnaire used in this survey makes it possible to understand various aspects of migrants' economic life before migration, during their time abroad, and after return.

## Chapter 6. Employment and Poverty Reduction: An Analysis Using Household Data

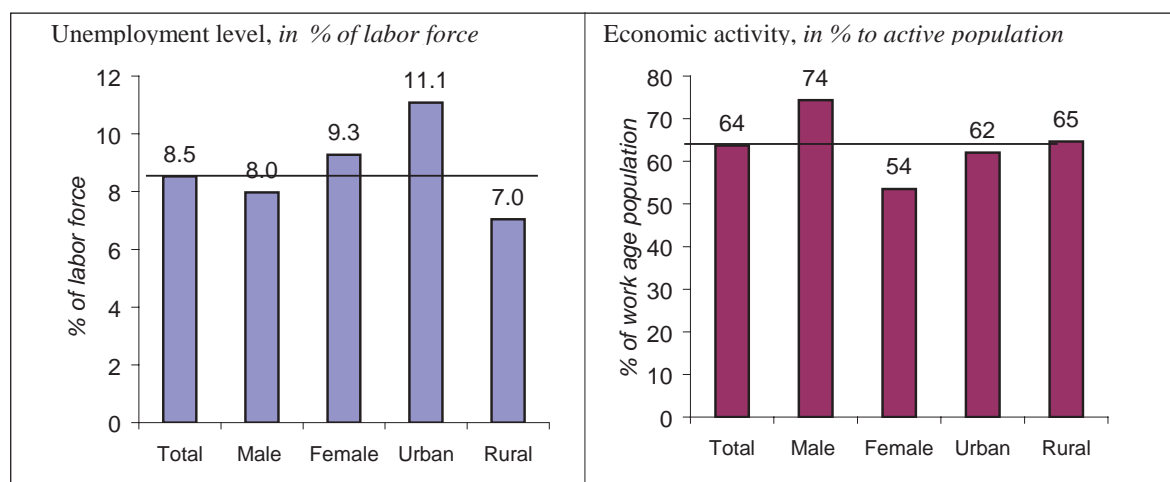
### 6.1. The Role of Employment and Labour Market Variables in Poverty Reduction

Data on employment and type of work provide very important information in order to understand the poverty situation since revenue from labour activity is the main source of income for both poor and non-poor households. The analysis of labour market and poverty data presented in this section is based on the Integrated Household Survey (KIHS) implemented in the Kyrgyz Republic for the year combined with the Labour Force Survey (LFS) and poverty modules. The KIHS survey has been implemented by the NSC of the Kyrgyz Republic since 2003; and the availability of data on labour market indicators and poverty makes it possible to analyse the interrelation between these two important variables. The LFS module in the KIHS serves as an important source of information both on the total labour force (the employed and unemployed population) as well as on all inactive groups of the population. With regard to the employed population the survey considers all status groups, i.e., not only workers and servants (who receive a fixed salary) including the self-employed (at family enterprises) and also employers, employees in self-employment fields, members of cooperative producers as well as other contributors to family income. Usually the data includes information on employment for the last two weeks. In the survey itself no distinction is made between persons working full-time and part-time, yet this distinction can be made using the number of working hours per week.

Labour force statistics collected by the NSC is based on the concepts and definitions as recommended by the ILO in 1982. The adult population, including people aged 16 and above, is broken into three mutually exclusive groups: (1) employed; (2) unemployed; and (3) inactive population, i.e., persons who are not part of the labour force. The employed population includes all persons who are involved in paid labour (including family business) during the period under review. The category of unemployed includes people who do not have jobs during the period of review, yet are ready to start working and are and have been actively searching for a job during the four preceding weeks. Persons who are neither employed nor unemployed are considered inactive and are excluded from the labour force.

The labour market data is based on the LFS of 2004 according to which the total population aged 16 and above (the so called active population) was 3.42 million people of which the labour force including both employed and unemployed was estimated to be 2.18 million people. The number of unemployed was 185.7 thousand and according to the ILO estimate, the level of unemployment was 8.5 per cent. Economic activity, i.e. the ratio of the amount of employed and unemployed to the total active population was 64 per cent.

As shown in Figure 6.1, the unemployment level is higher in urban areas and among females. The participation coefficient of these categories allows us to conclude that they constitute the majority of those who quit searching for a job. The fact that in rural areas people experience a lower level of unemployment comparable to average national level of economic activity according to formal definition is a true indicator, however, further analysis suggests that in rural areas people suffer from underemployment and low-output work. The low level of unemployment and high economic activity of males as compared to females is not surprising due to many economic and cultural factors. However, this points to the existence of gender inequality in the labour market - an issue which may be analysed further.

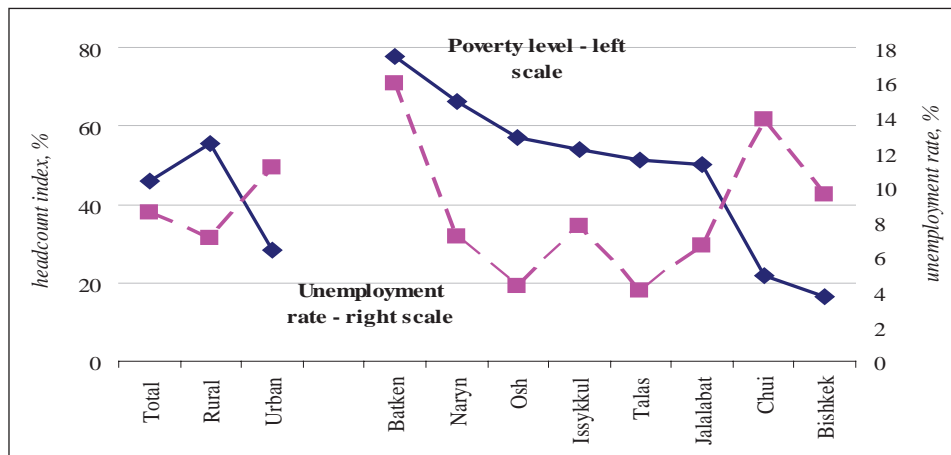
**Figure 6.1: Unemployment Level and Participation Coefficient, 2004**

Source: NSC, KIHS – 2004, author's estimates

### *How data on labour force may explain poverty reduction*

Although it is not easy to empirically establish a clear link between employment and poverty, data from household surveys provide some interesting insights in this respect. The labour force participation level of poor household members is comparable with the participation of non-poor, but the unemployment level among the poor population is higher. For example, based on KIHS for 2004 the unemployment level among people that belong to the poorest quintile is 11 per cent whereas this figure for the richest quintile is 6.5 per cent. This is indicative of the importance of employment (even in quantitative terms) in reducing poverty. On the whole, poor households are usually as active as the non-poor, but certain factors such as being employed in low-productivity sectors, lower levels of education and wide spread underemployment increase the risk of ending up among the poor.

The unemployment level may not necessarily be correlated with the poverty level in rural and urban areas and by region. Poverty levels in the Kyrgyz Republic differ significantly between urban and rural areas and by oblast, which are the largest administrative units. The poverty situation is the worst in Batken and Naryn oblasts whereas in Bishkek city and Chui oblast the situation is significantly better. Thus, even though one might expect a positive correlation between the levels of unemployment and poverty, this is not observed in the Kyrgyz Republic. In fact, Figure 6.2 shows that higher poverty level and lower unemployment level are observed in rural areas as compared to urban areas. However, low unemployment level in rural areas does not imply a full utilization of the labour force, given seasonal employment and high levels of or underemployment in these areas.

**Figure 6.2: Unemployment and Poverty levels, 2004**

Source: NSC, KIHS – 2004, author's estimates

An analysis of unemployment and poverty levels by oblast level shows a positive correlation between these two indicators only in Batken oblast and to a certain degree in Naryn oblast. The opposite picture is seen in Chui oblast and the capital city (Bishkek) representing the most developed areas both economically and industrially. This can be explained to a certain degree by a number of factors such as the prevalence of urban settlements (and, consequently, the absence of productive intra-economic activity which exists in rural regions), closure of large enterprises inherited from the Soviet regime, a high level of internal migration and a surplus of additional labour force in these regions.

A cross-tabulation of poverty status of the employed to their respective sectors reveals expected results. For example, the incidence of poverty is the highest among those engaged in agriculture. There is a sharp contrast of poverty rates between urban and rural households irrespective of the sector, with about 25 per cent of the employed in urban areas being classified as poor, and 50 per cent of rural workers. Commercial services provide jobs for 25 per cent of all employed, and, with about 33 per cent of workers being classified as poor, this sector is one of the most efficient in terms of providing higher incomes. With regard to industry, although the number of employed in urban and rural areas is nearly the same, the poverty level varies significantly. Does this mean that industrial enterprises, located in rural areas, are less productive? One of the explanations might be that the abundance of rural labour allows rural industrial enterprises to set wages at a considerably lower level than companies in urban areas.

**Table 6.1: Poverty Level and the Distribution of Employed among Sectors, 2004**

Sector	Poverty level, %			Distribution of employed, % to total		
	Total	Urban	Rural	Total	Urban	Rural
Total	42	25	50	100	35	65
Agriculture	54	26	56	40	2	38
Industry	34	27	43	17	9	8
Market services	33	25	43	24	14	10
Public services	34	24	44	19	9	10

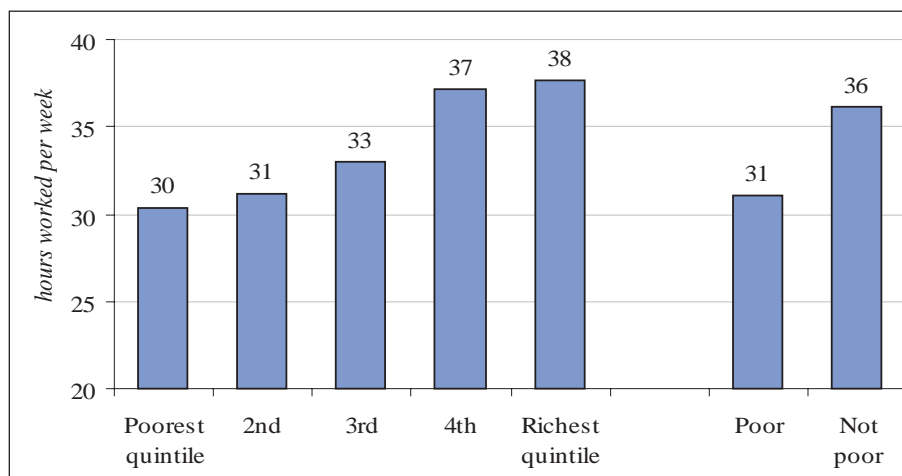
Source: NSC, KIHS 2004, author's estimates.

A lower number of working hours is associated with a higher level of poverty. Household survey findings suggest that the number of hours worked per week is 34.3 for all employed

people<sup>32</sup>. Clear, although not very steep, increase in working time is observed among consumption quintiles. Figure 6.3 shows that in 2004 workers of the poorest quintile worked 30 hours per week whereas workers of the richest quintiles worked on average 38 hours. If we categorize the first two quintiles as “the poor” and the following three quintiles as “the not-poor”, then on average, “the poor” worked only 31 hours whereas for “the not-poor” this figure was 36 hours. This means that the employed poor population automatically loses one day a week and as they represent about one third of the employed this implies an inefficient use of labour resources.

Taking into account the fact that according to legislation the maximal number of working hours per week is 40 hours it becomes clear that shorter working time is due to less working hours in rural areas.

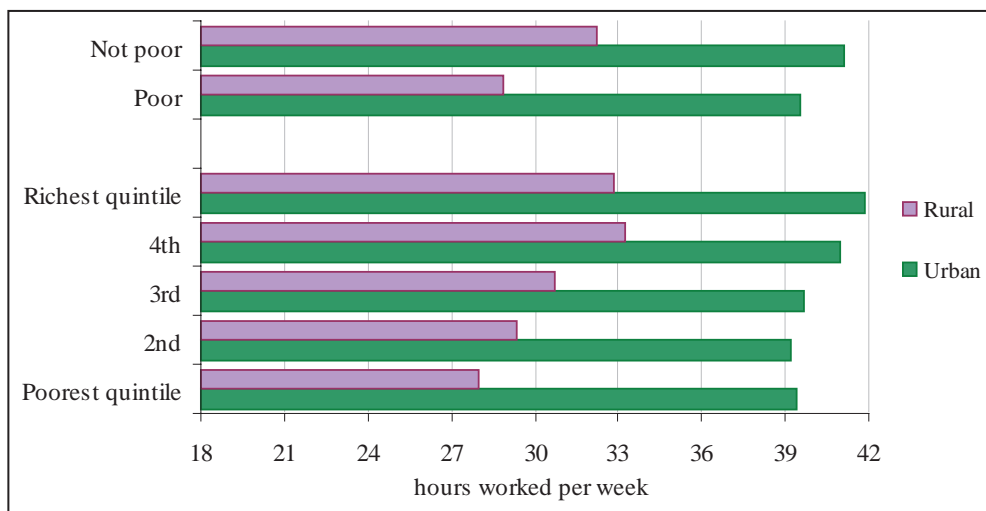
**Figure 6.3: Average Number of Hours Worked, 2004**



Source: NSC, KIHS – 2004, author's estimates

Underemployment is a serious issue in rural regions due to a number of factors including low labour productivity due to work in small economies. According to the KIHS 2004, agriculture which is the main sector in these regions provided work for 39 per cent of the employed population in 2004. In relation to efficiency in the use of labour force resources, this may however show unfavourable results. The average number of hours worked per week in agriculture is 23, which means that households are only working (in this sector at least) half of the legislative amount of 40 hours. Naturally, this average conceals an uneven distribution of labour workload during the year which to a great extent may be explained by the seasonal nature of work in rural area. In examining the extent to which rural households search for additional work it is found that this presents an insignificant portion of the employed population. Generally, rural residents find additional work in the same sector due to lack of alternative opportunities. Thus, the poverty level in rural regions is closely correlated with underemployment (Figure 6.4).

<sup>32</sup> Taking into account main and additional work.

**Figure 6.4: Average Number of Hours Worked in Urban/Rural Regions, 2004**

Source: NSC, KIHS – 2004; consumption quintiles, author's estimates

Income from work represents a major source of cash income<sup>33</sup> (see Table 6.2). The employers who constitute only 1 per cent of the total employed population have the highest cash income. Two large categories of workers – those recruited by private persons and those working in formal enterprises – are very similar in terms of salary, hours worked and poverty level. Another large category of workers labelled “Household contributors” (persons involved in household work) located almost entirely in rural area represents household members that do not look for alternative sources of income. Considering that this category has a relatively low level of income and that the number of worked hours is only 19 per week this might imply that the employment potential of this group are not being fully utilised.

**Table 6.2: Type of employment, salary and poverty level, 2004 (%)**

Employment category	Distribution of employed, %	Total cash income, soms per month	Wage income, soms per month	Poverty rate, %	Hours worked per week
Employers	1	3 768	2 755	28	41
Employed by individuals	15	2 047	1 800	35	43
Self-employed	28	1 963	1 074	50	33
In enterprise/organization	33	1 773	1 492	31	40
Members of cooperatives	1	1 107	660	37	37
Employed in farms	0	882	672	37	40
In-house activity	7	326	4	30	24
Household contributors	15	210	115	63	19

Source: NSC, KIHS 2004, author's estimates.

As indicated in Table 6.2, people that reported to be self-employed constitute about 28 per cent of the total employed population representing the second largest group of the employed and living predominantly in rural area (about 75 per cent). The income level of the self-employed is the lowest and poverty indicators are the highest as compared with other large categories of the employed population (with the exception of the category of household

<sup>33</sup> Salary received from main and additional jobs as well as income from self-employment are included.



contributors)<sup>34</sup>. Almost half of the self-employed belong to the “poor” category which may possibly be explained by the instability of this type of work and the fact that the majority work in the agrarian sector. If we look at the efficiency aspect for this category, the average number of hours worked is only 33 hours per week, which is relatively low – exceeding only the corresponding figure for the “household contributors”. In sum, leaving aside the “household contributors”, poverty is highest among the self-employed followed by members of cooperatives and those employed in farms.

## 6.2 Receipt of Money Transfers and Work in the Informal Economy

Money transfers play a significant role in growth promotion. According to various estimates the number of Kyrgyz citizens working abroad varies from 14 per cent to 23 per cent of the total labour force. The fact that such a large number of citizens are able to find work abroad substantially reduces tension in the domestic labour market diminishing the problem of unemployment. Moreover, empirical evidence suggests that remittances play a significant role in ensuring economic growth and poverty reduction through an increased quality of consumption among households that receive money transfers<sup>35</sup>.

**Table 6.3: Private Transfers as a Ratio of Household Income and Consumption, 2004**

	Private transfers as % to income			Private transfers as % of consumption		
	Urban	Rural	Total	Urban	Rural	Total
By consumption quintiles						
Poorest quintile	7.6	6.9	7.1	8.7	4.1	5.0
2 <sup>nd</sup>	9.7	7.1	7.8	8.1	3.9	4.6
3 <sup>rd</sup>	8.9	6.6	7.3	7.0	3.6	4.4
4 <sup>th</sup>	6.4	6.1	6.3	4.5	3.3	3.9
Richest quintile	7.2	7.0	7.1	4.8	2.3	3.4
Average	7.5	6.8	7.1	5.4	3.3	4.1
By poverty status						
Not poor	6.8	6.4	6.6	4.7	2.8	3.6
Poor	9.7	7.1	7.9	8.8	4.0	5.0

Source: NSC, KIHS – 2004; consumption quintiles, author's estimates

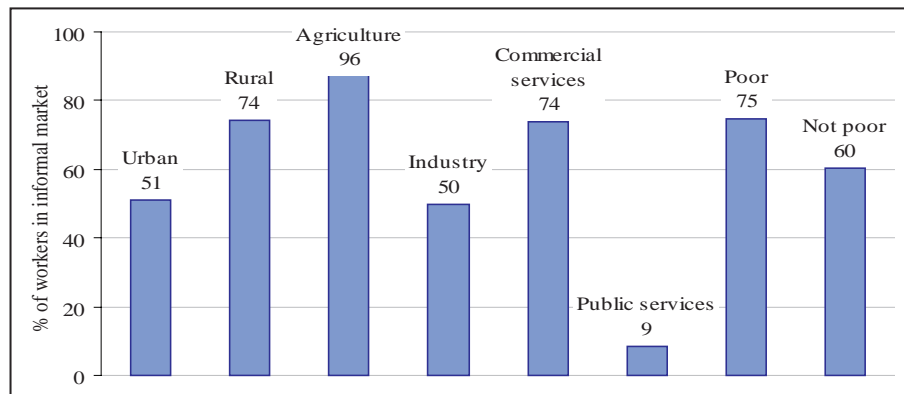
Money transfers from private persons represent the third major source of income after salaries and pensions. Unfortunately, the KIHS 2004 does not include money transfers from working migrants, considering only amounts of transfers received by households from relatives and friends. This indicator referred to as “transfers from private persons” takes into account all transfers received by household from relatives living in the country and abroad. In the present analysis this indicator has been used to represent transfers from abroad, making it difficult to identify the amount of transfers received solely from working migrants. Survey findings suggest that money transfers constitute an important income source of households and make about 7 per cent of all monetary income (pensions represent 12 per cent). Money transfers account for about 4 per cent of household consumption (Table 6.3) and undoubtedly play a more important role for urban households as compared to rural residents (not only as coefficient but also in absolute figures). In examining the importance of money transfers by consumption quintiles or poverty level (Table 6.3) it becomes clear that the richer the household the less important is the role of transfers in the consumption.

<sup>34</sup> One may be interested in comparing the average wage rates in various occupations with the poverty line. If one recalls (from Box 3.1 in Chapter 3) that the poverty line (for 2003) was estimated to be about 24 Som per day, the average wages in cooperatives and farms do not appear to be enough from the point of view moving above the poverty line.

<sup>35</sup> According to the balance of payments of the National Bank of the Kyrgyz Republic money transfers made up 8.1 percent of GDP in 2004 and 13 percent in 2005. In comparison, direct foreign investments for the same years were 7.9% and 1.8% respectively.

According to the NSC about 66 per cent of the active labour force is employed in the informal sector<sup>36</sup>. Moreover, the data suggests that the majority of people employed in this sector reside in rural areas where about 75 per cent of the population are involved in the informal labour market as compared to 50 per cent in urban regions. An analysis of the distribution of the employed population by sectors of the economy shows that almost all of those employed in the agrarian sector are categorised as working informally while for industry the share is 50 per cent. Informal employment is also widespread in the sphere of commercial services since the majority of such services (transport, trade and food) are provided by minor enterprises and private entrepreneurs. Since public administration, health and educational sectors are state owned it may be expected that the share of informal activity in these sectors is relatively small.

**Figure 6.5: The Prevalence of the Informal Sector, 2004**



Source: KIHS 2004

An analysis of the distribution of working members of poor and non-poor households in formal and informal activities clearly indicates that the majority of the poor are employed in the informal sector (75 per cent) while the share of informal employment for non-poor households is lower, although still significant (60 per cent) (Table 6.5). Working in the informal sector is closely linked to the level of education. For example, only 30 per cent of people with university level education work in the informal sector whereas 81 per cent of workers with secondary education, who represent the largest category of the labour force, work in the informal sector.

### 6.3 The Role of Education and Skills in Poverty Reduction

It is generally recognized that education increases the possibility of finding work in the labour market and receiving a higher salary. This implies that access to education is a key factor in escaping poverty. The general educational level of the population of the Kyrgyz Republic is relatively high as a result of historically large investments in education during Soviet times. International evidence shows that people with higher level of education are less prone to poverty and have increased opportunities for employment although this difference is not as apparent in Kyrgyzstan as in other countries. (Table 6.4).

Workers with secondary and incomplete secondary education are more prone to poverty risks. Findings from a household survey implemented in 2004 suggest that 48 per cent of the employed population in Kyrgyzstan has “only” secondary education and that this group is the most vulnerable with regard to poverty, with 50 per cent – belonging to the category of the “poor population”. This can be partly explained by the fact that 75 per cent of this population group works in rural areas where opportunities to find higher paid job are limited. In fact, in

<sup>36</sup> The definition of the informal sector corresponds to ILO recommendations and includes all types of activity which produce goods and services predominantly to ensure employment and profit-making for working persons. As a rule, no labour agreements are signed in accordance with the law and labour relations are built on occasional, relational, personal or social relations. Usually, larger part of informal produce is used for own consumption although some part may be sold at the markets. Hence, informal employment includes entrepreneurs who are not legal entities, persons employed by private bodies, persons in self-employment sphere, persons working at households and production structures for own use.



terms of the poverty level there is a significant difference between workers in rural and urban regions and this applies not only to people with secondary education but to other categories as well. For instance, about 57 per cent of persons with secondary education working in rural area belong to the poor whereas the poverty level for this category in urban area is only 32 per cent.

**Table 6.4: Education Level, Unemployment and Poverty Level, 2004**

Educational attainment	Distribution of labour force, %	Unemployment rate, %	Participation rate, %	Poverty rate, %
University	18.6	6.3	74.0	22.8
Vocational	24.5	7.8	77.1	36.5
Secondary	48.4	9.4	70.8	50.4
Basic and lower	8.0	10.3	26.2	47.6

Source: NSC, KIHS – 2004; consumption quintiles, author's estimates.

An interesting trend is observed with regard to the category of working people who have secondary or vocational education<sup>37</sup>. The impression is that persons with certain skills are more in demand at the labour market and that, for this category unemployment and poverty levels are relatively lower. The fact that people with secondary education are generally in a worse situation than those with specialized secondary education questions the capacity of general secondary education to provide students with the skills that are demanded in the labour market and which would provide them with access to the labour market. The same issue arises with regard to the system of higher education which is currently going through the process of adapting to increasing market demands for specialists. However this category of workers which accounts for about 19 per cent of the labour force<sup>38</sup> is in a more favourable position both with regard to employment as well as poverty. The unemployment level among people with higher education is about 6.3 per cent and the poverty level is “only” 23 per cent (Table 6.4). In urban regions only 15 per cent of those with university level education are referred to as the poor while in rural area this the share is 33 per cent. The majority of people with higher education find jobs in public institutions such as schools and hospitals with a low level of salary.

<sup>37</sup> Institutions of vocational education have a lower status than higher education institutions and provide educational services to people with secondary and primary education. These educational institutions inherited primarily from the Soviet system specialize mainly in training workers for different sectors of the economy (agriculture, construction, services).

<sup>38</sup> This category includes those who entered the university but did not complete their education.

## Chapter 7. Towards A Strategy for Employment Intensive Growth For Poverty Reduction

Based on the framework of analysis adopted for this study, and the empirical analysis of the linkage between economic growth, employment and poverty reduction presented in the earlier parts of this report, it can be suggested that a strategy for employment intensive growth as a route out of poverty should have three inter-related elements: (i) a high rate of economic growth, (ii) a pattern of growth that is sufficiently employment intensive so as to productively absorb the addition to the country's labour force and also allow a transfer of workers from sectors characterized by low levels of productivity to sectors with higher levels of productivity, and (iii) a greater ability of the poor to integrate into the growth process and benefit from it. The policy framework of the country would need to address all three elements mentioned above.

### 7.1 Economic Growth

Kyrgyzstan resumed its economic growth in 1996, and since then has been able to achieve a moderate rate of economic growth of 4.7 per cent per annum. The macroeconomic environment appears to be quite stable, which, in theory, should be conducive to economic growth. For example, inflation came down to single-digit level in 2000 and since then has declined further. Budgetary deficit (as percentage of GDP) has been within reasonable limit, especially after 2000. However, despite the achievement of macroeconomic stability, the economy has not been able to achieve stability in its economic growth. For example, in 2002 and 2005 the economy experienced stagnation and negative growth respectively. It seems from the experience of those two years that the overall growth of the economy is still dependent too much on a few activities, e.g., gold mining, and electricity generation. When they decline, it becomes difficult for growth in other sectors to offset the negative effect of their growth. It is thus clear that with respect to the rate of growth, not only the overall level but also its stability over time would need to be addressed.

One variable (other than macroeconomic stability) that is critical for economic growth is investment. Figures presented in Chapter 3 show that the level of investment (as percentage of GDP) has not only remained low, but also declined after 2000. Policy makers in Kyrgyzstan appear to be aware of the need to reverse this trend. For example, the Country Development Strategy (CDS) projects investment as percentage of GDP to go up to 36.5 per cent by 2010. However, the feasibility of this target and the mechanism(s) for attaining it requires careful examination. The basic strategy appears to be to rely almost entirely on private investment. In fact, public investment is projected to decline to 1.8 per cent (from 4.6 per cent in 2005) while private investment is projected to rise from 17.8 per cent to 34.6 per cent. It is not clear how the infrastructure needed to attract private investment would be created if public investment declines to such levels. This point becomes particularly important due to two factors. First, in any developing economy, public investment is critical for developing the needed infrastructure and other externality-providing sectors. Second, in the particular case of Kyrgyzstan, such investment would be even more important in view of the policy of relying more on small and medium enterprises for bulk of the development, because such enterprises cannot be expected to invest in infrastructure and other externality-inducing sectors<sup>39</sup>.

It is also important to note that the decline in investment took place during a period when the country achieved an improvement in its macroeconomic environment (in terms of low inflation and budget deficit). It thus seems that in addition to macroeconomic stability, there are other factors that are important in determining the rate of investment and economic

<sup>39</sup> An earlier UNDP study (Khan, 2003) made these points quite clearly and made a strong case for not only reversing the declining trend in overall investment but also the declining share of public investment. That study also provided a detailed analysis of how public and private investment could be financed.

growth in Kyrgyzstan. A thorough examination of the relevant factors is called for. As argued below (see Section 7.2), at the current level of employment elasticity, achieving higher rates of employment growth and poverty reduction in Kyrgyzstan would be contingent upon a substantially higher rate of GDP growth which, in turn, would require the rate of investment to be higher. Understanding the reasons for low investment and policies for raising its level would be critical for achieving a stronger nexus of economic growth, employment and poverty reduction in the country.

Some recent analysis of the investment climate has focused on the so-called 'business climate' and barriers to entrepreneurship, and have identified (i) the tax system, (ii) regulatory measures including the procedures of granting licenses and permissions, and (iii) poor governance as the major factors hindering the growth of business. It needs to be noted, however, that according to the World Bank's Doing Business 2007 report, Kyrgyzstan ranked 90th among 175 countries covered by the survey. Indeed, the country has ranked favourably on all major doing business indicators compared to most transition countries - outpacing most resource-rich countries in the region, e.g., Azerbaijan, Kazakhstan, and Uzbekistan. This relatively good ranking of the country is mostly due to the first wave of reforms related to price liberalization, abolition of capital controls, and large scale privatization. The Kyrgyz Republic ranks better than the Europe and Central Asia (ECA) average, and even close to the average for high income countries. For example, it takes 21 days to start a business in the Kyrgyz Republic which is only 1.5 days more than the average for high income countries, and about 16 days less than the ECA average. The minimum capital required to start a business in the Kyrgyz Republic is well below the requirement for all its neighbouring countries and the ECA and OECD average.

It thus appears that Kyrgyzstan has made important progress in improving the climate for investment in the economy, and yet, there are areas (viz., the tax system, the regulatory environment and governance) in which further work remains to be done. There is a good deal of awareness about these issues in the country, and they have also been discussed in some details elsewhere<sup>40</sup>; so the present report does not need to go into the details.

## 7.2 The Pattern and Employment Intensity of Economic Growth<sup>41</sup>

Since the pattern of growth and its employment intensity are important factors in achieving high rates of poverty reduction, from the point of view of a strategy for pro-poor growth, it is necessary to consider ways and means of achieving a pattern of growth that is more employment intensive and results in greater productivity and returns to labour. A look at the sectoral pattern of growth in Kyrgyzstan shows that while growth in agriculture and services has been moderate and stable, growth in industry has not been so. Indeed, after the break-up of the former Soviet Union, Kyrgyzstan has gone through a period of de-industrialization (which, in turn, was due in large part, to the disruption in the erstwhile supply chain). Moreover, growth in the latter has been dominated by a few large scale activities (e.g., mining and electricity) of a relatively capital-intensive nature and a narrow range of manufacturing industries. Although the country should have the potential for the growth of labour-intensive manufacturing industries, the base remains rather narrow - consisting mainly of textiles (including garments), food products and furniture. Given the paucity of data on manufacturing at a disaggregated level, it is very difficult to say anything with confidence on the constraints faced by labour-intensive industries. This, clearly, is an area requiring further investigation from the point of view of engendering a process of more broad-based and employment intensive growth.

<sup>40</sup> For example, in the World Bank's Doing Business 2007 report.

<sup>41</sup> The Country Development Strategy document also mentions, as one of the goals, raising economic growth for poverty reduction through employment and income increase (paragraph 69, p.12). However, the document does not elaborate on how economic growth, employment and poverty reduction would be integrated in the strategy that is envisaged. It simply mentions "targeted implementation of National Employment Policy" as one of the measures under the labour market component. It would be important to fully integrate the employment policy into the development strategy.

Measured by the elasticity of employment growth with respect to output growth, the overall employment intensity of growth of the Kyrgyz economy is inadequate from the point of view of absorbing the annual addition to the labour force. With the estimated employment elasticity of 0.4, a GDP growth of at least 6 per cent per annum is required to achieve an employment growth of 2.4 per cent per annum which would be just adequate to match the current rate of growth of labour force. And if the backlog of the unemployed and under-employed labour has to be absorbed into productive employment, the rate of employment growth would have to be higher. And in order to achieve that, the economy will have to achieve a higher GDP growth or greater employment intensity of growth or both. It would be reasonable to suggest a GDP growth of 7 per cent per annum would be required to achieve an adequate rate of employment growth<sup>42</sup>. As mentioned in Chapter 3, greater employment intensity would not necessarily have an adverse effect on labour productivity as long as that is attained through higher growth of more labour intensive sectors and the overall employment elasticity of the economy remains lower than 1. With the elasticity of employment currently estimated at 0.4, the economy of Kyrgyzstan appears to be far away from hitting that possibility.

Thus, what would be important from the point of view of having a more employment intensive growth is to identify sectors/activities (especially in manufacturing) that are by their nature relatively more labour-intensive and examine ways and means of creating (or improving) incentives for their growth. Two broad areas of policies would need to be addressed in that respect: (i) economic policies, and (ii) labour market policies.

Economic policies would be important from the point of view of ensuring the growth of (i) sectors that are labour-intensive by their nature, e.g., labour-intensive manufacturing, construction, services, etc., and (ii) sectors where the poor are concentrated, e.g., agriculture, rural non-farm activities, and urban informal sector. A few things can be done in this regard. The first thing to do would be to check if there are any biases in the policy environment against any of these sectors - be it in terms of pricing (of inputs as well as outputs), taxation, regulatory measures or any other means. Such biases would need to be removed in order to create a policy environment that is conducive to their growth. Second, and a point related to the above is the relative prices of the key factors of production, viz., labour and capital. Sometimes, in an effort to create incentives for investment, measures that favour the use of capital rather than labour are undertaken. Any such measures would need to be looked at carefully from the point of view of their impact on relative factor use. In particular, the possible impact of economic policies (both at the macroeconomic and sectoral levels) on employment would need to be analyzed, and necessary changes in policies introduced. In other words, it would be important to bring about coherence between economic policies on the one hand and policies relating to employment and poverty reduction on the other.

Going beyond overall economic policies, it would be important to examine the policy environment faced by sectors that are key to employment growth. Small and medium sized enterprises (SMEs) need a particular mention in that regard. It may be mentioned here that the role of SMEs in both output and employment has increased significantly during the post-reform period. Indeed, more than half the employed population of Kyrgyzstan now work in such enterprises. And within the framework of the government's policy of encouraging the growth of private sector, a number of measures have been introduced to promote the growth of SMEs. They range from improvement of the legal base regulating businesses to simplified tax system, and reduced income taxes and contributions to the Social Fund. While further improvements can be made in the environment faced by the SMEs, especially with regard to administrative controls and access to finance, it also needs to be seen whether the

<sup>42</sup> For purposes of comparison, one may recall the suggestion made in the National Employment Policy adopted by the Government of Kyrgyzstan in 2006: "Except in agriculture and trade, the rate of GDP growth should be not less than 7-7.5 per cent in order to reduce the dimensions of poverty as foreseen by NSPR" (section 5.1). However, the NEP appears to adopt the goal of a 2 % annual growth of employment. It is not clear why this figure has been adopted although, as mentioned in the present report, the current rate of labour force growth appears to be 2.4%, and in order to absorb the backlog of the currently unemployed and underemployed, employment growth will need to be over 2.4%.

“policy environment” is the only constraint faced by such enterprises or whether there are other constraints, e.g., those from the demand side.

On labour market policies, a point that is often made concerns the possible impact of institutions governing the market on the magnitude of employment created. More specifically, rigidities in the labour market are cited as obstacles to the creation of employment. In Kyrgyzstan, the Labour Code of 2004 was designed to make the labour market more flexible especially in terms of hiring and firing of workers, and the benefits they are entitled to (e.g., reduction in severance pay from two months to one month, reduction of maternity leave, and so on). Wage flexibility also appears to have increased. Changes have taken place in the contractual arrangements. Several questions would arise in the context of the reforms introduced in the labour market. First, what has been the impact of labour market deregulation on employment? In other words, has deregulation of the labour market has resulted in higher employment growth? Have changes in the contractual arrangements had any adverse impact on the protection of workers? What has been the experience with regard to the implementation of the new Labour Code? How can labour market flexibility that is needed (and has been introduced) to create incentives for investment and job creation be combined with necessary protection for workers? The present report was not intended to analyse these issues; but they need to be addressed in future.

### 7.3 Integration of the Poor into the Growth Process

In addition to high and stable growth of an employment intensive character, from the point of view of poverty reduction, it is important for the poor population to have a greater ability to integrate into the growth process and get access to the jobs that result from growth. The factors that are important from this point of view include the levels of education and skill of the poor, their ability to get access to necessary productive assets including finance (the latter is important for those who are in self-employment), the efficiency with which the labour market intermediates between available jobs and the seekers of jobs.

#### *Skill development*

Skills gap is a major impediment for employment. In many transition countries changes in the structure of economy, emergence of private enterprises and integration into the world market have demanded certain specializations, such as professional qualifications, and computer and language skills, while some professions and skills pertaining to previous system are no longer in demand. Bridging the gaps in education, skills and other professional characteristics of workers can help in matching market requirements and the unemployed or under-employed job-seekers. In this respect, it would be essential to examine which sectors of the economy have a greater potential to grow in the medium to long term and what kind of skills they are going to require.

Given that the service sector is playing a greater role in economic growth and employment creation, more attention needs to be paid to the education and other qualifications required for the activities in that sector. Tertiary education and other specialized qualifications have an important role in this respect.

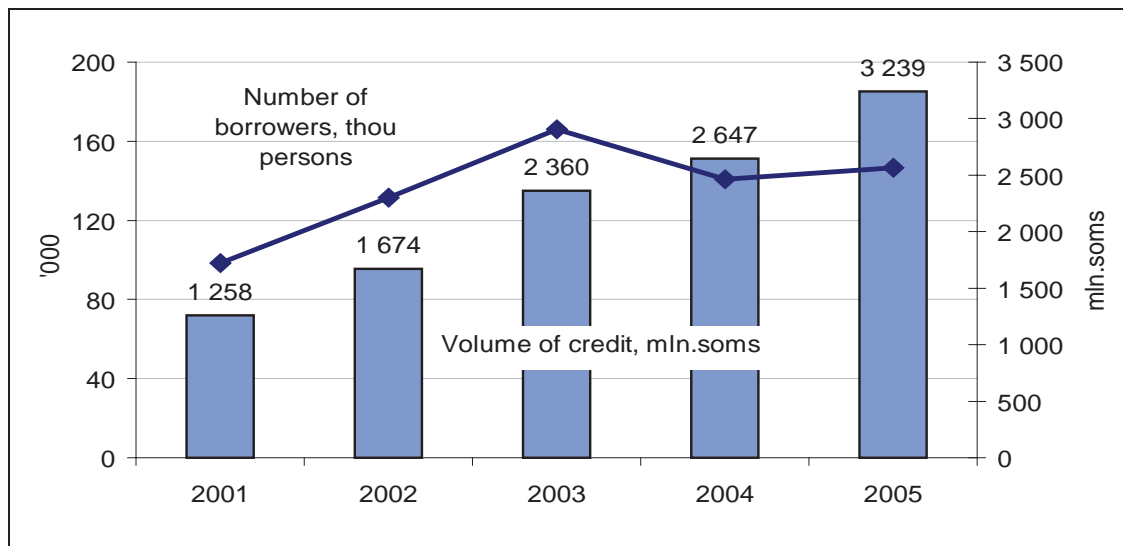
#### *Micro finance*

Micro-finance can play a valuable role in promoting self-employment, and is proving to be very useful in the Kyrgyz Republic in improving the livelihoods of the poor. There are a large number of microfinance institutions (MFIs) operating in the country: 6 large microfinance companies, 309 credit unions and 98 smaller companies and agencies (as of 2005). By end-2005 the volume of micro-credits amounted to 3.24 billions soms (3.2 per cent to GDP) and number of borrowers reached 147 thousand people (28 people per 1000 population). Most of the micro-credits were targeted to develop quick-return activities such as trade and dining services (71 per cent of all credits) and agriculture (18 per cent). Only 3 per cent of these credits were borrowed for activities in industry.



Given the small size of loans (22 thousand soms in average or around 540 US dollars) and the fact that 78 per cent of borrowers were women, microfinance plays an important role in targeting the poor and creating jobs in the form of self employment and small enterprises. Given strong demand for microfinance, the existence of a large network of lenders in all regions and relatively stable development of this sector, microfinance has good potential in creating more jobs and thus contributing to poverty reduction. However, there is no serious study to assess how microfinance in the Kyrgyz Republic is making borrowing households better off<sup>43</sup> through job creation or business expansion. This is an area where serious research is needed.

**Figure 7.1: Development of microfinance, 2001-05**



Source: NSC, Publication 'Social Trends in the Kyrgyz Republic', 2007

#### *Active labour market policies*

Active labour market policies (ALMPs) can be defined as purposive, selective interventions by the government, acting directly or indirectly, to provide work to, or increasing the employability of specific groups in the labour market. Following are possible elements of a package of ALMPs (i) skill training and re-training for the unemployed and the employed, (ii) public employment services, (iii) subsidized employment (e.g., wage subsidies, and direct job creation measures). The above measures could be universal or targeted to specific groups in the labour market (e.g. the youth).

ALMPs can serve as useful instruments for enhancing structural change in an economy by facilitating allocation and re-allocation of labour between various sectors of an economy. They can, on the one hand, serve as a way of temporarily meeting the employment/income needs of workers, and on the other, can play a more permanent role of facilitating structural change in a dynamic economy and serve the needs of both workers and employers.

Kyrgyzstan appears to have the key elements of ALMPs, like a functioning public employment service, the institutional framework for skill training, and job creation programmes. The employment policy in this regard would be to utilize them as an integrated package of measures within the framework of ALMPs for specific groups such as the youth, employed workers facing the prospect of lay-off or sectoral mobility, etc. The feasibility - in terms of administrative aspects of implementation as well as budgetary implications - of applying this policy instrument should be studied carefully.

<sup>43</sup> A number of credible client-level impact studies tend to find that continued access to microfinance by over the years produces a range of significant benefits for client households (CGAP, Focus Note: Aid Effectiveness in Microfinance, April 2006).

### *Gender*

Given the higher rate of unemployment, lower participation rate amongst women, and their over-representation in occupations with lower wages, there has to be a gender focus in all the policy areas mentioned above – be it education and skill development, access to finance or active labour market policies. While greater access to education and skill development would be a pre-requisite for mobility to occupations involving higher wages, efforts will also be needed to identify and act on any other ways in which women may be facing discrimination in the labour market.

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