



# **INCOME INEQUALITY IN KYRGYZSTAN: THE REDISTRIBUTIVE EFFECT OF SOCIAL BENEFITS**

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This paper gives an overview of income inequality in Kyrgyzstan. An analysis of the national development strategies suggests that the issue of income inequality has not been popular among policymakers. An analysis of social assistance transfers provides evidence that the current social assistance policy cannot be effective in reducing inequality in income distribution. I argue that a redistribution of social benefits is essential and can become one of the first steps toward alleviating income inequalities in Kyrgyzstan.

## **Background**

Income inequality has become one of the biggest concerns of human and economic development over the past few years. Recent global findings suggest that despite some declining trends in income inequality, levels remain unacceptably high.<sup>2</sup> Reasonable arguments are offered in favor of a certain level of income inequality, since it creates

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<sup>2</sup> World Bank, *Poverty and Shared Prosperity 2016: Taking on Inequality* (Washington, DC: World Bank, 2016).

incentives for economic development.<sup>3</sup> However, this does not hold true for poor and developing countries with high poverty rates, lack of human capital, and weak institutions. In fact, empirical evidence shows that high levels of inequality are more likely to harm growth in developing than in developed countries.<sup>4</sup>

Furthermore, a high share of accumulated income concentrates political and decision-making power in the hands of a few, leads to a suboptimal use of human resources, and causes investment-reducing political and economic instability. Like weak markets, weak governments and poor public policy are likely to exacerbate the effects of inequality (of income, assets, education and so on) on growth.<sup>5</sup>

Income inequality increases the power and importance of social hierarchy. As a result, a long list of problems is more common in societies with larger income differences.<sup>6</sup> This includes high social tensions, a large, persistent informal sector, widespread regional divides, and gaps in access to education and healthcare.<sup>7</sup> In societies that are more equal, people are much more likely to trust each other, measures of social capital suggest greater community involvement, and homicide rates are consistently lower.

Finally, one of the important reasons for caring about inequality, especially in developing countries, is that it leads to inequality of opportunities for future generations.<sup>8</sup> If families have vastly different economic resources, some children will begin life with an unfair disadvantage. This deepens the poverty gap, so that people stuck in poverty require even greater efforts from public policy to overcome these conditions.

### **Box 1. Measures of income inequality**

There are many measures of income inequality. All are based on income distribution within different income groups of the population. Income inequality metrics usually estimate shares of income accumulated by a certain share of population, e.g. 10 percent (decile) or 20 percent (quintile). None of the measures are perfect; each has its pros and cons, so the choice depends on the research purpose.

The Lorenz curve is a graphical representation of the distribution of income or of wealth. It is often used to represent income distribution: it shows a percentage of households and what percentage of the total income they have. The Gini coefficient is defined mathematically based on the Lorenz curve. It takes values from 0 (perfect equality), to 1 (or 100 percent, which expresses maximal inequality in income distribution).

<sup>3</sup> First, inequality affords incentives for individuals to work hard, innovate, and undertake risky but potentially productive investment projects. This results in increased output and productivity, and therefore higher average incomes and growth rates. Inequality thus acts as a prime booster for entrepreneurship development. Second, inequality is essential because it reflects different levels of effort and talent among people. Third, some concentration of income encourages growth through a higher rate of saving and more investment.

<sup>4</sup> Nancy Birdsall, "Income Distribution: Effects on Growth and Development," in *International Handbook of Development Economics*, ed. Amitava Krishna Dutt and Jaime Ros, vol. 2, chap. 48 (Cheltenham UK and Northampton, MA: Edward Elgar, 2008); Robert J. Barro, "Inequality and Growth in a Panel of Countries," *Journal of Economic Growth* 5, no. 1 (2000): 5–32. Barro showed that there is some evidence inequality retards growth in poor countries but encourages growth in richer places. Growth tends to fall with greater inequality when per capita GDP is below around \$2000 (1985 US dollars).

<sup>5</sup> Birdsall, "Income Distribution."

<sup>6</sup> Kate Pickett and Richard Wilkinson, *The Spirit Level: Why Equality Is Better for Everyone* (London: Penguin, 2010).

<sup>7</sup> OECD, *Divided We Stand: Why Inequality Keeps Rising* (Paris: OECD Publishing, 2011).

<sup>8</sup> World Bank, *Poverty and Shared Prosperity 2016*.

The 10:10 or 20:20 ratios compare how much richer the top 10 percent (or 20 percent) of the population is compared to the bottom 10 percent (or 20 percent). The Palma ratio is defined as the ratio of the richest 10 percent of the population's share of gross national income divided by the poorest 40 percent's share.

The National Statistics Committee of the Kyrgyz Republic (NSC KR) uses the Gini coefficient as a national income inequality measure. It also provides estimates of income shares accumulated by deciles, top and bottom quintiles, and estimates 10:10 ratio.

In this paper, I use data from the Household Budget Survey (HBS), conducted by the NSC on an annual basis. The HBS data is drawn from a representative sample of more than 5000 households. The NSC KR aggregates information from HBS and publishes data on households' income structure divided by deciles. The HBS has some shortcomings. For example, income data for the richest 10 percent are not very reliable, given the fact that many rich people refuse to participate in the survey or withhold true information about their income. However, the HBS data represent an average cut and show the distribution of average income components. This allows us to get an average picture and grasp some real trends in income distribution. Today it is the only data available to assess income inequality in the country.

All of the above expressed concerns are applicable to the situation in Kyrgyzstan. After the collapse of the Soviet Union, dramatic economic transformations caused a rise in the inequality of income distribution that lasted until the early 2000s. After that, there was a significant reduction in income inequality, with the Gini coefficient declining nearly 20 percent. Then, starting in 2008, the gap between rich and poor began to steadily widen, with the result that in 2013 Kyrgyzstan reached its peak of income inequality (see Table 1).

If we look more closely at income inequality in Kyrgyzstan, we can see that the situation is indeed tough. The dynamics is not stable: the Gini coefficient fluctuates around 40 percent and the Palma ratio is around two. Shares of accumulated income of the poorest and the richest population segments differ significantly. Yet, we can see some improvements in the Gini coefficient, with a decline from 45.6 percent in 2013 to 40.8 percent in 2015. However, this reduction is not associated with an increase in income shares of the poor population. The income is redistributed among the richer income groups, resulting in overall decline of Gini. Meanwhile, the share of income accumulated by the poorest 10 percent of population is still around 2 percent.

**Table 1. Kyrgyzstan's income inequality profile**

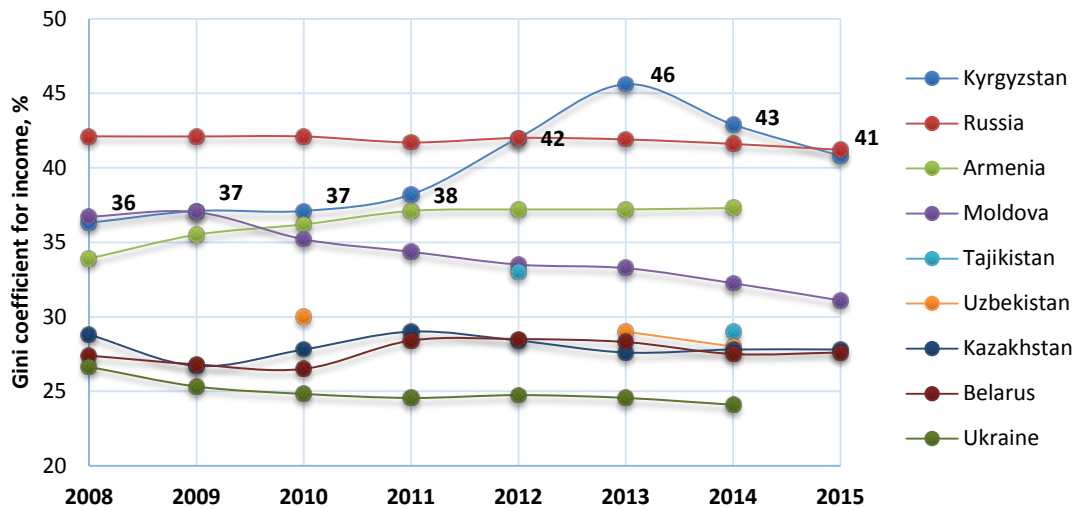
	<b>2000</b>	<b>2008</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Gini coefficient, %	45	36	46	43	41
Palma ratio*	2.4	1.4	2.6	2.4	1.6
Share of income of 10% poorest, %	1.7	2.7	1.6	2.1	2.2
Share of income of 10% richest, %	33.1	26.3	34	37	26.5
Ratio of incomes of 10% richest to 10% poorest, %	-	-	21.4	17.2	11.8

\*Author's own estimations.

*Source: National Statistics Committee of the Kyrgyz Republic*

As a result, today Kyrgyzstan has the highest income inequality among the Eurasian Economic Union countries and nearly the highest among the CIS countries. Figure 1 represents dynamics of the Gini coefficient for selected CIS countries for which data are available. It shows that, while other countries had relatively constant or declining trends in the Gini coefficient, Kyrgyzstan's was growing. Despite a decline in Gini over the past two years, income inequality in Kyrgyzstan remains at a considerable level.

**Figure 1. Dynamics of the Gini coefficient: Selected CIS countries**



*Source: Countries' national statistics offices*

The issue of income inequality is rarely discussed in Kyrgyzstan: there is not much literature or research on the effects of income inequality in the country. With that, the problem of income inequality is a crosscutting issue, which affects not only monetary wealth, but also the extent to which people are deprived of the goods, services, and opportunities to live long and healthy lives. For example, the multidimensional poverty index<sup>9</sup> shows that 13.9 percent of the population lives in multidimensional poverty and has two or more deprivations in health, education, infrastructure access, and monetary assets. It is also important to mention social inequality, along with increasing tensions that lead to greater probabilities of social and political protests and violent actions. Kyrgyzstan has already had two power shifts or “revolutions” in the recent past, accompanied by violent conflicts involving the poorer population in the southern regions.

The negative effects and implications of income inequality would be mitigated if Kyrgyzstan pursued a sustainable policy promoting inclusivity of growth and more equal income distribution. However, as my analysis suggests, the issue of income inequality in Kyrgyzstan has not been popular among policy makers. As a result, two main factors—an absence of national priority on the issues of income inequality, and a lack of inclusive growth—have undermined progress in poverty reduction and sustained income inequality.

## **Factors causing persistent income inequality in Kyrgyzstan**

### *National policy*

A number of national development strategies have been implemented in Kyrgyzstan since the early 2000s, which determine the development path of the country for specific periods. They set national goals and priorities and act as the basis for sectoral policies. An analysis of these documents shows, unfortunately, that the issue of income inequality has tended to disappear from national goals and priorities (see Table 2).

<sup>9</sup> This index is calculated by the National Statistics Committee for purposes of the National Human Development Report for publication in 2016.

**Table 2. References to income inequality and poverty in national strategies**

	<b>CDF: NSPR 2003-2005</b>	<b>CDS 2007-2010</b>	<b>CDS 2009-2011</b>	<b>NSSD 2013-2017</b>
Goal on poverty reduction	✓	✓	✗	✗
Policy priority	✓	✓	✓	✗
Poverty indicators	✓	✓	✗	✓
Goal on income inequality	✓	✗	✗	✗
Policy priority	✓	✗	✗	✗
Inequality indicators	✓	✗	✗	✗

*Source: Author's own analysis*

*Notes: CDF – Complex Development Framework; NSPR – National Strategy for Poverty Reduction; CDF – Country's Development Strategy; NSPR – National Strategy for Sustainable Development.*

In 2001, Kyrgyzstan's Parliament approved the Complex Development Framework (CDF), an innovative long-term development program. In 2002, within the CDF, the Government developed the National Strategy for Poverty Reduction for 2003–2005 (NSPR). The NSPR was a powerful document aimed at addressing severe social problems, including extreme poverty and inequality. One of the NSPR's proclaimed goals was taking on inequality in income distribution. It explicitly stated: "understanding that economic growth is necessary but not enough to eradicate poverty, and it should go along with more equal income distribution, the Government will undertake a number of measures to prevent further increase in income inequality."<sup>10</sup> With that, the NSPR provided a set of national indicators to monitor its progress, including the national Gini coefficient, the level of extreme poverty, and the poverty gap. Although the NSPR revealed several shortcomings, it did lead Kyrgyzstan to achieve some progress in reducing poverty and sharing prosperity.

The CDF was followed by the Country's Development Strategy 2007–2010 (CDS-1). This Strategy was the first national document to include the Millennium Development Goals (MDGs) as a base for the country's development. The Strategy therefore tried to address a variety of social and economic issues, including economic prosperity, healthcare and education development, gender equality, environmental problems and others. Unfortunately, the problem of income inequality no longer played a leading role. However, the term "inequality" was mentioned in the Strategy in the context of corruption, healthcare, and education. This was a good thing, since the priorities of the Government would include poverty reduction through equal access to education, healthcare, and social protection.

The next national strategy—The Country's Development Strategy 2009–2011 (CDS-2)—continued on the path of CDS-1. Although some of the social indicators were still there, inequality and poverty were barely noticeable as development priorities.

In 2013, the President signed the first National Strategy for Sustainable Development for 2013–2017 (NSSD). This strategy is the first step to introducing the principles of sustainable development in the country. It is a complex document accompanied by the Program of Transition to Sustainable Development, a set of action plans and lists of monitoring matrices. The NSSD has two parts. The first part describes a basis for sustainable development via five main pillars, including solving social tasks and problems. The second part sets priorities for economic development, i.e., sustainable economic growth. Unfortunately, neither the section on social problems nor the sections on economic priorities underline the importance of poverty and income inequality reduction. The NSSD itself does not contain any references to the income inequality problem.

<sup>10</sup> *National Strategy for Poverty Reduction for 2003–2005*, adopted in accordance with the Resolution of the Government of the Kyrgyz Republic #269, May 8, 2003.

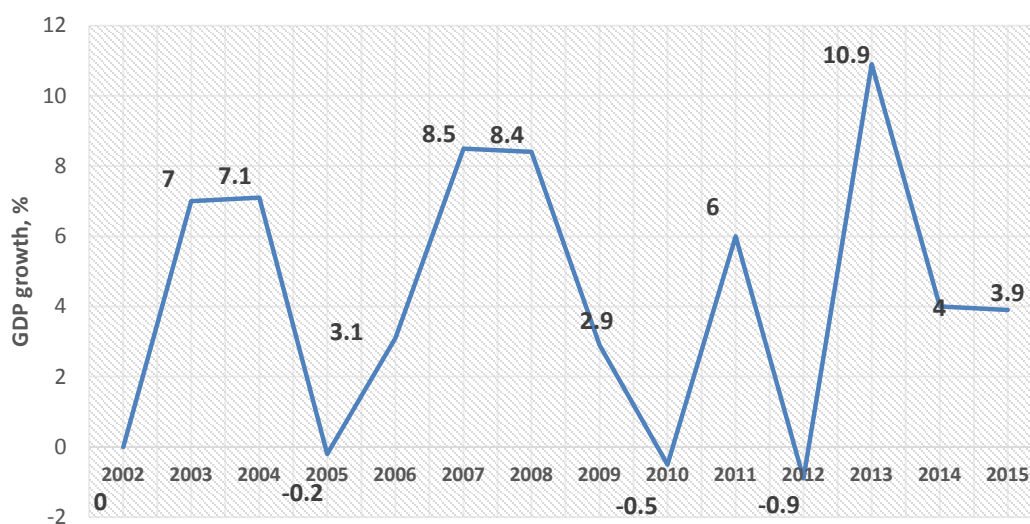
One of the big distinctive features of the NSSD is that it has a separate monitoring matrix for human development indicators. This is a big improvement compared to the previous national strategies. Unfortunately, this matrix still lacks a significant number of necessary targets, including income inequality targets and a breakdown of poverty indicators.

A lack of focus on poverty and income inequality is already projected on the results of NSSD implementation. We now have only a year left until the end of the NSSD, and the progress on poverty reduction is minimal. The monitoring matrix sets the poverty level equal to 25 percent at the end of 2017, but given the fact that in 2015 the poverty level increased to 32.7 percent, it is hard to imagine that the country will accomplish the stated indicator.

### *Lack of inclusive growth*

Economic growth and economic development as a whole are necessary, but—as will be discussed further—not sufficient for progress on reducing income inequality. Kyrgyzstan has not been able to achieve sustainable economic growth, having been undermined by various shocks. These shocks included violent power shifts (“revolutions”) and issues with the Kumtor gold mining company. In fact, since 2001 the country has shown zero or negative GDP growth rates (see Figure 2) four times.

**Figure 2. GDP growth rates, %.**



*Source: National Bank of the Kyrgyz Republic. \*2015 – preliminary data.*

Figure 2 clearly shows the reflection of the shocks in economic growth. Since the Kyrgyz economy significantly relies on Kumtor’s operations,<sup>11</sup> serious technical problems affecting Kumtor in 2002 dropped the growth to zero. Political events in 2005 and 2010 gravely affected the investment climate and business environment, which led to a halt in many business operations and production activities. Finally, in 2012, again political and technical issues with Kumtor reversed the country’s economic growth. On top of that, Kyrgyzstan’s economy suffers from a number of substantial problems, including weak economic institutions, an inefficient business environment, and distorted markets.

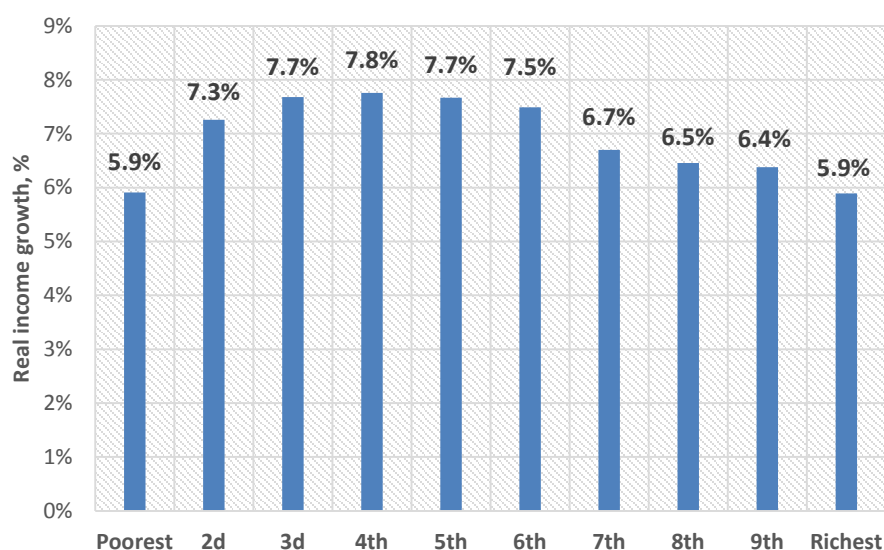
While economic growth unquestionably plays a vital role in a country’s development, it is also critical that special efforts are made to ensure that vulnerable segments of the population are able to participate in economic growth. If income inequality interacts with

<sup>11</sup> According to Kumtor’s 2015 report, its share in GDP amounted to 6.8 percent; in total exports, 39.7 percent. <http://www.kumtor.kg/ru/kumtors-basic-operating-results-in-2015/>.

poor policy, then whatever growth occurs is going to help the poor less, given the less equal distribution of income. Growth must be inclusive: that means that all economic participants have equitable opportunities and the benefits of economic growth are enjoyed by everyone. If there is a high level of income inequality, then growth must not only be inclusive, but it should benefit society's poorer groups. Income inequality will decline only when the income growth rates of less wealthy individuals are higher than those of wealthier.

In Kyrgyzstan, real GDP growth rates for the population in the bottom part of the income distribution are significantly lower than for the middle part.<sup>12</sup> This is expressed in the fact that the lowest deciles on average do not have higher growth of income (see Figure 3).

**Figure 3. Average growth of real income by deciles, 2004–2015**



*Source: Author's own calculations*

Figure 3 shows the annual average growth in real income of different income groups of the population for the past ten years. Not only is the average growth in the poorest decile among the lowest, it is the same as the growth in the three highest decile groups. The real income of the poorest population was increasing by 5.9 percent annually on average during 2004–2015, while in the second to seventh decile groups annual average growth reached nearly 8 percent. At the same time, the average growth of income in the richest income groups (eighth to tenth) was not much less and was equal to the same 5.9 percent. As a result, we see a relatively stable decreasing trend in poverty rates, but not in income inequality: on average, the poverty rate has been decreasing by 4 percent annually, but the Gini coefficient by only 0.2 percent.<sup>13</sup>

When an economy fails to provide substantial and equal gains to each category of the population, the role of social policy becomes salient. Social policy, if well designed, can be much more than a safety net: it can significantly contribute to productive development. Social welfare institutions reduce social tensions and enhance the legitimacy of the political system, thus providing a more stable environment for long-term growth. Redistribution policies via social transfers are a key tool to ensure that the benefits of growth are more broadly distributed and that the results need not be expected to undermine growth. But it is

<sup>12</sup> International Monetary Fund, Kyrgyz Republic: selected issues (2016), IMF Report # 16/56 (R). <https://www.imf.org/external/russian/pubs/ft/scr/2016/cr1656r.pdf>.

<sup>13</sup> Author's own calculations based on data of the National Statistics Committee of the Kyrgyz Republic.

also important to promote equality of opportunity in access to and quality of education. Poor people spend most of their money on consumer products, and very little on human capital, e.g., education and healthcare. Social assistance therefore can bring more improvements to poor people's budgets and reallocate more resources toward savings and human capital investments.<sup>14</sup> Here important questions arise: Can the social assistance system in Kyrgyzstan address the needs of the poor? Is it effectively designed to target the poor? Can the current system become an instrument to reduce income inequalities?

### **Current social policy**

The system of social protection in Kyrgyzstan is multidirectional. As proclaimed by the government, the main tasks of social protection are “to support the most vulnerable categories of population, to facilitate economic activity of the working population and assist people in getting out of difficult living situations.”<sup>15</sup> There are two main functions of the social protection system: 1) social security, and 2) social assistance. Social security includes pensions and other social insurance transfers and is excluded from this research. I focus on social assistance, since that is the system that is assumed to implement the tasks described earlier.

Social assistance encompasses a variety of transfers. It includes maternity benefits, state benefits, temporary disability benefits, unemployment benefits, funeral benefits, and so forth. In this context “benefit” means a cash transfer, whose amount and designation are defined in accordance with Kyrgyzstani law, to a population from the social assistance budget.

For example, the Law of the Kyrgyz Republic № 318 dated December, 29, 2009, “On the State Benefits,” distinguishes between two state benefits: 1) monthly social benefit (MSB), and 2) monthly benefits to poor families with children (MBPF).

The MSBs are paid to certain categories of children, persons with limited abilities, senior citizens, and so forth. The list of persons eligible for receiving MSBs is established in accordance with the Law. MBPFs are paid to families with income below the guaranteed minimum income. The guaranteed minimum income is established by the law and people can apply for the MBPF only if their average income per household member does not exceed it.

According to the data of the Ministry of Finance's “Open budget” portal in 2015, 7,397 billion soms (approximately USD 114.8 million<sup>16</sup>) were allocated from republican and local budgets to social assistance. The total budget of social assistance in 2015 constituted 5.5 percent of the budget's expenditures (see Table 3).

There are four main types of transfers that form the social assistance budget. Two of them—MSB and MBPF—were already mentioned. Maternity benefits are paid in forms of one-time birth benefits, pregnancy, and childcare benefits.

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<sup>14</sup> My estimations suggest that on average people from the higher part of the income distribution tend to spend 2.3 times more on healthcare and education than people in the bottom part.

<sup>15</sup> Program of Development of Social Protection System in the Kyrgyz Republic for 2015–2017, #85, approved by the Government of the Kyrgyz Republic on February 27, 2015.

<sup>16</sup> Average annual exchange rate in 2015 was 64.5 soms/1 US Dollar.

**Table 3. Kyrgyzstan’s social assistance budget**

	<b>thousands soms</b>	<b>%, social assistance</b>	<b>%, total budget</b>
Total social assistance	7,397,035	100%	5.5%
<b><i>Out of which:</i></b>			
Monthly social benefits	2,401,479	32%	1.8%
Cash compensations	1,930,525	26%	1.4%
Monthly benefits to poor families	1,852,478	25%	1.4%
Maternity benefits	1,004,281	14%	0.7%
Other social assistance transfers	208272	3%	0.2%

*Source: Author’s own calculations based on “Open Budget” data, Ministry of Finance*

The cash compensations are a little bit tricky. These are the transfers paid to certain categories of citizens, e.g., rearward workers recognized to be invalids, families of perished military men, invalids of the Chernobyl APP accident, etc. The list of eligible categories and sizes of the benefits is established in accordance with Resolution of the Government of the Kyrgyz Republic № 795 dated December 22, 2009, “On Payment of Cash Compensations Instead of Benefits.” There are 25 categories of population eligible for receiving the compensation payment. A few words must be said about the origin of the term “compensation payments.” This system is the inheritance of the USSR social protection system. Before 2010 there were various non-monetary privileges for certain categories of the population, expressed in a form of free train tickets, free medicine, preferential utility payments, etc. In order to raise the effectiveness of the social protection system, since January 1, 2010, the Kyrgyz Republic has monetized benefits. Instead of giving out the types of benefits—e.g., for public transport, for health services, for utility services—compensation payments are made.

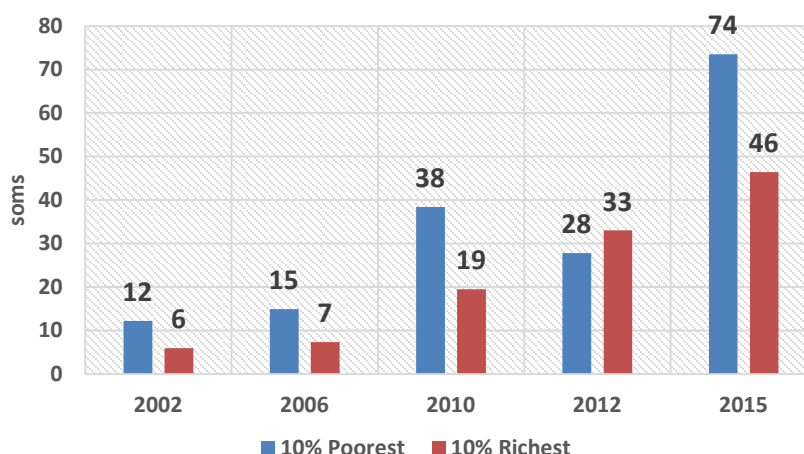
Monthly social benefits constitute the largest share of the total assistance budget, amounting to up to 32 percent. Meanwhile the cash compensations and monthly benefits to poor families take about 25 percent of the budget, and 14 percent of the social assistance budget goes to maternity benefits.

An overview of the system confirms the assumption that social assistance does not take into account a needs-based assessment and is not targeted to the poor. Among the benefits, only the MBPF is based on a certain income level. Aside from maternity benefits, it is unclear what income level the recipients of the other two types must have. The basis for receiving cash compensation is compliance with a list of categories, which are set and unchangeable. The categories are based solely on a person’s status. Neither living standards nor income levels are taken into account. The MSBs are granted irrespective of the income level. Meanwhile, the sizes of cash compensations, independent of the region of residence, have been established from 1,000 to 7,000 soms per month. The MSB size is 2,500 soms. The average amount of the MBPF in 2014 was only 554 soms,<sup>17</sup> and the number of recipients was 310,717, while the official number of poor people amounted to 1.8 million.

As a result, not only do rich people receive benefits, but the average amount of benefits received by the richest 10 percent is not much smaller compared to the 10 percent poorest. Figure 4 shows the average per capita benefits in the structure of incomes of the 10 percent richest and 10 percent poorest segments of the population.

<sup>17</sup> National Statistics Committee of the Kyrgyz Republic.

**Figure 4. Average amounts of benefits per capita received by 10% richest and 10% poorest income groups (soms)**



*Source: National Statistics Committee of the Kyrgyz Republic*

Not surprisingly, the nominal amounts of benefits have been increasing. The monetization took place in 2010, and that resulted in a significant increase in average benefits for both the poor and the rich. However, the data show that the effect of monetization was more beneficial for rich people. In 2012 the average benefits of the 10 percent richest were even higher than the average benefits of the poor. In 2015 the average benefit amount received by the richest people was almost two-thirds of the benefit received by the poorest. At the same time, there is a certain portion of rich people receiving monthly benefits designated for poor families. The data show that during 2010–2015, on average, 1 to 6 soms of the total benefits received by the 10 percent richest population were constituted by the MBPF.<sup>18</sup> This indicates a number of problems with the administration of social benefits, when even targeted assistance cannot be distributed efficiently.

Unfortunately, those are not the only adverse tendencies. The growth in real benefits has also changed, but not to the advantage of the poorest population (see Figure 5). One would think that given the nature of the social assistance, the growth of benefits would be higher at the bottom part of the income distribution. However, as shown in Figure 5 the benefits increase is uncorrelated with the income distribution and the highest decile has the highest growth.

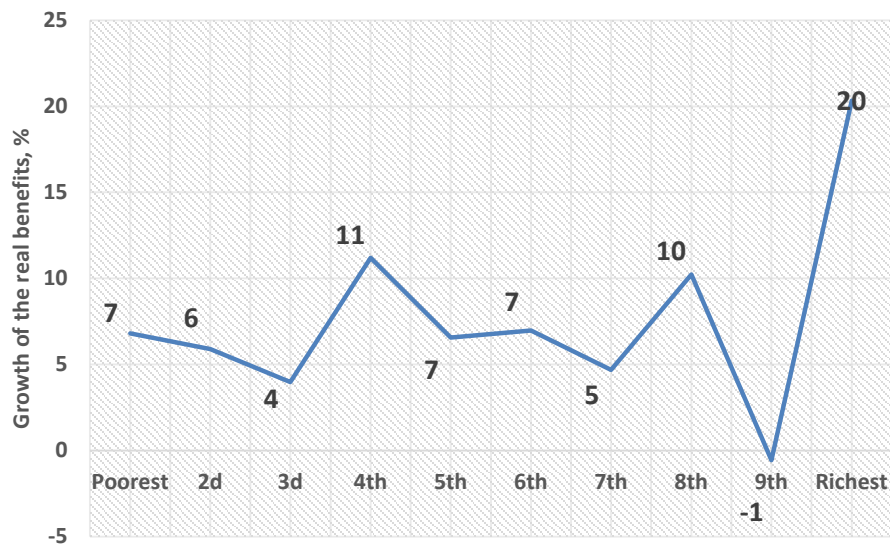
A study by the Organization for Economic Co-operation and Development (OECD) shows that the effect of cash transfers on income dispersion is greater than that of taxes.<sup>19</sup> The results indicate that cash transfers reduce income inequality, as measured by the fall in the concentration of market income before and after transfers, by nearly 20 percent. If we look at the specifics of the region, a policy brief from the International Labour Office (ILO) shows that the effect of transfers on reducing the Gini coefficient was the highest for Europe and the Central Asia region.<sup>20</sup>

<sup>18</sup> Based on the Household Budget Survey data, provided by the National Statistics Committee of the Kyrgyz Republic.

<sup>19</sup> Isabelle Joumard, Mauro Pisu, and Debbie Bloch, “Tackling Income Inequality: The Role of Taxes and Transfers,” *OECD Journal: Economic Studies* (2012), published online first, [http://dx.doi.org/10.1787/eco\\_studies-2012-5k95xd6l65lt](http://dx.doi.org/10.1787/eco_studies-2012-5k95xd6l65lt).

<sup>20</sup> Malte Luebker, “The Impact of Taxes and Transfers on Inequality,” *Travail Policy Brief #4* (2011), International Labour Office, [http://www.ilo.org/wcmsp5/groups/public/---ed\\_protect/---protrav/---travail/documents/publication/wcms\\_160436.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/publication/wcms_160436.pdf).

**Figure 5. Average growth of the real benefits received by 10% income groups, 2004–2015**



*Source: Author's own calculations*

Evidence suggests that Kyrgyzstan's social assistance system fails to take the needs assessment into account or focus primarily on the poor. Meanwhile, the experience of many countries shows the positive effect of cash transfers on income inequality reduction. The World Bank report makes the case for "safety net" interventions, which are programs designed to provide regular support to poor and vulnerable people in cash or in-kind. These programs can offer assistance that is conditional or unconditional. Both types of transfers can be effective, with unconditional often preferred in settings where administrative capacities and the provision of public services are weak.<sup>21</sup> The World Bank report cites many successful stories of increased cash transfers and reduced income inequality, including the experiences of Burkina Faso, Cambodia, Bangladesh, Pakistan and many others.

### **The redistributive effect of social assistance benefits**

In order to understand the possible impact of social assistance transfers on income inequality in Kyrgyzstan, I conducted a simple statistical exercise. The idea of this exercise is to see how income distribution would change if the benefits were redistributed from higher deciles to lower ones. To do so I recalculated the average per capita income in each 10 percent income group by adding and subtracting the amount of benefits to and from the corresponding group. I imposed the assumption that benefits should be re-distributed from fifth and higher deciles to the poorest population.<sup>22</sup> This assumption is based on the fact that the median income (50 percent cut-off or fifth decile) is considered a threshold for the middle class, and therefore does not represent poor population. In fact, the poverty rate in Kyrgyzstan is 33 percent and I allow a significant interval to ensure I do not include people close to the poverty line in the redistribution process.

<sup>21</sup> World Bank, *Poverty and Shared Prosperity 2016*.

<sup>22</sup> I have tested other assumptions, involving redistribution of benefits from the tenth decile only, from the ninth and tenth, and from eighth to tenth deciles. Unfortunately, the amounts of average benefits are very small, and therefore the effect is hard to see. It only becomes evident when benefits are distributed from the fifth decile and higher.

Unfortunately, the available data do not allow me to distinguish between benefits received by higher deciles. However, as shown previously, the majority of social assistance transfers are in fact intended to target the poor and vulnerable population, except for maternity benefits. Therefore, the second assumption I impose is that, on average, 100 percent of state benefits are to be received by poor people only.

Using the data from 2000–2015 I therefore estimated the hypothetical income of each income group—from poorest to richest—to see what the income distribution would be now, if Kyrgyzstan had a social assistance policy that completely targeted the poor population.

## Results

The first conclusion I obtain from the estimations is that the average income of the fifth and higher deciles does not change when the benefits are taken away. The average amount of benefits compared to the income level of rich households is very low, and therefore does not play a significant role in their income structure. By contrast, the average income of the poorest households increases notably. Table 4 shows the percentage increase (decrease) in average income after the benefits are redistributed.

**Table 4. Percentage change in average income after redistribution**

	Poorest	5th	6th	7th	8th	9th	Richest
Change in average income	10.30%	-0.7%	-0.5%	-0.4%	-0.3%	-0.2%	-0.2%

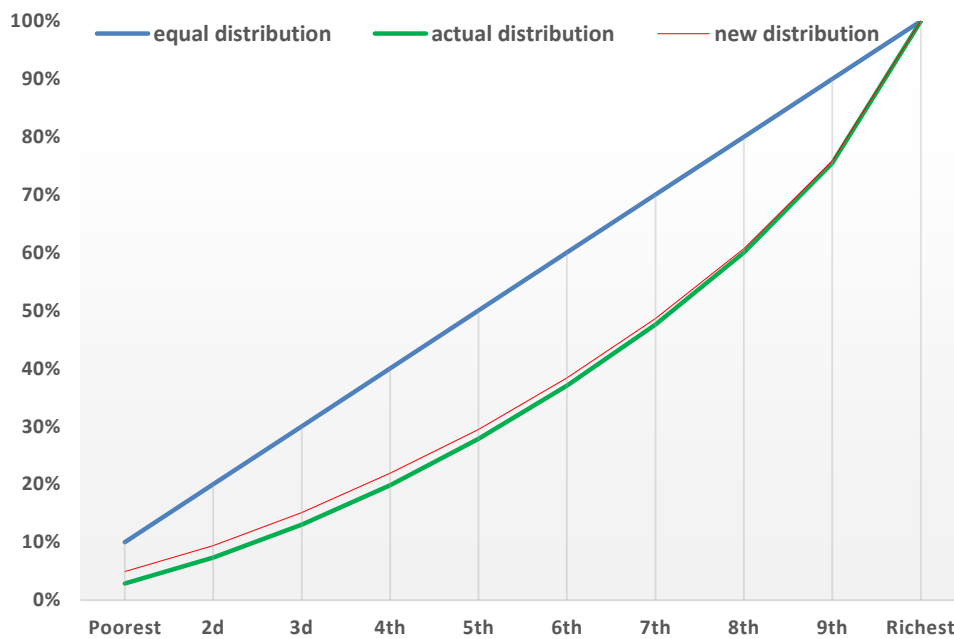
The average decrease in income of the fifth decile and higher does not exceed one percent. In fact, for the richest 20 percent of the population their income on average falls by 0.2 percent only. Meanwhile, the average increase in income of the poorest decile is over 10 percent with the redistribution. In reality, what does not matter for the rich does matter for the poor. New average incomes allow me to estimate the hypothetical shares of income by deciles. I therefore approximate the level of income inequality by showing the shares of income belonging to different income groups. Table 5 represents the actual and new distribution of income shares.

**Table 5. Accumulated shares of income by 10% income groups before and after redistribution**

	1st	5th	6th	7th	8th	9th	10th
<b>Actual distribution</b> <sup>23</sup>	2.86%	7.99%	9.21%	10.54%	12.44%	15.42%	24.56%
<b>New distribution</b>	4.92%	7.56%	8.89%	10.23%	12.15%	15.14%	24.12%

<sup>23</sup> Estimated based on actual distribution of average income levels by 10 percent income groups.

**Figure 6. Redistributive effect of social benefits: new Lorenz curve**



*Source: Author's own calculations*

Given the small amounts of average benefits, the redistributive effect is not very high. However, the results indicate that the share of income accumulated by the poorest decile has almost doubled, with associated decreases in shares of higher deciles. The share of accumulated income of the poorest decile increased from 2.86 percent to 4.92 percent. Therefore, the income distribution has become more equal, as shown by the new Lorenz curve in Figure 6. The red line represents the new income distribution, which now is closer to the perfect equality line, and more important, this effect is gained through the increase in income share accumulated by the poorest population.

### **Concluding remarks and recommendations**

While poverty reduction has been included on the policy agenda in Kyrgyzstan, the issue of income inequality has received less focus. Not only is income inequality itself harmful to economic and human development of Kyrgyzstan, but it can also significantly limit progress on reducing poverty. Therefore, poverty reduction efforts should be accompanied by directed efforts to alleviate inequality in income distribution. Certainly, reducing income inequality requires a set of complex measures, including promoting inclusivity of economic growth, creating better-functioning labor markets, and developing appropriate institutions. Yet, one of the possible short-term and feasible solutions for Kyrgyzstan could be reform of the social assistance system. Improvement of the targeting mechanisms of social benefits and focus on people at the bottom of the income distribution increase the accumulated share of income for the poorest and decreases inequality.

To achieve progress in income inequality reduction it is necessary to reintroduce goals and priorities into national development strategies. The current National Strategy for Sustainable Development ends in 2017. The government will have to develop a new strategy, which is a good occasion for assembling targets and goals on income inequality reduction. Once the

national goals are introduced, the sectoral policies can be developed, including social assistance policy reforms.

Furthermore, Kyrgyzstan has committed to the achievement of the global Sustainable Development Goals.<sup>24</sup> In December 2015 the Coordination Committee on adaptation, realization, and monitoring of Sustainable Development Goals was established (Resolution of the Government of the Kyrgyz Republic N<sup>o</sup> 867 dated December 22, 2015). The Coordination Committee is responsible for adapting the global goals formulations and coordinating activities aimed at introducing global goals into strategic documents. One of the Sustainable Development Goals is to reduce inequalities within and among countries (SDG 10). The SDG 10 agenda includes achievement and sustainability of income growth of the bottom 40 percent of the population and promotion of social and economic inclusion of all.<sup>25</sup>

Within the framework of the Coordination Committee, it is necessary to establish a working group of government officials and experts in the field to discuss the possibility of the social assistance system's reform as one of the instruments to achieve progress on SDG 10 and to reduce income inequality in Kyrgyzstan.

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<sup>24</sup> <http://www.kg.undp.org/content/kyrgyzstan/en/home/post-2015.html>

<sup>25</sup> United Nations General Assembly, Seventieth Session: *Resolution adopted by the General Assembly on September 25, 2015, A/RES/70/1*, distr. General October 21, 2015.

## Annex 1. Economic and income inequality indicators

	GDP growth, %	Poverty rate, %	Gini, %	10:10, times	Palma ratio	Shares of income, %									
						100%	90%	80%	70%	60%	50%	40%	30%	20%	10%
<b>2000</b>	5.4	62.6	-	19.5	2.4	33.1	17.0	12.4	9.7	7.8	6.3	5.0	4.0	2.9	1.7
<b>2001</b>	5.3	56.4	-	17.8	2.3	33.6	16.1	12.0	9.6	7.8	6.4	5.2	4.2	3.1	1.9
<b>2002</b>	0	54.8	41.9	15.8	2.1	30.9	16.7	12.5	10.0	8.1	6.7	5.5	4.3	3.3	2.0
<b>2003</b>	7	49.9	40.7	14.4	1.9	30.0	16.6	12.6	10.1	8.3	6.8	5.6	4.5	3.4	2.1
<b>2004</b>	7.1	45.9	42.2	14.8	1.9	29.4	16.8	12.8	10.4	8.4	6.9	5.6	4.4	3.4	2.0
<b>2005</b>	-0.2	43.1	43.3	17.5	2.2	31.9	16.9	12.5	9.9	8.0	6.5	5.3	4.2	3.1	1.8
<b>2006</b>	3.1	39.9	44.6	14.4	1.8	26.6	18.8	13.5	10.6	8.5	7.0	5.6	4.4	3.2	1.8
<b>2007</b>	8.5	35.0	42.2	16.1	2.1	31.1	16.7	12.6	10.0	8.1	6.6	5.4	4.3	3.2	1.9
<b>2008</b>	8.4	31.7	36.3	9.7	1.4	26.3	15.9	12.7	10.5	8.8	7.5	6.3	5.2	4.1	2.7
<b>2009</b>	2.9	31.7	37.1	11.0	1.6	27.4	16.2	12.5	10.5	8.6	7.3	6.1	5.0	3.9	2.5
<b>2010</b>	-0.5	33.7	37.1	11.1	1.6	27.5	16.2	12.5	10.5	8.6	7.3	6.1	5.0	3.9	2.5
<b>2011</b>	6	36.8	38.2	12.0	1.7	28.2	16.4	12.6	10.2	8.7	7.1	5.9	4.8	3.7	2.4
<b>2012</b>	-0.9	38.0	42.0	15.8	2.1	30.9	16.6	12.7	9.9	8.1	6.8	5.4	4.3	3.3	2.0
<b>2013</b>	10.9	37.0	45.6	21.4	2.6	33.9	17.1	12.4	9.6	7.7	6.2	4.9	3.8	2.8	1.6
<b>2014</b>	3.6	30.6	42.9	17.2	2.4	37.0	13.7	10.9	9.1	7.6	6.3	5.4	4.8	3.1	2.1
<b>2015</b>	3.4	32.7	40.8	11.8	1.6	26.5	18.0	13.8	10.9	8.0	6.5	5.8	4.7	3.6	2.2

## Annex 2. Average total income and average benefits by deciles, soms

		<b>poorest</b>	<b>2d</b>	<b>3d</b>	<b>4th</b>	<b>5th</b>	<b>6th</b>	<b>7th</b>	<b>8th</b>	<b>9th</b>	<b>richest</b>
2000	<b>income</b>	120	173	217	264	312	376	450	553	731	1279
	<b>benefits</b>	4	4	3	3	2	3	2	1	2	1
2001	<b>income</b>	163	271	359	452	557	675	830	1041	1392	2903
	<b>benefits</b>	6	7	4	3	4	3	3	3	3	6
2002	<b>income</b>	187	314	417	523	640	781	957	1202	1606	2966
	<b>benefits</b>	12	15	10	12	9	8	6	5	6	6
2003	<b>income</b>	220	298	358	427	505	594	743	901	1127	1896
	<b>benefits</b>	13	7	7	3	5	3	4	2	3	2
2004	<b>income</b>	207	343	428	516	597	694	826	1006	1322	2333
	<b>benefits</b>	13	10	11	9	7	6	4	2	3	3
2005	<b>income</b>	260	402	526	633	755	895	1058	1276	1672	3225
	<b>benefits</b>	17	7	16	12	6	5	9	10	6	4
2006	<b>income</b>	280	440	562	671	787	917	1090	1344	1774	3267
	<b>benefits</b>	15	21	9	8	5	5	5	4	4	7
2007	<b>income</b>	420	612	756	887	1027	1193	1409	1718	2157	3987
	<b>benefits</b>	12	12	4	17	4	3	7	3	2	2
2008	<b>income</b>	582	935	1172	1396	1632	1908	2246	2719	3503	6176
	<b>benefits</b>	12	7	5	6	5	3	4	4	3	3
2009	<b>income</b>	704	1122	1401	1670	1979	2288	2631	3140	3998	6411
	<b>benefits</b>	21	12	10	10	7	4	8	2	4	3
2010	<b>income</b>	768	1146	1387	1652	1914	2192	2577	3015	3811	6487
	<b>benefits</b>	38	23	17	12	11	11	8	15	11	19
2011	<b>income</b>	889	1417	1760	2070	2354	2649	3029	3562	4421	7212
	<b>benefits</b>	36	18	26	21	16	8	6	11	22	14
2012	<b>income</b>	971	1552	1903	2265	2565	2886	3362	3964	4930	7755
	<b>benefits</b>	28	17	24	36	4	9	8	16	14	33
2013	<b>income</b>	867	1487	1847	2190	2540	2976	3514	4201	5284	8452
	<b>benefits</b>	44	31	24	22	30	24	14	13	11	8
2014	<b>income</b>	1127	1823	2280	2682	3156	3636	4203	4969	6082	9611
	<b>benefits</b>	33	50	38	28	28	20	21	12	12	16
2015	<b>income</b>	1165	1833	2309	2779	3255	3754	4295	5068	6283	10006
	<b>benefits</b>	74	39	30	32	29	18	17	15	8	46

**Annex 3. Change in average income after redistribution of benefits by deciles, %**

	<b>10th</b>	<b>9th</b>	<b>8th</b>	<b>7th</b>	<b>6th</b>	<b>5th</b>	<b>1st</b>
<b>2000</b>	-0.1%	-0.3%	-0.2%	-0.5%	-0.7%	-0.5%	9%
<b>2001</b>	-0.2%	-0.2%	-0.3%	-0.4%	-0.5%	-0.8%	14%
<b>2002</b>	-0.2%	-0.4%	-0.4%	-0.6%	-1.0%	-1.4%	21%
<b>2003</b>	-0.1%	-0.3%	-0.2%	-0.5%	-0.5%	-1.0%	9%
<b>2004</b>	-0.1%	-0.2%	-0.2%	-0.5%	-0.8%	-1.2%	12%
<b>2005</b>	-0.1%	-0.3%	-0.8%	-0.9%	-0.6%	-0.8%	16%
<b>2006</b>	-0.2%	-0.2%	-0.3%	-0.5%	-0.6%	-0.7%	11%
<b>2007</b>	-0.1%	-0.1%	-0.2%	-0.5%	-0.3%	-0.4%	5%
<b>2008</b>	-0.1%	-0.1%	-0.2%	-0.2%	-0.2%	-0.3%	4%
<b>2009</b>	-0.1%	-0.1%	-0.1%	-0.3%	-0.2%	-0.3%	4%
<b>2010</b>	-0.3%	-0.3%	-0.5%	-0.3%	-0.5%	-0.6%	10%
<b>2011</b>	-0.2%	-0.5%	-0.3%	-0.2%	-0.3%	-0.7%	9%
<b>2012</b>	-0.4%	-0.3%	-0.4%	-0.2%	-0.3%	-0.2%	9%
<b>2013</b>	-0.1%	-0.2%	-0.3%	-0.4%	-0.8%	-1.2%	12%
<b>2014</b>	-0.2%	-0.2%	-0.2%	-0.5%	-0.5%	-0.9%	10%
<b>2015</b>	-0.5%	-0.1%	-0.3%	-0.4%	-0.5%	-0.9%	11%