

Assessment and recommendations

Kyrgyzstan made a rapid transition to a market economy following independence from the Soviet Union. However, social protection provision has been much slower to adapt to the post-Communist context, due in part to the social insurance system that it inherited. Although pension receipt is almost universal among the elderly and thus serves as a critical buffer against poverty for them and their families, the cost of maintaining this system has imposed severe constraints on the development of social assistance, social services and labour market policies in place.

A rebalancing of social protection provision is essential for enhancing its impact and ensuring its political and financial sustainability. This report explains how this rebalancing should be carried out within a broader process of systematisation that seeks to increase coherence and co-ordination across the sector, thereby optimising resources, expanding coverage and maximising the impact of social protection at an individual, household and national level. The breadth of social protection coverage, which combines the USSR's cradle-to-grave system with relatively young programmes, provides considerable potential for such efficiencies and synergies.

This report is intended for a broad audience, including social protection stakeholders both within Kyrgyzstan and abroad. Although Kyrgyzstan's trajectory since independence has in various ways been unique, the challenges it confronts in transitioning from a Soviet-era social protection system to one that is appropriate for a market-based economy are common to many former Soviet Republics. Meanwhile, it faces many of the same difficulties as other developing countries in ensuring that poverty-targeted benefits reach intended recipients and in promoting social insurance in a context of high informality.

Social protection must align to changing needs in Kyrgyzstan

The national poverty rate remains high. It soared post-independence, declined rapidly in the early 2000s, stabilised at around 30% between 2008 and 2015 and then dipped to 25.4% in 2016. A large proportion of the population remains vulnerable: in 2015, 35% of the population had income between the national poverty line and 1.5 times that level. Broader measures of deprivation have shown signs of improvement after provision of basic services deteriorated dramatically following independence. Financial constraints limit the quality of services, especially in rural areas. Income inequality rose sharply in the years following independence but has since fallen.

The aggregate shift in the income distribution masks important dynamics among groups at different income levels. Upward and downward income mobility has intensified in recent years, and there was greater downward mobility than upward mobility between 2010 and 2015, suggesting that social protection is not able to maintain individuals' incomes in times of difficulty. Moreover, analysis of the poor population indicates that only a small proportion of poor individuals receive social assistance, although many poor households contain one or more pensioner benefiting from the contributory system.

Lifecycle risks are concentrated among Kyrgyzstan's large young population. The prevalence of poverty among children is striking: the poverty rate among those aged 6

and under was 43.1% in 2015, more than ten percentage points higher than the overall poverty rate. Stunting is a concern across income groups. Although child mortality has declined significantly since 2000, the maternal mortality rate rose over this period and is highest in the region. Vaccination rates have increased for children in rural areas but declined for those in urban areas.

Pre-school enrolment has risen significantly in recent years, to around 25%, but this level is far below Soviet-era enrolment rates and is concentrated in urban areas. While enrolment in primary and lower secondary education is close to universal, it is substantially lower for upper secondary school, at around 53%. In urban areas, upper secondary enrolment rose from 47% in 2009/10 to 59% in 2013/14 while enrolment in rural areas declined over the same period. Enrolment in upper secondary is higher for girls than for boys. Attendance rates for primary and secondary education are higher in rural areas than urban areas but urban children tend to perform much better than their rural counterparts. In general, education outcomes are very low and many school-leavers lack basic skills when they enter the labour market.

The transition from school to work is very challenging, especially for girls. Some 15.4% of the entire youth population (aged 15-29) was not in education, employment or training in 2013. This rate was much higher among females than among males. The unemployment rate among youth classified as economically active was 12% in 2014, down from 14% in 2009 but higher than the overall unemployment rate in 2014 (8.2%). Meanwhile, childbirth among underage women has increased steadily since 2000, with the increase particularly pronounced in urban areas.

Working-age individuals in Kyrgyzstan confront three major risks: unemployment, informality and emigration. For female workers, withdrawal from the labour market represents a fourth risk: less than 50% of the female population over age 15 was economically active in 2015. The unemployment rate has averaged around 8.5% over the past decade, while 20% of employed workers are working fewer hours than they would like, 26% earn low pay and over 40% are working excessive hours.

Informality is rising fast, accounting for 71.8% of total employment in 2014, up from 60.2% in 2002. The rate is higher among men than among women and higher in rural areas than in urban areas. The high rate of social insurance contributions is a key driver of informality.

Between 15% and 20% of the population is estimated to be working abroad (almost all in Russia), where wages are considerably higher than in Kyrgyzstan. Younger workers from the south of the country are the most likely to emigrate. Migration has major benefits to the economy: remittances equated to 34.5% of gross domestic product (GDP) in 2016, one of the highest levels in the world. The unemployment rate would probably be higher (or wages much lower) were it not for high levels of emigration. However, migrants (and the families they support) are highly vulnerable, and emigration is associated with various social problems within Kyrgyzstan.

Kyrgyzstan suffers from a double burden of disease. Infectious diseases, such as tuberculosis (TB) and (increasingly) HIV/AIDS, are a persistent problem but the burden of non-communicable diseases has become an even greater challenge. Inequalities in health outcomes exist, with health care not equally accessible to all segments of the population. Among the 2.3 million individuals who required medical assistance in 2015, 31.8% did not access any health services. Financial hardship related to the cost of health services is common; 39% of total health expenditure was out-of-pocket in 2014.

According to the 2015 Kyrgyz Integrated Household Survey, 0.9% of the total population lives with some kind of disability. Poverty is more prevalent among households that include people with disabilities, which reflects partly the additional associated cost and partly low levels of labour-force participation among people with disabilities. The disability rate among young people has risen rapidly in recent years, which could reflect either a deterioration of health outcomes among children or better reporting. The latter might have been driven by recent increases in the value of social assistance benefits for children with disabilities.

The contributory pension system acts as a crucial buffer against poverty among people with disabilities and the elderly, provided they spent a significant amount of time in formal employment. Although pension coverage among the current elderly population is nearly universal – a legacy of the near-full employment prior to independence – the value of pension payments tends not to be high.

Different surveys provide different evidence on the subjective wellbeing of Kyrgyz people. Gallup data indicate that Kyrgyz people are among the least positive in the region but domestic surveys paint a more positive picture, showing that around half the population expects their situation to improve in the future.

Looking ahead, changing demographics will have a major bearing on the economy and on demand for social protection. Although the age structure of the population is currently favourable, the population is ageing. An increased number of elderly will put significant pressure on pension spending, already one of the largest public expenditures. Kyrgyzstan's population will remain predominantly rural until around 2050 and thus particularly vulnerable to climate change, which poses both short- and long-term threats.

The overall macroeconomic context in Kyrgyzstan is improving. Recent elections occurred without incident and the economy has shown great resilience in recent years. However, Kyrgyzstan's openness to trade and its reliance on its neighbours – Russia in particular – leave it vulnerable to events outside its borders. Domestically, the energy sector is a major concern; costly electricity subsidies for residential consumers are a major burden on the state's resources and will be very difficult politically to eliminate.

Social assistance and labour market policies have less impact than social insurance

Amid the economic and fiscal crises that followed independence, the Government of Kyrgyzstan (GoK) managed to maintain Soviet-era arrangements despite severe fiscal constraints and surging demand for benefits. Once the economic situation stabilised (briefly) in the middle of the 1990s, the GoK embarked on a series of measures to address massive deficits in the pension and health systems and introduced a poverty-targeted social assistance programme – the Unified Monthly Benefit – to reduce poverty among households with young children.

Further reforms to the structure of social protection provision were undertaken towards the end of the first decade of the 2000s. A new, fully funded individual account component was added to the pension system and in-kind benefits for privileged groups of the population were replaced with monetary benefits. However, the reforms of the past two decades have not been enough to guarantee the sustainability of social insurance arrangements or ensure the effectiveness of social assistance and labour market policies for vulnerable groups. They have also led to a fragmentation of social protection provision.

The social insurance system (which is managed by the Social Fund, a Ministry-level institution) provides benefits in the event of old age, disability or death of a contributor. For individuals who were employed for a significant proportion of their careers under the Soviet system, social insurance is functioning relatively well. However, coverage among today's workforce is much lower.

The number of Social Fund beneficiaries is increasing much faster than the number of contributors, partly due to high levels of informality and emigration. Moreover, the proportion of contributors who pay the full contribution rate is declining, which is putting strain on the pay-as-you-go component of the system. Transfers by the Republican Budget to the Social Fund finance the basic pension component, on which workers with low levels of contributions rely for the majority of pension benefits. They also finance non-contributory pensions for the military, which is a rapidly growing burden on public finances.

The pension system is caught in a vicious circle. To ensure sustainability, it must reduce benefits, increase the number of contributors or raise the contribution rate. Reducing benefit levels or increasing the contribution rate is likely to further deter individuals from contributing, while growth of the informal sector will make it very difficult to expand the contribution base. Meanwhile, the growing burden of financing the basic pension component is crowding out non-contributory programmes.

Social assistance, which is managed by the Ministry of Labour and Social Development (MoLSD), is implemented on a much lower scale than social insurance. In 2017, the MBPF was the largest programme by both coverage and expenditure, providing a monthly cash transfer to households with children under age 16 (or under 18, if they are still in education) and whose per capita income does not exceed the value of the guaranteed minimum income.

Coverage of the MBPF has declined significantly in recent years. Only 4.9% of the population lived in households eligible for the MBPF in 2015. This is much lower than the overall poverty rate, reflecting the fact that the MBPF was established to eradicate *extreme* poverty, which today affects a very small proportion of the population. However, the MBPF has been shown to exclude a large proportion of the poorest of the poor, due in large part to the programme's administrative challenges. Households that are deemed ineligible for the MBPF might also be excluded from co-payment exemptions for health services.

Overall, the MBPF does not have a large impact on the incidence or depth of poverty. This is due partly to its low coverage and partly to low benefit levels, which, although they have risen significantly in recent years, remain far below the extreme poverty line. As a consequence, the GoK is considering reforming state benefits from 2018; the new dispensation is likely to combine categorical targeting with means-testing and is expected to have a greater impact on poverty than the current MBPF but at a higher cost.

The other main social assistance programme – the Monthly Social Benefit (MSB) – is the umbrella term for cash benefits payable to different vulnerable groups regardless of income. These groups include people with disabilities (including children), orphans, mothers who have had seven or more children (known as heroine mothers), and elderly individuals who are not eligible for pensions from the contributory system. Benefit levels vary between these groups but tend to be higher than the value of the MBPF. Coverage of the MSB has risen much faster than the population as a whole in recent years, while the

value of benefits has increased for some groups and not for others. Maternity and funeral benefits also exist but are only payable to workers who worked in the formal sector.

Cash payments (compensations for privileges) are paid monthly to some 25 groups. Some categories receive these benefits based on merit rather than vulnerability and should not necessarily be considered social protection recipients. However, other recipients are from vulnerable groups, indicating potential overlap with the MSB. The number of individuals receiving these compensations has declined for most categories and the value of the benefits has been frozen in real terms in recent years. As a result, expenditure has declined significantly both in real terms and as a proportion of total spending.

The provision of social services is dominated by residential institutions; other services are very scarce due to resource and capacity constraints at a local government level, as well as a lack of legislation to clarify the state's obligations in this area. The GoK has made important advances in improving oversight of residential institutions, which are managed by a range of different institutions, but is making slow progress in reducing the number of children enrolled therein.

The MoLSD also oversees active labour market policies for vulnerable groups, although these exist on a very small scale. Public Employment Services act as a gatekeeper for labour market policies, assisting with job searches and connecting the unemployed with micro-credit, but are constrained by a lack of information on the labour market. The largest active labour market policy is public works programmes, which are implemented in a highly decentralised manner and overwhelmingly employ men rather than women. An unemployment benefit exists but the value is extremely low and strict eligibility criteria mean it is paid to a very small number of the unemployed.

Overall, social protection provision covers a wide range of risks but the allocation of resources across the sector is very unbalanced. The proportion of elderly receiving pensions is close to 100%, while less than 10% of the population access social assistance and labour market policies. The most notable gaps in coverage are instruments for the urban poor, unemployed youth (especially women) and migrant workers. These gaps will often result in pensioners living with younger generations, stretching their (often low) pension benefits across large households.

Fiscal space for expanding social protection is limited

Imbalances in provision of social protection are reflected in the structure of expenditure, which is growing in real terms and was equal to 10.7% of GDP in 2015, making it the largest component of government expenditure – higher than spending on health and education combined. Old age pensions (including the military) accounted for 72% of this expenditure, while the MBPF, MSB and compensations combined were worth around 15%. Assuming the overall resource envelope for social protection remains unchanged, pensions will absorb an ever greater proportion of expenditure, not only due to financial imbalances in the Social Fund (currently covered by the Republican Budget) but also rapid growth in spending on military pensions.

Economic growth and increased tax revenues have accommodated growth in social protection spending in recent years but Kyrgyzstan relies on external support to finance its spending and recently breached its maximum debt threshold. Over the long-term, reprioritisation within the social protection sector is a more promising source of fiscal space for expanding social protection spending than additional allocations to the sector.

Fiscal incidence analysis shows the fiscal system is progressive, although the size of the pension system means there is likely to be significantly more horizontal redistribution (between individuals of similar income) than vertical redistribution (between individuals at different level of income). The impact of high taxes (of which indirect taxes account for the lion's share) and high social protection spending on poverty is approximately neutral. The incidence of public services – particularly health and education – is thus an important determinant of the overall impact of the fiscal framework on poverty.

Rebalance social protection through a systemic approach

The GoK should rebalance social protection provision to align it to the needs of Kyrgyzstan today and to ensure its future sustainability. This rebalancing should occur in the context of a broader reform to establish a social protection system in Kyrgyzstan, as envisaged by recent social protection strategies.

Kyrgyzstan's broad range of social protection programmes, high level of expenditure, the concentration of social protection policy at central level and the acceptance of social protection as a basic right all pave the way for promoting coherence and co-ordination across the social protection sector. However, the structure of the MoLSD is not well aligned to a systemic approach and the provision of social assistance and social services is undermined by low capacity and a lack of clear roles and responsibilities at local level. At the same time, the MoLSD has so far been unable to influence social insurance policy.

There has been important progress in establishing an effective information infrastructure for social assistance beneficiaries through the Corporate Information System for Social Assistance (CISSA). This database will significantly improve the efficiency and transparency of all business processes related to social assistance. However, steps are needed to improve its functionality, ensure its sustainability and link it to other databases being developed for social protection and for the population as a whole.

Systematisation of social protection would also require a reallocation of expenditure across social protection pillars and major changes to the structure of key programmes. Merging the MBPF with a categorical benefit for children would be a major step towards enhancing the impact of social assistance. Strengthening the mandate of the MoLSD to provide social services at a local level might improve the operation of social protection at a local level but would require a significant reform to the inter-governmental system. A similarly bold decision is required for social insurance to protect the sustainability of the system and ensure adequate protection for future generations of retirees, possibly including the introduction of a universal old-age grant as the basis for retirement provision.

Recommendations

Introduce a universal infant benefit as part of state benefit reform

- Establish a three-component state benefit for families with children, incorporating universal grants for newborns and infants and a poverty-targeted grant for older children.
- Provide the infant benefit to children up to their second birthday initially but increase the eligibility age to three within five years.

- Ensure that vulnerable children are linked to social services, health and education (in particular pre-school facilities), creating a subsystem of social protection specifically for children and vulnerable families.
- Eliminate the guaranteed minimum income from the calculations for eligibility and benefit value for the poverty-targeted component.
- Simplify the eligibility assessment for the poverty-targeted component.

Reform and scale up social services

- Create a legislative framework for the provision of social services according to a guaranteed minimum level of services for specified vulnerable groups.
- Identify clear roles and responsibilities between social protection experts employed by *aiyl okmotu* (local government) and the staff of the MoLSD for the provision of social services at a local level.
- Expand the capacity of the social workforce by ensuring social workers possess the required skills and training as well as adequate resources.
- Ensure that children at residential institutions (and their families) are linked to other social protection arrangements, especially after they leave institutions.

Scale up public works programmes to revive labour market policies

- Catalogue and analyse existing implementation of public works programmes.
- Design a national strategy and policy framework for public works programmes at the same time as enhancing MoLSD's capacity in this area.
- Establish participation quotas for women, the youth and people with disabilities and ensure skills acquisition is mainstreamed into projects.
- Ensure the involvement of local communities and administrations in identifying participants and designing activities to ensure that projects are useful.
- Set up stringent monitoring and evaluation systems to assess their impact.

Establish a universal social pension based on the basic contributory pension and the MSB

- Introduce contributions and increase the retirement age for military pensions.
- Align retirement ages and indexation policy for old-age and adult disability MSB benefits with basic pension component.
- Over time, consider merging the old-age and adult disability MSB and basic pension component to create a social pension.
- Use social pension as the basis for a broader reform of retirement provision to safeguard the long-term sustainability of the Social Fund while maintaining universal coverage of public retirement benefits.
- Establish an inter-governmental task team chaired by the Vice Prime Minister on social affairs to guide retirement reform.

Restructure MoLSD to enhance systematisation of non-contributory programmes and co-ordination across social protection sector

- Move the unit responsible for co-ordinating social protection policy to report directly to the Minister of Labour and Social Development.
- Align units with a labour/employment portfolio to specific labour market programmes.
- Establish specific capacity for social insurance and social services to reflect other proposed changes.

Ensure functionality and sustainability of CISSA

- Accelerate the implementation of CISSA as the principal information tool for non-contributory benefits, ensuring its functionality for users outside Bishkek.
- Link CISSA to other databases currently being developed for the social protection sector as well as to population registries.
- Capacitate the MoLSD to manage CISSA at a central level and in the regions.

Close equity gaps in access to health services

- Close avenues for opting out of the Mandatory Health Insurance Fund.
 - Gather data regarding different individuals' capacity to pay in order to increase contributions from informal sector workers.
 - Enforce the enrolment mandate and establish appropriate incentive mechanisms such as matching contributions from budgetary funds.
- Use funds from increased contributions to retain physicians in rural areas and incentivise improved quality of care, for instance by developing indicators for output- and quality-based performance payments.
- Further strengthen health service integration, using the integration of TB drugs in the Additional Drug Package as a model.
- Better target user-fee exemptions and increase coverage of exemptions for pharmaceuticals.



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