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Asian Development Bank



Asian Development Bank

A Study on International Migrants' Remittances in Central Asia and South Caucasus

**Country Report
on**

Remittances of International Migrants and the Financial Sector in the Kyrgyz Republic

This report has been prepared by a team of experts from the Center for Social and Economic Research—the Kyrgyz Republic. The principal authors of the report are Roman Mogilevsky (team leader) and Aziz Atamanov. The authors are thankful to their colleagues Nikolai Chuikov, Ekaterina Gardyushina, Irina Lukashova, Irina Makenbaeva, and Alibek Omorov for their valuable help in collecting data for this study as well as to Shamsia Ibragimova, who kindly provided database and materials of the study on remittances and poverty in the Kyrgyz Republic. They are also grateful to the management and staff of the National Bank of the Kyrgyz Republic for providing data and to the management of commercial banks in the Kyrgyz Republic for sharing their views on the development of the country's remittance industry. The report benefited from useful comments provided on its earlier drafts by Bahodir Ganiev, Manuel Orozco, and Betty Wilkinson.

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CONTENTS

Executive Summary	i
Introduction	1
1. Remittance Flows in the Kyrgyz Republic	1
1.1. Economic Background for Remittances	1
1.2. Previous Studies of Remittances in the Country	2
1.3. Measuring Remittances in the Kyrgyz Republic	4
1.4. Remittance Dynamics	6
1.5. Remittance Inflow Composition	8
2. Macroeconomic Effect of Remittances	12
3. Remittance Pattern on Micro level	18
3.1. Profiles of Remittance Senders and Recipients	19
3.2. Remittance Transfer Pattern	20
3.3. Remittances and Business Activities of Recipient Households	29
3.4. Remittance Recipients and Financial Sector	30
4. Issues and Patterns in the Marketplace of Remittance Transfer Businesses	32
4.1. Regulatory Environment for Money Transfers	32
4.2. Money Transfer Operators in the Kyrgyz Republic	33
4.3. Competition in the Remittance Market	36
5. Remittances and Financial Intermediation	40
6. Issues and Recommendations	47
APPENDIXES	
1. Migration Patterns	50
2. Complementary Tables and Graphs	53

CURRENCIES AND EQUIVALENT UNITS

Currency Unit = Som

\$1 = 40.16 Som

1 Som = \$0.025

ABBREVIATIONS

ADB	– Asian Development Bank
AML	– anti-money laundering
ATM	– automated teller machine
BOP	– balance of payment
CAREC	– Central Asian Regional Economic Cooperation Programme
CEE	– Central and Eastern Europe
CIS	– Commonwealth of Independent States
EBRD	– European Bank for Reconstruction and Development
EurAsEC	– Eurasian Economic Community
FDI	– foreign direct investment
FSU	– former Soviet Union
GDP	– gross domestic product
IFC	– International Finance Corporation
IMF	– International Monetary Fund
KAFC	– Kyrgyz Agricultural Financial Corporation
KfW	– Kreditanstalt für Wiederaufbau (German government-owned development bank)
lhs	– left-hand side (with regard to a graph vertical axis)
MTO	– money transfer operator
NBFI	– nonbanking financial institution
NBKR	– National Bank of the Kyrgyz Republic
NSC	– National Statistical Committee of the Kyrgyz Republic
ODA	– official development assistance
PPP	– purchasing power parity
rhs	– right-hand side (with regard to a graph vertical axis)
ROA	– return on assets
ROE	– return on equity
RRS	– remittance recipient survey
SOE	– state-owned enterprise
SSC	– Settlements and Savings Company
US	– United States
VAT	– value-added tax
WDI	– <i>World Development Indicators</i> (publication of the World Bank)

Note:

In this report, \$ refers to US dollars.

Executive Summary

Remittance Flows in the Kyrgyz Republic

i. Currently, labor migration and remittances have become a big issue in the Kyrgyz Republic because they significantly affect the domestic labor market, private consumption, imports, government budget, family relations, and many other aspects of the country's economic and social condition. So far, too little is known about remittances and their impact on the economy and financial sector development. Empirical literature on remittances in the Kyrgyz Republic is very scarce and many remittance-related issues are still open.

ii. Official source of data on remittances in the Kyrgyz Republic is the National Bank of the Kyrgyz Republic (NBKR). In accordance with the International Monetary Fund's (IMF's) *Balance of Payments Manual*, NBKR's remittance estimates consist of three components: (i) compensation of employees, (ii) workers' remittances, and (iii) migrants' transfers. NBKR bases its remittance measuring methodology on commercial banks' data on cross-border monetary transfers (via money transfer operators (MTOs) and bank accounts), information of large companies in the Kyrgyz Republic on salaries of foreign employees, and the National Statistical Committee of the Kyrgyz Republic's (NSC's) data on the number of permanent migrants as well as the estimated average value of the property that they move across the border. However, these pieces of information are incomplete; and therefore, NBKR has to make some assumptions regarding the interpretation of different types of cross-border money transfers. The most important assumption is that all monetary transfers to and/or from the Kyrgyz Republic sent by individuals via MTOs and the postal system are considered workers' remittances. The incompleteness of information on amounts as well as the economic nature of transborder financial flows and the need to employ assumptions result in some notable shortcomings of this measurement methodology, the most important of which may be lack of accounting for informal transfers and risk of misinterpretation of the economic nature of financial transfers (e.g., mixing together compensation of employees, workers' remittances, revenues from exports of goods and services, international credit operations, etc.).

iii. Remittances demonstrated a very fast exponential growth in 2002 to 2006. On the average, remittances inflow more than doubled every year. These remittance data do not account for informal money transfers of migrants, which are part of the balance of payments' (BOPs') residual item "net errors and omissions." Fast growth of this item in 2003 to 2006 indirectly indicates a continuous increase in informal money transfers of migrants.

iv. There are three formal channels of sending remittances: (i) MTOs, (ii) bank accounts, and (iii) transfers via the Kyrgyz Post. According to the NBKR data, almost all remittances—close to 95%—come to the Kyrgyz Republic through MTOs whose role is growing with time.

v. Two main sources of remittances for the Kyrgyz Republic are the Russian Federation and the United States (US). In 2005, transfers from the Russian Federation accounted for 86% of total remittances sent while the share of the US was 11%. Third and fourth important sources, Kazakhstan and the United Kingdom, together gave less than 3% of total number of transactions and less than 1% of total amount of remittances.

vi. A detailed analysis of remittance transactions indicates that large (\$10,000–50,000) and very large (more than \$50,000) transactions make up a relatively small share in the total number of transactions, but their shares in the total amount of transactions are very large and growing. In 2005, large transactions accounted for 22% of the total amount of remittances via MTOs and very large transactions accounted for 72% of this total amount; thus, leaving just 6% for smaller transactions. It follows from the data that the remittance growth trend in 2002 to 2006 should be attributed to the growth in these large and very large transactions. Transactions of this size

normally could not come from remittances of labor migrants. Therefore, massive migration of Kyrgyz citizens to the Russian Federation and Kazakhstan as well as their eventual employment in construction, municipal services, and other relatively low-paying jobs do not seem to be a major source of remittance growth.

vii. A much more realistic explanation of large transactions and growth in their number and amount is that these transfers represent revenues from and loans for the trade operations of the Kyrgyz wholesale shuttle and retail traders in markets of Russian cities. If this is the case, then the larger part of “workers’ remittances” is a mixture of revenues from exports of goods and services, trade credits, and mixed income of Kyrgyz retail traders operating in the Russian Federation. Remittance growth then should be attributed to a shift in revenue repatriation pattern—from informal to formal (mainly MTOs) channels—and to expansion in the Kyrgyz shuttle trade.

Macroeconomic Effect of Remittances

viii. In recent years, remittances have been growing quickly. They are now the country’s second large source of foreign currency; the first is exports of goods. In the small open economy of the Kyrgyz Republic, such significant external inflows of money could affect virtually all economic variables.

ix. It is well known and confirmed by data generated in the framework of this ADB project that households use a large part of remittances for consumption. From a macroeconomic perspective, this means private consumption is to be positively linked to remittances inflow. Statistical analysis reveals a significant positive correlation between these two variables. As private consumption comprises the largest part of gross domestic product (GDP), remittances could also indirectly have a positive effect on GDP growth and employment. The data indicate a weak positive impact of remittances on GDP growth and provide some statistical evidence of increased employment in the informal sector associated with remittances growth exist. Analysis does not reveal any measurable impact of remittances on investments into fixed capital.

x. The relationship between remittances and imports is easily understandable and visibly better. It is well known that the share of imported consumer goods in the total consumption is high, so part of the remittances may be spent to finance imports of consumer goods to the country. There is a statistically significant positive correlation between remittances and imports. As taxation of imports is a key source of government revenues in the Kyrgyz Republic, the growth of imports (partially fueled by remittance inflow) has to result in growth of government revenues. Data confirm this hypothesis and demonstrate that statistically significant positive correlation between remittances and government revenues exists.

xi. Inflow of remittances has led to a fast increase in the country’s money supply. Remarkably, that until 2007 this very fast growth in money supply (31.5% per annum on the average) did not cause any serious inflation; the average annual inflation rate in 2002 to 2006 was just 4.0%. The surge in money supply has been absorbed by a growing money demand that should be attributed to deepened financial market, reduction in in-kind settlements between economic agents, and probably, some substitution of foreign currency by soms in domestic economic transactions and population savings.

xii. The global trend of depreciation of the US dollar also affected the som, which strongly appreciated versus the US dollar in nominal terms in 2001 to 2006. In real terms, however, the som appreciates for non-Commonwealth of Independent States (CIS) countries but depreciates significantly for CIS countries, mainly vis-à-vis the ruble. The real exchange rate dynamics seem to affect Kyrgyz exports to CIS countries positively and do not appear to be an important reason for the hike in imports, which took place in recent years.

xiii. Thus, analysis of data suggests that the inflow of workers' remittances to the Kyrgyz economy: 1) has some positive impact on GDP and personal consumption; 2) contributes to growth of imports and, indirectly, of government revenues; 3) is associated with some growth of employment in informal economy; 4) does not produce any measurable effect on investments; and 5) has no negative consequences for inflation and real exchange rate.

Remittance Pattern on Micro level

xiv. To understand the factors driving remittance flows, it is necessary to take the perspective of individuals and households—i.e., senders and recipients of these money transfers. Analysis in this section is based on data of two surveys conducted in the framework of the ADB project. The first is a representative household survey covering 3,997 households in all parts of the Kyrgyz Republic and providing information on household characteristics, welfare, migration, and remittances. Another source of data is a survey of recipients of remittances that was conducted in October 2006 in Bishkek and Osh at the premises of several Kyrgyz banks. Majority of the cases in these two surveys produced broadly consistent results.

xv. Household survey data shows that majority of migrants come from rural areas. An absolute majority of migrants has completed secondary or higher education; 82.5% of migrants go to the Russian Federation, 12% go to Kazakhstan, and only 5.5% go to other countries. Majority of migrants stay abroad for a short period; the average period is 1.2 years. Two main sectors of employment of Kyrgyz migrants are construction (45%) and trade (30.4%). Migrants from Bishkek have more diverse sector distribution with much fewer of them working in the construction industry.

xvi. It follows from the data that 16% of households in the Kyrgyz Republic receive remittances; in Bishkek, this share is smaller (11.2%). Total amount of remittances has been estimated at \$256.4 million (9% of GDP). This amount considerably differs from official estimates and from numbers circulating in the Kyrgyz media. Cash remittances comprise 95% of the remittances and 5% are in the form of goods. Average amount of remittances per receiving household for the country appeared to be \$1,380 per annum varying from \$1,255 in rural areas to \$1,865 in Bishkek.

xvii. According to the household survey data, more than 80% of all remittances come from the Russian Federation, slightly less than 10% from Kazakhstan, and another 10% from other countries. A very small share of remittances coming from the US—although this source of remittances is the second largest in the NBKR database—may indicate that the small group of people receiving remittances from this country (mainly those who live in Bishkek, have higher education, and whose income status is considerably higher than the average) has not been sufficiently covered by the household survey. The household survey data provides a geographical distribution of recipients of remittances within the country and almost three quarters of all cash remittances go to the southern part—Osh city, Osh oblast, as well as Jalalabat and Batken oblasts.

xviii. In the survey, households reported much smaller amounts of remittances than it follows from the NBKR data (even controlling for possibility of remittance consolidation by senders). This may be seen as an additional confirmation of the idea that a large part of the money entering the country via large transactions through MTOs is not from workers' remittances but rather from trade- and other business-related monetary flows.

xix. It follows from the survey data that majority of migrants (78.5%) use bank accounts and/or MTOs for money transmission—i.e., formal channels—and that a major part of remittances (78.2%) enters the country through this channel. The second important channel is money carried by migrants themselves. This channel is used by 25.6% of all households

receiving remittances and 17.2% of all cash remittances come in this way. The role of intermediaries appeared to be relatively low; merely 8.2% of all households use this channel and individual intermediaries bring only 4.3% of total amount of cash remittances.

xx. According to both surveys, in absolutely majority of the households, a sender decides on the type of money transfer system to be used and notifies recipients about the money transfer. Majority of the respondents receive information on the transfer within one day. Only 36% of the respondents can get their money immediately after receiving notification of such transfer. Typically, waiting time for the remaining 64% respondents is several hours. Moreover, 88% of the respondents did not report paying any commission to the money transfer company when receiving their money. Three quarters of all recipients get their money in US dollars. In some cases, people receive soms and rubles. It is noteworthy that considerably more people prefer to receive money in the national currency.

xxi. Data pertaining to length of receiving remittances by households shows that more than half reportedly received remittances for less than one year, while the share of households that received remittances for more than 5 years is about 10%.

xxii. In the remittance recipient survey, 73% of all respondents collected money that were sent to them, 14% did this for other people, and 13% participated in bulk remittance transactions, i.e., they owned only part of the money. The share of bulk remittances seems considerable. Pooling remittances may be related to the remitters' desire to minimize costs and risks associated with remittance-sending procedure.

xxiii. The household survey shows that more than half (59.9% in the household survey) of all households receiving remittances reported the availability of some savings, while only 37.3% that do not receive remittances have savings. Majority of households receiving remittances save money in the form of cash (in national or foreign currency) and only 1% of the respondents save money in the form of banking deposits.

xxiv. According to the household survey, there appeared to be not much difference between households receiving remittances and those not receiving them in their use of and attitude toward financial services. Less than 13% of households borrow money from any source, merely 1.7% lends money, and less than 1% has bank accounts or any type of banking card. People borrow money mainly from their relatives and/or friends (55%), microfinance organizations and credit unions (22%), and banks (17%).

xxv. Statistical analysis indicates that the probability of a household to have a bank account is higher for those households with higher income (without remittances), higher education of the household head, living in an urban area, and has some savings. These results show that mainly urban people with higher income and educational status compose a narrow group of banking system clients and that receiving remittances does not produce any measurable increase in the probability of closer contact of households with the banking sector. Data in the surveys indicate that majority of people do not understand the purpose of banks and how they could use them. Largely, this is a consequence of lack of previous banking experience. This then raises the issues of educating people on the use of financial services and demonstrating to them potential advantages of different financial products.

xxvi. It follows from the above analysis that the population, especially those from rural areas and the poor, still has little access to financial services. On one hand, this is a consequence of generally low level of income and welfare of the larger part of the population of the Kyrgyz Republic. On the other hand, both financial institutions and their potential clients consider the usage of financial services as some kind of luxury accessible only for those with higher income and educational status, or for people with lower-than-usual risk and transparency aversion. This

view has its historical roots. The situation in the financial sector and the living standards of the population, however, are gradually improving. Thus, it is time for financial institutions to invest in confidence building and in educating people on the use of financial services.

Issues and Patterns in the Marketplace of Remittance Transfer Businesses

xxvii. The Kyrgyz Republic has neither specific legislations on international money transfers nor restrictions on foreign currency transactions and savings for residents and nonresidents. Inbound and outbound international travel with foreign currency in cash is also not restricted. There are no legal restrictions on the size of outbound transfer, while the size of inbound remittances is regulated by legislation of the country of origin of the transfer or by internal rules of MTOs.

xxviii. While there are no legal restrictions, in practice, only commercial banks (except the Kyrgyz Post) implement money transfer transactions. The domination of commercial banks in providing international money transfer services could be explained by the fact that only banks have adequate liquidity and resources to work with asymmetrical flows of money transfers, as inbound remittance flows are much larger than outbound ones. Money transfer companies operate in the country via their agents, which are the Kyrgyz commercial banks. Practically all (19 of 21) active banks operating in the Kyrgyz Republic are involved in the business of money transfers.

xxix. The Kyrgyz Republic has 16 international MTOs and three domestic money transfer systems. Geographically, a dense network of outlets opened by commercial banks to serve international money transfers covers the country. An important and attractive feature of transfers through MTOs is that it is not necessary to disclose any sensitive information about the sender and the recipient as well as the economic nature of the transaction. Absence of transfer taxation also seems a crucial factor in determining the popularity of this remittance channel.

xxx. All commercial banks provide a service of international money transfers via bank accounts. However, this option is much less popular than the use of money transfer systems, which do not require opening a bank account. There could be several reasons for the relatively low popularity of bank accounts as a money transfer tool: (i) it is not always legally possible to open an account for a Kyrgyz migrant in the destination country, (ii) there are much fewer bank branches than MTO outlets in the country, (iii) the relatively costly and burdensome procedure of opening of bank accounts, (iv) the relatively high transaction costs for some types of transfer operations, (v) according to bank representatives, the very introduction of anti-money laundering (AML) legislation has caused an outflow of clients from commercial banks, and (vi) the fact that opening bank accounts may undermine informality, which is a key source of competitiveness of Kyrgyz shuttle traders.

xxxi. In recent years, NBKR, supported by donors, paid a lot of attention to the modernization of the payment system in the country. This resulted in much better infrastructure for international money transfers via SWIFT and establishing an interbank processing center. Yet, banking cards, which seem to be one of the most convenient methods of international money transfers via banking system, are not a popular tool in the Kyrgyz Republic. The situation with banking cards is illustrative of the problem of the slow introduction of new financial services and technologies in the country. Interviews with bankers show their interest in introducing new technological solutions such as mobile banking, but need technical assistance in designing new financial products that would be affordable for potential clients.

xxxii. One more international money transfer channel is the so-called informal transfers, which include the bringing in of cash to the country by migrants or their agents (typically relatives or friends). Recently, it was the most popular way of sending money back to the Kyrgyz Republic.

However, during the last 2 years, the situation has been dramatically changing. Different sources indicate that majority of migrants have switched to the use of formal channels. The affordable costs, reliability, and wide network of MTO outlets eliminated the main advantages of informal transfers.

xxxiii. The availability of numerous MTOs and consumers in the market, combined with a competitive and reasonably regulated banking sector, liberal regulatory regime for international money transfers, and low entry barriers made this market's structure in the Kyrgyz Republic competitive. One could think of at least three facets of competition in this market: (i) between MTOs, (ii) between banks, and (iii) between transfer-sending channels. No obvious leading MTO in the market exists. In different periods and by different indicators, Anelik, Contact, UNISStream, and Western Union have been in this position. The factors affecting market shares may be many, including: (i) proximity of systems' retail outlets to the migrants; (ii) size of transaction costs; (iii) density of MTOs' outlets in the Kyrgyz Republic as well as their proximity to recipients of remittances; and (iv) convenience and/or quality of services provided by the systems to the clients.

xxxiv. Commercial banks form another group of competitors in the Kyrgyz Republic's remittance market. It follows from the data that *Ecobank* is an absolute leader in the market followed by Kyrgyzstan Bank, Amanbank, and Settlements and Savings Company. These banks make some efforts to reach their clients both in the Kyrgyz Republic and the Russian Federation, but so far no bank has seriously strengthened its position in the market by introducing new technological solutions or providing complimentary financial services, conditions of which are sufficiently attractive for their clients. Analysis of transaction costs for different sending channels explains why expensive post transfers and transactions through bank accounts are much less popular than MTO transfers.

xxxv. Thus, the money transfer market has undergone a very dynamic period of development in the last 4 to 5 years and has converted into a competitive segment of business activity of the Kyrgyz financial sector. In addition, commercial banks have established themselves as a reliable remittance channel.

Remittances and Financial Intermediation

xxxvi. After the banking crises at the end of the 1990s, the Government and NBKR took significant corrective measures toward macroeconomic stabilization and put in place a more rigorous regulatory system for financial institutions. These measures have contributed to creating a healthier environment for financial sector development.

xxxvii. As of end 2006, there are 21 active commercial banks in the Kyrgyz Republic. One can see a considerable and fast expansion of total assets, liabilities, and own capital of commercial banks in the period 2001–2006. Only in 2006, the capital of the banks increased by 48%, assets by 29%, and liabilities by 26%. Still, GDP shares of these indicators are lower than in majority of the CIS countries. An analysis of the structure of the banking assets shows that banks generally follow a very conservative policy in terms of allocating their assets and keeping significant resources in liquid form. Having significant liquidity reserves, the banks are less interested in remittances as a source of capital. So far, their main incentive to work with remittances is to earn income from money transfer services.

xxxviii. In the last several years, commercial banks have expanded considerably their loan portfolio and deposit base. Important trends in the banks' financial intermediation activity are the growing role of deposits and credits in national currency, expansion of consumer credit and mortgage loans, and considerable reduction in interest rates for credits (although the rates still remain high). In general, the Kyrgyz financial sector has substantially expanded its

intermediation in recent years. The share of total deposits in GDP increased from a tiny 3.5% in 2001 to 14.9% in 2006. Aggregate credit of banking and nonbanking financial institutions (NBFIs) to nonfinancial corporations and individuals grew from 3.4% GDP in 2001 to 14.6% GDP in 2006. Yet, financial intermediation is still small in the Kyrgyz Republic compared with other countries.

xxxix. Expansion of all activities of the Kyrgyz banking sector has led to some improvement of its financial results. Return on assets (ROA) and return on equity (ROE) of commercial banks increased to 3.3% and 22.4% in 2006 from 2.3% and 17.6% in 2005. Interestingly, noninterest income of commercial banks approached their gross interest income and exceeded net interest income. This indicates that other financial services including money transfer operations are as important for the banks as intermediation activities.

xl. The banking sector of the Kyrgyz Republic is relatively small and there is no obvious leader in the market. Concentration in the banking sector had no clear trend in 2002 to 2005, and it significantly decreased in 2006. Among active commercial banks, two are owned by the state and all remaining banks are private. Fifteen banks have foreign shareholders and foreign participation in 10 banks exceeds 50%. One could distinguish between three groups of banks: (i) with prevailing domestic ownership; (ii) with full/partial ownership of Kazakh banks; and (iii) with full/partial foreign ownership. Of these groups, the first is much less capitalized and, perhaps partially for this reason, is the most active in the market of international money transfers. However, even banks that are most interested and active in the remittance market make little effort to transform recipients of remittances into full-scale customers.

xli. Although NBFIs are an important source of credit for the economy, their role diminished starting in 2007 with the transformation of the Kyrgyz Agricultural Financial Corporation into the Aiy! Bank in December 2006. In addition, the securities market in the Kyrgyz Republic is rather weak.

xlii. Thus, the Kyrgyz financial market is growing quickly from a very low basis. Largely, this growth is a consequence of macroeconomic stabilization in recent years, considerable strengthening of regulation of the sector, inflow of FDI, and maintained competitive environment. Still, the financial market in the country is shallow and financial intermediation is insufficient to meet the country's needs. Banks consider remittances only as a source of noninterest income and make only little effort to provide intermediary services to the senders and/or recipients of remittances. However, with some revival of consumer finance, growing competition in the banking sector, and adaptation of households receiving remittances to contacts with the banking sector, chances for more successful financial intermediation seem to be increasing.

Issues and Recommendations

xliii. Following the discussion of remittance flows and their impact on the development of the economy and the financial sector of the Kyrgyz Republic, it seems that in the last 4 to 5 years this impact indeed has been significant. Macro- and microeconomic consequences of the remittances inflow appeared generally positive. The remittance inflow also raised a number of issues, which the authorities and business community of the Kyrgyz Republic have to address.

These issues include:

- clarifying the notion of remittances in the Kyrgyz context and refining the methodology of their measurement and tracking;
- creating an enabling environment for conversion of remittances into investments into the Kyrgyz economy; and
- increasing and broadening the scope of financial services offered to and used by remittance senders and recipients.

xliv. All the above allow the formulation of recommendations to the Kyrgyz authorities, donors, and the banking community in the country.

To the Government and the national bank:

- Introduce new remittance-measuring methodology and to coordinate it with other countries of the region receiving remittances;
- Establish a system of regular periodic data collection, analysis of, and reporting on remittance and migration flows in the country;
- Negotiate with the Russian Federation, Kazakhstan, and other countries sending remittances regarding measures for improving the status of migrants and facilitating remittance flows using bilateral and multilateral (e.g., Central Asian Regional Economic Cooperation Programme (CAREC) frameworks);
- Provide financial literacy training to remitters and their families, as well as to introduce such training into the school curriculum;
- Review financial legislation to amend the same and to enhance the introduction of modern remittance technologies such as mobile banking;
- Revise AML legislation and/or practices of its application to avoid distraction of clients from the banking sector;
- Refrain from introducing specific remittance regulations and instead, strengthen general banking regulations; and
- Avoid introducing any form of remittance taxation.

To donor organizations:

- Support the adoption of legislation in sending countries (e.g., Kazakhstan), which would enable and/or ease access of Kyrgyz migrants to banking services;
- Provide technical assistance and, possibly, financial resources to the Kyrgyz banks for development of financial products (e.g., mobile banking) that are attractive and affordable for senders and recipients of remittances; and
- Provide training programs on financial education for senders and recipients of remittances.

To Kyrgyz commercial banks:

- Develop a long-term banking strategy for recipients of remittances by investing into infrastructure and new technological solutions (e.g., mobile banking), possibly forming consortia for these purposes;
- Lower their fees for clients and make their services more convenient for recipients of remittances on condition that they use complimentary banking services (e.g., waive cashing fee if the client puts its remittance on time deposit or loans from the bank); and
- Conduct more aggressive and more targeted advertising campaigns that explain long-term benefits of extensive use of financial services—especially for investments, bulky expenditures (ritual ceremonies or education), and retirement costs.

INTRODUCTION

1. This report has been prepared in the framework of the ADB study on Remittances and Poverty in Central Asia and South Caucasus. This is a country study on the financial sector and remittances in the Kyrgyz Republic. Together with a parallel study on remittances and poverty in the Kyrgyz Republic, it forms two specific outputs on the Kyrgyz Republic of the ADB project.

2. The study aimed to analyze the impact of remittances on the macroeconomic situation in the Kyrgyz Republic and on development of the financial sector in the country. The paper has six sections and three appendixes. Section 1 addresses definitions, measurement techniques, amounts, and structure of remittances in the Kyrgyz Republic. Section 2 assesses the relationship between remittances and different macroeconomic variables in recent years. Section 3 provides information on individual and household characteristics of senders and recipients of remittances, pattern of remittance sending, and use on micro level. Section 4 discusses remittance channels used in the country and competition in the remittance marketplace. Section 5 provides a review of the Kyrgyz financial sector and opportunities for its development related to remittance inflow. Section 6 summarizes the report's contents and formulates recommendations for economic policy regarding remittances and related issues. Appendixes 1 and 2 provide background information on migration and financial institutions in the Kyrgyz Republic. Appendix 3 contains tables and graphs, which provide additional details on remittances and remitters in the country.

1. Remittance Flows in the Kyrgyz Republic

1.1. Economic Background for Remittances

3. Massive cross-border monetary flows involving individuals characterize the Kyrgyz Republic through all years of its independence. This is due to several factors:

- *Large permanent migration* (see Appendix 1) – After the breakup of the former Soviet Union (FSU), many ethnic minority groups in their respective republics started moving to the republics of the FSU or to other countries where they comprise a majority of the population. In the Kyrgyz Republic, many Russians, Germans, and other minority groups moved to the Russian Federation, Germany, etc., while a smaller but also significant number of ethnic Kyrgyz people returned to the Kyrgyz Republic. This permanent migration required cross-border movement of their property and increased frequency of intra-family monetary transfers as many families are split by inter-republican borders.
- *Widespread shuttle trade* – Under the conditions of the previous economic system that had collapsed, shuttle trade largely replaced official trade implemented by legal entities concerning imports and, later, exports of goods.¹ This trade modality required traders to bring with them large amounts of money (either in cash or via financial system channels) from the Kyrgyz Republic to other countries and back.
- *Liberal foreign currency circulation regime in the Kyrgyz Republic* – Since the early years of independence, the Kyrgyz Republic has had a very liberal currency regime. As early as 1993, the national currency was introduced; thereafter, there were practically no restrictions on the exchange of national to foreign currency

¹ See, for example, the study on *Central Asia: Increasing Gains from Trade through Regional Cooperation in Trade Policy, Transport, and Customs Transit* (ADB 2006).

and vice versa—neither for individuals nor for other legal entities (e.g., corporations and other financial institutions). This allowed migrants and shuttle traders to have foreign and national currencies necessary for their operations.

4. Only in 2002 to 2003 did professional and political discussions focus on remittances in the Kyrgyz Republic. This happened for two key reasons: (i) a swift increase in migration of Kyrgyz workers to the Russian Federation and Kazakhstan due to a robust economic growth and a fast-growing labor demand in these countries coupled with a large wage differential between these oil-rich countries and the Kyrgyz Republic; and (ii) macroeconomic stabilization and measures for strengthening the financial sector, which were implemented after the 1998–1999 financial crisis that created in the early 2000s a better environment for some expansion of financial services, particularly an increased activity of MTOs and a surge in money transfers via this channel. This made a considerable part of long-existing flows (shuttle traders' operations) visible for everybody. Both trends have developed further from 2004 to 2007. Currently, labor migration and remittances have become a big issue in the Kyrgyz Republic because they have significantly affected the domestic labor market, private consumption, imports, government budget, family relations, and many other components of the socioeconomic situation in the country.

5. Another important process that has been developing during the same period must be mentioned—i.e., the maturing of some segments of informal economy in the Kyrgyz Republic, especially garment production and exports, and conversion of the Kyrgyz Republic into the regional center of reexporting activity. Many thousands of people are employed now in the garment and trade industries of the Kyrgyz Republic. The open market, *Dordoi*, which is near Bishkek, has become the largest distribution center serving the whole Central Asia and many parts of Siberia and Ural regions of the Russian Federation. Commodities imported from the People's Republic of China, Turkey, and the United Arab Emirates as well as those produced in the Kyrgyz Republic (mainly garments) are sold in that open market to traders or individuals from the Kyrgyz Republic and other Central Asian republics who, in turn, reexport them to other countries. Another large market in Kara-Suu in the southern part of the Kyrgyz Republic serves a similar role for the densely populated region of Fergana Valley. These activities also involve massive cross-border financial transactions implemented by individuals and may expand because of significant consumption growth in the whole region of Central Asia and the Asian part of the Russian Federation.

1.2. Previous Studies of Remittances in the Country

6. Two known papers are devoted to the issue of remittances in the Kyrgyz Republic and their impact on the economy. The first was prepared by the Economic Policy Institute (Esenaliev 2005) and the second by the Ministry of Finance (Japarov and Ten 2006). Additionally, a recent publication of the World Bank (2006) covers the issue of remittances in Central and Eastern Europe (CEE) and FSU including the Kyrgyz Republic.

7. To assess the role remittances play in the Kyrgyz economy and to evaluate their magnitude, the Institute of Economic Policy conducted in 2005 a survey of 1,177 respondents comprised of labor migrants or members of their families. The sample does not pretend to be representative of the country. According to the survey results, two-thirds (67%) of respondents go to the Russian Federation and 19% go to Kazakhstan. Remittances mainly come in cash (61%) and only 34% of the respondents send money through the banking system. Half of remittances were reportedly spent on daily needs, 10% were directed to investments, and the remaining part was spent on health care, education, purchase of durable goods, etc. Average size of remittances was estimated at \$1,419 per migrant per year.

8. This paper used two approaches to estimate the total value of remittances. Under the first approach, official numbers about money transfers from NBKR were used. As official numbers reflect money transferred only through the financial system, they should be increased by 66%² to account for the money entering through informal channels. Using such approach, the total volume of inbound remittances in 2003 was estimated at \$207 million (official number from NBKR was \$70.3 million). Under the second, the number of labor migrants and the average size of remittances were used. As there was no official data on the number of labor migrants, data from the different sources was used and several assumptions were made. In particular, information about 350,000 thousand labor migrants in the Russian Federation and Kazakhstan was taken from the International Organization for Migration. In addition, there was an assumption that there are 50,000 labor migrants in other countries. Using these numbers, the volume of remittances in 2003 was estimated at \$520 million. This number forms 27% of GDP and 158% of the budget expenditure in 2003. The main conclusion of this paper is that remittances play a crucial role in the socioeconomic development of the Kyrgyz Republic, accelerating economic growth by increasing consumption and decreasing in poverty. The accuracy of these estimates highly depends on the accuracy of underlying data on remittances sent via formal channels, assumptions on the number of labor migrants, and the representation of the survey sample. As the author of this paper noted, none of these estimates are guaranteed, so they should be seen as indicative only.

9. The authors of the second paper estimated the size of remittances in 2005 using the approach similar to that of the Institute for Economic Policy. The only difference is that they assumed that the share of money entering through the banking system increased to 44%. They came up with an interval estimate for remittance inflow to the Kyrgyz Republic in 2005, that is, \$520–750 million. For verification of this number, the authors compared data from the National Statistical Committee of the Kyrgyz Republic (NSC) on the population's monetary income with the turnover of retail trade and paid services. Excessive consumer expenditures over monetary income appeared to be close to the remittances estimate received by the authors.

10. The paper of the World Bank (2006) focuses on trends of international migration and remittances in Eastern Europe and FSU countries. In this report, the situation in the Kyrgyz Republic is analyzed based on different data sources such as official statistics, household budget survey, and survey of returned migrants. The report shows that Kyrgyz citizens favored the Russian Federation and Kazakhstan as migration destinations. In 2002, more than 75% of remittances went to rural areas. An analysis of data from household budget surveys conducted in six European and Central Asian countries shows that richer households receive more remittances than the poor do. For instance, only 0.8% households received remittances in the poorest quintile of the Kyrgyz Republic, while the richest quintile had 7.0% households as recipients of remittances. In addition, among all countries under consideration, only in the Kyrgyz Republic was the ratio of remittances to consumption higher for richer households than for poorer ones. Aggregate information from the six countries also shows that a larger part of remittances is used for financing consumption of food and clothing, but a significant share (over 10%) is used also for savings and education. Majority of migrants prefers spending shorter times abroad and then return home. The survey also shows that during their stay in the Russian Federation, many migrants from the Kyrgyz Republic and Tajikistan work in sectors requiring low skills only.

² Calculated as 100% less 34% coming via formal channels (see paragraph 7 of this section).

1.3. *Measuring Remittances in the Kyrgyz Republic*

11. To tackle the issue of remittances and their impact on the Kyrgyz economy, it is necessary to consider first the financial flows that are associated with remittances in the Kyrgyz context.

12. According to the International Monetary Fund's (IMF's) *Balance of Payments Manual*, remittances consist of three components:

- Compensation of employees comprising wages, salaries, and other benefits earned by individuals for work performed for and paid by residents of those economies other than those in which they are residents.
- Workers' remittances cover current transfers by migrants employed in new economies where they are considered residents. A migrant is a person who comes to an economy and stays there, or is expected to stay for a year or more.
- Migrants' transfers are contra-entries to the flow of goods and changes in financial items that arise from the migration of individuals from one economy to another.

13. NBKR, which is responsible for compiling the balance of payments (BOPs) of the country including these three entries, has limited information on these monetary flows. Therefore, the remittance-related methodology of NBKR is based on sensitive assumptions. The sources of information and assumptions are described below.³

14. NBKR has the following information on cross-border monetary flows involving participants in the Kyrgyz Republic:

- data on repatriated wages and salaries of foreign employees, who are not residents of the Kyrgyz Republic and are working on large joint ventures in the Kyrgyz Republic such as Kumtor Operating Company, the largest gold-mine enterprise;
- data on international monetary transfers to and from the Kyrgyz Republic done by individuals through banking accounts including card accounts, money transfer systems (e.g., *Western Union* and the like, see section 4 of this report), as well as the postal system; and
- data on the number of permanent migrants to and from the Kyrgyz Republic and the estimated average value of the property that they bring with them to the country of destination.

15. Importantly, in majority of cases apart from data on repatriated wages/salaries of foreign employees working in the Kyrgyz Republic, NBKR has no information on the migrant/worker status of people sending money to and/or from the Kyrgyz Republic and on the economic nature of such transactions (e.g., intra-family transfer, payment for goods/services, person-to-person loan disbursements, etc.). Therefore, NBKR currently uses the following rules:

- repatriated wages/salaries of foreign employees working in the Kyrgyz Republic are considered outgoing compensation of employees;

³ In June 2007, the National Bank of the Kyrgyz Republic (NBKR) introduced important modifications into their methodology of estimation of remittance flows. The *2006 Balance of Payments*, a publication, contains revised (upwards) estimates of remittance flows for 2002–2006. It states that the amount sent via official channels is adjusted for informal cash transfers by multiplying on unspecified coefficient, which is greater than one. This information is insufficient for this paper's analytical purposes; therefore, this study is based on initial NBKR's data and methodology.

- all incoming and/or outgoing monetary transfers to and/or from the Kyrgyz Republic sent by individuals via MTOs and the postal system are considered workers' remittances;
- all incoming and/or outgoing monetary transfers to and/or from the Kyrgyz Republic sent by individuals via banking accounts with amounts below or equal to \$3,000 are considered workers' remittances, while transfers that are \$3,000 and above are considered business transactions and are not counted as remittances; and
- migrants' transfers are estimated as a product of the number of immigrants/emigrants and the average value of each migrant's property.

16. According to this approach, there is no incoming compensation of employees in the Kyrgyz BOPs. In addition, NBKR has no information about and does not attempt to account for international informal cash transfers done by individuals (money brought by migrants or by their agents to and from the Kyrgyz Republic in cash).

17. The incompleteness of information on amounts and economic nature of transborder financial flows as well as the need to employ assumptions result in some important shortcomings of this measurement methodology. In our view, these shortcomings are:

- *Lack of accounting for informal transfers* – These transfers may compose a significant share of total remittance inflow/outflow.
- *Risk of misinterpretation of economic nature of financial transfers* – For example, all transfers via MTOs, which are a major part of all financial flows currently identified as remittances in the Kyrgyz Republic, and the postal system are considered workers' remittances. However, many options are equally possible: (i) repatriation of money earned as employee compensation in the Russian Federation or in other countries by Kyrgyz citizens who stay there for less than a year; (ii) repatriation of money earned in the Russian Federation or in other countries by Kyrgyz citizens who stay there for a year or more (workers' remittances there would not be an interpretation error in this case only); (iii) compensation of the costs of goods brought by Kyrgyz shuttle traders to other countries (exports of goods at free-on-board (fob) prices); (iv) compensation of transportation and other costs associated with bringing of goods from the Kyrgyz Republic to other countries; (v) sending of export credit resources by a trader in another country to a Kyrgyz counterpart (credit operation which is to be accounted in the financial account of BOP); (vi) international intra-family transfers (other transfers in the BOP classification). Obviously, other options are also possible.
- Similarly, misinterpretation may take place with regard to transfers via banking account as the threshold of \$3,000, which is used for separating workers' remittances from business transactions, lost its empirical ground.

18. Thus, of the three components of remittance inflows, only two—workers' remittances and migrants' transfers—are actually estimated by NBKR. Only one, workers' remittances, is relevant to the labor migration issue and is capable of influencing the Kyrgyz economy and its financial sector.⁴ The estimated amount of workers' remittances, however, most probably represents a mixture of components with different economic meaning.

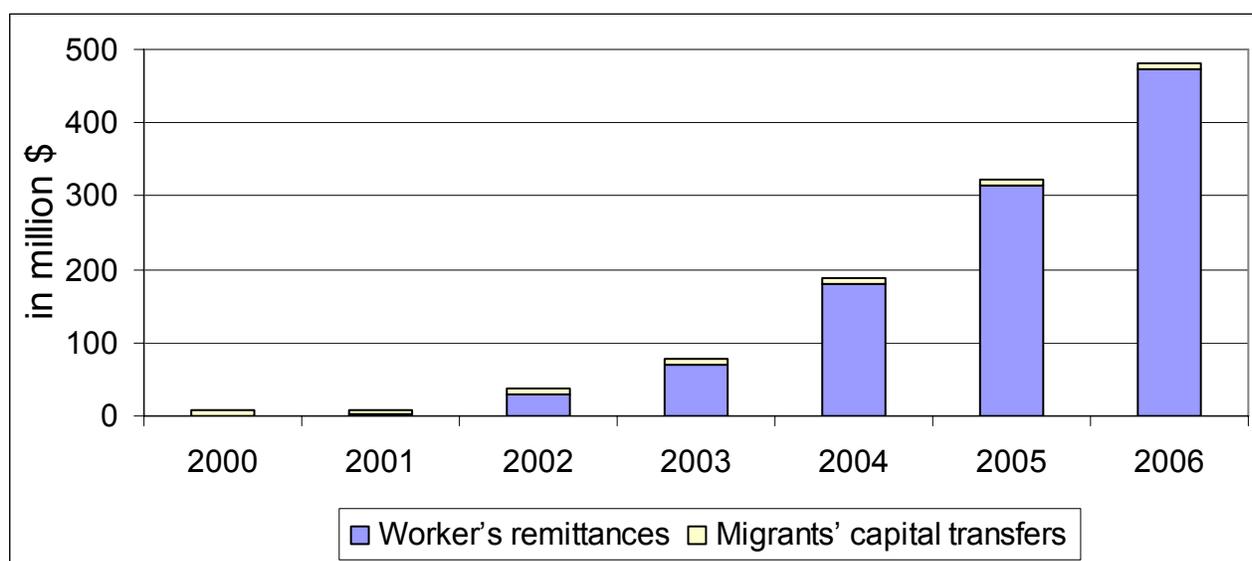
⁴ Migrants' transfers in their estimated form have no link to labor migration and to any phenomena associated with it.

1.4. Remittance Dynamics

19. Remittances⁵ demonstrated very fast, exponential growth in 2002 to 2006 (Figure 1, quarterly data on remittances and their components are provided in Table A1). The average annual growth rate of remittance inflow (credit) for these 5 years is 125% (i.e., on the average, the remittances more than doubled every year). The growth rate was somewhat reduced in 2005 to 2006 but, for these years, it was still 50% and more per annum. This dynamics has been mainly driven by the inflow of workers' remittances, which, on the average, tripled yearly. Inflows of migrants' transfers, in contrast, were almost constant over this period, which is always below \$10 million per annum.

20. There was also a growing outflow of remittances (debit in Table A1) in these years. The average annual growth rate of total remittance outflow in 2002 to 2006 is 22%. This outflow was also mainly driven by the item on workers' remittances, which increased from zero in 2001 to more than \$40 million in 2006. This growth may reflect an increased activity of Chinese traders as well as Uzbek and Tajik hired workers in the Kyrgyz Republic, and the expansion of international intra-family (and possibly business) transfers involving Kyrgyz citizens. Another growing item of remittance outflow is migrants' transfers. This reflects an increase in permanent emigration from the Kyrgyz Republic and in the estimated value of emigrants' properties. However, inflow of remittances has been growing much faster than their outflow, so net total remittances grow fast as well.

Figure 1. Dynamics of Remittance Inflow into the Kyrgyz Republic



NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.
Sources: NBKR and authors' estimates (for 2006).

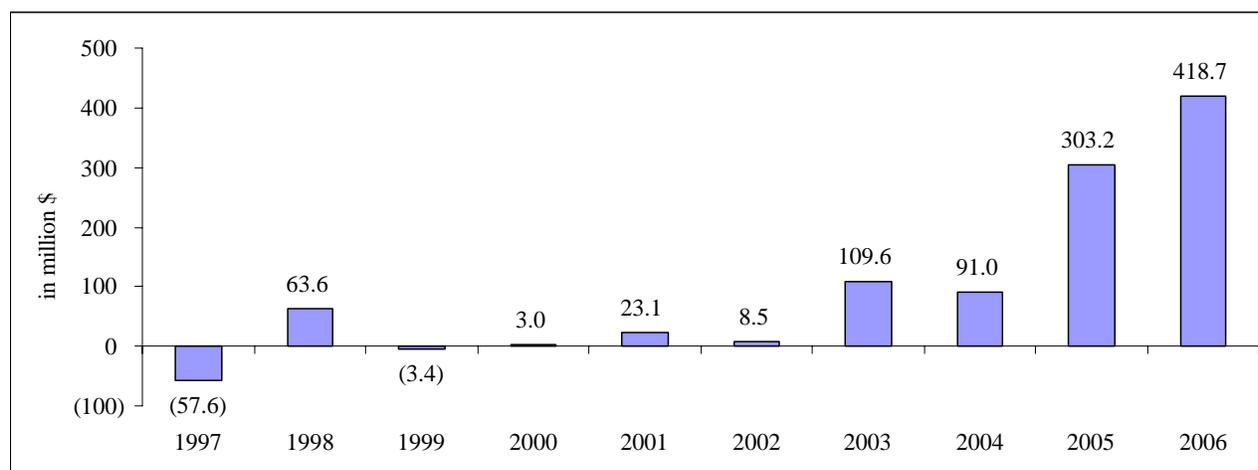
21. As already noted, these data on remittances do not account for informal money transfers of migrants. Some indirect information on these informal transfers may be derived from the analysis of the BOP item on "net errors and omissions." This item, in essence, is a balance of all informal foreign currency transactions in the Kyrgyz economy. These informal transactions include imports and exports implemented by shuttle traders (only a small part of these trade flows are covered by official statistics); smuggling of some commodities such as gasoline from Uzbekistan and Kazakhstan, where prices for these commodities were and still are subsidized;

⁵ In sections 1.4, 1.5, and 2, quantitative estimates of remittances are those published by NBKR in the *2006 Balance of Payments*.

other receipts from illegal activities; and, among others, informal transfers of Kyrgyz workers abroad. Figure 2 shows that until 2003, net errors and omissions fluctuated—sometimes with large amplitude—around zero. This means that different components of informal foreign currency flows had been basically balanced. However, since 2003, one can notice a significant increase of this item indicating a growing inflow of foreign currency to the Kyrgyz Republic. Of course, as to which components of informal flows contributed to this growth is unknown, but it is possible to presume that some part of this growth is related to informal transfers.

22. Quarterly dynamics of workers' remittances (transfers through formal channels) and net errors and omissions (possible proxy for informal transfers) in 2002 to 2006 is compared in Figure 3. Both variables have similar upward trends (dash lines in Figure 3) and a similar seasonal pattern of change (Figure 4). These similarities,⁶ especially the similarity in seasonality, may indicate that these two flows originate from the same source. This does not mean, however, that all errors and omissions could be attributed to workers' remittances. On the contrary, remittances of formal workers are also a mixture of different components, including remittances, as net errors and omissions are. This indirectly confirms the conclusion in section 1.2 of the report.

Figure 2. Net Errors and Omissions in the Balance of Payments of the Kyrgyz Republic⁷



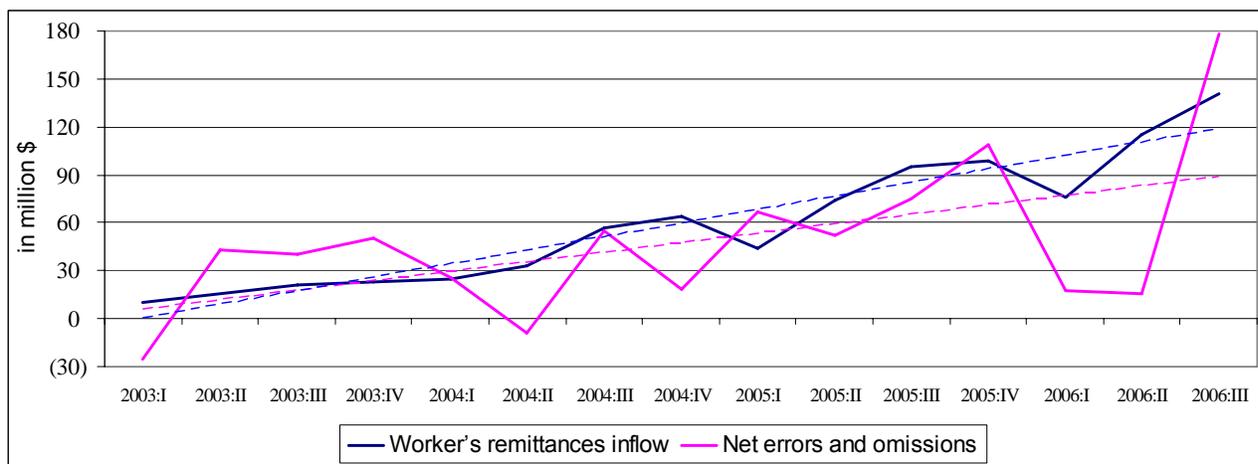
NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.

Source: NBKR.

⁶ The faster growth of formal transfers compared with net errors and omissions conform to the assumption that formal transfers gradually replace informal ones due to the strengthening of the Kyrgyz financial system.

⁷ The 2006 data are preliminary.

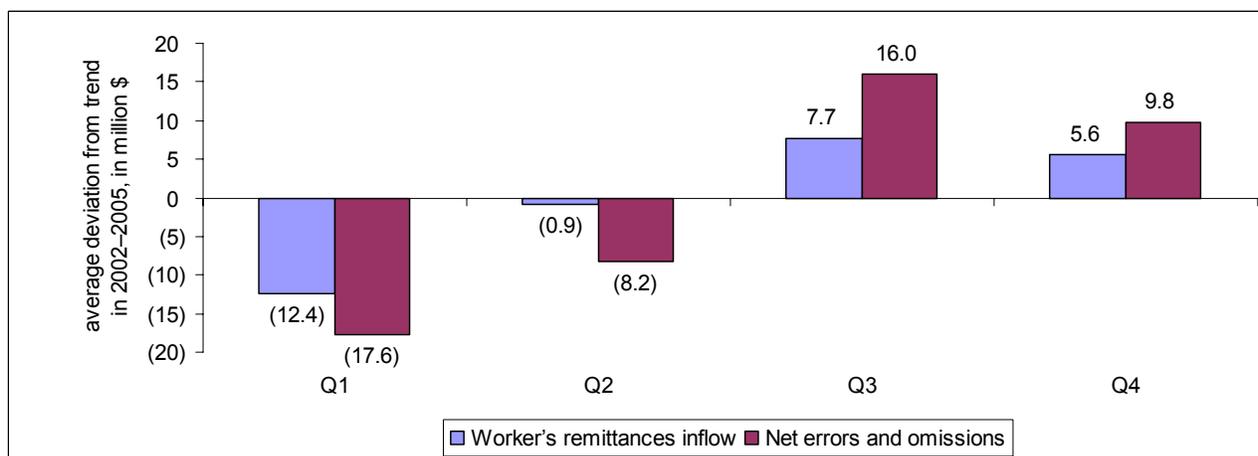
Figure 3. Dynamics of Net Errors and Omissions vs. Workers' Remittances in 2003–2006



NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.

Source: NBKR.

Figure 4. Seasonality of Remittances and Net Errors and Omissions



NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.

Sources: NBKR and authors' calculations.

23. The distinct seasonality of both formal and informal transfers—their relative increase in the third and fourth quarters and decrease during the first quarter of every year—may be linked to the pattern of cross-border movement of Kyrgyz workers and shuttle traders who are not residents of their country of migration. During winter, they usually stay at home and do not earn any income, which is the source of remittances, nor do they have a need to send home remittances. Such need typically appears closer to the end of their stay abroad, which is the second part of the year.

1.5. Remittance Inflow Composition

24. Disaggregated data on international monetary transfers available at NBKR allow analyzing the geography of the transfers and their composition in terms of transaction value. NBKR collects information from commercial banks. This information is the main source for compiling the country's BOPs regarding transfers from individuals. The database contains the following information: country from which money is sent, money transfer channel, date of

transfer, and transferred amount in US dollars. There are some other fields in the database (commercial bank mediating the transaction, etc.), but these pieces of information are not available for research purposes according to the regulations on banking secrecy. NBKR started to compile the database in 1999 and data for 1999 (7 months) up to 2006 are used for the analysis in this report.

25. As mentioned, there are three formal channels of sending remittances: (i) MTOs, (ii) banking accounts, and (iii) transfers via the Kyrgyz Post (Kyrgyz' postal service). The relative roles of these channels in the total inflow of workers' remittances are shown in Table 1. It follows from the table that almost all remittances enter the Kyrgyz Republic through MTOs whose role is growing with time. Absolute amounts of money sent through banking accounts are increasing, but their share in the total amount is falling. The Kyrgyz Post serves only a small segment of the international transfers market.

Table 1. Workers' Remittances Inflow by Sending Channel

	2002		2003		2004		2005		2006 ⁸	
	Mil. \$	% of total	Mil. \$	% of total	Mil. \$	% of total	Mil. \$	% of total	Mil. \$	% of total
MTOs	24.4	80.5	62.8	89.3	167.0	93.3	295.4	94.3	455.3	96.2
Banking accounts	2.2	7.1	4.4	6.2	8.7	4.8	14.7	4.7	14.2	3.0
Kyrgyz Post	3.8	12.4	3.2	4.5	3.4	1.9	3.2	1.0	3.6	0.8
Total	30.3	100.0	70.3	100.0	179.1	100.0	313.3	100.0	473.1	100.0

MTO = money transfer operator, NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.
Source: NBKR.

26. Two countries are the main sources of remittances for the Kyrgyz Republic: the Russian Federation and the US (Figure 5). The Russian Federation's role as a source of remittances, which started in 2002, is continuously growing. In 2005, transfers from the Russian Federation accounted for 86% of the total amount of remittances sent, while that of the US was 11%. The role of other countries is much less important. Third and fourth important sources of remittances, Kazakhstan and the United Kingdom, together give less than 3% of the total number of transactions and less than 1% of the total amount of remittances. Kazakhstan, which is considered the second larger source of labor market for Kyrgyz migrants, may witness two things: (i) the migrants' preference for informal channels to send and/or bring money home from the relatively geographically close country, and (ii) unfriendly legal environment in Kazakhstan for using the services of financial institutions by nonresidents.

27. To understand trends in remittances, it is worth looking at the pattern of transfers in terms of distribution of transactions by country, channel, and size (see Figure A2a-d).

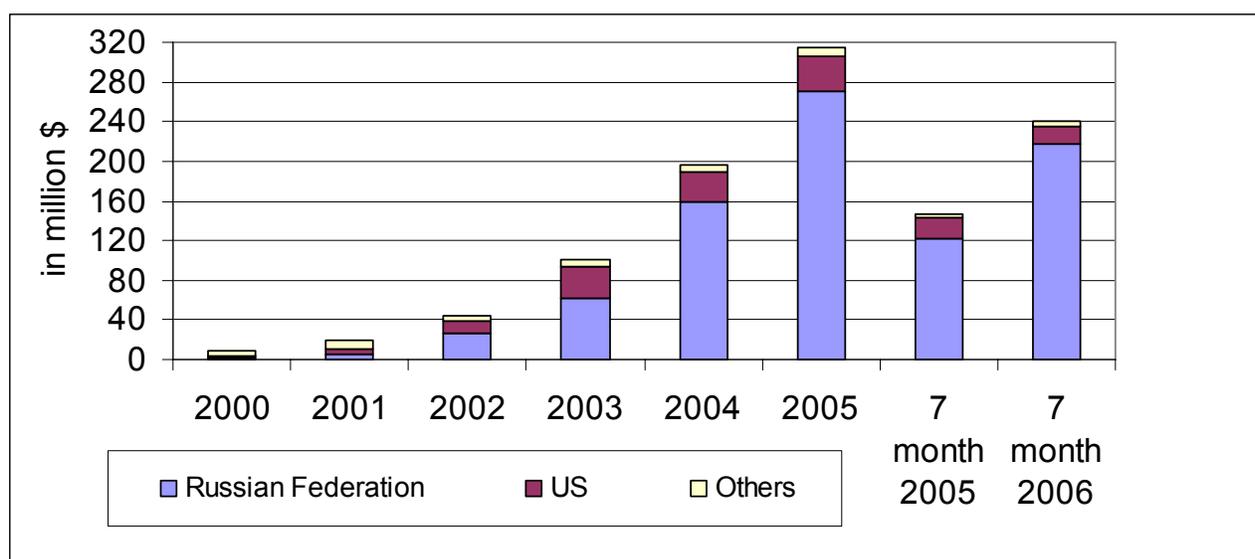
28. Data shows that pattern of transfers from the Russian Federation via MTOs has been changing since 2002 (Figure A2a). There were few large transactions before 2002, but from 2002 to 2004, one can see two to three (and more) times growth of amounts and the number of transactions each year, accompanied by a reduction in the median transfer size. Starting from 2005, the trend has changed again. The median size of transfer started to grow along with the number of transactions. Such dynamics could reflect changes in the senders' composition and their incomes. As mentioned, mass labor migration started in 2002. Since then, among all senders, labor migrants started to dominate with their relatively small money. This led to a decline in the median size of transaction. However, with the passage of time, people adapt to the situation in the receiving country and their incomes as well as monetary transfers start to

⁸ Preliminary data.

grow in size. Migrants also master some cost-reducing techniques such as consolidation of remittances⁹, leading to an increase in the median size of transfers. Other factors affecting both the number and the size of transactions could be the growing confidence in the reliability of transactions mediated by financial institutions, the expansion in number, and location of retail outlets serving MTOs' clients in the Kyrgyz Republic.

29. The transfers via MTOs from the US also went through some pattern change (Figure A2b). Similar, to the Russian Federation, a growing number of smaller transactions from 2002 to 2004 had replaced few larger transactions from 1999 to 2001. However, in 2005, the number of transactions fell almost sixfold with a simultaneous drastic increase in median (11 times more!) and mean size of transfer. Reasons for such a sharp change are unclear.

Figure 5. Main Countries of Origin of Workers' Remittance Inflows¹⁰



NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.
Source: NBKR

30. The existence of a threshold of \$3,000 for transfers via banking accounts to be considered as remittances explains why there is no trend in the size of transactions (Figure A2c and Figure A2d). Larger transactions are just censored from the database. One will notice that mean and median sizes of transfers via banking accounts from the US are considerably higher than those that are from the Russian Federation.

31. The large difference between mean and median size of transactions made via MTOs (see Figure A2a and Figure A2b) suggests very large single transactions, which account for a big portion of the total amount of remittances. The details of distribution of transfers via MTOs by transaction value are shown in Figure 6a and Figure 6b. These figures demonstrate that large (\$10,000–50,000) and very large (more than \$50,000) transactions make up a relatively small (while growing with time) share in the total number of transactions, but their shares in the total amount of transactions are very large and growing. In 2005, large transactions accounted for 22% and very large transactions for 72% of the total amount of remittances via MTOs, leaving just 6% for smaller transactions. On the contrary, the share of very small (less than \$100) and small (\$100.01–500) transactions in the total number of transactions was 30–50% in

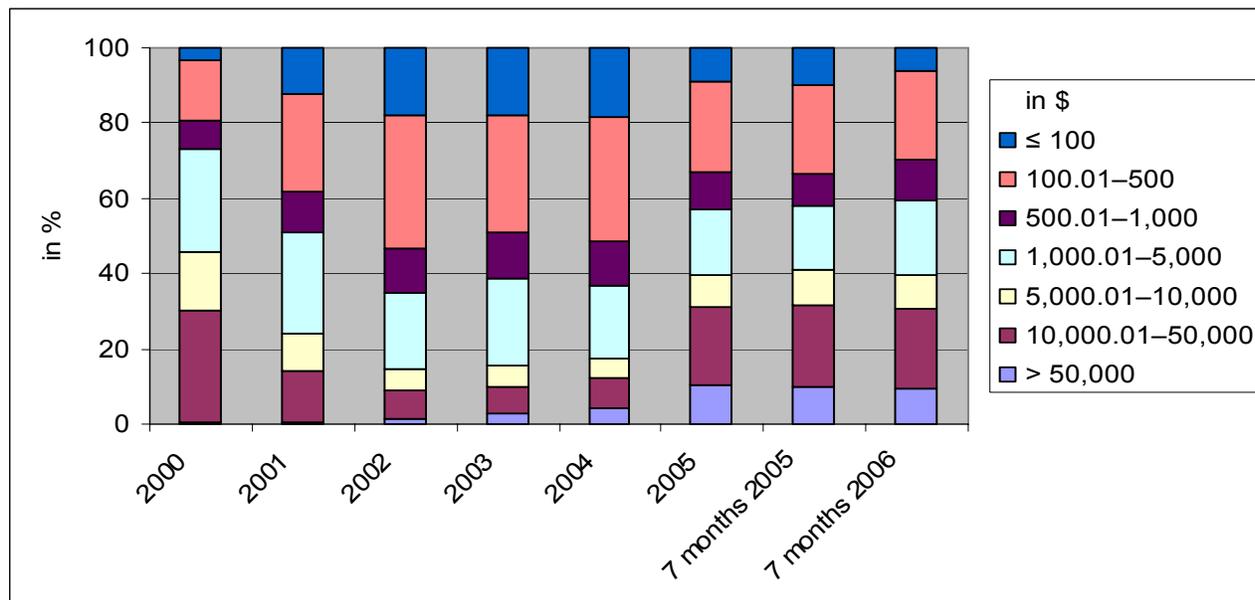
⁹ In the survey of recipients of remittances conducted in Bishkek and Osh in October 2006 in the framework of the ADB project on remittances, 13% of respondents indicated that they received bulk remittances.

¹⁰ Without transfers via post system, which are not disaggregated by country and by size.

2001 to 2006 (with a maximum of 51% in 2004), while their share in total amount of remittances was small and falling from 1.6% in 2001 to 0.3% in 2005 to 2006. Thus, small and medium (\$500–10,000) transactions dominate the total number of transactions, but large and very large transactions absolutely prevail in the total amount of remittances.

Figure 6. Distribution of Transfers via MTOs by Transaction Value

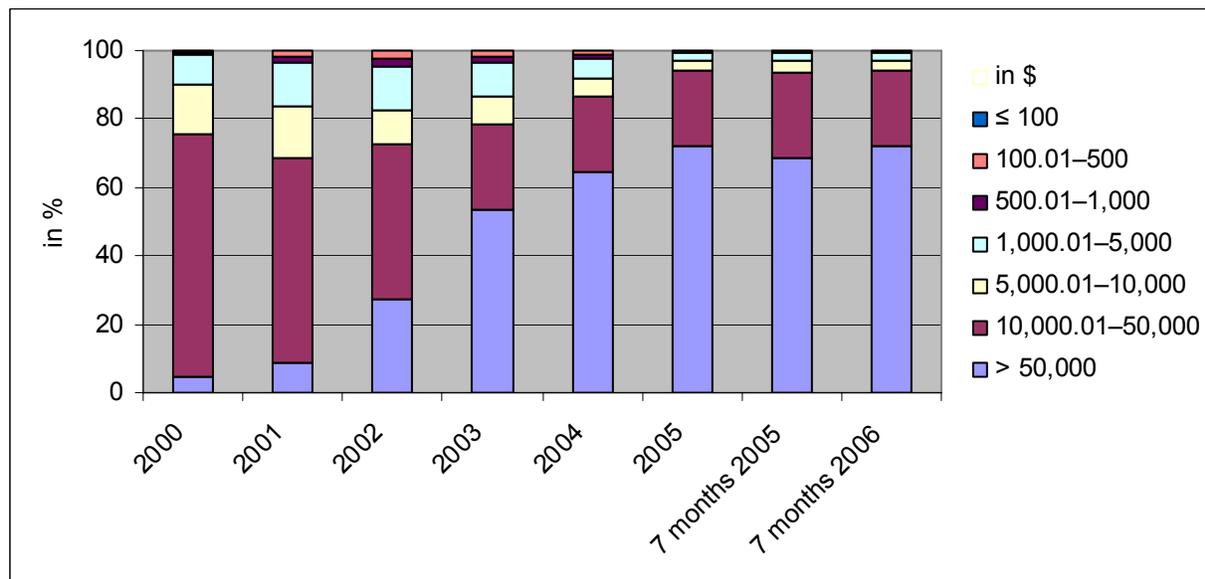
a) Shares in the Total Number of Transactions



MTO = money transfer operator, NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar, % = percent, ≤ = less than or equal to; > = more than.

Source: NBKR.

b) Shares in the Total Amount of Remittances



NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar, % = percent, ≤ = less than or equal to; > = more than.

Source: NBKR.

32. In 2005, 3,002 transactions were in the range \$10,000–50,000 and 1,549 transactions with values above \$50,000. The maximum transaction registered was \$779,000. In the first 7 months of 2006, the maximum single transaction was \$2,101,122, and there were five more transactions exceeding \$1 million! It also follows from the data that the number of large transactions, their share in the total amount of remittances, and maximum value of transactions increase with time. So the remittance growth trend in 2002 to 2006 should be attributed to the growth in these large and very large transactions. It is worth noting that this trend started simultaneously with the considerable revival of the Kyrgyz financial market (see more on this in section 5 of the report).

33. This prevalence of large transactions raises the question about their economic interpretation and their relationship to labor migration. Taking into account a typical income of Kyrgyz-hired workers in the Russian Federation—i.e., ranging from several hundreds to a few thousand US dollars per month for highly skilled workers—and the fact that they could save only a portion of it, the only possibility for their savings to be a source of very large transactions is the consolidation of remittances by a group of hired workers. While such consolidation does take place, the consolidation amounts could hardly exceed \$50,000. Therefore, the massive migration of Kyrgyz citizens to the Russian Federation and Kazakhstan and their eventual employment in these countries in construction, municipal services, and other relatively low-paying jobs do not seem to be a major source of remittance growth. Therefore, the increase in remittances is not necessarily associated with the growth in number of labor migrants.

34. A much more realistic explanation of large transactions and the growth in their number and amount is that these transfers represent revenues from and loans for the trade operations of the Kyrgyz wholesale shuttle and retail traders in the markets of Russian cities. If this is the case, the larger part of what is called “workers’ remittances” is a mixture of revenues from exports of goods and services, trade credits, as well as mixed income of Kyrgyz retail traders operating in the Russian Federation.¹¹ The remittance growth then should be attributed to a shift in revenue repatriation pattern—from informal to formal (mainly MTOs) channels—and to the expansion in the Kyrgyz shuttle trade.

2. Macroeconomic Effect of Remittances

35. In recent years, remittances have been growing so quickly that they have become the second large source of foreign currency for the country after exports of goods (Table 2). In 2002 to 2005, the inflow of remittances grew much faster than exports of goods and services, foreign direct investments (FDIs), official development assistance (ODA)—all positive items of the BOPs of the Kyrgyz Republic. In the 3 quarters of 2006, the only foreign exchange source with a growth rate higher than remittances was exports of tourism services. However, this item is much smaller than remittances. The share of remittances in GDP at market exchange rate is also growing. In 2005, it was at 12.7%, and in 2006, the inflow of workers’ remittances is preliminarily estimated at 16.8% of GDP.

¹¹ Interviews with representatives of some Kyrgyz diaspora organizations in the Russian Federation show that these organizations try to consolidate transfers of their fellow citizens (mainly traders) into large and very large bulk transactions.

Table 2. Relative Significance of Workers' Remittance Inflow Compared with Other Important Foreign Exchange Sources

Sources of foreign exchange for the Kyrgyz Republic	Workers' remittances as % of foreign exchange sources						
	2000	2001	2002	2003	2004	2005	2006
Exports of goods	0.3	0.4	6.1	11.9	24.4	45.6	58.3
Exports of services	2.1	2.4	21.4	44.4	85.4	122.6	126.3
Exports of tourism services	8.5	7.8	85.2	146.9	236.9	429.0	283.3
Gross FDI	1.5	2.1	26.3	47.8	102.0	148.9	141.0
ODA and other government receipts in foreign currency	0.7	1.2	8.6	27.1	69.0	152.1	515.3
For reference: workers' remittances as % of GDP (at market exchange rate)	0.1	0.1	1.9	3.7	8.1	12.7	16.8

FDI = foreign direct investment, GDP = gross domestic product, NBKR = National Bank of the Kyrgyz Republic, NSC = National Statistical Committee of the Kyrgyz Republic, ODA= official development assistance, US = United States, \$ = US dollar, % = percent, — = data not available.

Sources: NBKR, NSC, and World Bank.

36. In the small open economy of the Kyrgyz Republic, such significant external inflows of money could affect virtually all economic variables. One could identify several potential mechanisms of remittance influence on other macroeconomic variables. Households receiving remittances could increase their consumption; therefore, private consumption could be positively affected by remittances. It is also well known that share of imported consumer goods in the total consumption is high,¹² so part of the remittances may be spent to finance imports of consumer goods to the country. Arguably, one would not expect any considerable impact of remittances on investments into fixed capital. On one hand, inflow of remittances in many households is positively associated with savings (see section 3), so growth in remittances could cause a growth in domestic savings. This does not mean, however, that increased savings result in the growth of investments. Many households prefer to save by acquiring existing real estate, which is confirmed by the permanent increase in the prices of apartments and houses in Bishkek and Osh during the last several years. Obviously, this type of saving behavior does not contribute much to investments and GDP growth.¹³ So the overall impact on GDP could be expected to be positive, but less than on private consumption. Increased domestic production of consumer goods and services induced by remittances could cause some growth in employment. However, this growth may not be registered because a large part of consumer goods and services is produced in the informal economy.

37. Imports are a key source of government revenues in the Kyrgyz Republic. The state's custom committee collects value-added tax (VAT), excises, and custom duties on imports that, altogether, exceed 50% of the total tax collections. Therefore, an increase in imports—an expected outcome of the remittance inflow—should result in the growth of government revenues.

38. Remittances, which contribute to current account improvement, could also affect the exchange rate toward its appreciation. On the other hand, they may increase inflation if NBKR

¹² According to NBKR data, imports of consumer goods in 2006 amounted to \$497.5 million or 20 billion soms (at current exchange rate), which is 18 % of the total private consumption.

¹³ Of course, growing prices of apartments create more incentives for residential construction. One could see some signs of increased construction activities in Bishkek but, so far, this economic sector is not a major contributor to the country's GDP.

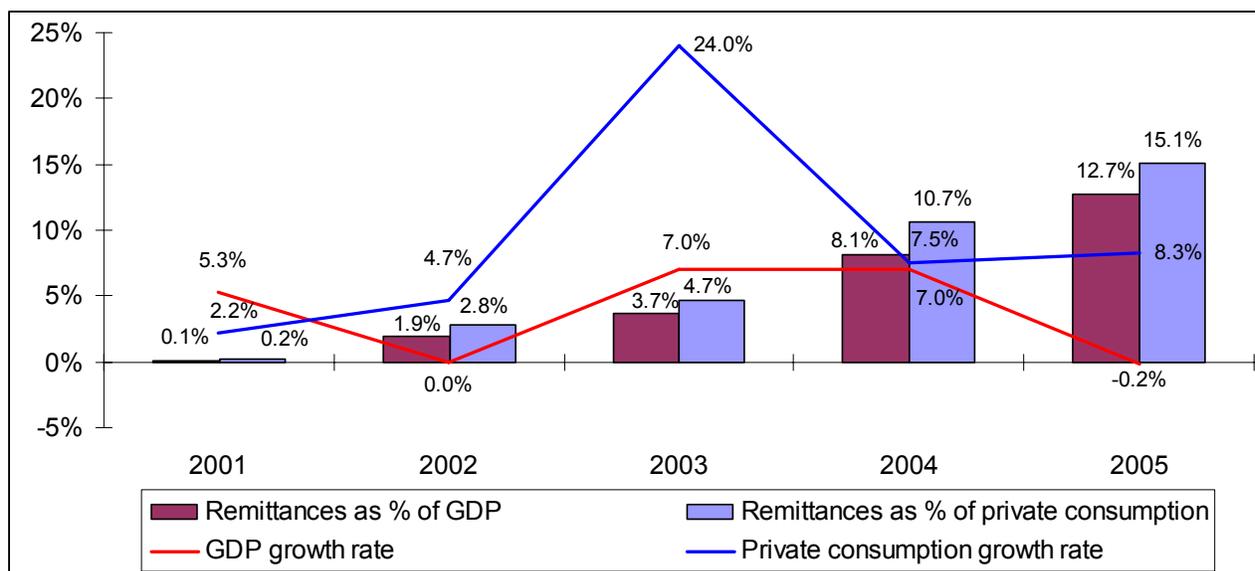
tries to sterilize the inflow of foreign currency by purchasing currency on open market, thus, accumulating net international reserves that, until very recently, were at a rather low level if measured in months of imports; this causes an increase in money supply in the economy.

39. The scenarios/hypotheses formulated in paragraphs 36 to 38 seem to correspond to general economic logic, but may or may not be true as, obviously, many other factors influence the country's economic development. Therefore, it is necessary to test them by looking at actual trends of the variables under consideration. It is worth noting that in the considered period, levels of almost all variables had upward trends; so, of course, all these variables were strongly correlated with remittances. However, these correlations could be spurious as many other growth-inducing forces and exogenous shocks were in the Kyrgyz economy apart from remittances. All these variables also have very large and, importantly, similar seasonality. This also increases the probability of spurious correlation. Therefore, the correlation of growth rates of seasonally adjusted variables seems to be a more reliable (but still imperfect) indicator of the existence of any causal relationship between remittances and other variables. The shortness of available time series (3 to 5 years only) precludes the use of more sophisticated methods of time-series analysis such as co-integration, etc.

40. With regard to the relationship of remittances to personal consumption and GDP, one will notice (Figure 7) that the share of remittances in GDP and personal consumption was permanently growing in 2001 to 2005 (preliminary data for 2006 also show continuation of this trend). In relation to GDP share, on one hand, this is a result of the very fast growth of remittances mentioned earlier while, on the other hand, of slow growth of GDP in the considered period where the average annual GDP growth rate for 2001 to 2006 was just 3.6%. This relatively low and unstable growth rate is partially explained by problems in the Kumtor gold mine, which is a major contributor to the Kyrgyz GDP. In 2002 and 2005, Kumtor had technological accidents that significantly decreased its production. NSC also publishes data on GDP without Kumtor; according to NSC data, the average annual growth rate of GDP without Kumtor in 2001 to 2006 was 4.5%. This number is not very high when compared with the growth rates of other CIS countries, which are closer to 10% per annum. This suggests that so far, the fast growth of workers' remittances was not associated with comparable GDP growth. However, an analysis of cross-correlation of remittances and GDP real growth rates quarterly series in 2002 to 2006 indicates a statistically significant (at 5%) yet not very strong¹⁴ positive correlation between remittances growth rate and GDP growth rate 5 quarters later (Figure A3a). Therefore, it seems that data provide some evidence of marginally significant positive impact of remittances on GDP growth.

¹⁴ Correlation coefficient of 0.51.

Figure 7. Workers' Remittances in Relation to GDP and Personal Consumption



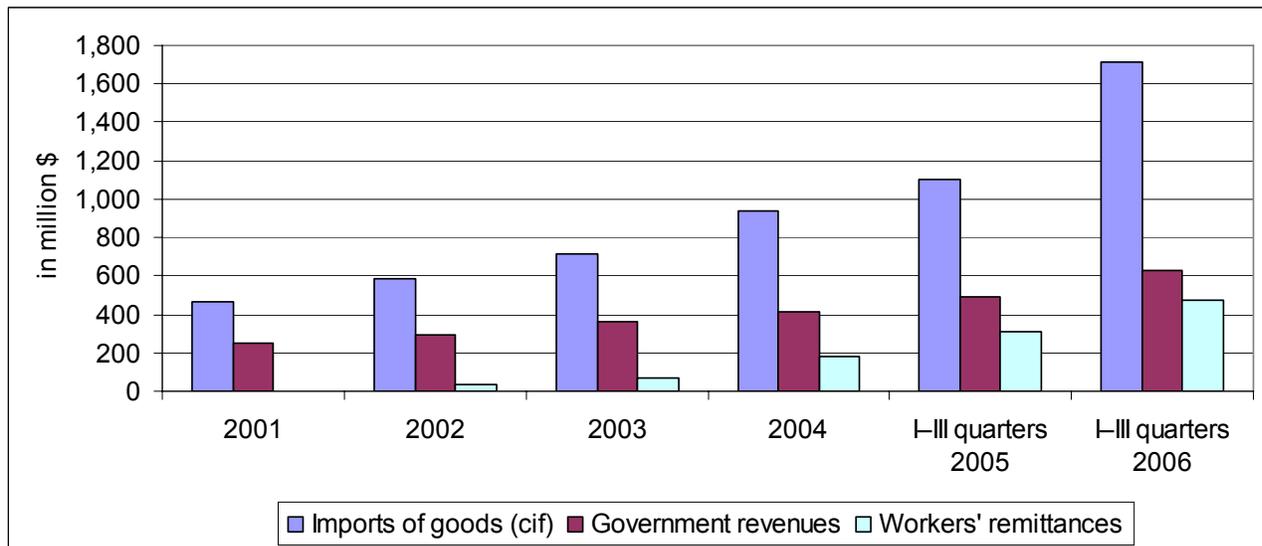
GDP = gross domestic product, NBKR = National Bank of the Kyrgyz Republic, NSC = National Statistical Committee of the Kyrgyz Republic, US = United States, \$ = US dollar, % = percent, () = negative value.
Sources: NBKR and NSC.

41. Growth of private consumption in 2001 to 2006 was much larger than GDP growth. Its average annual growth rate for this period was 11.2%. Wide fluctuations of private consumption growth rate (from 2.2% in 2001 to 24.0% in 2003 and 22.1% in 2006) somewhat erode correlation of private consumption and remittances. Still, cross-correlogram (Figure A3b) shows a 5%-statistically significant positive correlation between remittances and private consumption 4 and 5 quarters later.¹⁵ Thus, private consumption seems to be influenced by remittances while, of course, remittances have not yet become a major driving force for consumption (e.g., performance of the agriculture sector affects this variable immediately and much stronger).

42. The relationship between remittances and imports is much stronger (Figure 8). Both variables have similar upward time trends. Yet, an absolute growth of imports was always considerably larger than an absolute growth of remittances. This suggests that there should be other sources of financing of imports (e.g., exports of goods and services, foreign credit to private sector) apart from remittances.¹⁶ Cross-correlogram (Figure A3c) indicates a statistically significant positive correlation between remittances and imports with a 5-quarter lag.

¹⁵ There is also a marginally significant immediate (with zero lag) negative correlation between these two variables. The correlation coefficient sign is counterintuitive and may be a purely statistical phenomenon.

¹⁶ This is especially relevant for 2006. By preliminary data, the absolute growth of imports was \$617 million, while the absolute growth of net workers' remittances was only \$150 million. In other words, more than 3 quarters of absolute increase in imports was covered by sources other than remittances.

Figure 8. Remittances, Imports, and Government Revenues¹⁷

CIF = Cost, Insurance, Freight, NBKR = National Bank of the Kyrgyz Republic, NSC = National Statistical Committee of the Kyrgyz Republic, US = United States, \$ = US dollar.
Sources: NBKR and NSC.

43. The relationship between imports and government revenues (Figure 8 and Figure A3d) also appeared to be weaker than expected, while there is a statistically significant immediate positive correlation between these variables. According to expectations (paragraph 37), there appeared to be a statistically significant positive correlation with a 5-quarter lag between remittances and government revenues (Figure A3e).

44. As Figure A4 indicates, investments into fixed capital experienced a decline in 2001 to 2003 and started to grow again only in 2004. This investment growth in the last 2 to 3 years is closely associated with a big inflow of FDIs in 2002 to 2006. Gross FDI (in US dollar terms) in 2006 exceeded almost four times its value in 2001. Accounting for a very low degree of conversion of remittances into deposits, the low role of banking credit in financing capital investments and the low propensity of recipients of remittances to invest their money in business (see sections 3 and 5), one can then conclude that there is virtually no evidence of impact of remittances on investments in the Kyrgyz Republic.

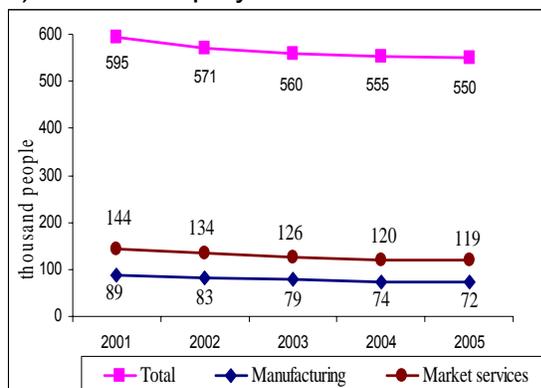
45. The impact of remittances on employment is not easy to measure because of the existence of a very large informal labor market, which includes mainly agriculture, trade, construction, and other market services as well as some manufacturing industries (e.g., garment and food production). Formal market covers nonmarket services (education, health, government, as well as social and municipal services) and industries represented by large enterprises (e.g., mining, power generation, railroad, communications, etc.). Figure 9a demonstrates that employment in the formal market has a permanent downtrend. Obviously, there is no positive impact of remittances on this employment component. Neither one should conclude from this picture that there is any negative impact of remittances on formal employment; this declining trend of employment in formal sector started well before beginning of the increase in remittances and labor migration. It is well known that reduction of formal employment is linked to imperfections in the country's business climate and a heavy tax burden—first, payroll tax—on formal enterprises. Recently, NSC published a household-survey-based data on informal employment in 2004 to 2005 (Figure 9b). These data conform to the

¹⁷ US dollar values of government revenues have been estimated at current exchange rate for each quarter.

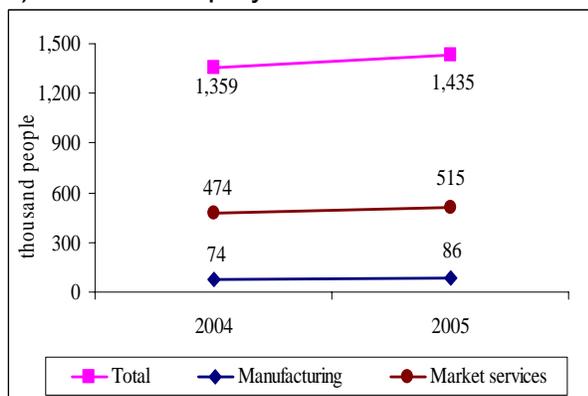
expectations of positive remittance influence on employment in market services and sectors producing consumer goods.

Figure 9. Formal and Informal Employment in the Kyrgyz Republic in 2001–2005

a) Formal employment



b) Informal employment



NSC = National Statistical Committee of the Kyrgyz Republic.

Source: NSC.

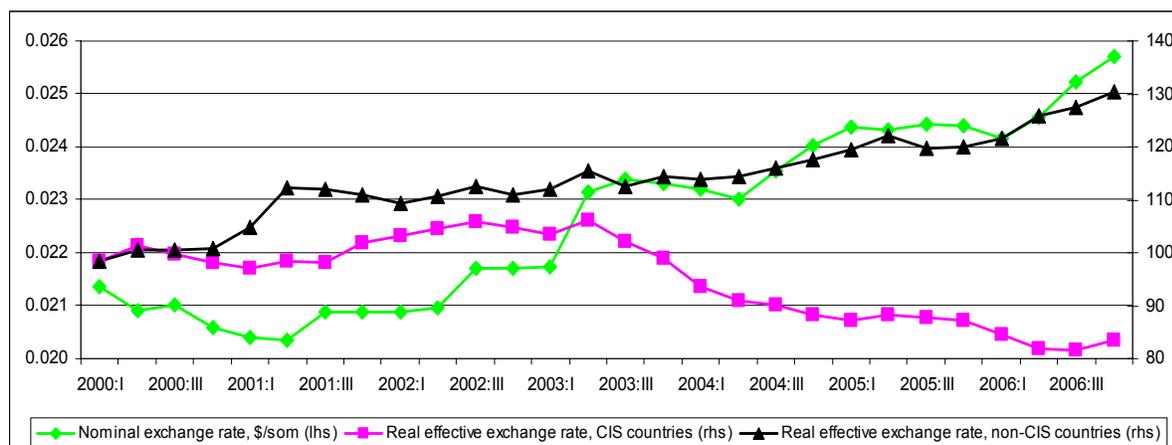
46. Inflow of remittances, together with tourism export revenues and some other BOP items, leads to increase in supply of foreign exchange on domestic currency market.¹⁸ NBKR is a major buyer of this currency. In 2001 to 2006, the net cumulative purchase of NBKR on interbank currency market was \$375 million; of the amount, \$186 million was for 2006 only. This allowed NBKR to increase its net foreign reserves from 2.6 billion soms (\$55 million) in 2001 to 24.7 billion soms (\$647 million) in 2006. This policy resulted in an increased money supply. Monetary aggregate M2x grew from 8.2 billion soms (\$172 million) at the end of 2001 to 32.3 billion soms (\$847 million) at the end of 2006. Remarkably, that until 2007 this very fast money supply growth (31.5% per annum on the average) did not cause any serious inflation. The average annual inflation rate (by consumer price index) in 2002 to 2006 was just 4.0%. This is a good result accounting for numerous unfavorable external shocks (e.g., increase in prices for oil and gas). Obviously, the surge in money supply has been absorbed by the growing money demand. Monetization of the economy increased from 11.1% GDP in 2001 to 28.5% GDP in 2006, which should be attributed to a deepened financial market (see more on this in section 5 of this report), reduction in in-kind settlements between economic agents, and probably, some substitution of foreign currency by soms in domestic economic transactions and savings of the population. However, it is necessary to note that the inflation situation has dramatically changed in 2007; in the first ten months of 2007 CPI grew by 20.1%, i.e., more than its cumulative growth in four previous years. While this inflation hike has been triggered by external price shocks, the role of inflationary pressure of the quickly growing money supply also should be recognized.

47. The global trend of depreciation of the US dollar also affected the som, which strongly (by more than 20%) appreciated versus the US dollar in nominal terms in 2001 to 2006. This nominal appreciation, however, does not mean an overall appreciation of the Kyrgyz currency (Figure 10). In real terms, the som appreciates for non-CIS countries by 17%, but depreciates significantly at 30% for CIS countries—mainly vis-à-vis the ruble—due to higher inflation in the Russian Federation and stronger nominal appreciation of the ruble versus the US dollar. Therefore, exchange rate developments increased competitiveness of imports from non-CIS countries in the domestic market and competitiveness of Kyrgyz exports in CIS markets.

¹⁸ Of course, not all these money come into the currency market because a large part of domestic turnover and a major part of savings are in US dollars or other foreign currencies.

Increased price competitiveness of Kyrgyz goods in CIS markets coupled with a robust growth of these economies led to a vast increase in Kyrgyz exports to these countries (increased 2.2 times in US dollar terms in 2006 compared with 2001). As already mentioned, imports also strongly increased in 2001 to 2006, but only some part of this increase could be related to real exchange rate developments as imports from CIS countries grew even faster than those from non-CIS countries despite real exchange rate dynamics that are unfavorable for them.

Figure 10. Exchange Rate Dynamics in 2000–2006¹⁹



CIS = Commonwealth of Independent States, NBKR = National Bank of the Kyrgyz Republic, lhs = left-hand side, rhs = right-hand side, Som = currency unit of the Kyrgyz Republic, US = United States, \$ = US dollar.

Source: NBKR.

48. Thus, the discussion and data above suggest that the inflow of workers' remittances to the Kyrgyz economy: 1) has some positive impact on GDP and personal consumption; 2) contributes to the growth of imports and, indirectly, of government revenues; 3) is associated with some growth of employment in informal economy; 4) does not produce any measurable effect on investments, and 5) has no negative consequences for inflation and real exchange rate.

3. Remittance Pattern on Micro level

49. To understand the factors driving remittance flows, it is necessary to take the perspective of individuals and households that send and receive these money transfers. In the context of this study, key issues for consideration are the composition of senders and recipients, their preferences regarding remittance transmission channels, impact of remittances on their savings as well as business activities, and the attitude of recipients of remittances toward services currently offered to them by the Kyrgyz financial sector.

50. Analysis in this section is based on data of two surveys conducted in the framework of the ADB project. The first is a representative household survey covering 3,997 households in all parts of the Kyrgyz Republic and providing information on household characteristics, welfare, migration, and remittances. Methodological details of this survey are provided in the report on remittances and poverty in the Kyrgyz Republic.

51. Another source of data is a remittance recipient survey (RRS), which was conducted in October 2006 in Bishkek and Osh at the premises of different branches of four banks: Ecobank, Bank Kyrgyzstan, Amanbank, and Settlement and Saving Company. Interviewed were 306 randomly selected recipients of remittances. Table A2 provides a composition of the sample.

¹⁹ Real effective exchange rate = 100 for 2000.

This survey does not pretend to be representative of the country's population for obvious reasons. For the next discussion, it is worth noting that the sampling method has led to a disproportionately high share of urban residents in the sample. Despite that, this survey provides some useful information on composition and behavior of senders and recipients of remittances. The questionnaire for this survey included questions on the social and demographic profile of recipients and senders, details of money transfer, savings, business activities, and experience with financial sector. Some questions have been included in both surveys and an analysis of similarities and/or discrepancies of data in the two surveys on these issues are provided below. This allows the shedding of additional light on remittance pattern at the household level.

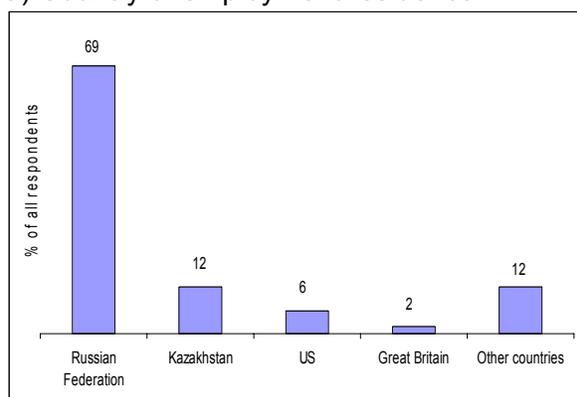
3.1. Profiles of Remittance Senders and Recipients

52. Household survey data allow drawing a profile of the Kyrgyz migrant (Table A3). An absolute majority of migrants comes from rural areas but, in terms of the share of migrants in the total population, urban areas other than Bishkek take the lead. Bishkek gives the smallest share of migrants. This is understandable because the employment situation in the capital is the best, while other urban areas are the worst in the country. By educational status, an absolute majority of migrants (77%) have completed secondary education; 16.5% have education higher than secondary (secondary special, higher, and postgraduate levels); and 6.4% have education below completed secondary. The share of migrants with higher education is significantly larger in Bishkek (41.8%); 82.5%—i.e., about five of six migrants—go to the Russian Federation; 12% to Kazakhstan, and only 5.5% go to other countries. However, Bishkek migrants go to Kazakhstan, especially to other countries much more frequently—in 16.5% and 16.6% of cases correspondingly. Majority of migrants stay abroad for a short period. The median period is 1.2 years (2 years for Bishkek). By occupational status, majority (71.6%) is employed in the private sector; 19.5% are self-employed, which is a relatively high share; 5.8% are employed in the public sector; 1.4% are students, and 1.7% has other types of occupation. Again, migrants from Bishkek demonstrate a somewhat different picture. A smaller share (51.9%) is employed in the private sector; considerably more people are employed in the public sector (12.7%) and those self-employed comprise 25.3%. Two main sectors of employment of Kyrgyz migrants are construction (45%) and trade (30.4%). Migrants from Bishkek have more diverse sector distribution with much fewer of them working in the construction industry. Thus, it is clearly necessary to distinguish between migrants originating from Bishkek and those from other areas because their pattern of migration is significantly different.

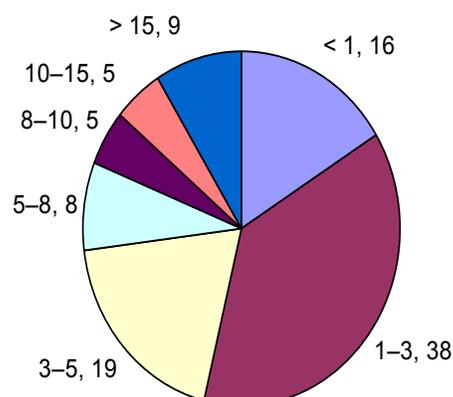
53. The survey of recipients receiving remittances gives a very similar picture with regard to migration geography (Figure 11a). The Russian Federation (with a big lead) and Kazakhstan are again two main destination countries of migrants; the US and the UK are the most important destinations outside the CIS. The lower share of migrants in the Russian Federation, compared with the household survey, could be explained by a much larger share of Bishkek residents in this survey who (see Table A3) go less frequently to the Russian Federation and more frequently to other countries.

Figure 11. Characteristics of Migrants Sending Remittances

a) Country of employment/residence



b) Duration of stay abroad (no. of years; %)



RRS = remittance recipient survey, UK = United Kingdom, US = United States, % = percent, > = more than, < = less than.

Source: RRS data.

54. Data on duration of stay of migrants abroad received from RRS (Figure 11b) are also generally consistent with the results of the household survey for Bishkek. They show that more than one third (38%) of the people work outside the Kyrgyz Republic for 1 to 3 years. Shares of migrants, who stay abroad for 3 to 5 years (19%), and newcomers who stay abroad less than 1 year (16%), are also significant; 27% of all migrants stay abroad for more than 5 years. In a considerable number of cases (14%), people continue to remit money after staying 10 and more years abroad. This is an evidence of stability of family relations in many Kyrgyz households.

55. Data on income of respondents (Table 3) correspond well to the well-known fact that incomes are higher in Bishkek than in Osh. Median per capita income for the sample is reasonably close to GDP per capita (21.9 thousand soms/\$545) in 2006. These data suggest that the income level of households receiving remittances is not very different from the average level for the country.

Table 3. Respondents' Household Annual Income per Capita

	Bishkek	Osh	All samples
Mean, thousand soms	40.4	22.5	31.3
Median, thousand soms	28.0	13.0	18.0

RRS = remittance recipient survey, som = currency unit of the Kyrgyz Republic

Source: RRS data.

3.2. Remittance Transfer Pattern

56. Data of these two surveys shed some light on remittance transfer preferences of the Kyrgyz senders and recipients. These relate to amounts, geography, forms, frequency, and channels of remittances, preferred currencies, consolidation of transfers, etc.

57. Household survey data on remittance amounts, forms, and shares of households receiving remittances are provided in Table 4. It follows from the data that 16% of households in the Kyrgyz Republic receive remittances. This share is smaller in Bishkek, 11.2%. Total amount of remittances has been estimated at \$256.4 million (9% GDP). This amount considerably differs from official estimates and from numbers circulating in the Kyrgyz media. Ninety five percent of remittances come in cash and 5% are in the form of goods (in-kind). In Bishkek, the

share of in-kind remittances approaches 10%. The average amount of remittances per receiving household for the country appeared to be \$1,380 per annum varying from \$1,255 in rural areas to \$1,865 in Bishkek.

58. It is interesting that RRS gives quite similar estimates for average amounts per household. In this survey, respondents (mostly Bishkek residents) reported median annual amount of remittances of \$1,800. This is very close to the estimate for Bishkek provided in Table 4. According to the RRS data, 95% of respondents get their money in cash. This coincides exactly with the value for the country and higher, but still close to the value for Bishkek from the household survey.

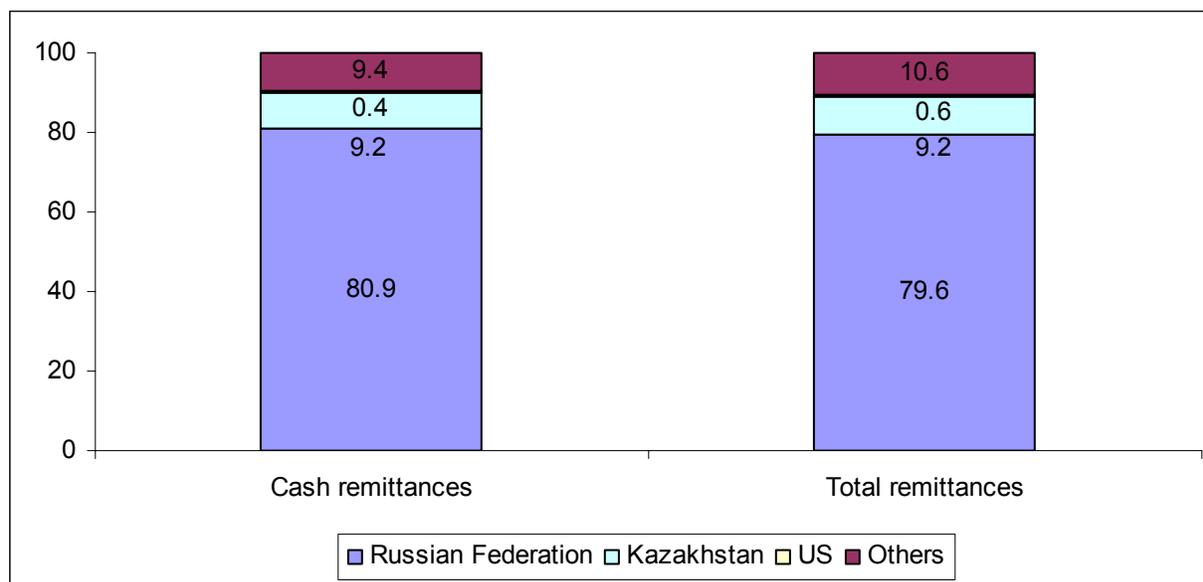
Table 4. Amounts of Remittances Received by Households

	Kyrgyz Republic	Bishkek	Other Urban Areas	Rural Areas
Households receiving remittances, in %	16.0	11.2	18.1	16.8
Total amount of remittances, in million \$	256.4	47.8	52.7	156.0
Share of cash remittances in total amount of remittances, in %	95.0	90.3	94.8	96.5
Average amount of remittances per annum				
Cash remittances per household, in \$	1,334	1,691	1,373	1,255
In-kind remittances per household, in \$	387	733	354	298
Total remittances per household, in any form	1,380	1,865	1,385	1,283
Share of remittances in total income of receiving households, in %	50.0	41.6	51.5	51.2

US = United States, \$ = US dollar, % = percent.
Source: Household survey data.

59. According to the household survey data, more than 80% of all remittances come from the Russian Federation (Figure 12), slightly less than 10% from Kazakhstan, and another 10% from other countries. Regarding the Russian Federation, these data are consistent with the NBKR data on geography of transfers (Figure 5). However, one can see a difference between these two sources of information regarding Kazakhstan and the US. Kazakhstan is the second large source of remittances in the household survey, while the NBKR database shows that it is not an important source of remittances. Possible reasons for this discrepancy are discussed in paragraph 26. The situation of remittances from the US is, in some sense, reverse. It is the second large source in the NBKR data but a very small item in the household survey. It is worth noting that in the RRS, a considerable share of the respondents (7%) reported the availability of relatives in the US and receiving remittances from them. These are mainly people living in Bishkek with higher education and with income status considerably higher than average. Obviously, this group is small in absolute numbers, while they may receive a significant portion of total remittances entering the country. Therefore, in the case of remittances from the US, it is possible to presume that this segment of recipients receiving remittances has not been sufficiently covered by the household survey.

Figure 12. Remittances by Country of Origin



US = United States, % = percent.

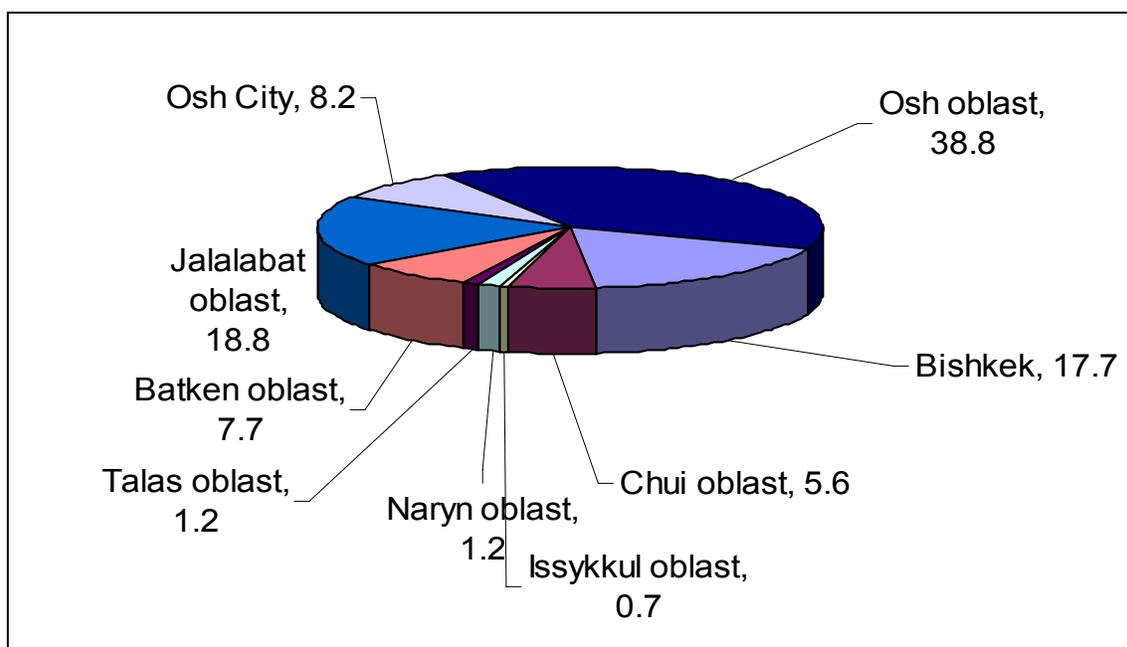
Source: Household survey data.

60. The household survey data provide geographical distribution of recipients of remittances within the country (Figure 13), which seems to correspond to the expectations. Almost three quarters of all cash remittances go to the southern part of the country—Osh City, Osh oblast, and Jalalabat as well as Batken oblasts. Batken oblast, which is one of the poorest regions of the country, receives a disproportionately high share of remittances compared to its population. This shows that labor migration and remittances are especially important for this oblast. Bishkek's share of remittances is roughly equal to its share in the country's population. More economically developed Chui and Issykkul oblasts receive just a small fraction of remittances.

61. Information on frequency and amounts of remittance transfers in the household survey allows estimating distribution of transfers by transaction value (Figure 14). According to these data, more than half of all transfers come in values in the range \$100–500 with a median value close to \$300. Large transfers (more than \$5,000) compose just 0.3% of the total number of transactions. These results differ significantly from those shown on Figure 6a²⁰ and indicate that households reported much smaller amounts of remittances than it follows from the NBKR data (even controlling for possibility of remittance consolidation by senders). This may be seen as an additional confirmation of the idea formulated in paragraph 34 that a large part of the money entering the country via large transactions (through MTOs) is not from workers' remittances but from trade- and other business-related monetary flows.

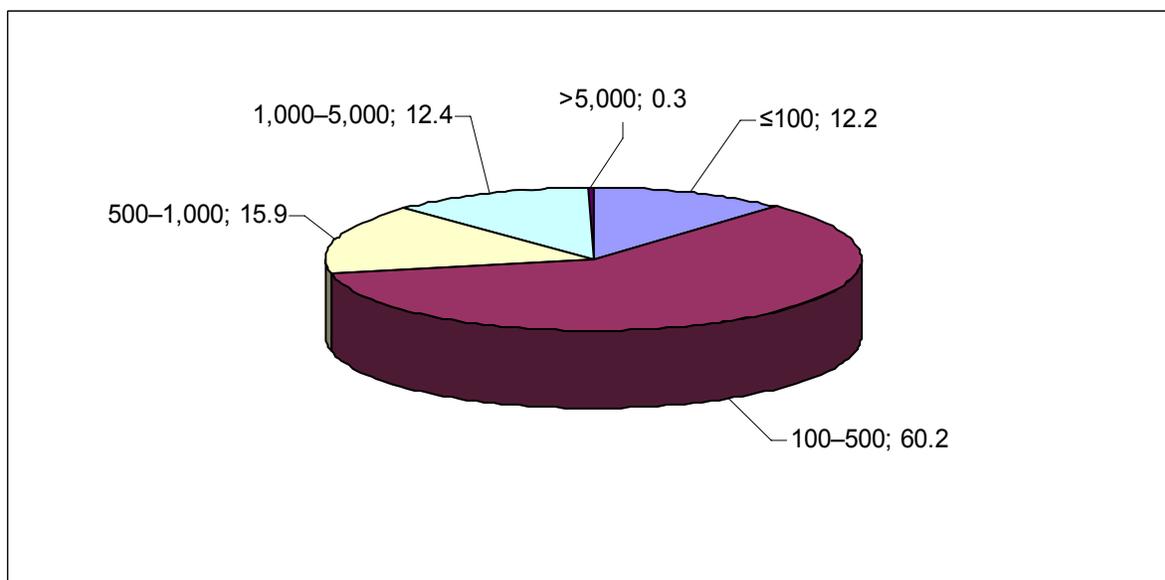
²⁰ While these figures are not fully comparable, more than three quarters of cash remittances in the household survey come via MTOs and/or the banking system; so distribution of remittances via this channel could not be too different from the distribution of all cash transfers.

Figure 13. Cash Remittances by Oblast, in %



Oblast = region, % = percent
Source: Household survey data.

Figure 14. Distribution of Cash Remittance Transfers by Transaction Value (in \$); % of Total Number of Transactions



US = United States, \$ = US dollar, % = percent.
Source: Household survey data.

62. Apart from remittance amounts, another important and relevant issue for this study is the selection of remittance channels by migrants and their households. One could distinguish formal channels of money transfer (e.g., MTOs, banking account, and postal service) and informal ones (migrant and individual intermediaries). Information on the current practices of migrants has been received from the household survey (Table 5). It follows from the table that majority of

migrants (78.5%) use bank accounts and/or MTOs for money transmission, i.e., formal channels, and that major part of remittances (78.2%) enters the country through this channel. The role of another formal channel, postal service, is negligible. The second important channel is carrying of money by the migrants themselves; 25.6% of all receiving households use it and 17.2% of all cash remittances come in this way. Many migrants commute, so they travel home often and have a chance to bring money with them. The role of intermediaries appeared to be relatively low—just 8.2% of all households use this channel—and individual intermediaries bring in only 4.3% of the total amount of cash remittances. One could also notice in the table that the amounts sent by formal channels (apart from postal service, which has limitations on the amount to be transmitted) are larger than amounts entering through informal channels.

Table 5. Channels for Cash Remittances

Channel	Households Receiving Remittances Using This Channel, in % ²¹	Average Remittance Amount, in \$ per Receiving Household	Share of the Channel in Total Amount of Cash Remittances, in %
Bank/MTO	78.5	1,330	78.2
Postal service	1.3	320	0.3
Carried by household migrant	25.6	898	17.2
Carried by friend/relative	6.9	646	3.3
Carried by other individuals	1.3	987	1.0

MTO = money transfer operator, US = United States, \$ = US dollar, % = percent.

Source: Household survey data.

63. Among the money transfer systems—which is the most popular remittance channel—the best known and popular are Western Union, Anelik, and UNistream (Table 6). People in RRS also were aware, more or less, and used MIGOM, Contact, Eco-perevod, MoneyGram, and Bystraya Pochta. These data are broadly consistent with the data of NBKR although in the latter, Contact is much more important and MIGOM as well as Eco-perevod are much less important. This discrepancy may be the result of the method of respondent selection at the premises of only few banks (more than half of the respondents were contacted at the Ecobank premises in Bishkek and Osh). Similar questions were asked in the household survey, while fewer MTOs were directly listed in the questionnaire. Results (Table 6) appeared to be reasonably consistent with that of RRS. Answering questions about the advantages of MTOs, people especially stressed that money transfers are quick, secure, and convenient, and that money collection procedures are simple.

²¹ More than one answer was possible.

Table 6. Use of Money Transfer Systems of All Respondents, in %

System	Aware of the System	Ever Used	Used Last Time	Used Most Often
RRS, % of all respondents				
Western Union	69	44	21	22
MIGOM	26	16	11	11
Money Gram	16	3	1	1
Contact	17	8	4	5
Leader	7	1	0	1
Anelik	50	33	20	17
Xpress Money	5	1	0	1
UNiStream	51	39	29	30
Travelex	11	3	1	1
Zolotaya Korona	6	1	1	1
Bystraya Pochta	14	5	4	3
Kyrgyz Transfer	4	0	0	0
Allure	5	1	0	0
Interexpress	2	1	1	1
Argymak	2	0	0	0
Country Express	1	0	0	0
Eco-perevod	19	7	3	3
Blizko	1	0	0	0
Household survey, % of all households receiving remittances				
Western Union	72	51	38	38
Anelik	38	21	12	13
Bystraya Pochta	3	0	0	0
MoneyGram	13	3	2	2
UNiStream	23	11	5	5
Contact	14	5	3	3
Interexpress	8	0	0	0
MIGOM	11	4	2	2

RRS = remittance recipient survey, % = percent.

Sources: Data from household survey and RRS.

64. Discussing informal channels, respondents in the household survey consider them secure/reliable (especially when a migrant carries money home), cheap, and readily available—although slow, which seems a main disadvantage in the eyes of remitters.

65. In RRS, by the very design of the survey, all respondents are users of formal channels. Still, they were asked about their attitude toward informal ones. Relatively few people reported usage and even awareness of informal channels of money transfers (see Table 7). Ninety six percent of respondents prefer formal ways of sending money and only 4% chose informal channels. The dominant reasons for preferring formal channels are their quickness, security, and convenience of use. The most popular informal way of sending money is through private persons (relatives and/or friends).

Table 7. Use of Informal Money Transfer Channels, % of All Respondents

Informal channel	Aware of the channel	Ever used	Used last time	Used most often
Conductor	25	4	1	1
Private person	34	11	7	4
Bus driver	19	6	3	2
Truck driver	5	1	1	1
Tourist agency	4	1	0	0
Stewardess	3	1	0	0

RRS = remittance recipient survey, % = percent.

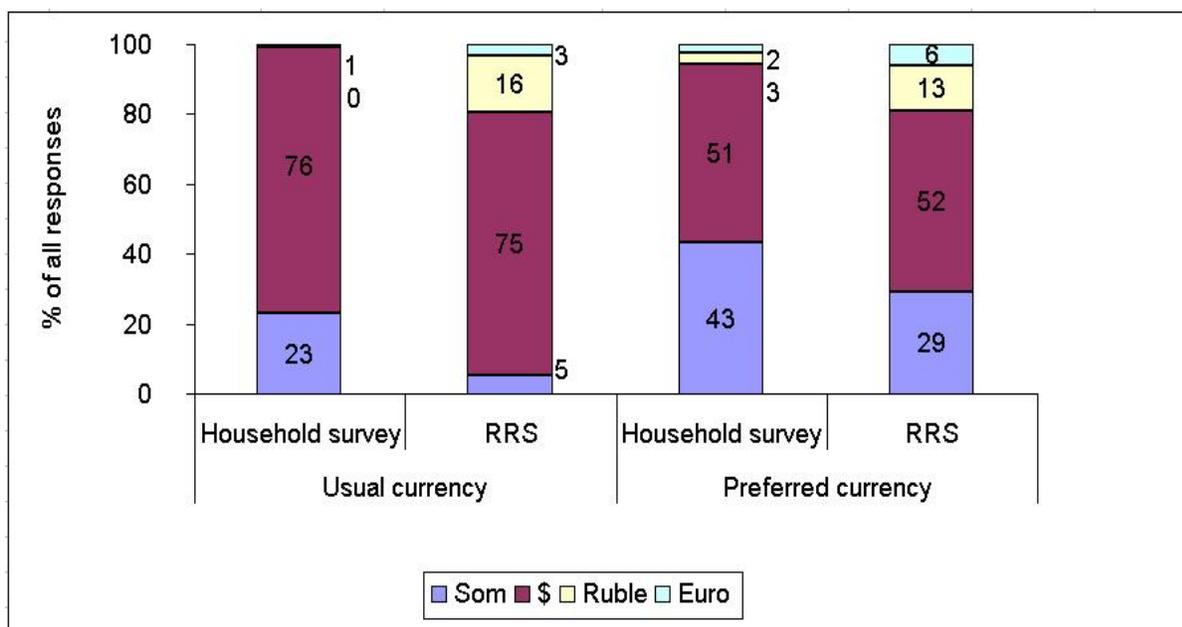
Source: RRS data.

66. In RRS, in absolutely majority of the households (83%), a sender decides on the type of money transfer system to be used and the remaining 17% is determined by the recipients. The senders notify 96% of the recipients about the money transfer and only 3% receive this information from an MTO. In the household survey, similar responses were received. Senders select the MTO to be used in 95% of cases and only in 5% are decisions made by/with participation of a recipient. The share of households notified about transfer by sender goes to almost 99.7% in the household survey.

67. According to the RRS data, 73% of respondents receive information about the transfer within one day; 25% in 2 to 3 days; and for 3%, it takes a week. Twelve percent of the respondents report paying some commission to the money transfer company when receiving money; 88% pay nothing. For those paying commission, the charge varies from 0.1 to 10% of the transaction amount with a median of 1.5%. Only 36% of respondents can get money immediately after receiving notification about a money transfer and 64% wait for their money. Waiting time varies from a few minutes to 3 days and the median reported time is 1 hour. In the household survey, respondents (mostly rural people) reported more time is needed for collecting money with a median of 4 hours, which is still a reasonable waiting time.

68. Both surveys provided similar data on currency of transfers (Figure 15). Three quarters of all recipients get their money in US dollars. In some cases, people receive soms (much more often in the household survey) and rubles (in RRS). Interestingly, considerably more people prefer receiving money in the national currency. This may be seen as an additional indication of the fact that remittances are mainly used for consumption, which is usually done in the national currency; rather than for savings in which traditional US dollars or the appreciating Russian ruble would be more preferable.

Figure 15. Currency of Money Transfers



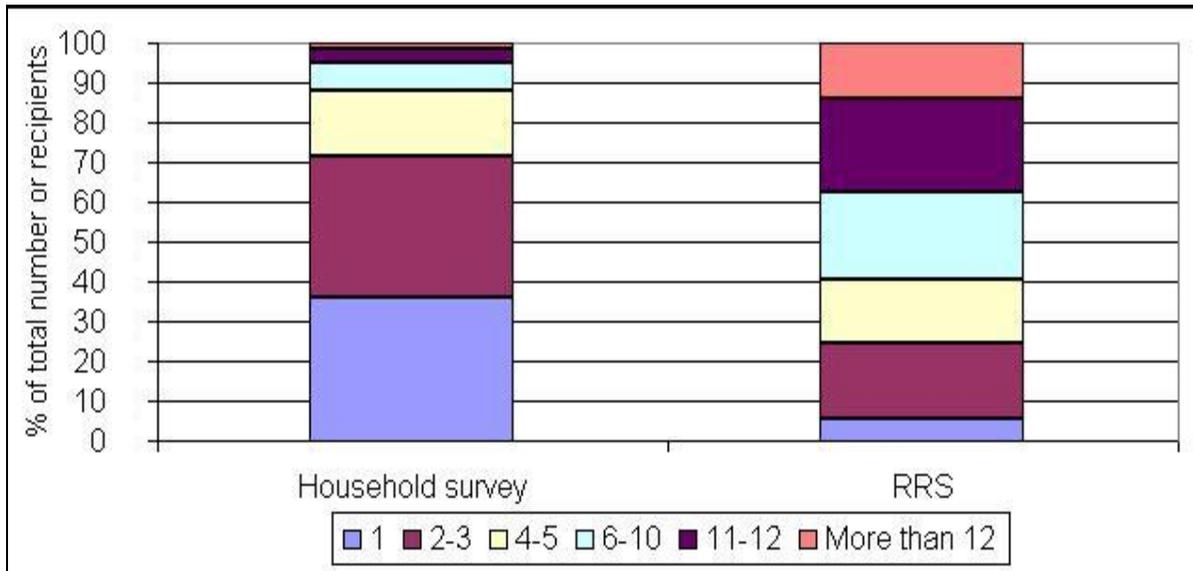
RRS = remittance recipient survey, ruble = currency of the Russian Federation, som = currency of the Kyrgyz Republic, US = United States, \$ = dollar, € = Euro, % = percent.

Sources: Data from household survey and RRS.

69. In contrast to the previous indicators, information on frequency of sending remittances significantly differs between two surveys (Figure 16). Respondents in the household survey reported much lower frequencies of sending money. More than 70% received money transfers 1 to 3 times a year. In RRS, such frequency was reported only by 25% of respondents. Just 6% of households receiving remittances got transfers more than 10 times per year; in RRS, this share was as high as 37%. One possible explanation for this discrepancy could be a difference between rural residents (prevailing in the household survey) and urban residents (prevailing in RRS). Access of the former group to key remittance channels is obviously lower than access of people living in an urban area. Correspondingly, frequency of transfers should be lower too.

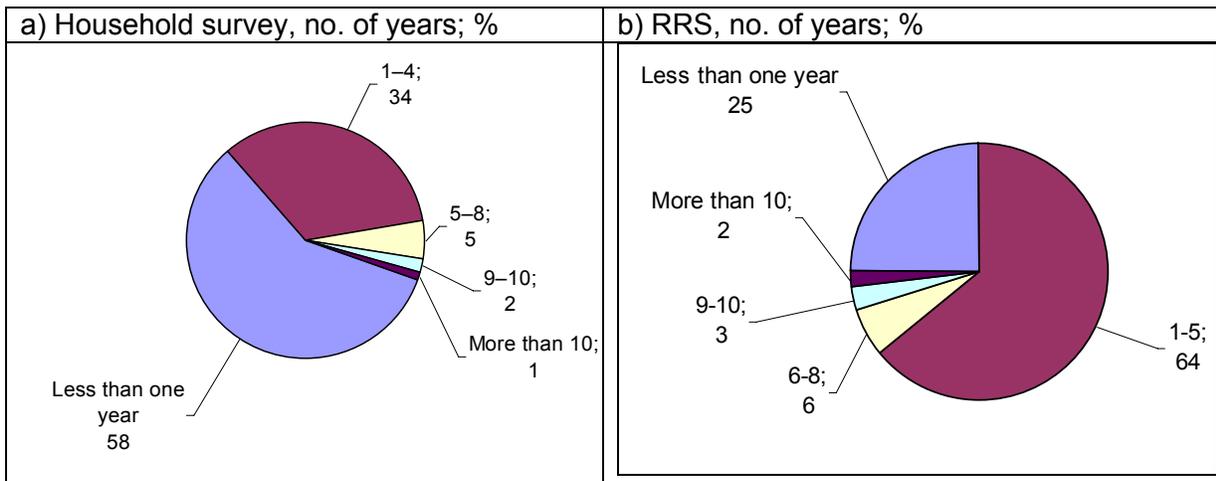
70. Data for length of receiving remittances by households from the two surveys are not fully comparable because of the different formulation of questions. However, comparison is still possible (Figure 17) and it shows that predominantly urban respondents in RRS receive remittances for a longer period than mostly rural people in the household survey in which more than half (58%) reportedly received remittances for less than a year. If one takes into account that migration decisions and remittances associated with them depend much on the available information and that urban people have much more opportunities to have access to information, these results seem reasonable. By both surveys, the share of households receiving remittances for more than 5 years is about/below 10%.

Figure 16. Number of Money Transfers per Year Received by the Respondents



RRS = remittance recipient survey, % = percent.
Sources: Data from household survey and RRS.

Figure 17. Length of Receiving Remittances by Respondents



RRS = remittance recipient survey, % = percent.
Sources: Data from household survey and RRS.

71. Household survey data shows considerable correlation between migrants' length of stay abroad and the length of period they send remittances. Correlation coefficient is 0.56 for those migrants who are receiving household members and 0.48 for migrants who are not members of receiving households. This indicates that family ties between migrants and their relatives in the Kyrgyz Republic are rather strong and are uninterrupted after some period.

72. Finally, in RRS, people destined for this transfer were asked and 73% of all respondents collected money sent to them, 14% did this for other people (e.g., urban people picked money for their rural relatives), 13% participated in bulk remittance transaction (i.e., they owned only part of received money). The share of bulk remittances seems considerable. Pooling remittances may be related to the remitters' desire to minimize costs such as reducing travel costs to MTO outlets, which may be relatively far from the migrants' working places, or utilizing

an economy of scale due to the use of regressive transfer fee schemes offered by some MTOs and/or banks, and risks associated with remittance-sending procedure.

3.3. Remittances and Business Activities of Recipient Households

73. Inflow of remittances significantly increases a disposal income of receiving households, which could be used not only for consumption but also for savings and investments into business activities. The surveys under consideration provided some information on savings and own businesses of households.

74. More than half of all households receiving remittances reported the availability of some savings (59.9% in the household survey and 68% in RRS). For comparison, in the household survey, only 37.3% of households that do not receive remittances have savings. Majority of households receiving remittances in the household survey save money in the form of cash in national (54.3% of all households in this category) or foreign (22.1%) currency. The third popular form of savings is purchasing consumer goods for future consumption (16.9%). Only 6.3% of households receiving remittances invest their money into businesses. Fewer people than expected, just 3.5%, reported using such form of savings as investments into real estate. Only 1% of respondents save money in the form of bank deposits. Practically all (94%) households without remittances that save do so in cash (soms). It is worth noting that registered preference for national currency as an instrument for savings is a new phenomenon. Previously, the common opinion was that people save in US dollars. This behavioral change may be related to low inflation in 2000s and a strong and continuous nominal appreciation of the som against the US dollar.

75. Whether a household receives a remittance or not, 73% of all respondents mainly use cash savings in emergency cases; for special events, 20%; for purchase of consumer goods, 15%; and for education purposes, 9%. In emergency cases, when their savings are insufficient, respondents in both surveys reportedly resorted to financial support of relatives and/or friends living in the Kyrgyz Republic or in other countries. Meanwhile, proportions on reliance in relatives at home or abroad appeared somewhat different. In the household survey, 81% of respondents receiving remittances rely on relatives and friends living in the Kyrgyz Republic and 60% resort to assistance of a relative living abroad (more than one answer on this question was possible). In RRS, 47% of all respondents request assistance from family members living in other countries (only one answer was possible here) and 40% ask help from family members living in the Kyrgyz Republic. In households without remittances, 92% rely on their relatives and/or friends in the Kyrgyz Republic and 17% resort to a community member/neighbor. People do not rely much on the support of or borrowing from any official organization including banks. In RRS, only 3% of respondents consider going to a bank for a loan in an emergency. This increased reliance on relatives abroad among recipients of remittances indicates that apart from other things, migration could be seen also as a way of diversifying a household risk. For example, a bad harvest or natural accident would affect households with migrants less than households without migrants; all members and relatives would be equally adversely affected.

76. Twelve percent of households (both receiving and not receiving remittances) reported the availability of business or entrepreneurial activity owned/carried out by household members. Only 18% of these businesses have hired labor (22% in the case of households receiving remittances), hence, in all other cases people are self-employed. Median number of hired workers is two and median time of business operations is 29 months. Households running their own businesses make some investments into them and median reported amount of investments for both remittance-receiving and non-receiving households is 20,000 soms (close to \$500). Thus, receiving remittances does not affect the households' propensity to have a business and their methods to operate it.

3.4. Remittance Recipients and Financial Sector

77. Financial activities of households considered in this section include borrowing, lending, and cashless settlements. Both surveys provided information on these issues.

78. According to the household survey, not much difference appeared between households receiving remittances and those not receiving them in their use of and attitude toward financial services (Table 8). Less than 13% of households borrow money from any source, just 1.7% of households lend money, and less than 1% of households have a bank account or any type of banking card. Households reported that they give money away in 14.5% of cases and contribute to community/religious organizations in 26.9% of cases.

Table 8. Involvement of Households in Financial Activities

	All Households	Households Receiving Remittances	Households Not Receiving Remittances
	% of all households in the category		
Borrow from any source	12.6	11.5	12.8
Lend money	1.7	2.5	1.5
Give money	14.5	19.3	13.6
Donate money to community/ religious organizations	26.9	29.6	26.3
Have bank account	0.7	1.3	0.6
Have credit card	0.4	0.8	0.4
Have debit card	0.2	0.4	0.1
Use ATM	0.2	0.6	0.1

ATM = automated teller machine, % = percent.

Source: Household survey data.

79. People borrow money mainly from their relatives and/or friends (55% cases of borrowing), microfinance organizations and credit unions (22%), and banks (17%). The relative popularity of nonbanking institutions as credit suppliers may be related to their proximity (compared with banks) to predominantly rural respondents in the survey. Outstanding debt amounts reported are not large; median is 10,000 soms (approximately \$260). The most popular reason for borrowing is business investments (22% of borrowers) and other relatively frequent reasons are consumption of goods (17%), health (9%), education (6%), and rituals (10%).

80. Key reasons for not having banking account are lack of money to keep/maintain a bank account (72.4% of households without account) and “no need of a bank account” (44.8%). Low trust in the banking system is a much less popular answer (18%). Technical issues such as “no bank near my house” (12.2%) and “complicated procedure for opening a bank account” (8%) are not considered by the respondents as main impediments for having a bank account. Regarding geographical proximity of a banking infrastructure to the respondents, median distance to a bank is 5 kilometers and median time to get to a bank office is 25 minutes.

81. Regression analysis of factors influencing probability for household to have a bank account (Table A4) indicates that this probability is higher for households with higher income (without remittances), higher education of household head, living in an urban area, and with savings. Amount of remittances received, involvement in entrepreneurial activity, and gender of household head do not appear to be significant determinants of access to bank services. These results are consistent with other data of the two surveys, which show that (i) mainly urban people with higher income and educational status compose a narrow group of banking system

clients and (ii) receiving remittances does not produce any measurable increase in probability of closer contact of households with the banking sector.

82. RRS survey provided somewhat different results regarding access of the respondents to financial services. Respondents with bank accounts comprise 23%, 8% have a credit or debit card, and 6% use automated teller machines (ATMs)—i.e., 10 to 20 times more than in the household survey. Among respondents with bank account, 55% have it in Ecobank, 13% in Kyrgyz Bank, and 10% in Settlement and Saving Company,²² fewer people reported accounts in seven other banks. Of those receiving remittances through a bank, 85% take the whole amount in cash, while 15% take part of the money in cash and leave the rest in their bank account.

83. The most popular reason for not having a bank account are “I do not need a bank account” (48% of answering this question) and “I do not have enough money to keep/maintain a bank account” (38%); 6% do not trust banks. Compared with answers received in the household survey, one would notice that lack of money becomes only the second important reason; obviously, respondents in RRS must have higher income status than in the other survey.

84. People did not express much enthusiasm in answering the question on potential incentives/banking services to make them keep part of their remittances in a bank; 68% did not respond at all. Among those who responded to this question, the most popular answers are to “provide higher interest rates on deposits” and “help open a bank account.” Obviously, majority of the people just do not understand the purpose of banks and on how to use them. To a large part, this is a consequence of lack of previous banking experience. This raises the issues of educating people on the use of financial services and demonstrating to them the potential advantages of different financial products. This is an area where the Government, financial institutions, and international organizations may undertake joint efforts.

85. In RRS, 39% of respondents reported the availability of some kind of financial obligations. The most frequent types of obligations are related to business (17% of all respondents with obligations), consumer credit (15%), and support of family members living separately from household (13%). Of these obligations, 47% are with family members, 27% with a bank, and 13% with a private lender. These obligations most typically are associated with running business and payment for education.

86. The above discussion shows that the population, especially those from rural areas and the poor, still has little access to financial services (see additional evidence of poor financial intermediation in section 5 of this paper). On one hand, this is a consequence of a generally low level of income and welfare of the larger part of the Kyrgyz population. People just do not have much money to save and enough assets to serve as collateral in borrowing operations. On the other hand, perceptions of problems in financial services exist in the society. As it follows from the surveys implemented in the framework of the ADB project, both financial institutions and their potential clients consider using financial services as some kind of luxury accessible only for those with higher income and educational status, or for people with lower-than-usual risk and transparency aversion. This view has its roots in the turbulent history of the Kyrgyz economy and its financial sector in 1990s up to the early 2000s. Because of such attitude, the number of clients of banks and other institutions is small. Banks cannot enjoy the economy of scale and keep their services' prices prohibitively high for majority of the population. This, in turn, constrains access of population to financial services. However, the situation in the financial sector and living standards of the population are gradually improving (see section 5). It is time for financial institutions to invest in confidence building and in educating people on the use of

²² These results may also be a consequence of method undertaken in selecting the respondents in the survey.

financial services. The Government and international development organizations should support such efforts of financial institutions.

4. Issues and Patterns in the Marketplace of Remittance Transfer Businesses

4.1. Regulatory Environment for Money Transfers

87. Inbound and outbound money transfers in the Kyrgyz Republic are regulated by the following main laws: “About transactions with foreign currency”, “About banks and banking activities”, and “About licensing”. Several regulations issued by NBKR are related to money transfer operations. No specific legislation on international money transfers currently exists.

88. Existing regulatory and legal framework establishes that only commercial banks and exchange offices with special license issued by NBKR have a right to make professional transactions in foreign currency with individuals. Legally, no regulation restricts organizations providing money transfer services. According to NBKR specialists, a license requirement for providing money transfer services is still being developed. A new license will include requirements as to organizational form, liquidity, and type of operators eligible to provide international money transfer services. Before introducing this license requirement, NBKR feels it is necessary to assess the possible impact of this legislation on the market, but it does not have enough resources and capacity for that.

89. The foreign exchange regime in the Kyrgyz Republic is very liberal. There are no restrictions on transactions and savings in foreign currency for residents and nonresidents. Inbound and outbound international travels with foreign currency in cash are also unrestricted, but currency amounts are subject to declaration at customs.

90. There are no legal restrictions on the size of outbound transfer, while the size of inbound remittances is regulated by legislation of the country of origin of a money transfer²³ or by internal rules of MTOs. For example, Kyrgyz Post limits the maximum size of a single transfer within the Kyrgyz Republic by 10,000 soms (\$250 in 2006). Restrictions on cross-boundary postal and telegraphic transfers depend on bilateral agreements between countries and are revised periodically.

91. In 2006, a new law preventing money laundering and financing of terrorism was enacted. According to this law, a banking transaction should be checked and information about it should be transferred to an authorized body, which is the Financial Intelligence Unit under the Ministry of Finance, if the transaction amount is equal to or above 1 million soms or its equivalent in foreign currency (slightly more than \$26,000 in mid-2007). The following transactions are subject to mandatory control should they exceed the above-mentioned threshold: all internal and external operations of depository institutions, foreign exchange operations, real estate deals where the threshold is 4.5 million soms or \$118,000, remittances, all suspicious deals and transactions, etc. No evidence of practical implementation of this very recent law has been revealed when the report was being prepared.

92. The Kyrgyz Republic is a member of the Eurasian Economic Community (EurasEC) along with Belarus, Kazakhstan, Russian Federation, Tajikistan, and Uzbekistan. This international organization’s aim is the elaboration of unified foreign economic policies, tariffs and

²³ There is a restriction on money transfers through MTOs for residents of the Russian Federation. A single transaction through an authorized bank during a working day cannot exceed \$5,000. There is no limitation on money transfer amounts for nonresidents. Federal unitary enterprise, Russian Post/Pochta Rossii, provides electronic money transfer services to Kazakhstan and Belarus, while only postal transfers are available for other CIS countries. Starting 2005, the maximum amount of a postal money transfer for an individual is 100,000 rubles (close to \$4,000). The number of transfers is unlimited.

prices, and other operational components of the common market. EurasEC members inform each other about local laws regulating cross-border money transfers.

93. The monitoring body for international money transfers is the Department of Balance of Payment at NBKR. Each month, all commercial banks and the Kyrgyz Post report their inbound and outbound money transfers. Their information is expressed in US dollars (the currency of the BOPs compiled by NBKR) irrespective of actual currency of transaction.

4.2. Money Transfer Operators in the Kyrgyz Republic

94. While there are no legal restrictions, in practice, only commercial banks implement money transfers transactions. The only nonbanking institution operating on this market is the state enterprise, Kyrgyz Post. According to NBKR specialists, the domination of commercial banks in providing international money transfer services could be explained by the fact that only banks have adequate liquidity and resources to work with asymmetrical flows of money transfers, as inbound remittance flows are much larger than outbound ones.

95. As noted in section 1.3, remittances enter the Kyrgyz Republic mainly through money transfer companies. These companies operate in the country via their agents, Kyrgyz commercial banks. Therefore, the banks serve two remittance channels: banking accounts (including card transactions) and MTOs. Practically all (19 of 21) active banks operating in the Kyrgyz Republic are involved in the business of money transfers.

96. Sixteen MTOs are present in the Kyrgyz Republic, including two major global MTOs (Western Union and MoneyGram). Practically all MTOs are operating in the CIS: Allure (formerly STB Express), Anelik, Blizko, Bystraya Pochta (Fast Post), Contact, Country Express, Faster, InterExpress, Leader (formerly VIP Money Transfer/VMT), MIGOM, Travelex Money Transfer (TMT), UNISStream, Xpress Money, Zolotaya Korona (Golden Crown). In addition, there are three domestic money transfer systems: Argymak, Eco-perevod, and Kyrgyz Transfer. Usually, MTOs partner with several banks in the country²⁴ and vice-versa; banks serve more than one MTO simultaneously.²⁵ Technologically, Kyrgyz commercial banks usually use payment platforms of partner MTOs for transacting, information sharing, and monitoring. Using well-tested systems allows reliable performance of the money transfer systems and does not raise any concerns on the Kyrgyz bankers' side.

97. Geographically, a dense network of outlets opened by commercial banks to serve international money transfers covers the country. These outlets are located in all bank branches, but mostly outside them. Numerous MTO outlets could be found in the two largest cities, Bishkek and Osh, in practically all smaller towns, and in many large and even medium-size villages. For example, according to the data of MTO web sites, UNISStream has outlets in 57 towns and villages of the Kyrgyz Republic; Contact is present in 55 settlements; Anelik could be found in 63 locations; and 140 outlets serve Western Union in Bishkek only. As one could expect, the MTO network is especially well presented in the areas of massive labor emigration, which are in the south of the country.

98. An important and attractive feature of transfers through MTOs is that it is not necessary to disclose any information on the sender and recipient of the transfer (apart from personal identification) and on the economic nature of the transaction. The absence of transfer taxation also seems a crucial factor in determining the popularity of this remittance channel.

99. All commercial banks provide international money transfer services via banking accounts. However, this option is much less popular (see Table 1) than the use of money

²⁴ For example, in 2006, UNISStream had 11 bank partners, Western Union – 9, Anelik – 8, and Contact – 7.

²⁵ Ineximbank has 10 MTO partners, Ecobank has 9, and Kyrgyzstan has 8.

transfer systems, which do not require opening a bank account. Mainly urban people with higher educational and income status are users of transfers through bank accounts. There could be several reasons for the relatively low popularity of bank accounts as a money transfer tool:

- It is not always legally possible to open an account for a Kyrgyz migrant in the country of destination. This problem is especially typical for Kazakhstan.
- There are much fewer bank branches in the country (see section 5) than MTO outlets. They are located mainly in cities (only Bishkek has 48) and towns.
- Opening a bank account is costly and burdensome (at least, for unprepared and less-educated people). These costs²⁶ are perceived as high also because majority of the people still do not see the benefits of using a bank account for other purposes (e.g., deposits, loans, cards [see also section 5]).
- Some types of transfer operations (see section 4.3) have relatively high transaction costs.
- According to bank representatives, the very introduction of AML legislation has caused an outflow of clients from commercial banks. It is worth noting that according to this legislation, all very large transactions that compose a bulk of remittances entering the country must be reported by banks to the authorities should they come through bank accounts. This deters many clients from using bank accounts as transmission channel.
- Finally and closely related to that, the key source of competitiveness of Kyrgyz shuttle traders is informality and associated with that, is the radical reduction in tax payments (substituted by much smaller payments to officials in customs or open markets). From this point of view, using MTO services—implying just a minute contact with the banking system—is a more attractive option than opening a current account in a bank.

100. In recent years, NBKR supported by donors—mainly by the World Bank—paid a lot of attention to the modernization of the country's payment system. One activity directly related to international money transfers was establishing an interbank collective point for SWIFT at NBKR in 2002. This substantially increased the number of banks connected to SWIFT—currently, there are 20—and reduced the costs of its use. To establish a unified national interbank cashless settlements system and to introduce the national banking card, *Elcard*, an interbank processing center was established by commercial banks with the participation of NBKR. This center started operating in December 2006. Currently, 13 banks are members of the system and 6 accept payments with this card.

101. Bank cards, which seem one of the most convenient methods of international money transfers via the banking system, are not a popular tool in the Kyrgyz Republic. Use of bank cards implies high fixed and variable costs for customers. Two existing domestic card systems are not integrated with international ones. ATM and postal-terminal network is underdeveloped, so at this current stage of development, having or maintaining a bank card is a luxury affordable only for people with sufficiently high income. By the end of 2006, there were only 19 ATMs, 324 postal terminals, and 13 imprinters for international card systems in the country. Only 11.8 thousand cards of VISA and MasterCard systems have been issued by Kyrgyz banks. In 2006, cardholders made 242,000 transactions with their international cards. In more than 90% cases, these transactions were cash withdrawals from ATMs; settlements with cards in nonfinancial enterprises are still infrequent.

²⁶ For example, account opening fee (up to \$25), notarial attestation of signatures, and other documents for entrepreneurs (up to \$10).

102. The situation with bank cards is illustrative of the problem regarding slow introduction of new financial services and technologies in the country. Interviews with bankers show that they are interested in introducing new technological solutions like mobile banking,²⁷ but need technical assistance in designing new financial products affordable for potential clients. The key problem, which so far prevented banks from introducing many advanced technologies, is high fixed costs of equipment, software, and system design, which could not be covered through high user fees because the demand for this kind of services is very elastic.

103. It is worth noting that mobile telephony faced a similar problem in the country some time ago, but timely investments accompanied by aggressive advertisement campaign made this sector one of the most profitable and fast growing in the Kyrgyz Republic. Currently, five mobile phone operators working in three standards (including GSM and CDMA) provide services that are accessible in all populated areas of the country. The number of subscribers of mobile telephony is almost doubling each year; according to the consulting agency, Expert. This number exceeded 0.9 million people at the end 2006 and approached 1.3 million or 25% of the country's total population in April 2007. According to the same source, in Bishkek—the capital of the country—mobile telephony coverage exceeded 80% at the end of 2006. Therefore, the penetration of mobile telephony is already deep enough to make the introduction of mobile banking a practical task.

104. The Kyrgyz Post, which provides the third remittance channel, is a state-owned enterprise (SOE) with the widest network of offices in the country. It delivers money (postal money transfers, pensions, and different government allowances) to doorsteps. Similarly, its partners—other countries' postal services—have very good coverage of the destination countries of Kyrgyz migrants. This could be an important comparative advantage of this organization in the remittance market. However, so far, the Kyrgyz Post does not utilize it. The share of postal service in inbound transfers is marginal and diminishing (Table 1). Remittance transmission services of the postal system are the most expensive in the market. This SOE has not enough incentives and capacity to increase its role in the money transfer business. The Kyrgyz government is discussing a plan to establish a postal bank based on the postal service network.²⁸ Perhaps, this could be a chance to revive this remittance channel.

105. One more international money transfer channel is the so-called informal transfers, which include bringing in cash to the country by migrants or by their agents (typically relatives or friends). Just recently, it was the most popular way of sending money back to the Kyrgyz Republic. In early 2005, two thirds of all transferred amounts were estimated to have been transferred to the country through this channel; of these, around 30% were made through agents/intermediaries (Economic Policy Institute 2005). However, during the last 2 years, the situation has been dramatically changing. Different sources such as interviews with migrants, diaspora representatives, and bankers; data of household survey, and RRS in the framework of the current ADB project, indicate that majority of migrants have switched now to using formal channels (mainly MTOs, see details in section 3). Reduction in the role of informal intermediaries is especially striking. According to the surveys' data, less than 5% of all remittances enter through informal intermediaries and less than 10% of recipients frequently use their services. MTOs' affordable costs, reliability, and wide network of outlets eliminated the main advantages of informal transfers. People still bring considerable assets with them when returning to the Kyrgyz Republic; frequently not in cash but in the form of commodities to be

²⁷ Some Kyrgyz banks already made plans to introduce mobile banking, but recent political instability and associated change in ownership of the largest mobile operator—which was expected to be a partner in this business—did not allow these plans to become a reality.

²⁸ Part of post offices in this network is already used for banking service provision as Kyrgyz Post rented them to commercial banks.

sold in the domestic market. This means remittances are partially transformed into imports of goods.

4.3. Competition in the Remittance Market

106. As it follows from the above discussion, the growing demand for international money transfer services attracted many suppliers of these services to the market. The availability of numerous MTOs and consumers on the market—combined with the existence of a competitive and reasonably regulated banking sector, very liberal regulatory regime for international money transfers, and low entry barriers (the costs of equipment and expertise needed to start operations on this market are affordable for commercial banks)—made this market's structure in the Kyrgyz Republic truly competitive. One could think of at least three facets of competition in this market: (i) between MTOs, (ii) between banks, and (iii) between transfer-sending channels.

107. Table 9 provides a list of the most popular MTOs. The table demonstrates that there is no obvious leading MTO in the market. In different periods and by different indicators, Anelik, Contact, UNISStream, and Western Union have been in this position. In the early years of the development of international money transfer business (2000–2003), Western Union was absolutely the leader in the market. It had the largest market share both in the number of transactions and in the amount of money transferred. This is natural as Western Union is a relatively old MTO that developed its business in other regions of the world and was prepared to step into the Kyrgyz market immediately when it emerged. MoneyGram, another global provider of these services, has been less successful in this market and received only a secondary role. With the passage of time, however, CIS-based MTOs were taking over the leading positions. First, Anelik and then Contact as well as UNISStream gained the largest shares of the market. Currently, leadership in the market is split between these systems. In the number of transactions, Contact has the largest share (which approaches 50% of the total number of incoming transfer operations. Western Union and Anelik are two other MTOs used by Kyrgyz remitters most frequently. From the point of view of the share of money remitted, the situation is different. UNISStream is now the largest channel for transfers; its market share was one fourth of all money in 2005 and 40% in 7 months of 2006. Shares of Anelik and Western Union have been gradually declining, but they still keep the second and third places.

Table 9. Main MTOs Serving Incoming Transfers in the Kyrgyz Republic

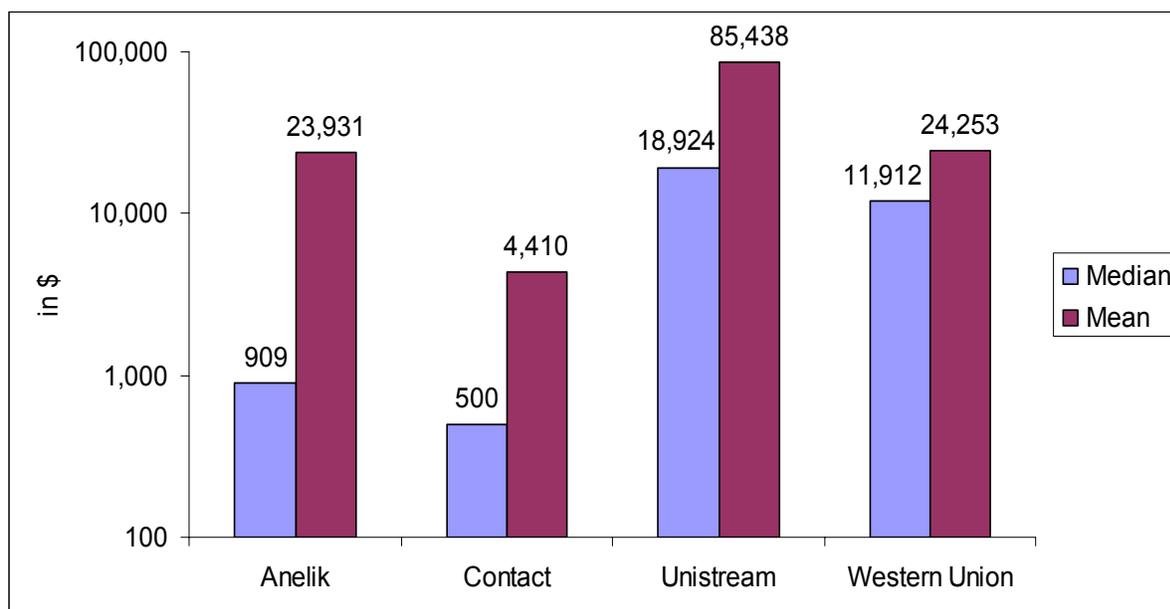
	2000	2001	2002	2003	2004	2005	7 months 2005	7 months 2006
Share in total number of transactions through MTO, in %								
Anelik	0	5	29	27	14	21	19	15
Contact	0	5	8	23	41	42	41	44
Leader	0	0	0	0	4	2	2	6
MIGOM	0	0	0	3	4	3	3	4
MoneyGram	0	9	5	3	1	1	1	0
UNISStream	0	0	0	0	4	7	7	9
Western Union	100	81	58	44	29	20	22	18
Other MTOs	0	0	0	0	2	4	5	3
Share in total amount of money transfers sent through MTOs, in %								
Anelik	0	1	8	34	34	25	27	16
Contact	0	1	5	15	17	9	10	10
Leader	0	0	0	0	1	1	1	3
MIGOM	0	0	0	1	3	4	4	3
MoneyGram	0	3	7	4	2	1	1	1
UNISStream	0	0	0	0	13	30	25	40
Western Union	100	95	81	45	28	24	26	19
Other MTOs	0	0	0	0	1	6	5	7

MTO = money transfer operator, NBKR = National Bank of the Kyrgyz Republic, % = percent.

Source: NBKR.

108. The fact that Contact, which makes the largest number of transactions, is only fourth in the share of total amount of money transferred means that it remits smaller amounts per transaction compared with other MTOs. Figure 18 shows that mean and median amount of transaction for Contact is much smaller than for other major MTOs. UNISStream is another extreme case. It makes much fewer transactions, but these transactions are large or very large (mean transfer in 2005 exceeded \$85,000).

109. Analysis of transfers via MTOs by country allows getting further insight into the market structure. Situation with transfers from the Russian Federation (Figure A5a and Figure A5b) is similar to the aggregated picture: Contact makes large number of relatively small transactions, while UNISStream makes much less transactions with much larger size; Anelik is number two; and Western Union is number three for either indicator. However, the picture of transfers from the US (Figure A5c and Figure A5d) is somewhat different. Western Union is an absolute leader here both in the number of transactions and for transfers. MoneyGram is the only competitor with a considerable market share in the total amount of transfers. Interestingly, in 2005 to 2006, Anelik completely lost its market share in the US, which used to be large in 2002 to 2004.

Figure 18. Mean and Median Amount of Transaction for Leading MTOs in 2005

MTO = money transfer operator, NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar, % = percent.

Source: NBKR.

110. Another factor, which could affect the MTOs' competition outcomes, is costs of their transactions. Table 10 shows transaction costs of sending some typical transfer amounts from the Russian Federation (cities other than Moscow) to the Kyrgyz Republic (as of 1 May 2007). One can see that UNISStream's services for sending large amounts of money have been cheaper than services of its main competitors.²⁹ Price competition seems to be an important phenomenon in this market. Many companies offer regressive tariff scales trying to respond to the tendency to increase transaction amounts. Comparison of market shares of the five most popular systems in the Russian Federation with the systems' transaction costs (measured as percent of median transfer) shows that correlation coefficient between market shares and transaction costs is -0.56 and is significantly different from zero at 5% significance level. The negative correlation may be a consequence of flexible behavior of the remitters, who tend to switch to the cheapest system available.

²⁹ Anelik's rates shown in the table were introduced recently. In 2005 to 2006, Anelik had a flat rate of 3%, much higher than UNISStream. The "Super-Anelik" tariff with rates below 1%, which was introduced at the end of 2006, could be seen as an attempt to cut prices for its main competitor.

Table 10. Transaction Costs for Money Transfer from the Russian Federation to the Kyrgyz Republic by MTO

MTO	Transfer amount, in \$			
	500	3,000	5,000	10,000
Allure	2.0	2.0	1.6	1.0
Anelik	3.0	0.9	0.8	0.7
Contact	3.0	3.0	3.0	3.0
Leader	1.5	1.5	1.5	1.5
MIGOM	2.4	2.0	2.0	2.0
MoneyGram	4.6	3.2	2.1	1.8
Travelex	3.6	2.9	1.9	—
UNIStream	1.5	1.5	1.5	1.5
Western Union	4.8	3.3	3.6	3.8

MTO = money transfer operator, US = United States, \$ = US dollar, — = data unavailable.

Sources: Web sites of MTOs.

111. It follows from the above that different MTOs prevail in some specific segments of the market. Contact serves mainly individual labor migrants in the Russian Federation, and this explains relatively small transfer amounts. UNIStream is oriented more on bulk remittances and merchants' transfers from the Russian Federation. Western Union is a leader in the US market. However, the situation is very dynamic; market shares of different companies rise and fall quickly. The factors affecting market shares may be many, including: (i) proximity of systems' retail outlets to the migrants which, in its turn, is a function of general number and geographical coverage of their networks and the extent these networks match the location of majority of Kyrgyz migrants in the Russian Federation, US, and other countries; (ii) size of transaction costs; (iii) density of MTOs' outlets in the Kyrgyz Republic, and their proximity to recipients of remittances; and (iv) convenience/quality of services provided by the systems to the clients. It is worth noting that acute competition in the Kyrgyz market led to the situation when no leading MTO has an advantage in terms of proximity to recipients, as they all have well-developed networks in the Kyrgyz Republic (see section 4.2). However, this is more a result of work of Kyrgyz banks rather than MTOs themselves. Quality of services is also very similar for all existing MTOs. Therefore, the first two factors, density of networks outside the Kyrgyz Republic and transaction costs, seem decisive for the current position of MTOs in the market. Moreover, these are exactly the factors primarily affecting senders, usually the party deciding on the use of this or that remittance channel.

112. Commercial banks form another group of competitors in the Kyrgyz remittance market. By estimates, Ecobank is an absolute leader in the market,³⁰ followed by Kyrgyzstan Bank, Amanbank, and Settlements and Savings Company. These banks are the most active market participants also from the point of view of number of partner MTOs, number, and geographical diversity of retail outlets as well as advertisement efforts (e.g., TV, magazines, newspapers, booklets, newsstands, etc.) both within the Kyrgyz Republic and among migrants in the countries of their destination, mainly in the Russian Federation. Representatives of banks visit workplaces and residence of migrants in the Russian Federation as well as trains going there (the practice of Ecobank) to distribute booklets and leaflets promoting their services among migrants, and collaborate with diasporas and embassies of the Kyrgyz Republic in the Russian Federation and other countries (the approach of Amanbank). Ecobank also practices agreements with Russian banks and police offices distribute their information through these

³⁰ It is worth noting that despite Ecobank's share in this market (about 40%), this bank has no instrument to exercise market power. Therefore, this big market share does not limit competition in the market.

channels. All banks extend their networks of retail outlets and working hours (including weekends) of their branches and outlets in the Kyrgyz Republic to be more accessible and convenient for clients. In selecting their partner banks and MTOs in the Russian Federation, Kyrgyz banks try to collaborate with those well represented in areas where Kyrgyz migrants are located (i.e., Urals, Siberia, Moscow, and St. Petersburg) and which have the most client-friendly atmosphere. Anelik, with its long experience of working with Armenian labor migrants, is considered by the representative of Ecobank as an example of such partner. The banks make much less effort to serve Kyrgyz migrants in Kazakhstan or the People's Republic of China. Banks also do not attempt to develop approaches specific for different migrant groups (e.g., shuttle traders versus construction workers). No bank made any serious effort to strengthen its position in the market by introducing new technological solutions or providing complimentary financial services on conditions that are sufficiently attractive for their clients. It seems that bankers perceive their own financial services to be unaffordable for majority of senders and recipients of remittances.

113. Money remitters may choose not only between MTOs and commercial banks, but also between sending channels. As demonstrated above, sending transfers via MTOs without opening a bank account is absolutely the prevailing channel. Apart from structural problems, which could explain underutilization of bank accounts and marginalization of postal and telegraphic transfers (see section 4.2), there is also the issue of transaction costs. Postal services are the most expensive because their transfer fee goes as high as 10% of the transferred amount. This, of course, excludes the postal service from any serious participation in the market. Costs of transfers through bank accounts are much lower. A typical transaction may cost 0.2–0.5% (but not less than \$20–25) on the sender's side plus 1.04% (1% fee plus 0.04% retail sales tax) for cashing the transferred amount in the bank on the recipient's side. This makes transaction costs for banking accounts higher than those for some MTOs even for large amounts of transfers. For small amounts, below \$500, using bank accounts for transfers makes no economic sense because the transaction costs would exceed 5%.

114. Thus, the money transfer market has come through a very dynamic period of development in the last 4 to 5 years and has converted into a healthy, competitive segment of business activity of the Kyrgyz financial sector. Commercial banks have established themselves as a reliable remittance channel. It seems many market participants have matured to enter the next stage of development—i.e., integration/combination of money transfer services with other financial sector products.

5. Remittances and Financial Intermediation

115. The financial sector of the Kyrgyz Republic consists of the two-tier banking system and NBFIs.³¹ The regulatory body for the Kyrgyz financial sector is NBKR. Status, tasks, functions, organization, and activity principles of NBKR are legally set by the Constitution of the Kyrgyz Republic and the law on the NBKR of 29 July 1997. The main goal of NBKR is to achieve and support price stability by means of relevant monetary policy. The main objective that contributes to achieve the bank goal is to support the purchasing power of the national currency, ensuring of security, and reliability of the banking and payment system of the republic (Article 3 of the Law of the Kyrgyz Republic on the NBKR). To carry out its tasks, NBKR organizes and carries out its activity independently of the state authorities. NBKR has the following functions:

- Developing and conducting the monetary policy in the Kyrgyz Republic;
- Regulating and supervising activities of banks and other financial as well as credit institutions licensed by NBKR;

³¹ This paragraph is based on the NBKR web site information.

- Working out and implementing a unified exchange rate policy;
- Possessing an exclusive right to issue banknotes;
- Promoting effective functioning of the payment system; and
- Establishing rules of banking transactions, accounting, and reporting for the banking system.

116. In the 1990s, the Kyrgyz financial sector went through several severe crises, which substantially reduced its role in the economy and undermined the trust of economic agents toward banking and nonbanking institutions. These crises were caused by macroeconomic instability and inappropriate regulation of the financial sector. In the early 2000s, the Government and NBKR had taken significant corrective measures in both directions reducing government budget deficit, curbing inflation, and putting in place a much more rigorous regulatory system for financial institutions. Therefore, beginning from 2001, the Kyrgyz financial sector is developing in a considerably different and healthier environment than before, while this development started from a very low basis.

117. In terms of banking regulation and supervision, main laws regulating these issues in the Kyrgyz Republic are the Law “On National Bank” and the Law “On Banks and Banking.” According to these laws, NBKR is solely responsible for banking supervision and has the right to issue regulations and instructions to oversee bank activities. The Government cannot interfere with the activities of NBKR. NBKR has also an exclusive right of bank licensing. Should a bank fail to comply with its requirements, the latter has the right to impose penalties and corrective measures. In extreme cases, NBKR may suspend or revoke the license. NBKR conducts regular extensive off- and on-site inspections, and these now include regular stress testing of banks as one external supervision method. Significant efforts were made to introduce International Account Standards; and since 2003, commercial banks have been publishing financial statements according to these standards. By assessment of IMF and European Bank for Reconstruction and Development (EBRD), compliance with Basel Core Principles in the Kyrgyz Republic is generally “medium.” The main deficiencies are in the transfer of ownership and major acquisitions, supervision of overseas operations of domestic banks and local operations of foreign banks, risk management, and governance and auditing. NBKR is continuing its efforts in the regulatory area. Minimum capital requirements for banks have been increased to 60 million soms in early 2006; a further increase to 100 million soms (around \$2.6 million) is scheduled for 2008. NBKR has developed supervisory framework for market, country, and transfer risk and has instructed banks to maintain adequate capital to cover these risks effective January 2007. NBKR has also introduced regulations for consolidated supervision to monitor risks faced by financial institutions in line with the recommendations of the *2005 Basel Core Principles for Effective Banking Supervision Assessment*. A bill before parliament seeks to amend the central bank charter to enhance its autonomy and ensure legal protection of its employees in performing official duties.

118. Apart from commercial banks, NBKR supervises nonbanking credit institutions. All other financial institutions are supervised by the State Agency on Financial Surveillance and Reporting.

119. As of end 2006, the Kyrgyz Republic has 21 active commercial banks with 171 branches or 3.3 branches per 100,000 people (3.6 branches per 100,000 people in Bishkek). The branch density has not changed much compared with that at the end 2000, when it was 3.2. This indicator is low in international scale, well below its average value of 4.9 for low- and middle-income countries (*World Development Indicators* [WDI] data for 2004). Apart from the active banks, 11 commercial banks are in the process of external administration, conservation, or liquidation.

120. Key cumulative indicators of the banking system of the Kyrgyz Republic are provided in Table 11. One can see considerable and fast expansion of total assets, liabilities, and own capital of commercial banks in the period 2001 to 2006. Only in 2006, the capital of the banks increased by 48%; assets by 29%; and liabilities by 26%. Still, GDP shares of these indicators are lower than in majority of CIS countries.

121. An analysis of the structure of the banking assets in 2005 to 2006 (Figure 19) shows that, expectedly, their largest item is net credits to nonfinancial corporations and individuals. However, a large part of assets consists of highly liquid assets, which yield little/no income, money on “*nostro*” accounts in foreign banks, excessive reserves on correspondent accounts in NBKR,³² and cash. This means banks generally follow a very conservative policy in terms of their asset allocation. At the end of 2006, liquidity ratio for the banking system was 77.9%, i.e., much higher than NBKR’s normative of 30%. Similarly, capital adequacy ratio (capital-to-risk-weighted assets) was 28.3% compared with normative of 12%. This excessive liquidity is partially a reflection of the banks’ response on maturity mismatch of banking loans and deposits. As of end of 2006, average duration of loans was 20.1 months, while average duration of deposits was just 2.6 months. The low duration of deposits is a result of prevalence of call deposits; share of time deposits in the total amount of deposits (stability ratio) is as low as 22.4%. Still, liquidity reserves of the banking system are very large and sufficient to cover any disintermediation³³ risk. For purposes of this report, it is important that under current conservative credit policy, the banks have significant liquidity reserves. Some just recently received a significant inflow of capital from their domestic/foreign owners. This lowers interest of banks in remittances as a source of capital. So far, their main incentive to work with remittances was to earn income from money transfer services.

Table 11. Banking System Indicators

	2001	2002	2003	2004	2005	2006
Total assets of active commercial banks						
million Soms	4,958	7,836	11,274	17,471	21,709	28,057
% GDP	6.7	10.4	13.4	18.5	21.5	24.8
Total liabilities of active commercial banks						
million Soms	3,427	6,191	9,377	15,107	18,528	23,353
% GDP	4.6	8.2	11.2	16.0	18.4	20.6
Total capital of active commercial banks						
million Soms	1,530	1,645	1,897	2,364	3,182	4,704
% GDP	2.1	2.2	2.3	2.5	3.2	4.2

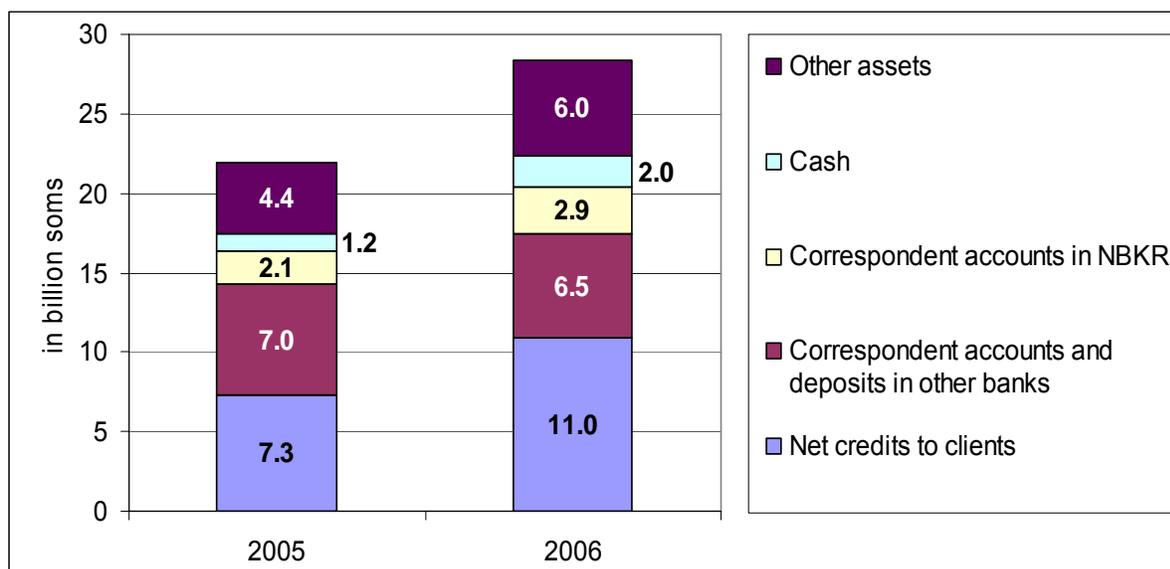
GDP = gross domestic product, NBKR = National Bank of the Kyrgyz Republic, Som = currency unit of the Kyrgyz Republic.

Source: NBKR.

³² In 2002 to 2006, excessive reserves of commercial banks in NBKR were always in the range of 50–60% of mandatory reserves.

³³ This means a massive premature withdrawal of deposits from banks by the population resulting from a panic of any nature.

Figure 19. Banking System Assets in 2005–2006



NBKR = National Bank of the Kyrgyz Republic, Som = currency unit of the Kyrgyz Republic.
Source: NBKR.

122. In 2006, the share of credits in total assets grew significantly, reflecting very fast expansion of banking credit to the economy (see also Table A5), which could be seen as a positive sign of increasing intermediation of the financial system. Another positive sign is some improvement in the quality of credit portfolio; the share of classified credits decreased from 10.7% in 2000 and 8.2% in 2005 to 6.1% in 2006. Further good news on the lending activity of Kyrgyz banks are related to the increase in share of longer-term loans (with maturity of more than 1 year) to 36.4% in mid-2006 compared with 30.4% a year earlier. The last year also marked an end of the long trend of increasing dollarization of deposits and credits. In 2006, the share of deposits (credits) in national currency in total deposits (credits) increased for the first time since 2001, from 27% (29%) in 2005 to 34% (31%) in 2006.

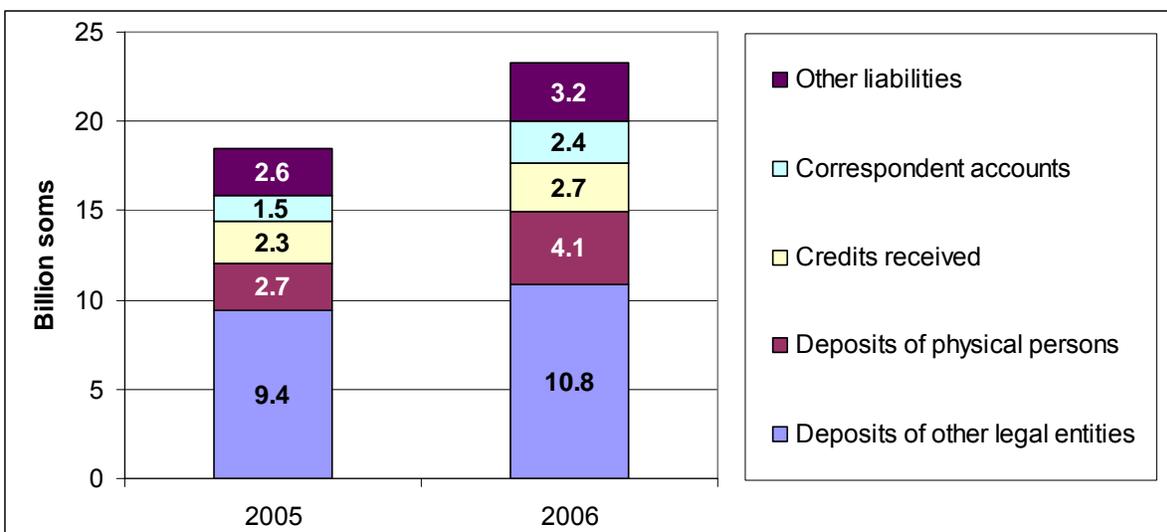
123. The economic sector receiving the largest share of all credit resources is trade. For the last 3 years, this share varies in the range 43–47% of total credits. The second large sector is industry; its share, however, fell from 21.7% at the end of 2003 to 12.7% in mid-2006. Consumer credits to households are the third large segment of the credit market with 7–9% share of all credits. Mortgage credits are the fastest growing sector; its share increased from 3.1% at the end of 2003 to 8.6% in mid-2006. Thus, consumer and mortgage credits to households have become an increasingly important part of financial services. This raises chances and incentives for involvement of recipients of remittances into closer contact with the financial sector.

124. Disinflation, growing supply of credits, and some efficiency improvements in the banking sector led to a considerable reduction in interest rates on credits from almost prohibitive 54.8%/32.3% per annum in national/foreign currency in 1999 to more realistic (while still high) values of 24.6%/16.8% in national/foreign currency in 2004/2005 (Table A5). In 2005 to 2006, interest rates slightly increased, reflecting a growing demand for credit and, perhaps, commercial banks' increased risk perception of political instability in the country.

125. Deposits of legal persons/entities and individuals are main items of commercial banks' liabilities (Figure 20). The share of deposits of individuals increased from 14.5% in 2005 to 17.8% in 2006. The share of call deposits in total deposits of legal persons/entities is very high

and growing; it increased from 83% in 2005 to 90% in 2006 (Table A5). Call deposits of legal persons are the largest item (more than 40%) in the Kyrgyz banks' liabilities and, as it was described above, one explanation for high liquidity indicators of the banking system.

Figure 20. Banking System Liabilities in 2005–2006



NBKR = National Bank of the Kyrgyz Republic, Som = currency unit of the Kyrgyz Republic.
Source: NBKR.

126. Interest rates on time deposits are low compared with the rates on credits (Table A5) and have a declining trend. In 2006, the real weighted interest rate on deposits in national currency was just slightly higher than zero. Nominal rates are somewhat higher (around 10% per annum in national currency) for deposits with maturity above 12 months, but the share of such deposits in total amount is relatively small.

127. Thus, the Kyrgyz financial sector has substantially expanded its intermediation in the recent years. The share of total deposits in GDP increased from a tiny 3.5% in 2001 to 14.9% in 2006. Aggregate credit of banking and NBFIs to nonfinancial corporations and individuals grew from 3.4% GDP in 2001 to 14.6% GDP in 2006 (Table A5). Yet, financial intermediation is still small in the Kyrgyz Republic compared with other countries. For example, according to WDI, in 2005, the share of domestic credit provided by the banking sector (NBFIs are not included) in GDP was 20.7% in the Russian Federation; 21.7% in Georgia; 24.7% in Kazakhstan; 32.3% in Moldova; 35.5% in the region of Europe and Central Asia; and 48.3% in low-income countries. By the number of deposits per 1,000 people (Table A5), the Kyrgyz Republic is far behind such countries as Armenia (111.4 in 2004) or CEE countries with this indicator's values in the range 1,000–2,000.³⁴

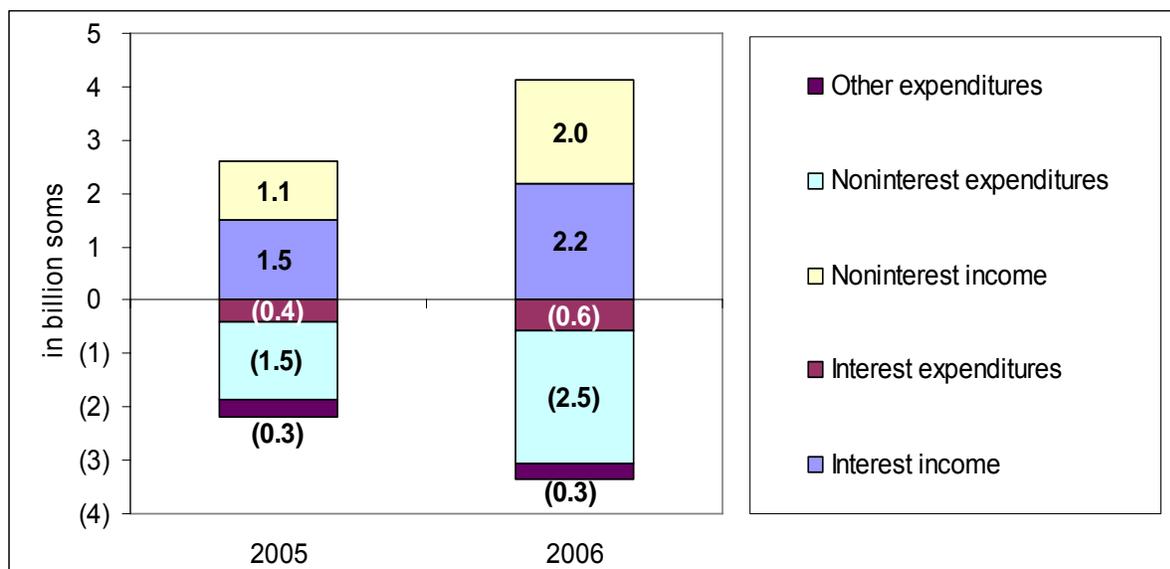
128. To boost confidence in the banking system and foster further financial deepening, NBKR plans to introduce a deposit insurance scheme for small depositors by late 2008.³⁵ Enabling legislation on deposit insurance has already been submitted to parliament and NBKR has drawn up the modalities for commercial banks' participation. It has also estimated the level of protection, total cost, and cost sharing between banks and the government. To enhance debtor information gathering by lenders, NBKR created a Credit Information Bureau in 2000, which was transformed into an independent credit bureau in 2003. To establish effective contract enforcement mechanisms, the Government and NBKR plan to amend the civil, housing, and

³⁴ Source of data is *World Development Indicators* for 2006.

³⁵ This paragraph is based on the 2007 International Monetary Fund report.

land codes as well as the laws governing collateral to harmonize provisions on collateralized lending by financial institutions and facilitate collateral seizure in cases of default.

Figure 21. Income and Expenditures of Commercial Banks



NBKR = National Bank of the Kyrgyz Republic, Som = currency of the Kyrgyz Republic, () = negative value.
Source: NBKR.

129. Expansion of all activities of the Kyrgyz banking sector has led to some improvement of its financial results (Figure 21). In 2006, all relevant indicators such as gross and net interest income, noninterest income, net operation income, net profits, return on assets (ROA), and return on equity (ROE), increased compared with that of 2005. Net profits increased from 430 million soms (\$10.5 million) in 2005 to 791 million soms (\$19.7 million) in 2006, i.e., growth by 84%. This improvement of profitability is partially a result of reduction in profits tax rate from 20% to 10%, which is effective from the beginning of 2006. ROA and ROE increased to 3.3% and 22.4% in 2006 from 2.3% and 17.6% in 2005. Interestingly, that noninterest income of commercial banks approached their gross interest income and exceeded net interest income. This indicates that other financial services, including MTOs, are as important for the banks as intermediation activities (deposits and credits).

130. The banking sector of the Kyrgyz Republic is relatively small. There is no obvious leader in the market. During 2002 to 2006, in different years, nine banks ranked as the first three banks by at least one of four indicators: statutory capital, assets, deposits, and credits. Asiauniversalbank has always been the largest bank in terms of deposits and assets and one of the leaders in terms of statutory capital. In term of credits, the leading position belongs to Ineximbank, which is also in the first three on all other indicators in 2004 to 2006. In 2002 to 2006, the share of the largest bank in any of these four indicators varied in the range 13–29%, and share of three largest banks were in the range 37–54%. As it follows from Table 12, concentration in the banking sector had no clear trend in 2002 to 2005, but it significantly decreased by all indicators in 2006.

Table 12. Herfindahl Index in 2002–2006

	2002	2003	2004	2005	2006
Statutory capital	0.0854	0.0848	0.0823	0.0869	0.0768
Assets	0.0916	0.0901	0.1215	0.1147	0.0909
Deposits	0.1349	0.0913	0.1249	0.1348	0.1089
Credits	0.1202	0.1012	0.1034	0.0986	0.0895

Sources: www.bankir.kg and authors' calculations.

131. Among active commercial banks, two—Aiyi Bank and SSC—are owned by the state. KICB has the Government as a minority shareholder; there are plans of privatization. All remaining banks are private. Fifteen banks have foreign shareholders and in 10 banks, foreign participation exceeds 50%. Large banks from Kazakhstan play a leading role in or have full control over five banks in the Kyrgyz Republic. Ownership structure somewhat influences bank strategies in the Kyrgyz market. One could distinguish between three groups of banks: (i) banks with prevailing domestic ownership; (ii) banks with full/partial ownership of Kazakh banks; and (iii) other banks with full/partial foreign ownership.

132. The latter group is more concentrated on serving transactions with the countries of owners' origin or joint ventures with participation of companies from these countries. With few exemptions, these banks are less active in other segments of the Kyrgyz financial market. Banks affiliated with Kazakh ones are well capitalized³⁶ and aggressive in the Kyrgyz domestic market, including its money transfer segment. Of course, they also serve transactions with Kazakhstan and Kazakh companies operating in the Kyrgyz Republic. Domestically owned banks are more active in the regions of the Kyrgyz Republic and in retail segment of the market. This category of banks is much less capitalized (just two such banks are in the first 10). Perhaps, this is one reason for this group of banks to be the most active in the market of international money transfers—all banks mentioned in paragraph 112 belong to this group of banks—expressed more interest in offering services that are more advanced to senders and recipients of remittances and in retaining their resources on banking accounts. They also explicitly expressed their interest in collaborating with ADB on these issues. Two other groups demonstrated much less interest toward this business. Domestically owned banks make some efforts to transform recipients of remittances into bank customers. They open branches near typical workplaces of their customers (e.g., in open markets), develop new deposit schemes for recipients of remittance (e.g., with no requirement for the minimum sum of deposit), etc. In spite of these efforts, they have not succeeded much and most recipients of remittances use money for consumption only and do not utilize other banking services. It is worth noting that no bank monitors the extent of financial intermediation to recipients of remittances. In addition, even the banks, which are most interested and active in the remittance market, make no effort to hire special staff to transform recipients of remittances into full-scale customers. The banks very often do not know what kind of products could/should be developed, how to sell these products to remittance clients, and how to use remittances for leveraging and capitalizing upon incoming flows.

133. As of end of 2006, NBFIs include (i) Kyrgyz Agricultural Financial Corporation (KAFC)³⁷; (ii) Financial Company for Support and Development of Credit Unions, which provides credits to credit unions; (iii) 12 insurance companies; (iv) 164 microfinance organizations; (v) 308 credit unions; (vi) 145 pawnshops; (vii) 269 exchange offices; (viii) 5 investment funds; (ix) 3 stock

³⁶ In recent years, they received substantial capital injections from their mother banks and all five are in the first 10 of Kyrgyz banks by statutory capital indicator.

³⁷ In December 2006, KAFC received its banking license and has been converted into Aiyi (Rural) Bank. This report covers activities of this organization only in the capacity of NBFIs.

exchanges; (x) 1 private pension fund; and (xi) 79 other financial institutions (e.g., financial brokers, investment consultants, etc.).

134. NBFIs are an important source of credit for the economy. In 2006, NBFIs provided credit to the nonfinancial sector in the amount 4,818 million soms or \$120 million (Table A5), 22.8% more than in 2005; this is more than 40% of banking credit to the economy. Of this amount, KAFC provided 2,069 billion soms (\$51.5 million), i.e., more than any commercial bank. Other lending NBFIs are microfinance organizations (2,055 million soms or \$51.2 million of credits in 2006), credit unions (674 million soms/\$16.8 million), and pawnshops (20 million soms/\$0.5 million). In 2006, 54.2% of all credits of NBFIs went to agriculture and 31.5% went to trade; the share of mortgage loans was 3.2%. It is worth noting in this regard that KAFC has been created and is capitalized by concessional loans of international financial institutions to supply relatively cheap credit to farmers and rural entrepreneurs. This explains also the fact that KAFC interest rates on credits are the lowest in the country (Table A5) and that KAFC credits have longer maturity, usually from 2 to 5 years.

135. Securities market in the Kyrgyz Republic is rather weak. The most significant segment of this market is trade with treasury bills. In 2006, volume of outstanding T-bills was 1,260 million soms (\$31.4 million or 1.1% GDP). T-bills gradually become longer-term financial instrument, short-term (3 and 6 months) bills have been almost completely replaced by 12-, 18-, and 24-month bills. This led also to a change of the previous trend of weighted yield on T-bills. In 2000 to 2005, the yield was falling from 14.2% to 7.1% per annum (reflecting a low interest of the Government to borrowing in the domestic market). However, in 2006, the yield increased to 9.5% with increase in the share of T-bills with 18- and 24-month maturity in the total amount of outstanding bills. Market of corporate shares and bonds is small. In 2006, there were only 2.2 thousand transactions (roughly nine transactions per day) in the Kyrgyz Stock Exchange. Total volume of trade was 3.9 billion soms (\$97 million or 3.5% GDP), of which only 0.84 billion soms (\$21 million) were transactions with securities listed in this stock exchange. Yet, this market has become much more active in 2006 than in previous years.

136. In sum, the Kyrgyz financial market is growing quickly from a very low basis. Largely, this growth is a consequence of macroeconomic stabilization in recent years, considerable strengthening of regulation of the sector, inflow of FDI, and maintained competitive environment. Still, the financial market in the country is shallow and financial intermediation insufficient to meet the country's needs. Banks consider remittances only as a source of noninterest income and make only little effort to provide intermediary services to the senders and/or recipients of remittances. However, with some revival of consumer finance, growing competition in the banking sector and adaptation of households receiving remittances to contacts with the banking sector, chances for more successful financial intermediation seem increasing.

6. Issues and Recommendations

137. It seems, following from the discussion of remittance flows and their impact on development of the economy and the financial sector of the Kyrgyz Republic (in sections 1 to 5 of this report) that in the last 4 to 5 years, this impact has been indeed significant. The remittances contributed to the growth of household consumption and extended contacts of the population with the financial sector in the Kyrgyz Republic as never before. This had numerous spillover effects to different segments of the national economy.

138. The remittance inflow also raised a number of issues, which have to be addressed by the authorities and the business community of the Kyrgyz Republic. These issues include:

- Clarifying the notion of remittances in the Kyrgyz context and refining the methodology of their measurement and tracking;

- Creating an enabling environment for conversion of remittances into investments into the Kyrgyz economy; and
- Increasing and broadening the scope of financial services offered to and used by senders and recipients of remittances.

139. It follows from the discussion in sections 1 and 3 that official data on workers' remittances in fact include also revenues from exports of goods and some other flows of different economic meaning. By this reason, actual remittances related to Kyrgyz migrants' labor abroad are somewhat smaller, while still significant for the country. A new remittance measuring methodology needs to be introduced, which would allow excluding irrelevant flows and accounting for remittances entering through informal channels.

140. The impressive growth of remittance transfer industry and voluntary switching of remitters from informal to formal remittance-sending channels, which took place in just a few years, could be attributed to liberal foreign currency use rules, competitive environment, and improved general regulation in the banking sector. The service providers, because of acute competition in the market, have lowered initially high transaction costs for remittance transmission. It is remarkable that quality of transfer services has not been questioned by any numerous stakeholder (recipients of remittances, bankers, regulators) interviewed in the framework of this study. This means that this market perfectly regulates itself. From this point of view, the plans of introducing new remittance-related legislation as well as the practices of application of existing AML legislation—which seem to be impeding the development of normal banking practices—may require reconsideration to avoid unnecessary distortions in the market.

141. Macro- and microeconomic consequences of the remittances inflow appeared to be generally positive. Apart from increase in household consumption, it caused also the development of services sector in the country, increase in imports and government budget revenues, and some expansion of domestic employment opportunities (mostly in the informal economy). The remittances had so far little influence on investments because of still low-welfare level of majority of households receiving remittances and because of lack of experience of the majority of the population with financial services. However, frequent and free of problems, contacts of significant new layers of the population with the banking system create a basis for the building of the population's confidence in the banking system, which is a key prerequisite for increase in financial intermediation.

142. Commercial banks successfully developed a dense network of MTO outlets. This contributed much to the expansion of this money transfer channel and to the growth in banks' noninterest income. However, they were less successful in providing the senders and recipients of remittances with other financial services. It seems that now it is the moment for the banks to begin an aggressive campaign for involvement of senders and recipients of remittances into much closer contact with the financial sector not limited only to money transfer services. This requires, however, a strategic and flexible approach from the banks and their preparedness to invest into education of their current and potential clients.

143. All the above allow formulating recommendations to the Kyrgyz authorities, donors, and the banking community in the country.

To the Government and the National Bank:

- Introduce new remittance-measuring methodology and coordinate it with other remittance-receiving countries of the region;
- Establish a system of regular periodic data collection, analysis of, and reporting on remittance as well as migration flows in the country;

- Negotiate with the Russian Federation, Kazakhstan, and other remittance-sending countries, measures on improving migrants' status and facilitating remittance flows using bilateral and multilateral (e.g., CAREC) frameworks;
- Provide financial literacy training to remitters and their families as well as introduce such training into the school curriculum;
- Review comprehensively financial legislation to amend and enhance for the introduction of modern remittance technologies such as mobile banking;
- Revise AML legislation and/or practices of its application to avoid distraction of clients from the banking sector;
- Refrain from introducing specific remittance regulations and strengthen general banking regulation instead; and
- Avoid introducing any form of remittance taxation.

To donor organizations:

- Support the adoption of legislation in sending countries (e.g., Kazakhstan), which would enable and/or ease access of Kyrgyz migrants to banking services;
- Provide technical assistance and, possibly, financial resources to Kyrgyz banks for developing financial products (e.g., mobile banking) that are attractive and affordable for senders and recipients of remittances; and
- Provide training programs in financial education for senders and recipients of remittances.

To Kyrgyz commercial banks:

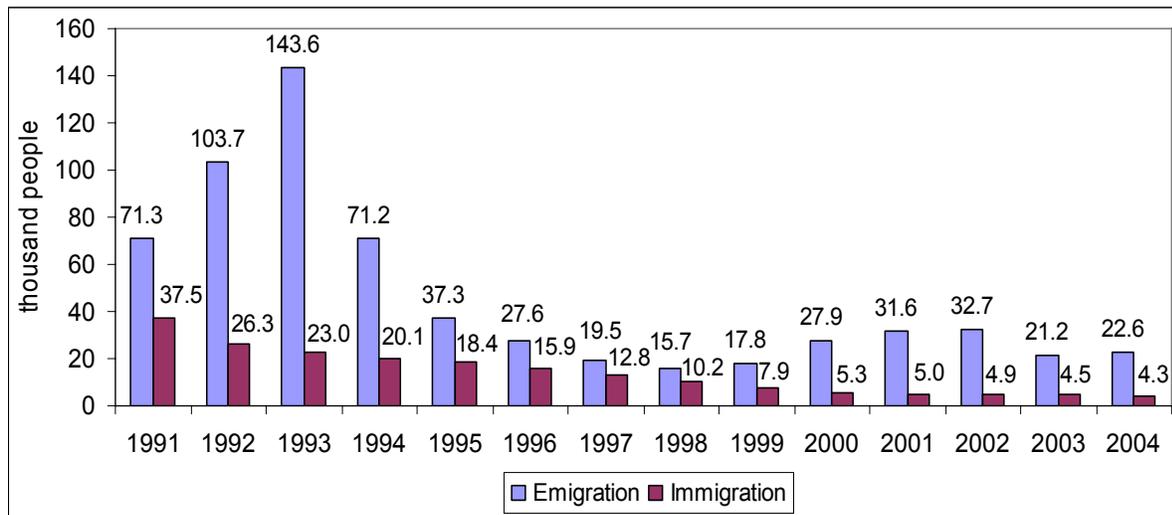
- Develop a long-term strategy of banking recipients of remittances by investing into infrastructure and new technological solutions (e.g., mobile banking), possibly forming consortia for these purposes;
- Lower their fees for clients and make their services more convenient for recipients of remittances on the condition that they use complimentary banking services (e.g., waive cashing fee if the client puts its remittance on time deposit or takes a loan from the bank); and
- Conduct more aggressive and more targeted advertising campaigns explaining long-term benefits of extensive use of financial services, especially for investments, bulky expenditures (rituals or education), and retirement costs.

MIGRATION PATTERNS

1. The tremendous social and economic change related to the breakup of the former Soviet Union (FSU) strongly affected the demographic situation in the Kyrgyz Republic. Fertility and birth rates dropped and the death rate declined following the transition to independence and the market economy, accompanied by sharp political and economic shocks as well as a period of continuous instability, sudden shift to a new environment with significantly greater risks and uncertainties, end of massive subsidies from the central Soviet budget, and the resulting decline in quantity and quality of social services. The natural population growth rate fell from 24.1% in 1987 (the last “quiet” year of the Soviet period) to 15.9% in 2006. Still, the population is growing relatively fast. In 2007, it reached 5.2 million people or 0.7 million more than in 1991, when the country gained independence.

2. The population is predominantly rural (65%) and young (children and adolescents compose 34% of the population while 57% are of working age). The issue of employment, especially rural employment, is therefore very acute. While official unemployment figures are rather low—registered unemployment is just 3% and estimated unemployment according to International Labor Organization definition is 9%—these figures presume that all peasants with a piece of land are employed. Because land and agrarian reform in the 1990s gave land to virtually every peasant, there is no rural unemployment according to official records. In reality, however, since the collapse of the previous mode of agricultural production based on extensive use of resources and permanent inflow of subsidies to large agricultural enterprises, agricultural activities have not been able to feed the growing rural population. A natural response to this situation is the migration of young people from rural to urban areas and, increasingly, abroad in search of employment opportunities. Labor migration has become a major social and economic phenomenon in the Kyrgyz Republic.

3. Migration both from and to the Kyrgyz Republic has been traditionally large since the end of the 19th century. However, in the pre-Soviet and especially in the Soviet period, migration was mainly immigration from Russia and Ukraine and was forced or organized (Cossack settlers in pre-Soviet times, evacuees during World War II, specialists and skilled workers participating in postwar industrialization, and students); and voluntary migration was marginal. The situation changed dramatically after independence. There was a large outflow of people in the early 1990s (Figure A1). All these people emigrated voluntarily for ethnic identity and economic reasons. All these migrations—apart from those of students—were associated with a permanent change of residence.

Figure A1. Emigration from and Immigration to the Kyrgyz Republic

National Statistical Committee of the Kyrgyz Republic.
Source: NSC.

4. Recently, however, there has been a new trend: temporary migration driven by exclusively economic reasons. The temporary migrants are mainly ethnic Kyrgyz, but ethnic minorities are also well represented. This makes the phenomenon different from the permanent migrations, where the migrants were mostly minorities (mainly Russians, Ukrainians, and Germans). The main destinations of the temporary migrants are Kazakhstan and the Russian Federation, but Kyrgyz migrants could be found also in many other countries. Currently, there are no reliable estimates of the number of international labor migrants in the Kyrgyz Republic. In 2003, the National Statistical Committee of the Kyrgyz Republic (NSC) conducted a one-time survey of labor migration, but did not disseminate the survey results. According to the International Organization for Migration, majority of labor migrants work in the Russian Federation (300,000) and in Kazakhstan, 50,000. Journalists even say the total numbers are closer to 500,000–700,000, but these figures seem too subjective and unfounded.

5. The reasons for migration are mostly economic. Living standards, wages, employment, and market opportunities are significantly higher in oil-rich Kazakhstan and the Russian Federation than in the Kyrgyz Republic, Tajikistan, or Uzbekistan. The migrants fill niches in the labor markets of Kazakhstan and the Russian Federation that their citizens do not find as attractive as other employment options. Apart from economic reasons, the migrants choose to go to Kazakhstan and the Russian Federation because they speak Russian—universally spoken by people in their 30s and 40s in the Kyrgyz Republic, but less common among younger people—and/or the Kazakh language, which is not much different from the Kyrgyz language, and because of cultural kinship with the other former Soviet republics.

6. Internal migration is also large. According to NSC estimates, the total number of internal migrants in 1999 to 2005 exceeded 350,000. Most internal migrants (72.8%) come from densely populated rural areas to Bishkek and Chui Valley. Similar to international labor migration, internal migrants are mainly young people.

7. It is worth noting that the Kyrgyz Republic not only supplies labor migrants to other countries but also receives them from other countries, mainly from Tajikistan and Uzbekistan. These immigrants work in agriculture and construction sectors and successfully compete in the domestic labor market of the Kyrgyz Republic with their attractive combination of skill, readiness to work for modest pay (even by standards of the Kyrgyz Republic), and good work ethic. Again,

there are no reliable statistics on these immigrants as they largely work on an informal basis, but there are certainly thousands of immigrant workers during the agricultural season in the Kyrgyz Republic. Chinese traders also become a visible component of foreign labor force in the country.

COMPLEMENTARY TABLES AND GRAPHS

Table A1. Balance of Payments Data on Remittance Flows¹

	2000				2001				2002				2003			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Compensation of employees – net	(2.5)	(2.8)	(2.6)	(2.5)	(2.3)	(2.4)	(2.9)	(2.7)	(3.0)	(2.7)	(2.9)	(3.7)	(3.1)	(3.2)	(3.0)	(3.3)
Credit																
Debit	2.5	2.8	2.6	2.5	2.3	2.4	2.9	2.7	3.0	2.7	2.9	3.7	3.1	3.2	3.0	3.3
Workers' remittances – net	0.3	0.3	0.3	0.4	0.4	0.4	0.6	0.5	4.4	6.4	8.4	9.1	9.0	13.3	20.4	22.3
Credit ²	0.3	0.3	0.3	0.4	0.4	0.4	0.6	0.5	4.7	7.2	8.9	9.6	9.8	15.5	21.5	23.4
Debit ⁴⁶	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.8	0.5	0.5	0.8	2.2	1.1	1.1
Migrants' capital transfers – net	(4.6)	(7.6)	(8.4)	(6.9)	(4.7)	(8.8)	(13.1)	(8.0)	(5.5)	(10.0)	(12.6)	(8.5)	(4.6)	(7.3)	(9.3)	(7.8)
Credit	1.1	1.8	2.0	1.6	0.9	1.7	2.5	1.5	1.3	1.4	1.9	1.8	1.6	1.7	2.1	2.4
Debit	5.7	9.4	10.4	8.5	5.6	10.5	15.6	9.5	6.8	11.4	14.5	10.3	6.2	9.0	11.4	10.2
Total remittances – net	(6.8)	(10.1)	(10.7)	(9.0)	(6.6)	(10.8)	(15.4)	(10.2)	(4.1)	(6.3)	(7.1)	(3.1)	1.3	2.8	8.1	11.2
Credit (gross inflow)	0.3	0.3	0.3	0.4	0.4	0.4	0.6	0.5	6.0	8.6	10.8	11.4	11.4	17.2	23.6	25.8
Debit	7.1	10.4	11.0	9.4	7.0	11.2	16.0	10.7	10.1	14.9	17.9	14.5	10.1	14.4	15.5	14.6

	2004				2005				2006		
	I	II	III	IV	I	II	III	IV	I	II	III
Compensation of employees – net	(2.9)	(2.8)	(3.1)	(4.9)	(4.1)	(4.0)	(4.8)	(4.5)	(5.1)	(4.7)	(4.7)
Credit											
Debit	2.9	2.8	3.1	4.9	4.1	4.0	4.8	4.5	5.1	4.7	4.7
Worker's remittances – net	22.8	30.2	51.6	59.1	38.9	64.7	87.0	89.7	68.5	103.8	128.3
Credit	25.0	32.7	57.0	64.4	44.3	74.5	95.3	99.1	75.6	115.0	140.6
Debit	2.2	2.5	5.4	5.3	5.4	9.8	8.3	9.4	7.1	11.2	12.3
Migrants' capital transfers – net	(7.3)	(10.8)	(12.6)	(13.1)	(8.7)	(16.7)	(20.4)	(17.8)	(11.1)	(16.2)	(21.7)
Credit	1.8	3.6	2.1	2.0	2.0	1.9	2.2	2.6	1.9	2.2	2.1
Debit	9.1	14.4	14.7	15.1	10.7	18.6	22.6	20.4	13.0	18.4	23.8
Total remittances – net	12.6	16.6	35.9	41.1	26.1	44.0	61.8	67.4	52.3	82.9	101.9
Credit (gross inflow)	26.8	36.3	59.1	66.4	46.3	76.4	97.5	101.7	77.5	117.2	142.7
Debit	14.2	19.7	23.2	25.3	20.2	32.4	35.7	34.3	25.2	34.3	40.8

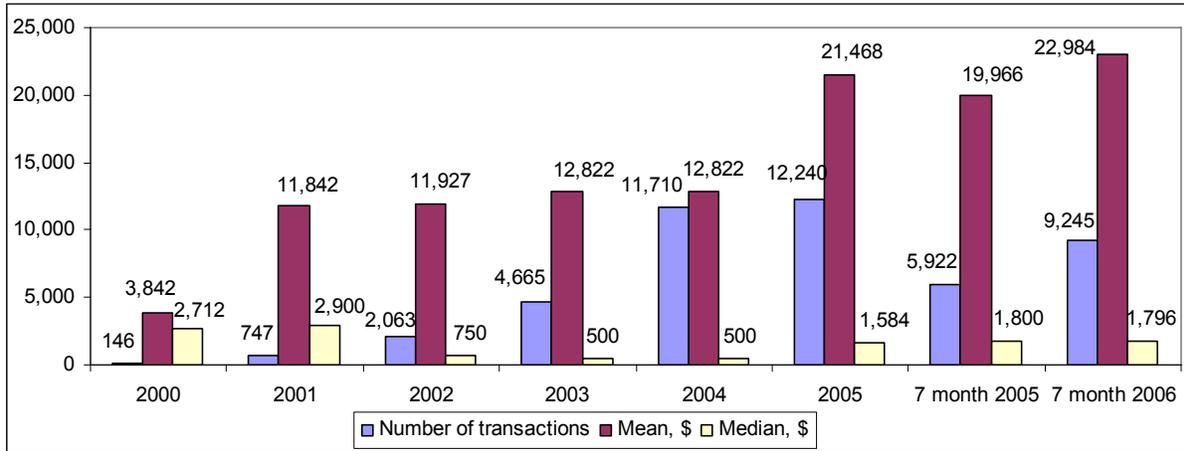
Sources: NBKR and authors' estimates.

¹ No data on workers' remittances, main component of total remittances, have been published before 2000.

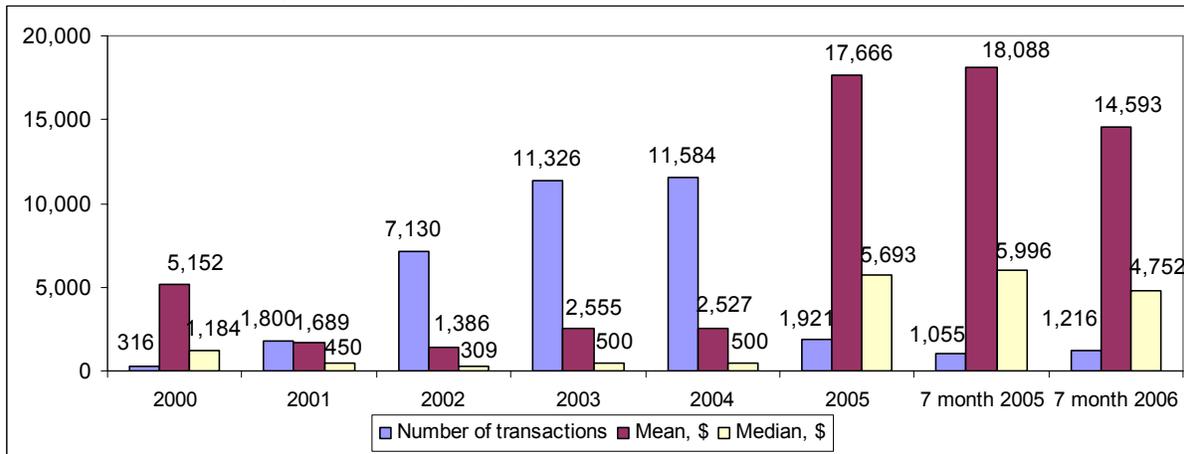
² Data on 2000 to 2001 are estimates; only net workers' remittances values have been published.

Figure A2. Mean and Median Transfer Size by Country and Transfer Mode

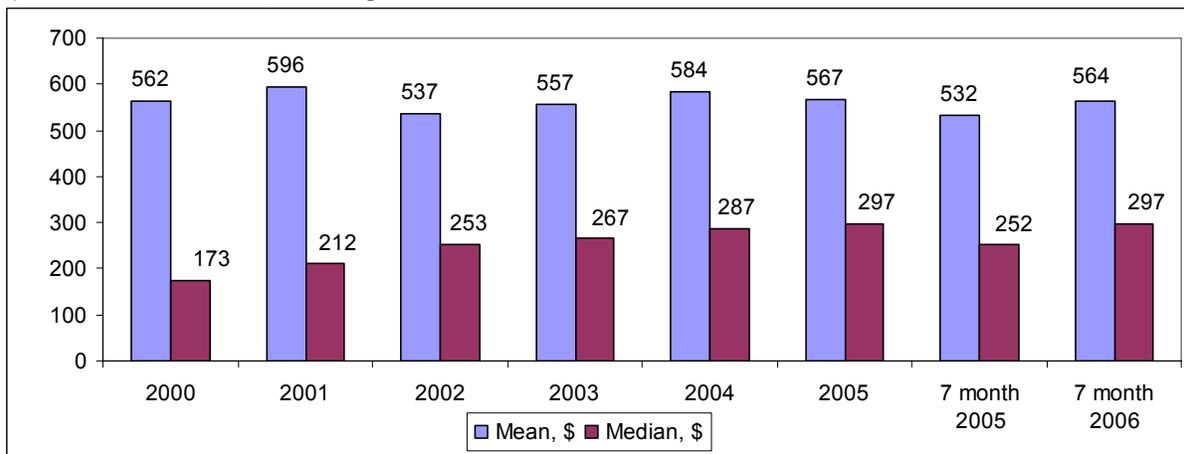
a) Russian Federation, money transfer companies



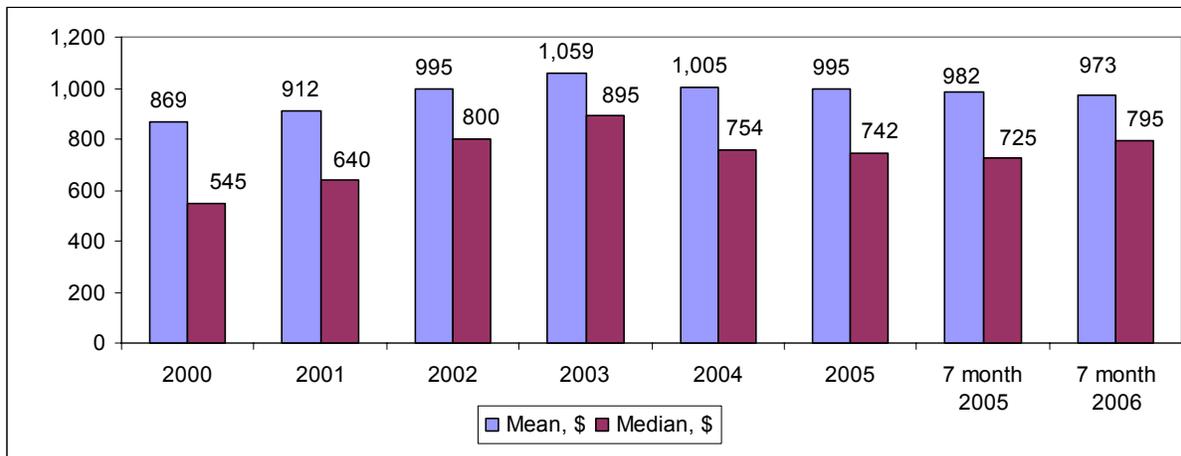
b) United States, money transfer companies



c) Russian Federation, banking accounts



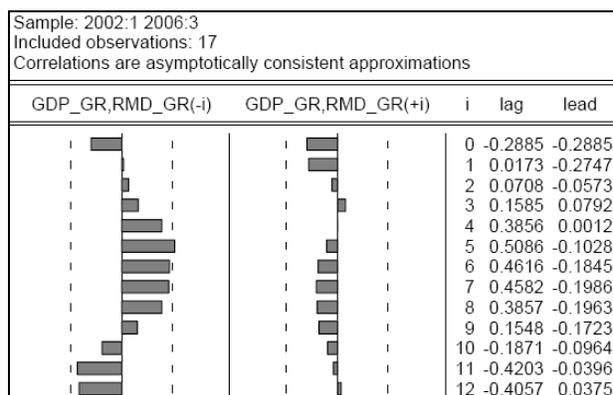
d) United States, banking accounts



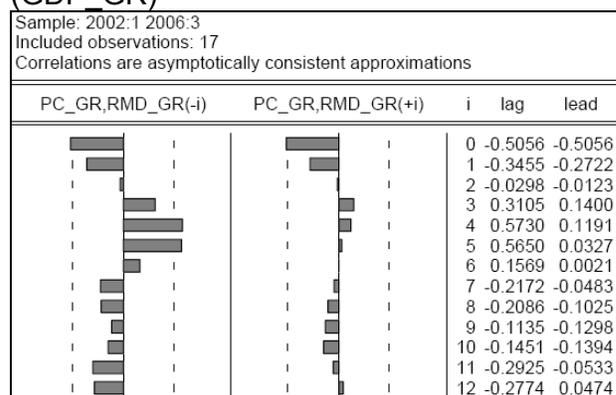
NBKR = National Bank of the Kyrgyz Republic, US = United States, \$ = US dollar.
Sources: NBKR and authors' calculations.

Figure A3. Cross-correlograms of Remittances and Key Macroeconomic Variables

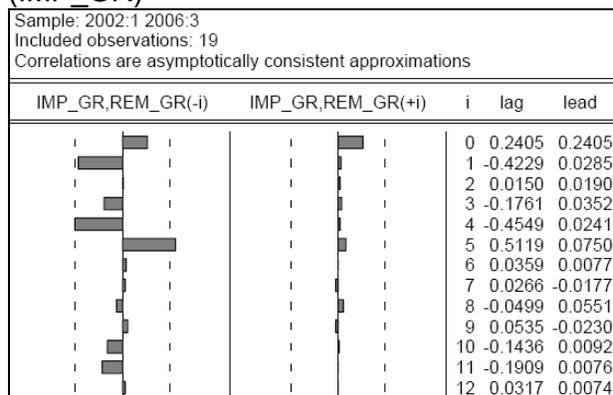
a) Growth Rate of Remittances (RMD_GR) vs. GDP growth rate (GDP_GR)



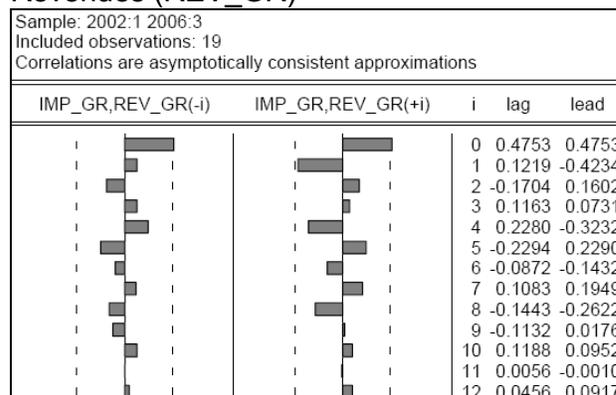
b) Growth Rate of Remittances (RMD_GR) vs. Personal Consumption Growth Rate (GDP_GR)



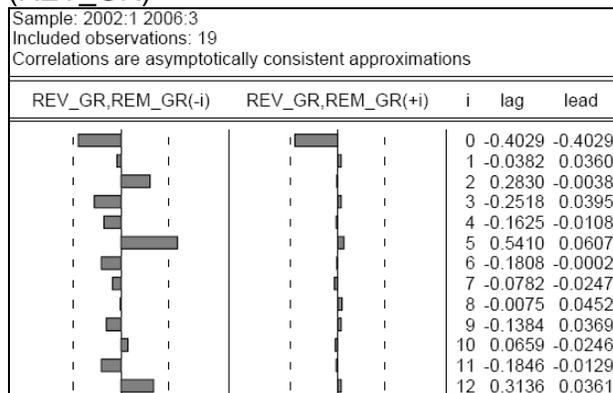
c) Growth Rate of Remittances (REM_GR) vs. Growth Rate of Imports of Goods (IMP_GR)



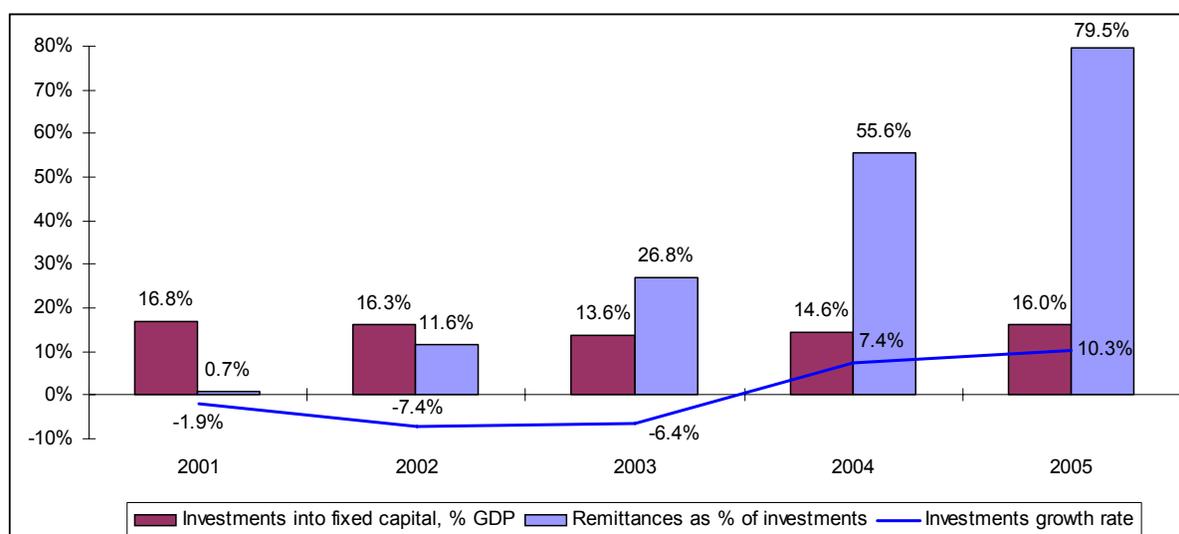
d) Growth Rate of Imports of Goods (IMP_GR) vs. Growth Rate of Government Revenues (REV_GR)



e) Growth Rate of Remittances (REM_GR) vs. Growth Rate of Government Revenues (REV_GR)



NBKR = National Bank of the Kyrgyz Republic, NSC = National Statistical Committee of the Kyrgyz Republic.
Sources: NBKR, NSC, and authors' calculations.

Figure A4. Remittances and Investments into Fixed Capital

GDP = gross domestic product, NBKR = National Bank of the Kyrgyz Republic, NSC = National Statistical Committee of the Kyrgyz Republic, % = percent, () = negative value.

Sources: NBKR and NSC.

Table A2. Sample Composition in the Remittance Recipient Survey

	Bishkek		Osh		All samples	
	Number	%	Number	%	Number	%
Number of respondents	156	100	150	100	306	100
Urban residents	136	88	108	72	246	80
Rural residents	18	12	42	28	60	20
Women – total	90	59	84	56	174	58
Age <21	13	8	3	2	16	5
Age 21–59	70	46	76	51	146	48
Age 60+	7	5	5	3	12	4
Men – total	63	41	65	44	128	42
Age <21	4	3	4	3	8	3
Age 21–59	57	37	57	38	114	38
Age 60+	2	1	4	3	6	2

RRS = remittance recipient survey, % = percent, < = less than.

Source: RRS data.

Table A3. Profile of Migrants

	Kyrgyz Republic	Bishkek	Other Urban Areas	Rural Areas
Migrants				
Number, thousand people	251.5	26.2	52.4	173.0
% of total population	5.0	3.6	6.2	4.9
% of population in able-bodied age	8.1	5.4	10.0	8.3
Female migrants, % of total number of migrants	27.5	40.5	26.8	25.7
Age of migrants, years				
Minimum	15	18	15	15
Median	28	32	31	27.5
Maximum	67	63	66	67
Education of migrants, % of total number of migrants				
Less than completed secondary education	6.4	2.5	10.0	6.0
Completed secondary education	77.1	55.7	72.6	82.0
Above secondary education	16.5	41.8	17.4	11.9
Migration destination country, % of total number of migrants				
Russian Federation	82.5	67.1	81.1	85.2
Kazakhstan	12.0	16.5	10.0	11.9
Other countries	5.5	16.6	8.9	2.9
Duration of stay abroad, years				
Minimum	0.1	0.1	0.1	0.1
Median	1.2	2.0	1.5	1.0
Maximum	24.0	24.0	10.4	11.0
Migrant occupation abroad, % of total number of migrants				
Self-employed	19.5	25.3	18.4	19.0
Entrepreneurial activity (with hired employees)	0.0	0.0	0.0	0.0
Employed in the public sector	5.8	12.7	7.9	4.2
Employed in the private sector	71.6	51.9	70.0	75.0
Unpaid family work (e.g., help in farm, housework)	0.7	0.0	1.1	0.7
Unemployed and looking for work	0.4	3.8	0.0	0.0
Unemployed and not looking for work	0.0	0.0	0.0	0.0
Student	1.4	2.5	2.1	1.0
Retiree with pension	0.2	1.3	0.0	0.2
Others	0.4	2.5	0.5	0.0
Sector, in which migrants are employed/undertake entrepreneurial activity abroad, % of total number of migrants				
Agriculture (including hunting, forestry, and fishing)	1.4	2.5	3.2	0.7
Mining and quarrying industry	0.0	0.0	0.0	0.0
Processing industry	6.6	10.1	8.4	5.5
Power, gas, and water supply	0.7	3.8	0.0	0.5
Construction	45.0	17.7	44.2	49.3
Wholesale and retail trade	30.4	27.9	26.8	31.9
Transport and communications	3.8	8.9	4.7	2.7
Financial sector	0.6	2.5	0.5	0.3
Public administration and defense	0.4	2.5	0.5	0.0
Education, health care, and social protection	0.6	3.8	0.5	0.2
Others	7.8	12.7	7.9	7.0
Migrants, who are seasonal workers, % of total number of migrants	44.1	26.6	43.7	46.8

Source: Household survey data.

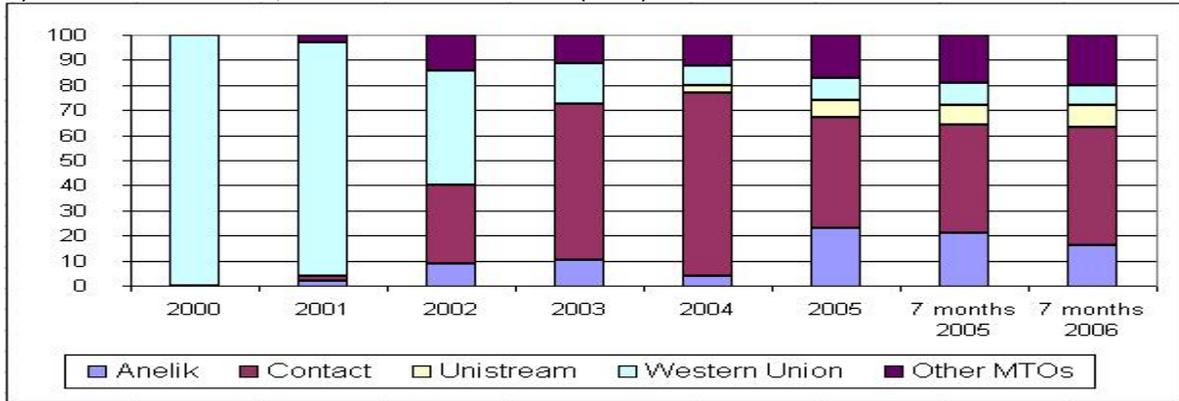
Table A4. Logit Model Describing Probability for Household to Have a Banking Account

Dependent Variable: Y				
Method: ML – Binary Logit				
Included observations: 3,997				
Convergence achieved after 12 iterations				
Covariance matrix computed using second derivatives				
Variable	Coefficient	Standard error	z-statistic	p-value
Urban	0.826	0.444	1.859	0.063
TOT_MON_REM	$2.69 \cdot 10^{(6)}$	$2.01 \cdot 10^{(6)}$	1.336	0.182
Gender	(0.360)	0.479	(0.752)	0.452
Education	1.005	0.461	2.179	0.029
Business	0.672	0.438	1.535	0.125
Income_WR	$1.36 \cdot 10^{(5)}$	$3.73 \cdot 10^{(6)}$	3.655	0.000
Savings	0.719	0.403	1.783	0.075
Constant	(6.796)	0.512	(13.272)	0.000
LR statistic (7 df)	43.32	McFadden R-squared		0.12612
Probability (LR statistic)	$2.89 \cdot 10^{(7)}$			
Variables				
Y	Binary variable equal 1 for households with at least one member having banking account and 0 otherwise			
Urban	Binary variable equal 1 for households living in urban area and 0 for rural households			
TOT_MON_REM	Total cash remittances received by household, soms			
Gender	Binary variable equal 1 for households with female head and 0 otherwise			
Education	Binary variable equal 1 for households, in which household head has higher education, and 0 otherwise			
Business	Binary variable equal 1 for households, which are involved in entrepreneurial activity, and 0 otherwise			
Income_WR	Income without remittances, soms			
Savings	Binary variable equal 1 for households, which reported availability of savings, and 0 otherwise			

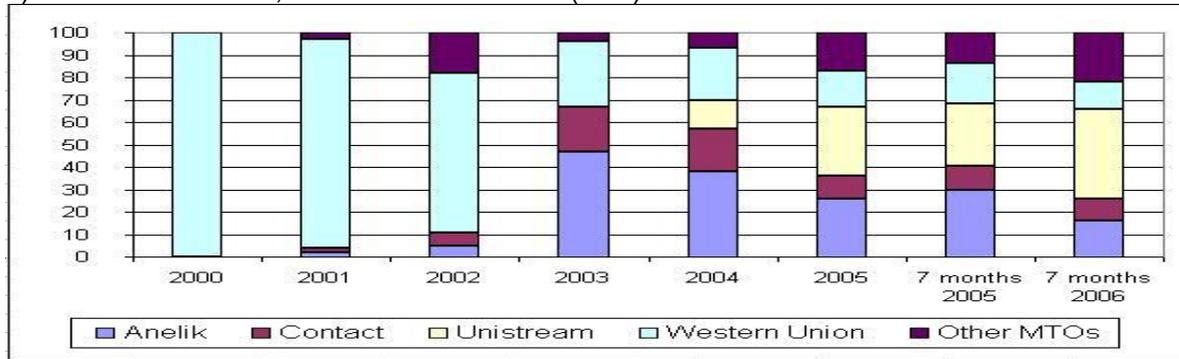
Sources: Household survey data and authors' estimates.

Figure A5. Structure of Transfers from the Russian Federation and the US by MTO

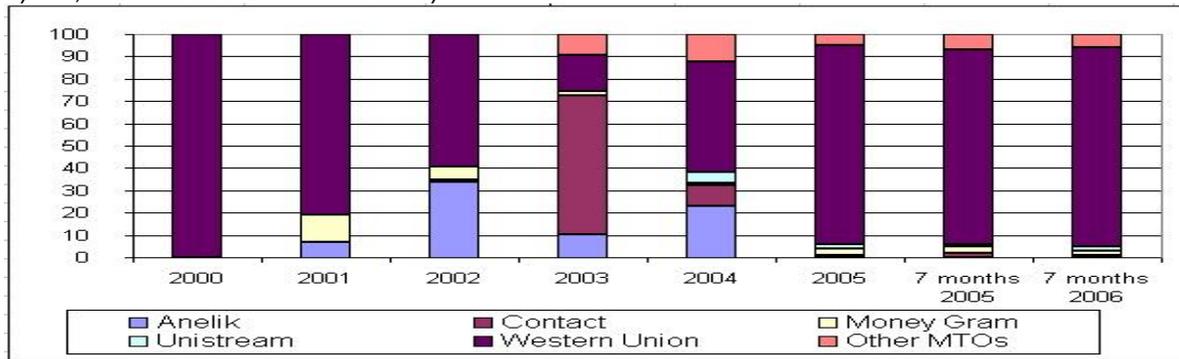
a) Russian Federation, number of transactions (in %)



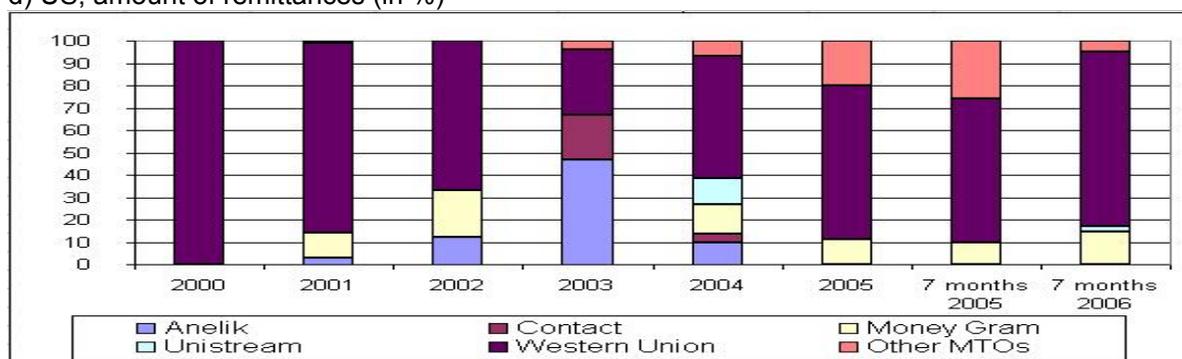
b) Russian Federation, amount of remittances (in %)



c) US, number of transactions in %)



d) US, amount of remittances (in %)



MTO = money transfer operator, NBKR = National Bank of the Kyrgyz Republic, US = United States, % = percent.
Source: NBKR

Table A5. Deposits and Credits

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Deposits of individual/s and other legal entities in national currency (end of period)											
Million soms	483.9	894.5	947.9	1,212.8	1,175.6	1,068.5	1,385.9	1,823.5	2,460.9	3,539.7	5,771.2
% GDP	2.1	2.9	2.8	2.5	1.8	1.4	1.8	2.2	2.6	3.5	5.1
Deposits of individual/s and other legal entities in foreign currency (end of period)											
Million soms	390.7	643.3	1,173.8	1,418.1	1,617.6	1,526.9	2,256.4	3,195.2	5,745.0	9,512.4	11,035.7
% GDP	1.7	2.1	3.4	2.9	2.5	2.1	3.0	3.8	6.1	9.5	9.8
Total deposits											
Million soms	874.7	1,537.8	2,121.7	2,630.8	2,793.2	2,595.351	3,642.3	5,018.7	8,206.0	13,052.1	16,806.9
% GDP	3.7	5.0	6.2	5.4	4.3	3.5	4.8	6.0	8.7	13.0	14.9
Banking credit to nonfinancial corporations and individuals, national currency (end of period)											
Million soms	250.1	453.0	479.5	439.0	457.2	654.2	847.3	1,127.4	1,723.9	2,207.1	3,469.0
% GDP	1.1	1.5	1.4	0.9	0.7	0.9	1.1	1.3	1.8	2.2	3.1
Banking credit to nonfinancial corporations and individuals, foreign currency (end of period)											
Million soms	157.1	470.1	1,235.9	982.7	998.3	863.3	1,164.1	1,767.1	4,081.5	5,505.0	7,881.3
% GDP	0.7	1.5	3.6	2.0	1.5	1.2	1.5	2.1	4.3	5.5	7.0
Total banking credit to nonfinancial corporations and individuals (end of period)											
Million soms	407.2	923.1	1,715.3	1,421.7	1,455.6	1,517.4	2,011.4	2,894.6	5,805.3	7,712.2	11,350.3
% GDP	1.7	3.0	5.0	2.9	2.2	2.1	2.7	3.5	6.2	7.7	10.0
Credits of nonbanking financial institutions to nonfinancial corporations and individuals (end of period)											
Million soms	-	-	-	-	-	874.0	1,256.8	2,010.1	2,772.0	3,922.2	4,817.7
% GDP	-	-	-	-	-	1.3	1.8	2.6	3.2	4.2	4.6
Weighted average interest rate on new time deposits, in %											
National currency	35.0	36.9	37.8	38.4	26.6	16.6	11.5	8.7	8.3	9.4	6.6
Foreign currency	-	-	-	-	7.5	5.8	5.5	3.6	4.3	3.1	5.3
Weighted average interest rate on new banking credits, in %											
National currency	58.3	49.9	42.5	54.8	50.1	36.4	30.2	25.1	24.6	25.4	25.6
Foreign currency	31.2	34.7	26.5	32.3	31.4	25.0	22.6	19.2	18.9	16.8	17.3
K AFC weighted average interest rate in national currency, %	-	-	-	-	-	27.4	21.3	17.3	17.0	15.8	14.2
Bank deposits, per 1,000 people	-	-	-	-	21.5	19.1	24.6	31.3	34.6	44.8	-

GDP = gross domestic product, K AFC = Kyrgyz Agricultural Financial Corporation, NBKR = National Bank of the Kyrgyz Republic, NSC = National Statistical Committee of the Kyrgyz Republic, % = percent, - = unavailable.
Sources: NBKR and NSC.