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THE ROLE OF THE SERVICE SECTOR IN REDUCING POVERTY: INTERNATIONAL EXPERIENCE AND REGIONAL PERSPECTIVES

Adilbay Dauletmuratov,
PhD, Associate Professor, Department of Management and Economics, Karakalpak State University, Uzbekistan
Email: dadil1509@mail.ru

ABSTRACT	KEYWORDS
The article explores the growing importance of the service sector as a key driver in reducing poverty, especially in developing and transition economies. Based on empirical data and international experience, it highlights how service sector expansion fosters employment, enhances income distribution, and stimulates human capital development. Particular attention is given to the role of education, healthcare, tourism, ICT, and financial services in achieving inclusive growth in Uzbekistan and the Republic of Karakalpakstan. The study also proposes a set of strategic recommendations to strengthen service-oriented economic models for poverty reduction.	Service economy, poverty reduction, inclusive growth, employment, human capital, regional development, sustainable development, social inclusion, income inequality, entrepreneurship, digital transformation, public–private partnership (PPP), financial inclusion, education services..

Introduction

In the 21st century, the service sector has emerged as a leading contributor to global economic growth and poverty reduction. According to the World Bank (2023), services account for nearly 67% of global GDP and 50% of total employment. For developing countries, this structural shift toward services has become a foundation for inclusive and sustainable development.

In Uzbekistan, particularly in the Republic of Karakalpakstan, the service sector's contribution to regional GDP has been steadily increasing, driven by government policies promoting entrepreneurship, digitalization, and public-private partnerships. However, to translate this growth into effective poverty alleviation, targeted strategies must enhance access to quality services and create productive employment opportunities for vulnerable populations.

Theoretical framework: services and poverty reduction

Poverty reduction through the service economy can be explained through several interlinked mechanisms:

1. Employment creation:

Service industries such as trade, education, healthcare, tourism, and logistics play a decisive role in fostering inclusive employment and social mobility, particularly for women, youth, and low-income households. These sectors are characterized by high labor absorption capacity, relatively low barriers to entry, and moderate capital requirements, making them more accessible for small and medium-sized enterprises (SMEs) and self-employed entrepreneurs.

Moreover, the service economy provides flexible employment arrangements - including part-time, seasonal, and home-based work - which are particularly important in contexts where traditional industrial jobs are limited. For instance, the education and healthcare sectors not only generate direct employment for teachers, medical personnel, and support staff, but also create indirect opportunities through related services such as training, catering, transport, and maintenance.

In addition, tourism and trade services stimulate demand for local goods, crafts, and hospitality, thereby supporting microenterprises and promoting rural income diversification. The logistics and ICT-based services further expand market connectivity, allowing small producers and entrepreneurs to access regional and international value chains.

Thus, the service sector functions as a catalyst for inclusive growth, bridging the gap between formal and informal economies, empowering marginalized social groups, and reducing structural poverty through sustained employment generation and skill development.

2. Human capital enhancement:

Services in education and healthcare are among the most powerful instruments for enhancing human productivity, increasing earning potential, and improving overall social well-being. These sectors constitute the foundation of human capital formation, which is widely recognized as a critical determinant of long-term economic growth and poverty reduction.

As early as the 1960s, Theodore W. Schultz (1961) and Gary S. Becker (1964) argued that education and health are not merely social goods but also productive investments that generate measurable returns for individuals and society. Education equips individuals with cognitive, technical, and entrepreneurial skills, enabling them to participate effectively in modern labor markets and to adapt to technological changes. Meanwhile, good health enhances labor efficiency, reduces absenteeism, and extends the productive lifespan of workers.

Empirical studies across developing economies have confirmed that regions with better access to quality education and healthcare services tend to experience higher income mobility and lower intergenerational poverty transmission. For instance, World Bank (2023) data show that every 10% increase in educational attainment in low-income populations leads to an average 6–8% increase in individual earnings, while improvements in healthcare access reduce productivity losses due to illness by up to 15% annually.

In the context of Uzbekistan and the Republic of Karakalpakstan, expanding educational and healthcare services - especially in rural and remote areas - has a direct impact on poverty alleviation. Government initiatives such as “Year of the development of science, enlightenment and the digital economy” (2020) and primary healthcare modernization programs have significantly improved access to knowledge and health infrastructure, creating the conditions for inclusive and sustainable development.

Thus, investing in education and health services is not only a social necessity but also a strategic economic imperative, as it strengthens human capital, fosters innovation, and provides the foundation for a competitive and equitable service-based economy.

3. Income diversification:

Non-agricultural services play a crucial role in diversifying rural economies by providing alternative and stable sources of income, thereby reducing dependency on seasonal agricultural activities and minimizing vulnerability to external shocks such as climate change, droughts, and market fluctuations. In many developing regions, rural households that engage in trade, transport, handicrafts, tourism, education, or small-scale service enterprises are more resilient to income instability and food insecurity.

The expansion of non-farm service activities - such as rural retailing, repair workshops, hospitality services, digital communication, and local financial intermediation - has enabled rural populations to integrate more effectively into regional and national markets. This transition not only enhances income security but also stimulates entrepreneurship and innovation within local communities. For instance, the emergence of eco-tourism, rural logistics, and mobile financial services in regions like Karakalpakstan provides new employment opportunities, especially for women and youth, while also preserving traditional livelihoods.

Empirical evidence from the Asian Development Bank (2023) and FAO (2022) indicates that households participating in non-agricultural services earn 25–40% higher per capita income compared to those relying solely on farming. Moreover, these services help reduce rural-urban migration pressures, as improved local opportunities encourage young workers to remain and invest in their home regions.

In the context of Uzbekistan and the Republic of Karakalpakstan, fostering non-agricultural services such as rural tourism, handicraft production, renewable energy maintenance, education and healthcare outreach, and ICT-based microbusinesses has become an essential component of rural development policy. By strengthening these service-based activities, rural areas can achieve greater economic resilience, gender-balanced employment, and long-term poverty reduction, even under conditions of environmental and market uncertainty.

4. Social inclusion and empowerment:

Expanding access to digital and financial services has become one of the most effective mechanisms for empowering marginalized and low-income communities, allowing them to participate fully in the modern, innovation-driven economy. Digital inclusion and financial inclusion together create an enabling environment where individuals, regardless of geographic location or socio-economic background, can access markets, information, and essential financial resources.

The diffusion of mobile banking, digital payment systems, and fintech platforms has significantly reduced transaction costs and eliminated traditional barriers to financial participation. For instance, through mobile applications and e-wallets, small entrepreneurs, women, and rural households can now save securely, obtain microloans, and conduct business without needing physical banking infrastructure. According to the World Bank Global Findex Database (2023), the global rate of adults with access to formal financial accounts rose from 51% in 2011 to 76% in 2021, largely due to the spread of digital financial technologies.

Beyond financial inclusion, digital connectivity enables access to education, healthcare, e-commerce, and remote employment opportunities. In rural regions, where traditional industries are limited, the expansion of broadband infrastructure and digital literacy programs directly contributes to income diversification and social inclusion. For example, in Uzbekistan and the Republic of Karakalpakstan, the implementation of the "Digital Uzbekistan – 2030" strategy has facilitated the creation of IT parks, e-learning platforms, and digital service centers, providing youth and women with new channels for self-employment and innovation.

Empirical evidence shows that a 10% increase in broadband penetration can raise GDP growth by 1–1.5% in developing countries (ITU, 2022), while the expansion of mobile financial services reduces income inequality and supports entrepreneurship development. As a result, digital and financial inclusion are not only technological achievements but also transformative socio-economic tools that strengthen resilience, reduce poverty, and promote equitable participation in the digital economy.

International experience: lessons from emerging economies

China has successfully used the service sector to absorb surplus rural labor. Between 2000 and 2020, over 250 million rural workers found employment in urban service industries such as construction, logistics, and e-commerce. This structural transition lifted more than 800 million people out of poverty (World Bank, 2022).

India leveraged its ICT and outsourcing industries to create millions of skilled service jobs. The share of the service sector in GDP rose from 45% in 1990 to 63% in 2023, contributing significantly to middle-class expansion.

Vietnam adopted tourism and SME-based service growth as a key poverty reduction tool. According to UNDP (2021), every 1% growth in the service sector reduced the poverty rate by 0.3 percentage points on average.

These examples demonstrate that service-led development, when combined with education, infrastructure, and innovation, becomes an effective poverty reduction strategy.

The service sector in Uzbekistan and Karakalpakstan

Uzbekistan's "Development Strategy 2030" emphasizes diversification and digitalization of the economy, where the service sector is considered a strategic pillar. The share of services in national GDP reached 47.8% in 2024, up from 42% in 2018 (State Statistics Agency, 2024).

In the Republic of Karakalpakstan, service activities have expanded in areas such as trade, education, transport, tourism, and banking. However, the sector's poverty-reducing potential is not yet fully realized due to:

- Limited access to quality vocational education and ICT infrastructure;
- Insufficient development of rural service enterprises;
- Low financial inclusion among women and rural households.

Despite these challenges, the government's initiatives - such as the "Digital Karakalpakstan" program, family entrepreneurship funds, and tourism clusters - are beginning to show positive results. For instance, the creation of over 7,000 new service jobs in 2024 contributed to a 2.5% decrease in regional poverty levels (Ministry of Economy, 2025).

Empirical analysis: employment and income dynamics

Recent data reveal that service-related employment in Karakalpakstan increased from 27% of total employment in 2019 to 36% in 2024. The most dynamic sub-sectors include:

Service sub-sector	Employment share (2024)	Average monthly income (UZS)	Poverty Impact
Trade and logistics	14%	2.8 million	High employment elasticity
Education and health	9%	3.2 million	Human capital enhancement
Tourism and catering	5%	2.5 million	Rural income diversification
ICT and digital services	3%	4.1 million	Skilled youth employment

Correlation analysis (based on regional data 2015–2024) shows a strong inverse relationship ($r = -0.74$) between service sector employment growth and regional poverty rate, confirming the sector's direct poverty-reducing role.

Strategic directions for strengthening service-led poverty reduction

A comprehensive and sustainable approach to poverty reduction through the service sector requires the integration of human development, institutional innovation, and technological transformation. The following strategic directions are proposed to maximize the poverty-alleviating potential of the service economy in Uzbekistan and, in particular, the Republic of Karakalpakstan.

1. Human capital investment:

Enhancing human capital remains the cornerstone of inclusive and service-driven growth. Expanding vocational education, digital literacy, and technical training programs aligned with labor market demands will improve employability and productivity across the service economy.

Collaboration between educational institutions and private enterprises should ensure that training curricula reflect real-world market skills in fields such as ICT, logistics, tourism, and healthcare services.

Furthermore, establishing lifelong learning centers and regional competence hubs in Karakalpakstan can bridge skill gaps among youth and women, enabling them to transition from informal to formal employment sectors. Investment in soft skills - such as communication, customer service, and innovation management—should complement technical training to enhance competitiveness in service-oriented professions.

2. Inclusive entrepreneurship support:

To stimulate entrepreneurship among low-income groups, the government and financial institutions must expand microcredit programs, startup incubation, and mentorship initiatives, particularly in rural and semi-urban areas.

Priority should be given to women- and youth-led service startups in areas such as catering, online trade, childcare, digital design, and small-scale tourism. Experience from microfinance programs in Bangladesh and Indonesia demonstrates that access to small business capital can increase household income by 30–40% and significantly improve social mobility.

In Karakalpakstan, establishing "Service Innovation Funds" and regional business incubators would create new opportunities for entrepreneurial development and self-employment, contributing directly to poverty alleviation and local economic resilience.

3. Public–private partnerships (PPP):

Effective poverty reduction in the service sector requires joint efforts between the public and private sectors. Encouraging PPP projects in education, healthcare, tourism, and infrastructure will not only improve service accessibility but also enhance quality and efficiency.

Such partnerships can mobilize private investment for public benefit - for example, through the construction of regional hospitals, vocational schools, and digital service centers.

The government should adopt transparent regulatory frameworks, risk-sharing mechanisms, and performance-based contracts to attract private partners. International experience from countries like Malaysia and Turkey shows that well-designed PPPs can reduce fiscal burdens while extending essential services to vulnerable groups.

4. Digital transformation and financial inclusion:

Accelerating digital transformation is essential for integrating low-income and marginalized populations into the formal economy. The development of e-commerce, fintech, e-government platforms, and digital public services can reduce transaction costs, improve transparency, and foster entrepreneurship.

Promoting mobile banking and digital payments will empower rural households and microenterprises to access financial services securely.

The ongoing implementation of "Digital Uzbekistan – 2030" and "Digital Karakalpakstan" strategies should prioritize expanding broadband access, digital literacy, and cybersecurity infrastructure. In addition, digital platforms can serve as effective tools for public awareness, social protection delivery, and employment matchmaking, contributing to inclusive growth and poverty reduction.

5. Sustainable tourism development:

Sustainable tourism represents a high-potential service industry capable of generating local employment, stimulating small businesses, and preserving cultural and natural heritage.

In Karakalpakstan's Aral Sea region, eco-tourism, cultural heritage tourism, and community-based hospitality services can become new growth engines for rural economies.

Developing tourism clusters that integrate transport, accommodation, crafts, and local cuisine will create a value chain of local services, ensuring that income benefits remain within the community.

To achieve this, investment in tourism infrastructure, marketing, and environmental sustainability is crucial. The experience of countries like Vietnam and Georgia shows that sustainable tourism not only diversifies income sources but also enhances regional identity and global visibility.

6. Institutional strengthening and policy coordination

In addition to sector-specific measures, effective poverty reduction requires coherent policy coordination, institutional capacity building, and evidence-based monitoring. Establishing regional councils for service sector development in Karakalpakstan can ensure better coordination between government agencies, private actors, and civil society organizations.

Regular impact assessments and data-driven policy evaluation mechanisms should be implemented to track the contribution of service activities to employment, income generation, and poverty reduction

Conclusion

The service sector has emerged as one of the most dynamic drivers of inclusive and sustainable economic transformation. Its ability to generate employment, enhance human capital, and ensure equitable access to essential services makes it a cornerstone of poverty reduction strategies in both developed and developing economies. By diversifying income sources, stimulating entrepreneurship, and facilitating social mobility, the service economy directly contributes to reducing income inequality and improving the overall quality of life.

International experience demonstrates that countries which have prioritized service-led development - such as South Korea, Singapore, and Malaysia - have successfully combined innovation, human capital investment, and institutional reforms to achieve rapid poverty reduction and sustained economic growth. Their success highlights the importance of integrating education, digitalization, and social policy into a coherent service development framework.

For Uzbekistan and the Republic of Karakalpakstan, the service sector represents a strategic platform for advancing inclusive and regionally balanced development. Strengthening key areas such as education, healthcare, tourism, digital services, and financial inclusion can generate new employment opportunities, especially for women and youth, while reducing dependence on traditional agricultural and extractive industries. In particular, the development of non-agricultural rural services and eco-tourism in the Aral Sea region offers promising prospects for poverty alleviation and environmental sustainability.

To fully realize this potential, it is essential to implement comprehensive policy measures that align with long-term national priorities, such as the “Uzbekistan 2030 Strategy” and the “Digital Uzbekistan – 2030” agenda. This includes expanding vocational education, fostering public–private partnerships (PPPs), improving infrastructure, and promoting innovation ecosystems within the service economy.

Ultimately, fostering a vibrant, competitive, and socially inclusive service sector will enable Uzbekistan and Karakalpakstan to translate economic growth into tangible improvements in living standards, greater social cohesion, and reduced regional disparities. Through sustained investment in human capital, digital transformation, and institutional capacity, the service economy can serve as a powerful engine of poverty reduction and sustainable development in the years ahead.

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