Improving Resource Governance in the Kyrgyz Republic: 12 Priority Issues for the Mining Sector

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Natural Resource Governance Institute

Contents

About this publication

All too often those who analyze the contribution that a country's mining sector makes to its economy do not look further than the mining industry itself. To avoid that mistake, this document analyzes the management of the Kyrgyz Republic's extractive industries with consideration of linkages to broader macroeconomic issues including revenue management, public spending and private sector development, and broader governance issues including government strategy and transparency and accountability. This document aims to catalyze a discussion about a more holistic approach to resource governance.

This discussion paper was prepared using the Natural Resource Charter and the Natural Resource Charter Benchmarking Framework, a robust framework for unified natural resource governance that outlines policy options and practical advice based on global best practices in management of natural resources.[1] The charter is structured around 12 good practice principles ("precepts") that cover the sequence of decisions that governments must make to turn subsoil resources into development. (See figure 1.) Each precept covers a broad area of decision-making, from the foundations of good governance, to the decision to extract, to getting a good deal, to managing revenues and ending with investing for development. In each of these 12 sections, this document presents a brief contextual overview of existing resource management policies and processes followed by a priority issue, which identifies further work needed to address key policy challenges. (See table 1 for policy priority issues.)

The paper was written using publicly available information, and supplemented by interviews with key government decision-makers where possible. Primary research and consultations were carried out by local experts. The discussion paper was produced by an NRGI consultant in the Kyrgyz Republic, while NRGI staff provided the review and comments. It was then reviewed by government officials.

While utmost care has been taken to ensure that the contents accurately describe general circumstances in the Kyrgyz Republic, gaps in publicly available research and information across the shear breadth of issues dealt with by the report mean that some important issues may be missing or addressed only summarily. Readers are encouraged to scrutinize the findings and build upon them. This document and the framework upon which it is based could become the basis for ongoing discussions about reform on natural resource governance in the Kyrgyz Republic.

NRGI staff have used the findings of this paper to identify their key activity in the Kyrgyz Republic for 2017: a robust evaluation of the mining tax regime. Others working in the field can also use this analysis to shape their activities. The results of public discussions about further reform of mining sector governance will shape NRGI's work in the country beyond 2017.

1 NRGI. *Natural Resource Charter*, 2nd edition. 2014. http://resourcegovernance.org/analysis-tools/publications/natural-resource-charter-2nd-ed; NRGI Natural Resource Charter Benchmarking Framework, 2016. http://www.resourcegovernance.org/resourcebenchmarking

Figure 1. Overview of the natural resource charter good practice principles

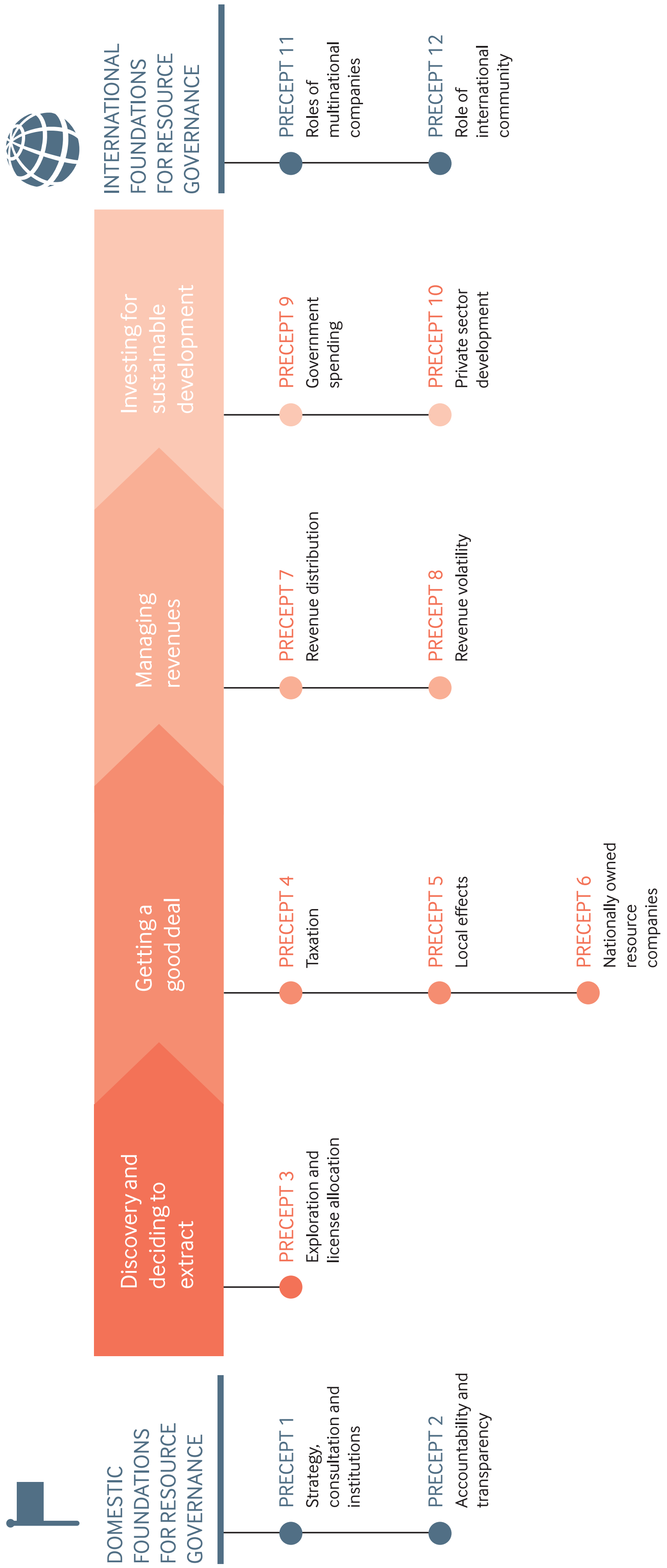

Table 1. Priority issues for parliament, government, international community and companies to consider

	Issue	Recommendation
Issues for the government and parliament		
Precept 1	Inclusive and comprehensive national strategy, clear legal framework and competent institutions	In-depth analysis will allow improving coordination for adoption of coherent decisions on mining policy formulation.
Precept 2	Accountability of decision makers to an informed public	Disclosure of key project level data will improve public understanding of the benefits of mining and will help ensure that government and companies are held to account.
Precept 3	Efficient exploration and production operations, and transparent allocation of rights	In-depth analysis will allow identification of strategies that ensure high-quality investors are attracted to the Kyrgyz Republic.
Precept 4	A tax regime that realises the full value of resources consistent with attracting necessary investment	Robust quantitative evaluation of the mining tax regime will better inform tax policy—attracting new investment while generating maximum revenues for the government.
Precept 5	Pursuing opportunities for local benefits, while mitigating and offsetting the environmental and social costs of resource extraction projects	Active participation of local communities in decision making will help in building trust among stakeholders, attract investors who wish to uphold global standards, mitigate environmental, social risks and secure local benefits.
Precept 6	Accountable nationally owned companies with well-defined mandates	Disclosure of a comprehensive set of information will help build SOEs that are beneficial to the governance of natural resources and the wider economy.
Precept 7	Investing revenues to achieve optimal and equitable outcomes, for current and future generations	Robust long-term revenue forecasts will inform government policy decision, including on savings and spending choices.
Precept 8	Smoothing domestic spending of revenues to account for revenue volatility	Introduction of "expenditure-smoothing rule" will ensure stable level of government spending independent of government revenues.
Precept 9	Using revenues as an opportunity to increase the efficiency of public spending at the national and sub-national levels	The evaluation of the current revenue sharing with regional authorities will ensure fair revenue allocation as well as efficient spending.
Precept 10	Facilitating private sector investments to diversify the economy and to engage in the extractive industry	Robust assessment will help identifying whether benefits domestic value addition will outpace environmental risks.
Issues for other stakeholders		
Precept 11	Commitment of extractive companies to the highest environmental, social and human rights standards, and to sustainable development	Companies' proactive engagement with local communities will ensure they have realistic understanding on how they will be affected by upcoming projects.
Precept 12	Promotion of governments and international organizations of an upward harmonization of standards to support sustainable development	The international community's further support will help in improving of the mining sector governance.

Introduction

BACKGROUND

Natural resources form a substantial part of the economy of the Kyrgyz Republic, with gold extraction the biggest contributor. According to the latest Extractive Industries Transparency Initiative (EITI) report, which covers 2013-2014, the mining sector contributed around 8 percent of GDP, over 50 percent of industrial production, 40 percent of total exports, 17 percent of tax revenues and 8 percent of total government revenues.

The most significant single project is overseen by the Kumtor Gold Company, a subsidiary of Canada's Centerra Gold Inc. The Kumtor mine has provided a steady stream of revenue to the Kyrgyz Republic for the past 20 years, but the company projects that open-pit operations will only last another ten years.[2] It is not clear whether new medium/large-scale mines that should become operational between before 2019 (see table 1 for a list of the biggest mines) and around 30 small/medium-scale mines to be opened after 2019 will be able to replace Kumtor production after 2026. This is important to consider given the Kyrgyz Republic's chronic budget deficit and high dependency on remittances and foreign aid.

Nor is it clear whether the revenues so far earned from mining have been used to develop the economy outside of the sector. This is relevant to the government's ambition to seize several opportunities: its entry into the Eurasian Economic Union; China's "One Road, One Belt" policy that seeks to redevelop trade routes across Central Asia[3]; the GSP+ status (Generalized Scheme of Preferences) granted by the European Union to the Kyrgyz Republic in 2016[4]; and tourism development—according to the World Travel and Tourism Council, among all countries in the world, travel and tourism will grow fastest in the Kyrgyz Republic at 8.2 percent of GDP from 2016 to 2026.[5]

Since 2012, the government of the Kyrgyz Republic has undertaken significant reforms in mineral resource governance, mainly with regard to licensing, the fiscal regime and revenue sharing to capture greater benefits for the country and mining-affected communities. Officials have also worked to increase transparency. Considering the growing role that the mining sector plays in the economy, authorities should carefully consider further policy development based on a holistic approach, which addresses both real opportunities for growth and development and a series of economic and political challenges that natural resource extraction presents.

2 Centerra Gold Inc. *Technical Report on the Kumtor Mine, Kyrgyz Republic*. 20 March 2015. 1-18. http://www.kumtor.kg/wp-content/uploads/2015/04/centerra_kumtor_technical_report_final_march_20_2015.pdf

3 Jack Farchy. "China Seeking to Revive the Silk Road." *Financial Times*. 13 May 2016. https://www.ft.com/content/e99ff7a8-0bd8-11e6-9456-444ab5211a2f

4 European Union. "European Union Grants GSP+ Status to the Kyrgyz Republic." 2 February 2016. https://eeas.europa.eu/delegations/kyrgyz-republic/13073/european-union-grants-gsp-status-kyrgyz-republic_en

5 The World Travel and Tourism Council. "Kyrgyzstan." *Travel and Tourism Economic Impact 2016*. 11. https://www.wttc.org/-/media/files/reports/economic-impact-research/countries-2016/kyrgyzstan2016.pdf

Table 2. Biggest mining companies in the Kyrgyz Republic (gold)[6]

	Company	Headquarter company/ companies	Headquarter location(s)	Start of operation
1	Kumtor Gold Company CJSV	Centerra Gold Inc.	Canada	1997
2	Bozymchak LLC	KAZ Minerals	Kazakhstan	2015
3	Altynken Ltd.	Superb Pacific Limited Kyrgyzaltyn OJSV	China Kyrgyz Republic	2015
4	Full Gold Mining LLC	Linbao Gold Ltd. Investment Company "Linsi" LLC China Road and Bridge Corporation	China	2016
5	Kaidi LLC	Individuals	China Kyrgyz republic	2016
6	CJSC Kichi-Chaarat	Tun-Lin	China	2017
7	Alians Altyn LLC	Vostok-Geoldobycha OSJC	Russian Federation	2018
8	Eti Bakir Tereksay" LLC	OJSC "Kyrgyzaltyn"(25%) "EtiBakir" A.S. (Turkey)	Turkey	2019
9	Chaarat Zaav CJSC	Chaarat Gold Holding Limited	British Virgin Islands	2019

6 Based on publicly available information.

Precept 1. Context, vision and coordination

Priority issue for the Kygyz Republic	In-depth analysis is needed to formulate coherent mining policy

Rules. In the Kyrgyz Republic the mining sector is governed by a variety of rules enshrined in policy documents and legal acts. The National Strategy for Sustainable Development (NSSD) of the Kyrgyz Republic for 2013-2017 provides a general vision for the Kyrgyz Republic's long-term economic, political and social development. The document includes mining in a list of five industries whose development (given the deficit of public financial resources), is assigned by the government to the private sector. At the same time the NSSD emphasizes that the government has to establish well-defined, simple and transparent legislative rules to create a favorable investment climate. In addition, in 2014, a consortium of local experts prepared the draft Strategy of the Mining Industry Development for 2015-2035, along with a detailed implementation plan. However, this document is not being used to reform the mining sector. A range of regulatory legal acts also address mineral resources governance, including Subsoil Law (2012) and corresponding regulations, Environment Law (1999), Environmental Review Law (1999), the Tax Code (2008) and the Land code (1999). General regulations on public finance, mainly the Budget Code (2016), deal with revenue management and government spending.

Institutions. A number of institutions are involved in the mining sector's management and regulation. The State Committee of Industry, Energy and Subsoil Use (SCIESU) is responsible for developing and implementing industrial and subsoil use policy. The Ministry of Economy develops general tax, investment and economic development policies. The Ministry of Finance is responsible for policy on non-tax payments and public finance. The State Agency of Environmental Protection and Forestry (SAEPF), in the absence of the Ministry of Environment, is responsible both for policy development and environmental protection. Local public administrations and local government bodies also play important roles, being responsible, among other things, for land allotment. The State Inspectorate for Ecological and Technical Safety (SIETS) monitors company compliance with mining rules and regulations.

CONTEXT

Natural resources present both opportunities and risks for the countries that choose to extract them. Managed well, they can support greater prosperity for current and future generations. Managed poorly they can cause economic instability, conflict and lasting environmental damage. To translate mineral resources into prosperity for the Kyrgyz Republic, the government should have a well-informed understanding of the resource base, the associated values of government revenues and other positive and negative impacts. This will allow it to define the direction for resource policy development so that the mining sector supports, rather than thwarts, national priorities.

Mineral extraction has significant potential to support economic growth in the Kyrgyz Republic. The country depends heavily on its extractive industry for exports—mineral extraction comprised around 47 percent of exports in 2009-2013.[7] (See figure 2 for value of exports.) However, it contributes less to government revenues and GDP—8.3 percent (USD 181.5 million) and 8.4 percent (USD 627.3 million) respectively in 2014.[8] The same year the value of government revenues from resources extraction amounted to USD 30.8 per person,[9] compared with an average income of USD 1,260 per year.[10] In addition, in 2014, resource wealth per capita by production amounted to USD 106.4.

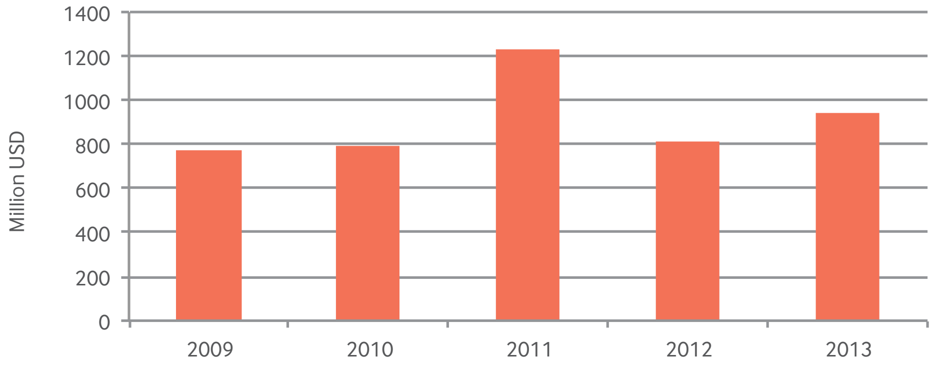

Figure 2. Value of resource exports in USD, 2009-2013[11]

The large value of resources exported each year suggests that managing the mining sector and its resulting revenues can considerably improve the welfare of Kyrgyzstanis. There is also significant room for growth in the future extraction of resource revenues. In the medium-term, according to the latest Kyrgyz Republic Midterm Social and Economic Development Forecast for 2017-2019 (MSEDF), one of the country's key documents for midterm budget forecast, the sector will generate more resource revenues, since four gold mines started/re-started production in 2015-16. However, MSEDF does not factor the start of gold and gold-copper extraction at five other large- and medium-scale mines during 2017-2019,[12] which could further increase the mining industry's input to the economy.

Available information on reserves and production (table 3), indicates that the Kyrgyz Republic has a high potential for increasing extraction of coal, oil and gas and its current level of gold production.

Table 3. Reserve-to-production ratio, 2013

Resource type	Production	Reserves	Ratio (years)
Gold	20 tons	635 tons	32
Coal	1,157,000 tons	1,380 million tons	1,192
Oil	81,000 tons	14,377 million tons	180
Gas	33 million m^3	6,513 million m^3	2,004

7 Extractive Industries Transparency Initiative. *EITI Report of Kyrgyz Republic for 2013-2014*. (Bishkek, 2015) 9.
8 *Ibid.*
9 According to the National Statistical Committee, as of early 2015 the total population of the Kyrgyz Republic was 5,895,000 people. Accessed 15 January 2017. http://www.stat.kg/media/publicationarchive/dd6e5a2a-2788-4818-b522-7edf2c73c391.pdf.
10 World Bank Data, Kyrgyz Republic gross national income per capita, accessed 1 February 2017. http://data.worldbank.org/country/kyrgyz-republic.
11 EITI 2015.
12 Jerooy, Chaarat, Shiraldjin, Kuru-Tegerek and Tereksay.

Government officials could benefit from collecting more information, such as average effective tax rates on mining companies, costs of project development and commodity price forecasts, to determine which assets are commercially viable at any point in time and to forecast future revenues from resource extraction.

Resource policy agenda

Currently, policies governing mineral resource management do not seem unified or robust. Challenges include that the licensing policy does not set the pace of licensing and does not take into account the existing lack of capacity of government bodies to oversee exploration/extraction operations. Further, the government did not base mining tax policy on economic evaluation metrics, and does not know the average effective tax rates for major commodities. Thus, it does not know whether to raise tax rates to ensure fair government take, or to decrease taxes to attract investment. Environment protection policy does not ensure meaningful participation of affected communities in decision-making. It is unclear how important a role state-owned companies play in ensuring that all citizens benefit from resource extraction. Finally, it is difficult to assess whether resource revenues should be used to stimulate economic growth nationally or whether a resource revenue sharing system is fairer for all citizens.

Moreover, despite the fact that the Subsoil Law and its corresponding regulations try to cover the main issues of subsoil use, the legal base consists of about 100 other norms, governing other sectors (aspects of industrial safety, the environment, water and land) that can have implications for mining. Some of these regulations are contradictory and their legal hierarchy is ambiguous.

PRIORITY ISSUE 1

Government institutions play a key role in developing and implementing state policies. Given the large number of Kyrgyz government bodies and municipal authorities involved in resource sector policy, it is necessary to assign clear roles and responsibilities to each, and ensure efficient coordination for information exchange and unified policy development. Some institutions need new roles. For example, local authorities do not have enough involvement in developing legal acts, especially those related to local impacts such as revenue sharing or remediation and mining project closures.

Distinctions between the responsibilities of different government agencies are not clear, which poses another challenge. For example, there is no clear distinction between SCIESU and SIETS on responsibilities for overseeing exploration and mining operations. While SAEPF is responsible for setting overall environmental policy, SCIESU develops legal acts related to remediation and mining project closures. SAEPF is developing changes in license retention payment rates, while the Ministry of Finance is responsible for policy on non-tax payments. While a specific agency under the Ministry of Economy is responsible for attracting investment, SAEPF also has such a function and works with potential investors.

Further, the fact that MSEDF does not address the launch of several gold and gold-copper mines between 2017 and 2019, indicates a lack of coordination between SCIESU (which possesses information about the time frame and scale of production) and the Ministry of Economy (which produces MSEDF).

Improving coordination to promote efficient information exchange and coherent decisions on policy will require detailed functional analysis of the state and municipal bodies involved in mining sector governance, as well as analysis of the information each of them collects. Doing so is especially important given that a number of mines will start extractive operations by 2019 and beyond.

Precept 2. Transparency and accountability

Priority issue for the Kygyz Republic	Disclosure of key project-level data will help the public understand the benefits of mining and will make it easier to hold the government and companies accountable

Rules. Legal provisions on citizens' access to information are enshrined in the Constitution (Article 33) and the following legal acts: Law on Guarantees and Freedom to Access Information (1997), Law on Access to Information under the State Authorities (2006) and Law on Procedure for Considering Citizens' Inquiries (2007). Data on certain aspects of the mining industry, such as taxes and non-tax payments, total exports, total industrial production and employment are subject to publication in accordance with the Budget code (2016) and the Law on State Statistics (2007). The Subsoil Law (2012) and corresponding regulations also call for publication of partial information on the licensing process, such as announcements of tenders and auctions. In addition, in 2004 the Kyrgyz Republic joined the Extractive Industry Transparency Initiative (EITI), thereby committing to follow the principles and requirements enshrined in the EITI Standard. Since then, 10 EITI reports have been published by the Kyrgyz Republic national EITI secretariat, the most recent covering 2013-2014.

Institutions. Three government bodies disclose resource related data. The National Statistical Committee releases general information on the social-economic situation, the Ministry of Finance releases data on revenues from the extractive sector, whereas SCIESU releases licensing-specific data. SCIESU is also responsible for EITI implementation.

Reforms. Currently the parliament is considering a new statutory wording of the Law on Subsoil, which includes a provision obliging all mining companies to submit EITI standard compliant reports to SCIESU.

CONTEXT

In environments with strong accountability, errors in planning or implementation are more likely to be recognized (by citizens, journalists, civil society, government officials and/or international actors) and corrected (by the government), and office holders are less likely to engage in corruption. Accountability helps generate policies and practices that reflect public interest and enjoy citizen support.

Transparency

General legislation is publicly available on government websites, in particular that of the Ministry of Justice,[13] and through the national newspaper, *Erkin Too*. However, legislation for some areas is harder to get hold of than others. For example,

13 Kyrgyz Republic Ministry of Justice, accessed 8 May 2016. http://cbd.minjust.gov.kg/ru-ru/npakr/search.

internal acts of government bodies, acts of municipal authorities and information on established practice are not available without submitting written requests to authorities. Legal documents establishing exploration and production rights, which contribute to legal frameworks at the project level, are not publicly available except for re-stated agreements on the development of the Kumtor gold mine.[14]

The Kyrgyz Republic has strong legal provisions for access to information, allowing citizens to apply for and obtain any information that public and municipal authorities hold, unless classified (state, commercial or banking secrets). However, citizen awareness on the right to obtain information is poor and perhaps the laws on access to information are yet to be tested for the extractive industry. Interested parties mainly obtain information by filing a request with a state authority. While it is good that these request-based channels exist, relying on them means that information might not be released in a timely manner. Moreover, certain important pieces of information may be missing from the public realm entirely. This is because aside from the National Statistical Committee, the National Bank and the Ministry of Finance, state authorities are not required by law to publish regular reports.

Some data are available in the public domain. The National Statistical Committee regularly publishes information on total exports, employment, investment, industrial production (including separate data for oil, gas, coal, and gold output), and some data on environmental protection. However project-specific figures for output of minerals (specifically gold) is not available.[15]

In accordance with the Budget Code, the Ministry of Finance discloses the detailed state budget, including total government revenues and expenditure, and monthly reports on its implementation. The Ministry of Finance also operates an internet portal called "Open Budget,"[16] providing information on each payment type and detailed receipts remitted to the state budget from each taxpayer on a monthly basis. In addition, despite the absence of legislated rules, SCIESU discloses the following information through its recently re-launched web page:

- A list of active licenses[17]
- A list of applications submitted to receive licenses through direct negotiations[18]
- All announcements on scheduled auctions and tenders.[19] These typically also include tender terms and conditions, which can include details such as the final date to launch a mining operation and the minimum investment necessary in social-economic development (referred to as the "social package"). Information on concluded tenders and auctions is yet to be included.
- A database showing the license retention payment to be made by each mining

14 The first concession agreement was concluded in 1993 between the government of the Kyrgyz Republic and Centerra Gold Inc. (at that time Kameco corporation). New terms for the development of Kumtor gold mine were agreed in 2009.
15 National Statistical Committee of the Kyrgyz Republic, http://www.stat.kg/en/opendata/category/14/.
16 "Open Budget Portal," Ministry of Finance of the Kyrgyz Republic, accessed 3 June 2016, http://budget.okmot.kg/en/.
17 State Committee of Industry, Energy and Subsoil Use, accessed 17 January 2017, http://www.gkpen.on.kg/Licenses/Licenses/LicensesList?isLicense=True.
18 State Committee of Industry, Energy and Subsoil Use, accessed 17 January 2017, http://www.gkpen.on.kg/Licenses/Licenses/LicensesList?isLicense=False.
19 State Committee of Industry, Energy and Subsoil Use, accessed 17 January 2017, http://www.gkpen.kg/index.php/2017-01-11-10-19-23/2017-01-11-10-19-23.

company.[20] The database includes a breakdown of each territorial unit and year (information is available for 2014, 2015 and 2016) and lists the different licenses for each administrative unit, including the license type (type of work and type of resource).

- An interactive map of licensed areas,[21] displaying: license type (type of work and resource), license issuance and expiration dates, company name, licensed area, licensed area size, a list of license agreements but not copies of the license agreements), and, if applicable, the license status (terminated or suspended). The interactive map links to a Ministry of Justice database of legal entities.
- An interactive map of all deposits/ore occurrences[22] (even commercially unattractive ones), taken from a cadaster produced during Soviet times. The map provides a location for each deposit/ore occurrence, brief geological information, types of minerals and work, and the quantity of reserves/resources.

Not all information on both maps (specifically the quantity of reserves/resources and type of license with regard to type of work) are necessarily up-to-date, which is likely because of the large number of licenses and deposits/ore occurrences.

In addition, EITI reports contain important information, especially on payments mining companies make to the government and the mining industry's contribution to total exports, industrial production, investment and GDP. However, EITI reports do not contain comprehensive resource information such as production, sales prices or exports for each medium or big project, because these data are not publicly available.

Official oversight

Parliament oversees government activity, including on issues related to resource governance. It has the power to adopt certain legal acts, the authority to appoint or recall relevant public officials, the ability to request reports on certain resource management issues, and the right to submit inquiries and issue instructions. The main parliamentary committee supervising the subsoil use sector is the Committee on Fuel and Energy Complex and Subsoil Use.[23] Three separate committees oversee environmental issues, budget and finance, and tax and economic policy. In addition, the Chamber of Accounts has a strong legal mandate to oversee the government's management of financial flows, including government bodies regulating the extractive sector. This institution is independent and accountable to both the President and parliament, which follows up on audit findings. Thus, mechanisms exist to scrutinize government activities. However, whether official oversight implementation is in line with international best practice is yet to be tested. Even though government agencies provide requested information to the legislature in a timely enough way, the latter cannot always assess whether the information is worthy of informing important decisions, or respond with appropriate legislation, as parliament lacks strong research and analytical support.

20 State Committee of Industry, Energy and Subsoil Use, accessed 17 January 2017, http://gkpen.on.kg/geostatistics/Index.aspx?OpenPage=pul.
21 State Committee of Industry, Energy and Subsoil Use, accessed 17 January 2017, http://gkpen.on.kg/lic/f3_rus.aspx?t=636207644077022187.
22 State Committee of Industry, Energy and Subsoil Use, accessed 17 January 2017, http://gkpen.on.kg/minresources/f1_en.aspx.
23 Parliament of the Kyrgyz Republic, accessed 20 December 2016, http://kenesh.kg/ru/committee/5/show/komitet-po-toplivno-energeticheskomu-kompleksu-i-nedropolyzovaniyu.

Communications and public oversight

Civil society, mass media and research institutions also play an important role in ensuring government accountability. Both at the legislative level and in practice, these groups may openly express opinions and influence government decisions. However, their understanding of issues related to the resource sector is limited to certain areas. Civil society is only knowledgeable on aspects it is involved in, such as conflict resolution, budgeting, regional development funds (RDFs), EITI regional trainings and environmental safety, but not on issues such as licensing, fiscal regime, state-owned enterprises (SOEs) or revenue management. Most representatives of the mass media also have an insufficient understanding of the resource sector. Most of the information the media provides is based on citations of public officials, members of parliament and various experts, and only a few journalists are renowned for their work in the mining sector. Research institutions, too, have not contributed much to resource management policy, because researchers have limited experience in conducting research and lack a deep understanding of resource sector issues.

PRIORITY ISSUE 2

Although SCIESU officials are taking measures to disclose more information, these measures would be stronger if anchored in legislation rather than adopted on an *ad hoc* basis. Disclosure should also be more comprehensive. First, disclosure should include actual licenses, license agreements, and concession agreements between the government and investors. Licenses are supposed to involve little negotiation and simply incorporate terms from law and tender/auction conditions, but their publication (or at least publication of key information) would increase transparency and trust, while also providing key information to oversight actors and citizens. This will improve monitoring, holding companies accountable for obligations such as launching projects by specific dates.

Second, no clear legal requirement exists for transparency of other important project-level data, such as the social package agreement, the beneficial ownership information required as part of a license application, environmental impact assessments (EIAs), and information on each project such as production, export volumes and sales prices. Lack of project-specific information prevents the public from understanding what the country gets from, for example, the Jamgyr gold mine or the Bozymchak copper-gold mine. SCEISU communicates some relevant information by circulating press releases and publishing them on its web page, but no publicly accessible central repository is available, though SCEISU's interactive map of licensed areas could be a starting point.

Third, there is little information on license allocation through direct negotiations, including the number of licenses issued, suspended, annulled, and the basis for these decisions. Replacing the direct negotiation system with the first come, first served system (in addition to tender and auction systems) that the Subsoil Bill[24] proposes (see Precept 3 for license allocation) could be a more transparent approach. This approach would require clear legal guidance as to when each system applies, and would need to incorporate protections such as making it mandatory to record the date and time of first come, first served applications for a transparent and non-discriminatory approach.

24 Articles 22 and 25 of the Subsoil Bill.

Precept 3. Exploration, licensing and monitoring operations

Priority issue for the Kygyz Republic	Ensuring strong geological data management systems and in-depth analysis of the licensing regime will help attract high-quality investors to the Kyrgyz Republic

Rules. Per the constitution,[25] subsoil is the sole property of the Kyrgyz Republic and, per the Subsoil Law (2012), acquiring subsoil use rights requires a license, state registration, concession agreement or production sharing agreement (PSA). A number of legal acts regulate license grants for subsoil use: the Subsoil Law and corresponding regulations; the Law on Concessions (1992) and the Law on PSAs (2002). The Oil and Gas Law (1998) and Coal Law (1999) also include some licensing issues with regard to oil, gas and coal projects, however, in practice, the Subsoil Law regulates the licensing regime for all minerals. The Subsoil Law also regulates licensing procedures, registration of artisanal miners, geological information management and issues related to survey/exploration/extraction. The Law on Land Transformation (2013) covers land use rights.

Institutions. Several state bodies are involved in managing and regulating the licensing regime and monitoring operations. SCIESU develops and implements subsoil use policy. SCIESU also oversees mining companies' compliance with license agreement terms and technical project documents, along with SIETS, regional public administrations and local government bodies. Regional public administrations and local government bodies grant land use rights.

Reforms. The Subsoil Law and its corresponding regulations face constant review and modification. Parliament is currently discussing the Subsoil Bill. As mentioned above, the bill, among other matters, proposes replacing the direct negotiations method of license allocation with a first come, first served approach.

CONTEXT

For a country to benefit from extraction, the government must attract competent and law-abiding companies that will discover and later extract new resources. Preparation before allocating licenses is an important step to ensure that licenses are granted to the right areas, at the right time, for a fair price and to competent companies.

Awarding resource licenses

Notwithstanding the different ways to acquire subsoil use rights mentioned above, in practice, almost all mining companies conduct exploration or extraction based on licenses. At present there are no PSAs and only one concession agreement (concluded in 1993 and re-negotiated in 2009) for the Kumtor gold mine. In addition, artisanal miners register with the state to receive patents that give them the right to extract resources.

Per the Subsoil Law, there are three ways for authorities to consider and grant license applications (see Table 3).

25 Article 12 of the constitution.

Tender	Auction	Direct negotiation
• Conducted for nationally important subsoil use areas, a list that the government determines (currently 55 deposits • An inter-ministerial commission establishes the terms and conditions for each tender (including application requirements and criteria for evaluation) • An inter-ministerial commission determines the winner	• Conducted for deposits/ore occurences, a list that SCIESU determines (currently 133 occurences) • Goes to the paticipant offering the highest price	• Conducted for all other subsoil use areas and for areas where two unsuccesful auctions have already occured • An applicant who submits all necessary documents to SCIESU receives a license

Figure 3. License allocation methods

As mentioned above, each license allocation method applies to different types of subsoil areas. However, while legislation clarifies that direct negotiation applies to areas either not subject to tender or auction or where auctions have failed, the Subsoil Law and corresponding regulations do not clearly outline the criteria for subsoil areas to be allocated through auctions and tenders.

License planning

The Geology Ministry of the Kyrgyz Soviet Socialist Republic explored and discovered almost all known prospective subsoil areas and deposits during Soviet times. SCIESU stores geological data (reports) collected during Soviet times at the State Geological Fund, mostly in paper format. From 1991 to the present, the government has not conducted or funded survey or exploration work, because of lack of funding. Although state enterprises under SCIESU have performed some work, it has not been substantial. Thus, when preparing a pre-licensing package of geological information (for companies to purchase), SCIESU uses scanned versions of Soviet geological reports. The government has already granted licenses for most subsoil areas for which geological information is available (including indicated reserves and ore grades). However, numerous preliminary estimated subsoil areas still exist. (See table 3), which require further exploration work.

In many countries, financing for such works comes from public funding, hiring private geophysical companies (with an agreement for the companies and government to share revenues from geological data sales) or funding from development banks such as the World Bank (which has a funding facility for mining countries). In the Kyrgyz Republic, because of insufficient public funding, junior companies with licenses conduct exploration work, including for the subsoil areas listed in table 4. SCIESU collects information from license holders through annual, semi-annual and final geological/production reports. Companies submit their reports in paper and electronic formats to the SCIESU's State Geological Fund. However, geological information that private companies collect remains the property of the license holder during the term of the license or a term the license agreement specifies. SCIESU keeps the geological information it collects from license-holders confidential until the license expires.

Table 4. Prospective reserves and resources[26]

Type of mineral	Number of areas/ deposits	Unit of measurement	Prospective reserves and predicted resources
Iron	12	million tons	1,791.4
Manganese	4	million tons	20.5
Vanadium (V_2O_5)	2	thousand tons	3,806.5
Chrome	2	thousand tons	3.52
Titanium (TiO_2)	1	thousand tons	126.9
Aluminum (bauxite) (Al_2O_3)	10	thousand tons	47,067.9
Aluminum (nepheline syenite) (Al_2O_3)	2	thousand tons	405,403
Copper	29	thousand tons	6,470.3
Cobalt	5	tons	964.6
Nickel	5	thousand tons	1,257
Lead	27	thousand tons	912
Zinc	27	thousand tons	452.9
Tin	14	thousand tons	277.7
Tungsten (WO_3)	20	thousand tons	276.2
Arsenic	10	thousand tons	270.9
Molybdenum	18	thousand tons	106
Beryllium	14	thousand tons	77.7
Bismuth	21	thousand tons	24,7
Mercury	29	thousand tons	48.3
Antimony	33	thousand tons	770.8
Strontium	7	thousand tons	355.8
Rare earth (ΣTR_2O_3)	11	thousand tons	75.1
Tantalum (Ta_2O_5)	12	thousand tons	88.5
Niobium (Nb_2O_5)	12	thousand tons	35.4
Vein gold	70	tons	2,123.7
Placer gold	63	tons	25.6
Silver	37	tons	7,406.5
Uranium	22	thousand tons	31.2
Thorium	14	thousand tons	54.7

Attracting more and better quality investors for the remaining vacant subsoil areas will require good management of Soviet geological information and data that companies whose licenses have now expired acquired from SCIESU. To achieve this, SCIESU's geology and information resources departments need more skills, organization and resources.[27]

26 Ministry of Economy of the Kyrgyz Republic. *Medium and Long-term Strategy of the Kyrgyz Republic Mining Industry Development for 2014-2035* (2014).
27 Interview with SCIESU management.

Regarding land use rights, in the Kyrgyz Republic a license grants the right to conduct exploration or extraction work only. Landowners or users (regional, state or municipal authorities or private persons) provide surface or land rights for exploration/extraction purposes, among other things; these can take up to several years to obtain. Cases have arisen in which landowners did not wish to lease their land or land ownership was unclear. In addition, cases arose in which SCIESU granted licenses to mine protected areas where exploration and mining activities are prohibited. Ideally, SCIESU should verify land ownership before issuing a license, but its limited authority and resources do not allow it to do so. Verification requires site visits and studying land title documents, which are not always readily available or accurate. SCIESU and SAEPF (which manages protected territories) need better coordination to avoid licensing in restricted areas and to consider requests for land transformation where appropriate. However, because these government bodies use different systems of geographical coordinates, such coordination may not be always possible. A land cadaster[28] (which the State Register Service maintains[29]) could simplify the licensing process; according to the legislation,[30] the land cadaster should be developed using a unified system of special coordinates.

Further, the Subsoil Law's technical pre-qualification requirement for license applicants only applies to tender applicants and covers technical elements including: experience in geology and mining, and possession and utilization of modern exploration, extraction and processing technologies.[31] An inter-ministerial tender commission develops the tender with government approval, and the terms of the tender usually provide details on pre-qualification criteria. For example, according to the terms of the 2015 tender on the second biggest gold deposit, Jerooy, applicants had to:

- possess no less than 5 years' experience in exploration and mining activities (including experience in other countries)
- possess and utilize modern exploration, extraction and processing technologies
- possess own funds, and/or be able to attract funds, necessary for the development of the Jerooy deposit and to conduct exploration works on Jerooy area

The Subsoil Law calls for only financial pre-qualification of auction applicants, for companies or individual entrepreneurs applying for licenses through direct negotiations, and for companies receiving licenses via transfer from other license holders, but no technical pre-qualification. This means that SCIESU cannot conduct a robust assessment of applicants' technical and financial qualifications. The only relatively thorough pre-qualification criteria for tender applicants that the Subsoil Law proposes are not included in the current Subsoil Bill. Rather, the bill leaves the issue to the discretion of an inter-ministerial tender commission. In case the bill is passed with its current statutory wording, the only legally required pre-qualification will be the financial capability of auction applicants. This does not guarantee that objectively competent companies will use the Kyrgyz Republic's subsoil—a matter of concern given the number of important deposits (e.g., iron, rare earth, zinc and lead) yet to be licensed.

28 Articles 101 and 108 of the Land Code.
29 Article 6 of the Regulation on Land Cadaster Maintenance.
30 Article 5 of the Regulation on Land Cadaster Maintenance.
31 Article 24.3 of the Subsoil Law.

Moreover, the government does not have a mid- or long-term licensing strategy that considers key factors such as international commodity prices, or securing benefits from value increases, in deciding licensing pace and order. On the contrary, licensing timing seems to depend on *ad hoc* auction or tender announcements, based on a need to replenish the state budget. The current system allows the granting of a license on any vacant area at any given time. The situation has led to a more than 100 percent[32] increase in the number of active licenses from 2012 to 2016. Currently there are more than 2,000 active licenses and more applications keep coming in.

Monitoring operations

SCIESU reviews exploration and mining field development plans (locally referred to as a *technical project*) to ensure technical safety and rational use of subsoil legislation at the start of the project. SCIESU also reviews annual reports and work programs over the project's course. SCIESU, SIETS and local authorities then assess whether mining companies' activities comply with the terms of the technical project and licensing agreements. However, because of the large number of licenses and lack of resources, reviewers may not be evaluating project documentation carefully enough to ensure it is technically sound. For the same reasons, oversight is limited and government bodies have to rely heavily on reports that companies submit as opposed to independently obtaining and verifying information.

32 EITI 2015, 39.

PRIORITY ISSUE 3

As the Kyrgyz Republic government does not have sufficient funding for geological surveys and exploration work, it could seek funds from development banks (in addition to private investment) to distribute the data to prospective companies seeking licenses. However, before doing that it has to ensure that existing geological data are well managed. Given its limited human and financial resources to maintain a strong geological information management system, SCIESU could seek the support of other countries' geological surveys, such as the British Geological Survey, the Geological Survey of Finland, or the United States Geological Survey.

Given the availability of geological data for certain prospects in the Kyrgyz Republic, incorporating a competitive element such as tenders and auctions (often not included in mining jurisdictions) seems appropriate. However, practice indicates certain difficulties with tenders and auctions in the Kyrgyz Republic. Not all announced tenders and auctions take place,[33] perhaps because of insufficient information about mining areas or geological unattractiveness of areas for which information is available. Other possible reasons include political instability (causing a negative investment climate), inappropriate timing (low market activity), insufficient marketing activities, potentially unattractive fiscal terms, excessive bureaucracy and a complicated legal framework. Also, legislation hardly provides applicants with much time to examine the information[34] before deciding whether to participate. It is also possible that some of the remaining assets on the tender and auction lists are not attractive enough for a competitive system, so perhaps those determining these lists are not maximizing available geological data. If this is indeed the case for some assets, they may be more appropriate for licensing via a direct negotiation or a first come, first served system (as the Bill on Subsoil envisages). An in-depth analysis would help determine the issues contributing to licensing shortcomings, and remedial steps.

33 From 2013 until now, three of nine announced tenders took place. As of July 2016, the SCIESU only auctioned 32 licenses for the 133 deposits/occurrences on the auction list.

34 Thirty days for tender applicants, 45 days for auction applicants.

Precept 4. Taxation and other payments

Priority issue for the Kygyz Republic	Robust quantitative evaluation of the mining tax regime will better inform tax policy, attracting new investment while generating maximum revenues for the government

Rules. Generally, all mining companies, including SOEs, make payments according to the legislated fiscal regime applicable to the mining sector. The Tax Code (2008), Law on Non-Tax Payments (1994), Subsoil Law (2012) and Law on Customs Regulation (2014) lay out the terms of this regime. Relevant legal acts stipulate payments for environmental pollution and other compensation fees. There is one exception: Kumtor Gold Company, which re-concluded an agreement with the government in 2009 that established a special fiscal regime.

Institutions. Three public authorities decide mining sector taxation[35] policy. The Ministry of Economy has primary responsibility for developing and revising overall tax instruments and the Ministry of Finance for overall non-tax payments. SCIESU sets mining-specific non-tax payments such as payment for license retention and revenues from auctions and tenders. Any member of parliament can initiate a bill to establish or revise any tax or non-tax instrument. Generally, the State Tax Service has primary authority to administer and collect mining revenues,[36] with the exception of some payments made to SCIESU, SAEPF and local governments. SCIESU also has some mining tax administration functions. For example, it verifies bonus calculations, computes license retention payments and provides consultations with respect to these. The Audit Chamber conducts independent audits of the revenue and expenditure aspects of the state budget, among other things. Specifically, it analyzes the completeness and timeliness of payments, including from mining, and audits the formation and effectiveness of utilization of republican budget means by government bodies.[37]

Reforms. The government is considering increasing the cost of license retention, to replenish local budgets and stimulate companies to perform.

CONTEXT

Resource extraction can be a significant revenue source for a government. To achieve this, the government must balance obtaining a share of the resource's value with terms that attract investment from capable companies.

35 "Taxation" refers to both tax and non-tax instruments.
36 Article 49 of the Tax Code and Article 1 of the Law on the State Tax Service (2009).
37 In the Kyrgyz Republic the state budget consists of two layers: the republican budget (central government) and local budgets (subnational governments).

Setting fiscal terms

In the Kyrgyz Republic, companies pay a corporate income tax (CIT) of 10 percent (low by regional standards[38]), except for gold mining companies. In 2013, the government imposed a separate revenue tax on gold producers and processors (since gold is the major subsoil asset of the country), to address the challenge of collecting corporate taxes. Since the revenue tax is based on gross sales revenues, it is relatively easier to measure than profit-based taxes such as CIT. The revenue tax rate is variable, as it depends on international gold prices (from one percent up to 20 percent). However, as creators of this tax concept did not use a detailed spreadsheet model during its development, its effectiveness is difficult to evaluate. The calculation of revenue tax has also some challenges. Thus, the Tax Code does not provide an explicit definition of the taxable base. For example, for revenue tax calculation, the Tax Code uses the terms: "gold ore," "gold concentrate," "gold alloy" and "fine gold." This raises questions when the code defines final salable product and tax liability. Another challenge is that legislation does not regulate how to tax concomitant minerals extracted along with gold (such as silver, copper and arsenic). Currently, companies pay no CIT on these metals, and changing this will complicate tax administration. In addition to revenue tax, two more income-based payments exist, royalty and payment for maintenance and development of local infrastructure (two percent of income). Members of parliament introduced the latter in July 2013 as an ad hoc measure to reduce the chance of local communities protesting against mining companies' activities. They did not base it on measured analysis.

Necessary economic analysis also seems to be missing for other resource-specific taxes and non-tax payments. For example, according to officials at SCIESU, the current basis for bonus calculations has to be revised, since it does not have robust economic justification. Further, costs of license retention, introduced in 2012 to stimulate mining companies to perform, are not based on sound economic analysis. Since then, some companies have returned their licenses to the government. However the payment is not as effective had been planned in the beginning, since some of the rates are not high enough to stimulate companies conducting works. The government is therefore planning to increase rates.

The lack of economic analysis in designing the mining tax regime does not necessarily imply poorly designed policy. However, without strong analysis it is difficult to evaluate the tax regime and difficult to understand how it can be improved to generate greater long-term revenues for the country.

Tax administration

According to the Tax Service Development Strategy for 2015-2017, Tax Service officials lack analytical skills, the Tax Service's organizational structure is ineffective and there is no integrated taxpayers' database. In addition, the Tax Service and other government bodies do not adequately coordinate and exchange information, which leads to untimely and insufficient receipt of information about taxpayers. It is also difficult to say whether the government enjoys full collection of taxes and non-tax payments, as it uses no relevant economic parameter.

38 According to *Doing Business 2017*, Kazakhstan has 10 percent CIT; in Mongolia it's 10 percent, but 25 percent for taxable profit exceeding a certain amount; and in Tajikistan it's 14 percent.

Accountability and transparency of the fiscal regime

In terms of the quality of tax rules, general legislation sets out all fiscal terms, except for those of the largest mine, Kumtor gold mine. A concessional agreement governs Kumtor's operations.

To promote transparency, the Ministry of Finance operates the "open budget portal"[39] portal mentioned earlier, which provides monthly information on payment types and detailed receipts from each taxpayer. This is commendable, and shows a far higher level of transparency than many of the Kyrgyz Republic's peers. There are two potential improvements to this already useful level of information. The tax base for each payment could be clearer. Further, while the State Tax Service's web page provides information on tax types for legal and physical entities,[40] (even though the list is not explicit[41]), the information lacks detailed explanations.

As for pubic consultations, the Ministry of Economy regularly communicates with different business associations, such as the Investment Council and the International Business Council. In addition, legislation requires that each bill be published on the web site of the bill's initiator (ministries, state committees and parliament) for public discussion. However, it seems as though authorities did not solicit opinions from mining companies when introducing new resource payments.

PRIORITY ISSUE 4

The government does not operate with spreadsheet models, so has been unable to analyze the effectiveness of the mining fiscal regime. Nor has anyone performed an independent evaluation of the mining fiscal regime. The government bases its forecasts of tax collection on information from mining companies rather than on its own calculations, which makes it reliant on company forecasts. Because the government does not use a fiscal model, it does not know the expected tax take in mining projects. Without identifying government take and how it compares to other developing countries, it is difficult to say whether any tax and non-tax payments rates should be changed. The most important step for the Kyrgyz Republic's fiscal regime is a modeling exercise to measure government take, responsiveness to changing economic conditions and other evaluative metrics. This fiscal model could also help the government forecast its future mining revenues, as discussed in Precept 1.

39 Ministry of Finance of the Kyrgyz Republic, "Open Budget Portal," accessed 3 June 2016. http://budget.okmot.kg/en/.
40 State Tax Service of the Kyrgyz Republic, accessed 3 June 2016. http://sti.gov.kg/faq
41 For example, the list does not include revenue tax for gold producers and processors.

Precept 5. Local costs and benefits

Priority issue for the Kygyz Republic	Participation of local communities in decision-making will help build trust among stakeholders, attract investors wishing to uphold global standards, mitigate environmental and social risks and secure local benefits

Legislation. In the Kyrgyz Republic, a wide range of legal acts govern environmental protection, which also apply to the extractive industry. The main ones are the Environment Law (1999), Law on Ecological Review (1999), Subsoil Law (2012), Law on General Technical Regulation on Environmental Security (2009), and Regulation on Environment Impact Assessment (2015). The Regulation on Environment Impact Assessment also contains procedures for local community involvement during an EIA. As for local benefits, the Law on Non-Tax Payments (1994) and the Subsoil Law (2012) include the social package mentioned in Precept 2, which addresses revenue sharing mechanisms and community development agreements for nationally important deposits.

Institutions. SAEPF has, in the absence of a ministry for environmental matters, primary responsibility for making and implementing policy on environmental protection as well as coordinating ecological monitoring activities of public authorities[42] and different organizations (including companies).[43] SCIESU also has a role in making policy with regard to reclamation and closure of mining objects. Generally, SIETS exercises state ecological oversight but local authorities also oversee project reclamations and closures. The latter are also responsible for organizing public consultations during the EIA process and working with local populations to prevent the EIA from interfering with mining company activities.

CONTEXT

The costs and benefits of resource projects are not shared equally by all people in a producing country. While the benefits of resource projects—stemming largely from resource revenues, job creation and business linkages—can be shared throughout the country, communities located close to project sites usually bear the brunt of the social and environmental costs of exploitation. Where activities are mismanaged, extraction can result in irreversible environmental damage and unmet expectations, which can give rise to local grievances and conflict. Government policy should therefore seek to protect affected populations from the negative impacts of extraction, while at the same time helping them harness the benefits.

42 SAEPF, Ministry of Health, State Register Service and Ministry of Emergency Situations Regulation.
43 Article 41 of the Environment Law.

Trust

From 2010 to 2014, mining related local conflict occurred throughout the Kyrgyz Republic, leading to a suspension of mining activities. The main cause of conflict was that local communities were rightly concerned with the potential environmental damage of mining projects, and did not trust the ability of central and local government to guarantee environmental protection.[44] Another major cause of conflict was that communities did not find benefit sharing to be fair. It appears that certain sub-groups within local communities were playing on people's concerns to gain financial benefits from mining companies.[45] In some cases, there were individuals interested in destabilizing the community by disrupting mining activities for their personal gain.[46]

The government took two measures to address the conflict. First, in 2012-2013, it made a number of legislative reforms, which mainly introduced revenue sharing mechanisms (discussed in more detail in Precept 9), but also a social package, a land rehabilitation fund, and a requirement to include input from local authorities in licensing (as part of auction and tender commissions). Second, government officials, mainly representatives of SCIESU, have been holding regular dialogues with local communities with some success, providing explanations on costs and benefits of mining activities, as well on ownership of natural resource wealth. Even though these measures have reduced conflict, underlying issues with the potential to create conflict still pose risks for the mining sector's development. For example, SCIESU held consultations with local communities more as an *ad hoc* measure to decrease their protests, rather than to ensure their participation at each stage of project decision-making. Moreover, top SCIESU officials held these consultations out of a personal desire to ensure development of the mining sector and, thus, the economy, despite the fact that legislation does not oblige them to do so. This raises questions about their sustainable commitment to local community consultations.

Impact assessment and cost mitigation

The main requirement of the environmental protection regime in the Kyrgyz Republic is that license holders must receive state approval with regard to ecological safety (mentioned in Precept 3) before launching any of the following activities: survey, exploration, exploitation, processing, recycling, remediation, and project closure.[47] As part of the process, license holders must submit EIA documentation to SAEPF for review. The documentation identifies measures to mitigate, minimize or compensate for environmental damage. It also explains how companies will prevent and respond to environmental disasters, and includes a program for local ecological monitoring to be conducted within one year after launching the activities.[48] While the policy framework indicates that the government has a strategic commitment to environmental and social protection, in practice state bodies lack the human resources and modern laboratories to conduct environmental monitoring or oversee

44 Oxus International, *Extracting Sentiments: The Effect of Mining Exploration and Extraction on Eight Communities in the Kyrgyz Republic* (2013), accessed on 10 June 2016. https://issuu.com/efca/docs/extracting_sentiments_the_effect_of.

45 Interview with Kuban Ashyrkulov, mining industry expert and former director of a gold mining company, http://serep.kg/fusce-lorem-ligula/

46 David Gullette, *Conflict Sensitivity in the Mining Sector of the Kyrgyz Republic* (2014), accessed 15 June 2016, http://www.osce-academy.net/upload/file/Mining_report_final.pdf.

47 Articles 3 and 13 of the Law on Ecological Expertise and Appendix 1 to Regulation on EIA.

48 Appendix 10 to the Regulation on Environment Impact Assessment.

the implementation of legislated rules such as whether companies conduct annual ecological monitoring. In addition, SAEPF's limited human resources, coupled with the large number of subsoil use licenses (more than 2,000), does not always allow the state body examining EIA documentation to thoroughly assess prevention and minimization measures. In some cases, environmental protection comprises payments from mining companies to compensate for pollution (including penalties for emissions and excess dumping).

Before submitting EIA reports for state approval, mining companies have to hold public consultations with communities in mining affected areas. However, the extent of local population input to the EIA process is unclear, as, according to EIA regulations, public consultations do not involve holding actual meetings with communities and reaching a consensus; rather, it is enough to make EIA documentation available at the offices of companies and local authorities, where people can submit written comments.[49] In addition, EIA regulations do not contain any rules about including all local population groups in consultations. This has led to a situation (based on available information[50]) where companies held public meetings mostly with "loyal" community members. Cases have occurred in which the project owner (company) hired people to fill the meeting venue or offered monetary remuneration to participants for voicing favorable opinions.

Local benefits

Payments from mining companies that go into local budgets comprise the main benefit that local communities derive from mining activities. These include payments for license retention, part of auction and tender objects' value, and part of the payment to maintain and develop local infrastructure (discussed in more detail in Precept 9). The Subsoil Law also provides a social package for nationally important deposits, of which there are 55 (not all of them yet allocated). The mining company and the local government executive body agree on a social package, to contribute to the region's social-economic development (in alignment with local development plans), in the form of vocational training, employment, and building infrastructure. However, the impact of the social package requirement is limited because state gave out licenses for most deposits of national importance before 2012, when the Subsoil Law did not enshrine social package requirement. Thus no social package obligations exist in the licensing agreements of companies[51] that received licenses for deposits of national importance before 2012. Nevertheless, a number of these companies provide benefits to local communities in the form of social infrastructure construction, procurement and employment. Another challenge to local benefits is that neither the Subsoil Law, nor any other regulation, provides detailed requirements for social packages. On the one hand this could mean that a mining community has relative freedom in deciding the requirements, which could prove unrealistic for a company. On the other hand, certain affected populations might lack capacity on negotiation and international good practice, and thus receive fewer benefits than they would otherwise receive.

49 Meetings are to be held only at local communities' request (Article 5 of EIA Regulation).
50 Public consultation meetings with local communities in Kepure-Bazar, Kemin and Ala-Buka.
51 Based on interview with the SCIESU.

Also, the legislation does not contain provisions for local content and local employment in the mining industry, which is why mining companies have taken a range of approaches to local procurement, from strategic to opportunistic, with varying degrees of success.[52] In practice, challenges exist on all sides. Communities have unrealistic expectations, low capacity to supply goods and services and poor access to affordable financing for local small and medium enterprises (SMEs). Also, employing locally and using local goods and suppliers could increase project costs and lower public revenues. However, the government can play an important role in ensuring mining companies have incentives to increase local content and in promoting linkages between the local workforce and mining companies.

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The potential for conflict, the *ad hoc* approach to consultations between the government and communities, and the limited ability of government to ensure environmental protection, all point to the importance of increasing meaningful participation and monitoring opportunities for local communities with regard to resource project decision-making.

First, the requirement for EIA documentation to be available for comment at the offices of companies and municipal authorities does not guarantee that companies will consider the opinions of community members. The government should require mining companies to hold actual meetings with different community groups (women, youth, pensioners and disabled). Second, regulations should require companies to disseminate the EIA statement (a summary of the EIA approved by SAEPF) during meetings. EIA documentation usually comprises several books and local communities, as well as local authorities, do not always have the time or technical ability to engage with these documents. Instead, companies should provide EIA statements in clear and locally comprehensible language, outlining the full range of risks and challenges the EIA identifies. Third, social package negotiations should incorporate the views of different groups in the impacted community: women, youth, pensioners and disabled (or at least the views of local council members), to help reach an agreement that meets the majority of community needs. Fourth, requiring disclosure of the final EIA statement (see Precept 2 on the transparency element) and social package agreements could be an important step in clarifying company obligations for both environmental protection and benefit sharing. It can also help ensure that communities play a constructive role in monitoring company compliance and that of state and local government.

In addition, given the limited capacity of local communities and authorities with regard to environmental issues, it may be worth involving specialized non-profit organizations to help build capacity during the EIA and ecological monitoring processes, especially given the fact that the legislation calls for public ecological monitoring and public environmental review. Public environmental review is a unique opportunity to scrutinize EIA documents, which other developing countries have not implemented. In practice, local authorities only rarely conduct public ecological monitoring and public environmental review, as they lack the financial resources. The national and local Nature Conservation and Timber Industry Development funds, managed by SAEPF, could potentially support these activities.

52 GIZ, *Local Content Development in Kyrgyzstan: Opportunities and Challenges* (2016) 2.

Precept 6. State-owned enterprises

Priority issue for the Kygyz Republic	Disclosing comprehensive information will help build SOEs that benefit both natural resource governance and the economy

Rules. State-owned extractive companies (which we call SOEs in this report), are joint stock (public) companies. The Law of the Kyrgyz Republic on Joint Stock Companies (2003) regulates their activities. In addition, state-owned companies face the same legal requirements as other legal entities, including standard tax treatment, dividend distribution, and license/permit requirements. Furthermore, these companies must comply with the public procurement requirements that the Law of the Kyrgyz Republic on Public Procurement (2015) sets out for government agencies and institutions. Joint stock companies listed at the Kyrgyz Stock Exchange must also follow the Law of the Kyrgyz Republic on Securities Market (2009), which, among other things, contains disclosure requirements, e.g., annual and quarterly reporting including financial statements and auditor's opinions, as well as disclosure of material events.[53] The Law on Joint Stock Companies contains limited disclosure requirements in relation to its activities, mainly only requiring stock companies to publish information on dividends, and to publish yearly reports if they are offering shares publicly and/or have more than 500 shareholders.[54]

Institutions. The State Property Management Fund (SPMF) holds the government's share in state-owned companies on behalf of the government. SPMF as a shareholder in state-owned companies participates at the general meeting of shareholders of state-owned companies, which is the highest governing body of such companies. The other governing bodies are the board of directors (responsible for SOEs overall management between the general meetings of shareholders), the executive board or directorate (responsible for the company's ongoing management), and the audit commission (oversees the company's financial activities). The general meeting of shareholders is not involved in ongoing management, but handles material issues, such as the election of the board of directors and audit commission, dividend distribution and dividend amounts.[55] The board of directors is in charge of overall, strategic management, including the election of the executive board and the auditor.

CONTEXT

The mining industry has four open joint stock companies with state participation:

1. *Kyrgyzaltyn - precious and rare metal mining (the largest company)*
2. *Suluktakomur - coal mining*
3. *Kyrgyzneftegas - oil extraction*
4. *Khaidarkan Mercury - monometallic ore and mercury mining*

53 Articles 30 and 31 of the Law on Securities Market.
54 Para 2, Article 31, Article 81 of the Law on Joint Stock Companies.
55 The Law on Joint Stock Companies stipulates that the dividend size cannot be greater than that recommended by the Board of Directors.

There is a general lack of public information on the governance, funding mechanisms and activities of all joint stock companies with state participation, not only those in the mining sector. A local public association, Precedent Partner Group,[56] *recently conducted research on the availability of information on organizations with state participation. The research found that the majority of state-owned companies did not and/or refused to provide information that Precedent Partner Group requested. Among others, Precedent Partner Group submitted requests to three state-owned mining companies: Suluktakomur, Kyrgyzneftegaz and Kyrgyzaltyn. Suluktakomur and Kyrgyzneftegaz did not respond, while Kyrgyzaltyn refused to provide the information, explaining that it is not financed by the state budget.*

This report will analyze the activities of Kyrgyzaltyn because it is the largest state-owned company, with more publicly available information.[57]

Kyrgyzaltyn's role and funding

Based on the information in Kyrgyzaltyn's 2016 first quarterly stocks report, charter and web page, Kyrgyzaltyn has four commercial roles: operator of gold mines, seller of gold ingots, equity shareholder, and owner of non-operational subsidiaries.

Operator. Kyrgyzaltyn has been acting as an operator since Soviet times. Currently, it has four production subsidiaries (see table 5 below). Despite the production and refining of gold products, Kyrgyzaltyn's operational activities remained unprofitable in 2013-2015. For example, its losses amounted to about 14 million Kyrgyzstani soms (KGS) in 2013,[58] about KGS 30 million in 2014[59] and about KGS 82 million for nine months of 2015.[60] The main reasons for these losses may be overstaffing at the Makmal Mine (1,165 people), high transportation costs, and worn-out equipment that causes gold losses of over 30 percent during processing.[61] According to the chairperson of Kyrgyzaltyn, the company's major mine, Makmal mine, will be depleted in 2017. This may cause the region's social-economic conditions to deteriorate, since Makmal mine accounts for 95 percent of the region's taxes. In addition, the majority of the 1,165 people working at the mine are locals, and will lose their jobs if the mine closes.[62] In light of this concern, the Kyrgyzaltyn chairperson emphasized the need to attract investment to conduct exploration works on several areas near the mine, including an area partially situated within the territory of a national park.

56 The public association Precedent Partner Group conducted the research titled *Access to information about organizations with the state participation and/or organizations financed from the state budget,* during November 2015-February 2016, with support from Canada Fund for Local Initiatives.

57 On July 2015, Kyrgyz Stock Exchange officially listed common shares of Kyrgyzaltyn OJSC , which means the company must comply with general legislation on disclosure of financial reports, information on dividends, large transactions, large shareholders, etc.

58 Kyrgyzaltyn Independent Audit Report as of 31 December 2013.

59 Kyrgyzaltyn Report on Profits and Losses for 2014.

60 Kyrgyzaltyn Report on Profits and Losses for 9 months of 2015.

61 Azattyk radio. Interview with Almaz Alimbekov, chairperson of Kyrgyzaltyn, 1 June 2016, http://rus.azattyk.org/a/27772049.html

62 Online media Vecherni Bishkek. Interview with Almaz Alimbekov, chairperson of Kyrgyzaltyn, 4 January 2017, http://www.vb.kg/doc/352999_almaz_alimbekov:_v_konce_2017_goda_zoloto_na_makmale_zakonchitsia.html

Table 5. Kyrgyzaltyn production subsidiaries

Integrated gold works-Makmalzoloto	Kyrgyzaltyn's largest production subsidiary. Extracts and recycles gold ore from Makmal gold deposit. Production license is valid until 2022, yet without further investment of around USD 30 million, Kyrgyzaltyn's CEO suggests that the mine will close by the end of 2017.
Solton-Sary gold mine	Infrastructure of this mine includes the Altyntor pit and a processing plant that annually produces more than 100 kg of gravity concentrate.
Tereksayskiy gold mine	Currently Kyrgyzaltyn exploits Terekkan gold mine and one area of Terek gold mine. The processing plant annually produces about 150 kg of float concentrate, which Kyrgyzaltyn sells to China and Kazakhstan.
Kara-Balta gold refinery	This gold refinery produces standard gold and silver bullions out of dore bead, supplied by Kumtor Gold Company, Full Gold Mining LLC and Altynken LLC. The refinery possesses the quality certificate "Good Delivery" of the London Metal Exchange.

Equity shareholder. Kyrgyzaltyn holds shares in six joint venture companies (see box 1 below). Little public information is available on Kyrgyzaltyn's shareholding in Jerooy Altyn CJSC and on joint venture arrangements between Kyrgyzaltyn and other shareholders of joint venture companies. Thus, the type of cooperation that exists between Kyrgyzaltyn and other shareholders, including the distribution of roles, responsibilities and dividends, is not clear. More information is publicly available on Kyrgyzaltyn's equity shareholdings in Centerra Gold Inc., partly because Centerra Gold Inc. discloses full information in its annual and quarterly reports, in keeping with Toronto Stock Exchange disclosure requirements. From 2011 until the end of 2016, an arbitration judgment against the Kyrgyz Republic from other foreign investment deals caused a freezing of Kyrgyzaltyn's shares and dividends in Centerra Gold Inc. However, the freeze ended in 2016.

Box 1. Kyrgyzaltyn equity shareholdings[63]

Centerra Gold Inc. – 28.9 percent

Jerooy Altyn CJSC – 40 percent

Altynken joint venture – 40 percent

Solton-Sary recycling joint venture – 75 percent

Tereksai recycling joint venture – 75 percent

Eti Bakir-Tereksay joint venture – 25 percent

Non-operational subsidiaries. In addition to its gold production subsidiaries, Kyrgyzaltyn has a number of non-operational subsidiaries, including a jewelry plant and shop, a medical center, a hotel, a sanatorium, an auto transportation enterprise and a specialized construction and manufacturing company. While these additional subsidiaries generate a positive net income, they do not align with Kyrgyzaltyn's main role as an extractive company and require additional time and resources, perhaps hindering its ability to operate successfully as an extractive company.

Funding mechanism. As Kyrgyzaltyn is a commercial open joint stock company the state budget does not finance it. Rather, it relies on its production subsidiaries, non-operational subsidiaries and equity participation for funding. Due to insufficient profits (partially because of the 2011 freeze Canadian courts placed

63 Kyrgyz Stock Exchange, *Kyrgyzaltyn Securities Report, 4th quarter* (2016), accessed 5 February 2017. https://www.kse.kg/files/BusinessReports/JSC_Kyrgyzaltyn-quarterly-2017-01-23.pdf.

on Kyrgyzaltyn's stake in Centerra Gold Inc. shares and dividends), Kyrgyzaltyn only raises funds through foreign direct investment (FDI).[64] For example, in 2015, Kyrgyzaltyn, along with Turkish company Eti Bakir, won a tender to develop Tereksay gold mine. Kyrgyzaltyn possesses a 25 percent share in the resulting joint venture, "Eti Bakir Tereksay." Kyrgyzatlyn plans to attract USD 30 million of FDI to conduct future exploration works and extraction in a number of areas.

Kyrgyzaltyn is subject to taxes like any other legal entity. As a shareholder, the SPMF receives dividends from its participation in Kyrgyzaltyn as any private investor would, and there were cases when PPMF received advanced dividends from Kyrgyzaltyn. For example, in 2011, Kyrgyzaltyn transferred KGS 1,290,610,400 (about USD 28 million) of the 2010 dividends Centerra Gold Inc. declared to the republican budget, towards future dividends for 2011 and consecutive years.[65] Table 6 shows the amount of paid and accrued dividends for 2011-2015. As of 2016, Kyrgyzaltyn will resume paying dividends to the republican budget.

Table 6. Accrued and paid dividends by Kyrgyzaltyn to the republican budget, 2011-2015[66]

	2011	2012	2013	2014	2015
Accrued dividends (% of net profit and amount in USD)		25% or 4,230 thousand	25% or 2,094 thousand	50% or 3,122 thousand	35% or 2,895 thousand
Paid dividends (USD)	27,970 thousand	0	0	0	0

The State Property Fund (as sole shareholder of Kyrgyzaltyn) decides how much of Kyrgyzaltyn's profits are directed to the republican budget. However, there is no clear formula to determine the amount. In contrast, there is clear formula to determine how much of the profits of the National Bank of the Kyrgyz Republic is to be remitted to the state budget annually.[67]

Kyrgyzaltyn corporate governance

Officially, PPMF, on behalf of the government, holds 100 percent of Kyrgyzaltyn's shares (9,641,239 in total).[68] The Kyrgyzaltyn charter clearly lays out PPMF's role as a shareholder and indicates that the government indirectly manages the company.

According to the Kyrgyzaltyn charter, the board of directors should consist of three members (currently there are two) who are elected for three years at a general shareholders meeting. In keeping with the Regulation on the Board of Directors of Kyrgyzaltyn, SPMF appoints board members from either SPMF staff or representatives. There are no clear provisions on who can or cannot be a member of the board of directors. However, the Regulation on the Board of Directors

64 Azattyk radio interview with Almaz Alimbekov, chairperson of Kyrgyzaltyn (2016).
65 Government Executive Order #180-r as of 20 May 2011.
66 Based on information found on the web page of the Kyrgyz Stock Exchange (www.kse.kg) and Kyrgyzaltyn's old web-page (http://kyrgyzaltyn.kg/old/kyrgyzaltyn.kg/novosti?start=66), both accessed 15 December 2016.
67 Article 13 of the Law on the National Bank of the Kyrgyz Republic.
68 On July 2015, the Kyrgyz Stock Exchange officially listed common shares of Kyrgyzaltyn OJSC as blue chips, which means the company has to comply with general legislation on disclosure of its financial reports and payments of dividends, among other matters. Accessed 9 July 2016. http://www.kse.kg/Listing/KALT-prospect-2015-12-31.pdf.

provides general qualification requirements for members of the board.[69] Board member profiles are not available, which makes it impossible to assess whether they meet criteria. The Regulation on the Board of Directors indicates that an internal document approved at the general shareholders meeting could provide more specific qualification criteria.[70] However, this document is not available in the public domain.

Today Kyrgyzaltyn employs over 2,450 people.[71] All employees are nationals of the Kyrgyz Republic. Although Kyrgyz legislation does not prohibit employment of foreign staff, state-owned companies almost never employ foreign nationals because of financial limitations. Companies with state ownership usually do not have well-designed policies to prevent conflicts of interest among top management.

SOE transparency and accountability

Based on reports Kyrgyzaltyn's webpage provides, the same local company, John Ashworth Audit Company, audited financial reports for 2013 and 2014. Since the Kyrgyz Stock Exchange has listed Kyrgyzaltyn since 2016, the company is required to publish its audited annual reports among other things. At present, only audit reports for 2013 and 2014 are publicly available.

Interviews that NRGI staff conducted in May 2016 with members of the Kyrgyz parliament revealed that parliament generally does not oversee Kyrgyzaltyn and its activities. However, some members of parliament submit inquiries to Kyrgyzaltyn on matters related to state interests.

PRIORITY ISSUE 6

In many countries, state-owned resource companies rank among the most opaque and unaccountable state institutions. The absence of a legislative requirement to disclose comprehensive information about the company's activities can reduce incentives for the company to act in the public interest. In the case of the Kyrgyz Republic, information disclosure requirements are not detailed enough. In particular, legislation does not require joint stock companies to publish information on the financial and operating activities of their branches and business divisions, including data on available mineral resources, mining and processing rates and sales.

For now, insufficient information in the public domain makes it difficult to assess whether state-owned companies are helping either the country's resource governance or wider economy. Without this information, it is an open question as to whether the Kyrgyz Republic gains more from using state-owned companies than it would from licensing private companies instead. It is worth pointing out, though, that since the freeze on Kyrgyzatlyn's share and dividends in Centerra Gold Inc. was lifted at the end of 2016, Kyrgyzaltyn will receive all dividends accrued during 2011-2016, part of which will be directed to the republican budget. However, the absence of legislation on how much of Kyrgyzaltyn's profits should go into the budget, makes it impossible to conclude how much the country might benefit.

69 Possession of knowledge on corporate finance, financial accounting, strategic planning, corporate law and management.
70 Article 4.3 of the Kyrgyzaltyn Regulation on the Board of Directors.
71 Kyrgyzaltyn Securities Report for 4th Quarter, 2016. Accessed 15 December 2016. https://www.kse.kg/files/BusinessReports/JSC_Kyrgyzaltyn-quarterly-2017-01-23.pdf.

The Kyrgyz Republic has room to significantly increase the transparency and accountability of its extractive companies, considering that in 2004 the country joined the EITI initiative and, therefore, must be willing to disclose information required under the EITI Standard. In particular, such information should include data on:

- Sales of extracted and processed (if applicable) mineral commodities
- Revenues related to SOE participation in exploration and production activities, including dividends received from partnerships
- Earnings the company retains
- Quasi-fiscal expenditures
- Joint ventures and subsidiaries
- Revenues that subsidiaries and joint ventures earn and retain
- Accounts payable (debts)
- Transfers between the parent company and subsidiaries and joint ventures

Precepts 7 and 8. Revenue management

Priority issue for the Kygyz Republic	Robust long-term revenue forecasts will inform policy decisions, including on saving and spending choices. When revenue forecasts indicate a greater contribution from mining to government revenues, an additional fiscal rule may help insulate government spending from commodity price volatility

Rules. General laws and policies around finance and budgeting guide the management of mining revenues. These include the Budget Code, which lawmakers passed in 2016 to unite all public finance management legal acts.[72] The annual Law on Republican Budget determines amounts of fiscal deficit, public debt and volume of public investment for the current and next two consecutive years, in accordance with the main direction of budget policy set out in the midterm fiscal framework (MDFP). It includes, among other matters, forecasts of revenue and expenditure, public debt limit, budget deficit, and priorities for public investment. Along with the MDFP, the International Monetary Fund's international indicators of debt sustainability (enshrined in the Midterm Public Debt Strategy [MPDS]) help determine the amount of public debt. The latest MPDS covers 2016-2018.[73]

Institutions. The Ministry of Finance is the main government body responsible for making and implementing public finance management policy, including public debt and major aspects of budget policy. The Ministry of Finance is the only government body to take concessional loans and grant the state guarantees. Parliament passes laws on the republican budget and the Republican Budget Execution Report. The latter incorporates an audit report from the Chamber of Accounts on republican budget execution.

CONTEXT

A government that derives a large revenue from resource extraction needs to be aware that these revenues may require a different approach than that of other revenue sources, principally because resource revenues are finite and volatile. Kumtor is an example of this. Most of the government's resource revenues come from this mine, but the owners plan to terminate operation by the end of 2026. It is not clear what will replace it as a revenue source. So, unless the country is to be worse off than it was before extraction, the government has to manage resource revenues in a sustainable manner. This involves limiting borrowing, investing resource revenues in economic growth, supporting economic diversification and expanding the tax base so that revenues keep flowing into government coffers after resource wealth is depleted.

72 Law on Basic Principles of Budgetary Law, Law on Financial and Economic Basis of Local Self-Governance and Law on Public and Non-Public Debt.
73 Approved by Government Decree #532 as of 6 October 2016.

Long-term fiscal sustainability

Currently, the government does not treat resource revenues differently from other revenues. This raises a need to examine how the government manages revenues within the general fiscal framework: borrowing, saving, spending and investment.

First, the government has been facing insufficient fiscal revenue to cover its needs, with no saving and a chronic budget deficit. (See figure 4.) The fact that government bonds and external sources (grants, loans) mostly finance the fiscal deficit, causes an increase in public debt and thus hinders long-term fiscal sustainability. While the government forecasts a decrease in the fiscal deficit by 2019,[74] the absence of any legislated limits on budget deficit levels means the deficit may increase if macroeconomic or political conditions change, and thus create more risks for fiscal sustainability.

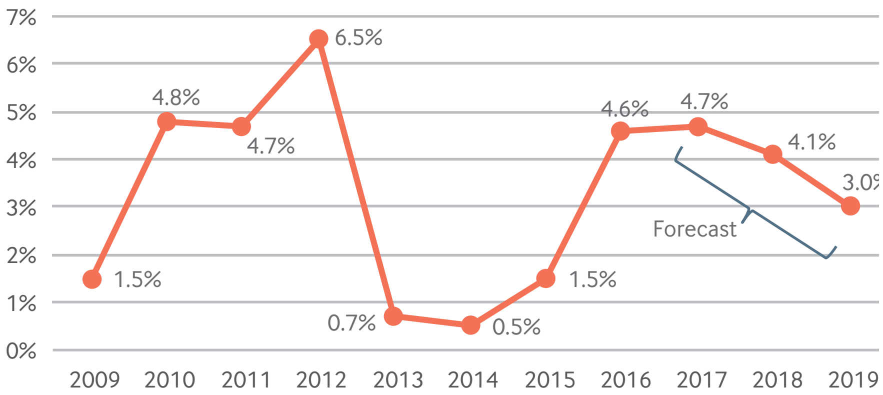

Figure 4. Fiscal deficit as a percentage of GDP, historical and forecasts, 2009-2019[75]

Second, the government directs a large share of public expenditure to the social sector and government employees wages (more than 50 percent), in addition to public debt service. During 2012-2016,[76] on average, the government directed 13 percent of total revenues to debt service. This will increase to an average of 17.3 percent in 2017-2019, according to the Midterm Budget Forecast. Remaining government revenues are directed, among other things, to national security, environmental protection, maintenance of the state apparatus and the public investment program (PIP).

Because of insufficient government revenues, external sources (concessional loans from international bilateral and multilateral institutions) are almost entirely financing PIP, especially with regard to power and transportation projects. According to the Midterm Budget Forecast, in 2017 external financing will likely contribute 96.5 percent to the overall PIP budget. The state budget incorporates concessional loans and grants, which constituted 18 percent, 15 percent and 31 percent of the state budget for 2014, 2015, and 2016 respectively.

Investment in infrastructure plays a crucial role in economic growth, but can negatively influence fiscal sustainability in case GDP grows faster than fiscal revenues in the long-term. For example, in the midterm GDP will increase by 4.4 percent on average, while fiscal revenues by only 3.6 percent on average.[77]

74 Kyrgyz Republic Midterm Budget Forecast for 2017-2019.
75 National Statistical Committee and Midterm Budget Forecast for 2017-2019.
76 Reports on budget execution for 2012-2016.
77 Kyrgyz Republic Midterm Budget Forecast for 2017-2019.

Despite the fact that public debt is currently within target indicators of debt sustainability (see table 7 for indicators),[78] according to the IMF[79] the Kyrgyz Republic is very close to receiving a rating of "high risk of debt distress." If the country is assessed to be at high risk of debt distress, this will limit access to external borrowing, which could potentially cut back PIP and create a high budget deficit in the future.

Table 7. Key target indicators for 2016-2018 public debt strategy implementation

Indicator	Target		
	2016	2017	2018
Ratio of public debt to GDP and remittances	No more than 56%[80]	No more than 56%	No more than 56%
Ratio of external public debt to GDP and remittances	No more than 36%[81]	No more than 36%	No more than 36%
Ratio of external public debt to republican budget revenues	No more than 250%[82]	No more than 250%	No more than 250%
Ratio of external public debt service to republican budget revenues	No more than 20%[83]	No more than 20%	No more than 20%

Since 2013, the ratio of public debt to GDP almost doubled (see figure 5), because of both a wide PIP and sharp national currency depreciation in 2015 (which increased the value of foreign denominated debt in terms of domestic currency). For public debt to depend so greatly on the exchange rate indicates the importance of the mining sector, as gold and other resources sales comprise about half of the country's exports.

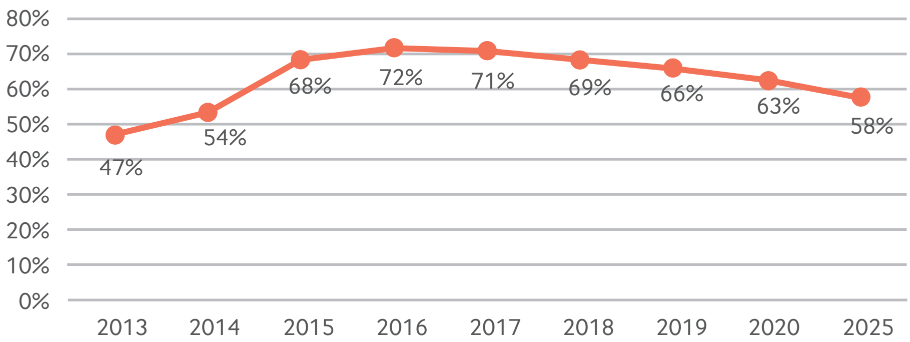

Figure 5. Public debt as percentage of GDP, 2013-2025[84]

Based on the above, it seems that PIP almost completely depends on unsustainable external borrowing, and that the government does not invest a major part of fiscal revenues, including resource revenues, in economic growth and public services development, undermining long-term fiscal sustainability. Recognizing these shortcomings, the government introduced the Budget Code in 2016, which, among

78 Public Debt Management Strategy of the Kyrgyz Republic 2016-2018.
79 International Monetary Fund, *Kyrgyz Republic Country Report* (2016), 42.
80 Target is of an advisory nature.
81 Allowable variation is +1.8 percent.
82 Allowable variation is +12.5 percent.
83 Allowable variation is 1 percent.
84 National Statistical Committee and International Monetary Fund forecasts.

other things, aims at gradually re-orienting the budget from social sector support to economic growth stimulation.

Expenditure volatility

Even though the Kyrgyz Republic only partially depends on resource revenues, two factors keep government revenues volatile. In addition to volatile commodity prices, the country depends on unsustainable external borrowing from the resource-dependent Russian Federation and Kazakhstan. Low global oil prices caused the economies of Russia and Kazakhstan to deteriorate, which led to a decrease in remittances to the Kyrgyz Republic (which, according to the National Bank, account for about 30 percent of GDP). It also caused exports to decrease, as these countries are some of the Kyrgyz Republic's main trading partners. This economic dependence on volatile revenues makes development planning much more difficult, since, as figure 6 shows, when revenues unexpectedly decline, the government has to cut capital expenditure and potentially hurt long-term development.

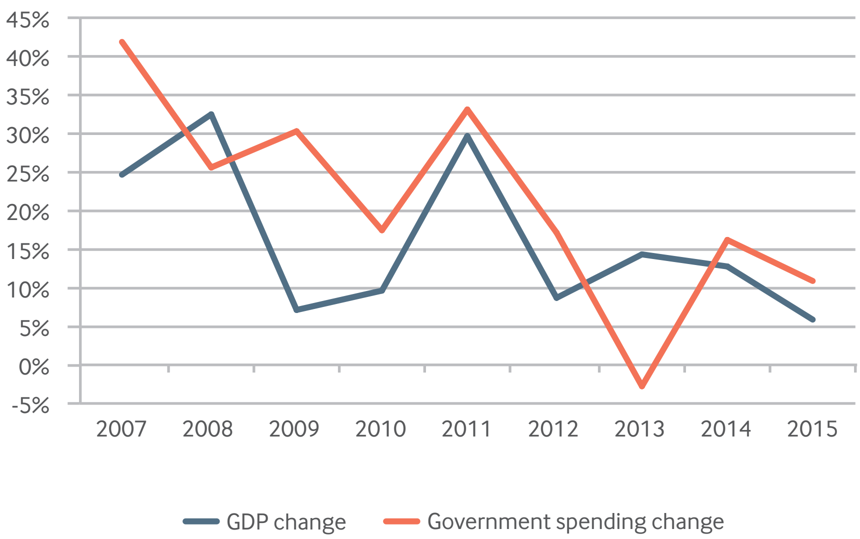

Figure 6. Changes in government expenditure and GDP (%), 2010-2015[85]

PRIORITY ISSUE 7

Currently the government produces only a three-year forecast, but it needs long-term forecasting of revenues, expenditure and economic growth to better inform its policy choices. Long-term forecasts are especially important given that production at Kumtor gold mine may terminate by 2026 while several other mines will either start or increase production in the long-term. Most important, a long-term forecast will illustrate how the mining industry's role will change in the face of increased commodity prices and changes in production. For example, the approved 2017 state budget and 2018-2019 forecast only include projections for three types of mining taxes. (See figure 7.)

Forecasting is always difficult, particularly when uncertain commodity prices strongly influence revenues and the economy. The fact that not all mines have similar ore characteristics is another complicating factor. For example, some mining

85 National Statistical Committee, accessed 9 October 2016 http://www.stat.kg/ru/statistics/nacionalnye-scheta/

companies export copper-gold concentrate and some produce gold concentrate that is refined in the Kyrgyz Republic. A robust, independent approach to producing and using resource forecasts, drawing from economic modeling of mines (mentioned in Precept 4), will help produce more realistic and dependable forecasts. Economic modeling includes projections of prices, costs, and production levels. The government can then measure their impact on government take, investor return, progressivity, and timing of revenue. Efficient coordination among relevant government bodies (mentioned in Precept 1) is essential to produce a robust forecast. Further, the government should produce long-term revenue forecasts before a significant increase in mining output. This will enable it to develop policies to manage resource revenues in keeping with one of its strategic objectives: stimulating economic growth.

Currently, resource revenues may not comprise a significant enough share of government revenues to affect government spending during revenue booms and busts, as non-resource revenues are large enough to cushion much of the volatility. However, if hypothetical long-term forecasts show a growth in resource revenue as a portion of government revenue (to, for example, more than 15-20 percent, based on the IMF's definition of a resource-rich country[86]), the government will need to implement specific policies to prudently manage the highly volatile and high volume mining revenues. This will require either bringing down external public debt, saving surplus revenue in a stabilization fund or investing revenues to expand the tax base, including through a special mineral fund. The government may use a mix of options to manage resource revenues. The creation of a fund would require administrative expenditure (e.g., for offices and salaries), as well as a comprehensive legal act covering transparency, independent external oversight, constraints on excessive risk-taking, clear deposit and withdrawal rules and a clear management structure.

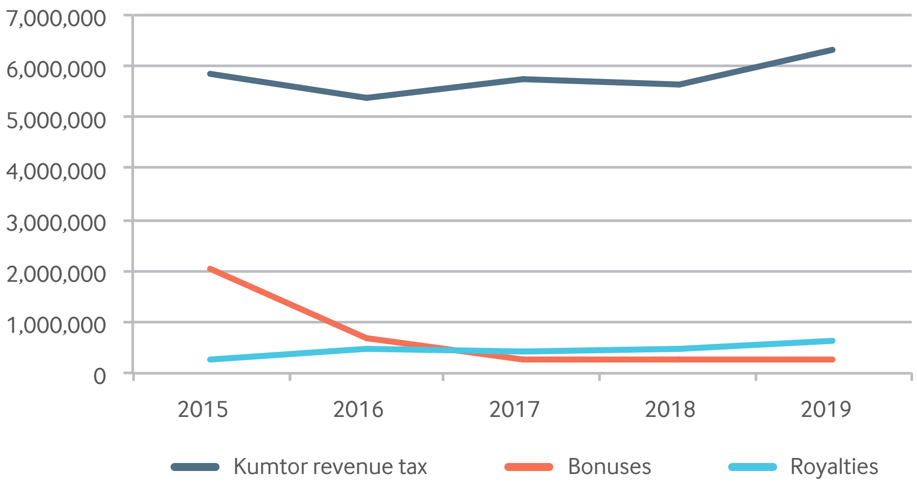

Figure 7. Kumtor revenue tax, royalties and bonuses in KGS billions, 2015-2019[87]

86 International Monetary Fund, *Macroeconomic Policy Frameworks For Resource-Rich Developing Countries* (2012), accessed 11 October 2016, https://www.imf.org/external/np/pp/eng/2012/082412.pdf.
87 Annex 3 to the Law on Republican Budget.

In addition, if revenues from extractive industries grow too fast for the government to manage the windfall, this can generate inflation, exchange rate appreciation or significant waste. In such a situation, the government will need to assess its absorptive capacity and exchange rate management policy.

PRIORITY ISSUE 8

As shown above, the Kyrgyz Republic's fiscal expenditures are volatile and pro-cyclical, meaning as a rule they increase when GDP rises and vice versa. As a result, public expenditure exceeds planned levels when there is a revenue windfall (as in the case with Jerooy), and decreases when revenues decrease unexpectedly (as with the Russian Federation's sharp economic downturn). Such macroeconomic instability does not allow the government to plan its expenditure in advance (given the absence of savings and insufficient fiscal revenues), which leads to poor decision-making with regard to capital expenditure.

In addition to the debt rule that the country currently follows, the fiscal framework should aim to control the volatility of government expenditure independent of public revenue. This could take the form of an "expenditure-smoothing rule" that would constrain overspending when unexpected revenues occur, in order to spend more during economic downturns. For example, Peru has enacted a rule limiting real current expenditure growth to four percent. Establishing fiscal rules seems particularly relevant given the Kyrgyz Republic's budget policy for 2017-2019 targets budget sustainability via enhanced budget discipline and potential increase of resource revenue. However, introducing such a rule will not be enough; enforcing it will be equally important to ensure stable long-term planning.

Any fiscal rule must encompass a system of information disclosure that will enable civil society to calculate whether the government is following the rule. Doing so, of course, requires a civil society with the skills and knowledge to make the calculation. Without these two elements, a fiscal rule alone may not ensure the government keeps to its long-term goals.

Precept 9. Government spending

Priority issue for the Kygyz Republic	The government should evaluate current revenue sharing with regional authorities to ensure fair revenue allocation and efficient spending

Rules. In the Kyrgyz Republic, authorities produce both components of the state budget, republican and local budgets, for the current and next two consecutive years. The MDFP shapes the republican budget, whereas territorial development strategies guide local budgets. However, local budgets should be consistent with MDFP provisions as well. Republican budget revenues, in accordance with government budget responsibilities, go into nationally important activities such as defense, environmental protection, health, education, social protection and economic issues. Local budget revenues mainly go into municipal facility maintenance, provision of municipal services and social-economic development of local territories, including local investment projects. The Budget Code includes all these provisions.

In addition to the Budget Code, the Law on Public Procurement (2015), the Law on Non-Tax Payments (1994), and the Regulation on Regional Development Funds (2014) regulate aspects of budget execution, such as public procurement and subnational revenue distribution (including mining revenue sharing arrangements). The Budget Code also enshrines certain rules on budget transparency, namely that all government agencies and local authorities should publish approved budgets and budget execution reports on their web pages. Other aspects of transparency will appear in bylaws that are yet to be developed in accordance with new rules in the Budget Code, including rules around investment projects management.

Institutions. Different government bodies play a role in state budget planning and execution. The Ministry of Finance produces the annual republican budget in agreement with government institutions, and issues regular reports on its execution. Parliament, in the form of corresponding laws, approves both the annual republican budget and its implementation report (subject to audit by the Chamber of Accounts). The Chamber of Accounts has the right to audit state-owned enterprises and usage of off-budget funds. Local municipal authorities prepare and execute local budgets, which local councils then approve. The Ministry of Finance also allocates resources to finance public investment projects, a list that the Ministry of Economy selects and appraises. The finance ministry also allocates resources to local investment projects (in addition to the revenues local budgets receive). The Ministry of Finance's Department of Public Procurement manages and monitors the public procurement process and the development of corresponding bylaws.

Independent bodies, such as Parliament and the Chamber of Accounts also oversee the budget process. The Budget Code dictates that Parliament approves a report on budget execution by passing a corresponding law that includes Chamber of Accounts audit results.

CONTEXT

Resource revenues could be invested in economic growth across the whole country. However, the result depends on efficiency of government revenue distribution, including on a sub-national level, quality of budget execution and accountability of these processes.

Public spending planning and execution

Since 2017, MDFP has been based on the Kyrgyz Republic's midterm social-economic development forecast and sectorial strategies and programs, which tie in with the government's overall strategic plans. In addition, the government produces a midterm strategy for sectorial expenditure distribution, which, among other things, includes performance indicators. These are good provisions since they align national budgets with national development goals (identified in the NSSD). Until now, the budget has not fully reflected all strategies. This is because ministries' main apparent concern in preparing budgets is to maintain, as far as possible, current activities and levels of employment,[88] which means they develop some sector strategy documents separately from the budget process and without considering cost implications. Even though government agencies prepare multi-annual budgets, two factors make it hard to assess the extent to which budgets are/will be based on future demands and expected changes in available resources. First, as mentioned in Precepts 7 and 8, the Kyrgyz Republic's economy (hence public revenue) depends highly on external factors, which complicates revenue and expenditure forecast. Second, sectorial strategies include public investment projects, the financing of which largely depends on unsustainable external borrowing. This situation may indicate a necessity to earmark rising mining revenues for national priorities.

Further, authorities generally align up-to-date budget execution with the originally approved budget in aggregate terms. However, ministries and agencies made substantial adjustments to expenditure composition during the year. According to the World Bank public expenditure and financial accountability report, this may indicate that the approved budget did not allocate resources optimally, or that priorities changed during the year. As a result, ministries and agencies that rose in priority during the year received a greater share of available resources.[89] To address these challenges, the government recently introduced a program budget.

The government develops public investment projects in accordance with the NSSD 2013-2017. The Government Program on Transition of the Kyrgyz Republic to Sustainable Development for 2013-2017 further specifies the amounts of financial resources necessary to implement each of the investment projects the NSSD identifies. However, managing public investment comes with a number of challenges. Selecting, monitoring (including data collection) and appraising projects is not effective because of the low capacity of responsible government employees[90] and lack of a documented framework. Thus, there is no guarantee of a 30 percent rate of return on all public investment projects, which is the suggested target for developing countries (projects

88 The World Bank, *Kyrgyz Republic Public Expenditure Review Policy Notes*, 15. http://documents.worldbank.org/curated/en/887061468089699711/pdf/889770ESW0whit0ox385256B00PUBLIC00.pdf

89 The World Bank, *Kyrgyz Republic Public Expenditure and Financial Accountability* (2015), 29, accessed 11 July 2016, https://pefa.org/assessment/kg-mar15-pfmpr-public-en.

90 In spite of the fact that about 15 percent of investment expenses go into capacity building.

the World Bank finances have a 27.5 percent return rate).[91] In addition, according to the IMF, the Kyrgyz Republic has a relative public investment efficiency of around 40 percent, making it the least efficient among its regional peers. Efficiency of public investment is especially important given the government will need to repay its high debt without any major future correction to the balance of income and expenditure.

The government implements five methods of public procurement, including the possibility to conclude an agreement without holding a competitive tender. Regardless of the method they use, all government and municipal bodies and SOEs must register on a Ministry of Finance web portal for public procurement[92] and post information related to tender procedures (tender opportunities, contract awards, agreements and the results of procurement complaints). In addition, all government bodies as well as local governments and SOEs must make all public procurements public by developing and posting annual procurement plans on the web portal.

Revenue distribution

In the Kyrgyz Republic, the central government and local authorities spend all the resource revenues they receive through the national budget, which reports resource and non-resource revenues. However, some revenues bypass the budget process, with other institutions receiving and spending them directly. For example, one percent of revenue from Kumtor Gold Company goes to the Issyk-Kul Oblast Development Fund (IKODF).In total, this fund has received more than USD 50 million (USD 7.1 million in 2015).[93] The Regulation on Issyk-Kul Oblast Development Fund[94] identifies its main objective as off-budget financing of Issyk-Kul Oblast social-economic development programs, but does not specify the legal status of the IKODF. The fact that the republican budget allows for payments to IKODF (from ministries' and agencies' special accounts revenues)[95] means it is a public institution. This raises two points. First, IKODF, being a public institution, must conduct procurement in accordance with the Law on Public Procurement. As of January 2017, IKODF has made no procurement announcements on the official public procurement web portal. Second, the Budget Code (as well as previous public finance legislation[96]) prohibits establishing any off-budget funds, except for funds based on voluntary contributions. Since Kumtor Gold Company pays one percent of its income to IKODF within the legal agreement,[97] it is considered an obligatory payment. This raises the important question as to whether IKODF has the legal basis to exist as an off-budget fund.

In addition, Kumtor Gold Company and its parent company Centerra Gold Inc. make direct payments to the state-owned company Kyrgyzaltyn (see figure 7), which are considered its income. Kyrgyzaltyn also generates profit from the sales of refined gold. (See Precept 6 on the role of Kyrgyzaltyn.)

91 International Monetary Fund, Kyrgyz Republic Report No. 16/186 (2016) 57, accessed 7 October 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr16186.pdf.
92 Ministry of Finance of the Kyrgyz Republic, accessed 3 July 2016, http://zakupki.gov.kg/popp/
93 Kumtor's Basic Operating Results in 2015, accessed 5 August 2016, http://www.kumtor.kg/wpcontent/uploads/2016/04/Basic_Operating_Results_2015_en.pdf.
94 Approved by the government decree as of 27 July 2011, #416.
95 Appendix 3-1 to the Law on Republican Budget for 2017 and forecast for 2018-2019.
96 Law on Basic Principle of Budgetary Law.
97 Agreement on New Terms for the Kumtor Project among Government of the Kyrgyz Republic on behalf of the Kyrgyz Republic and Kyrgyzaltyn JSC, Centerra Gold Inc., Kumtor Gold Company CJSC, Kumtor Operating Company CJSC and Cameco Corporation as of 24 April 2009.

Management fee (USD 1 per ounce)	**Refinement**	**Dividends and sales of shares**
• **12.3 million** during 1994-2015 • **0.3 million** in 2015	• **47 million** during 1994-2015 • **13.3 million** in 2015	• **172.2 million** during 1994-2015 • **9.6 million** in 2015

Figure 8. Types and amounts of payments Centerra Gold Inc. and Kumtor Gold Company make to Kyrgyzaltyn (USD)[98]

As mentioned in Precept 6, part of Kyrgyzaltyn's profits go into the republican budget. Kyrgyzaltyn's publicly available financial reports do not contain enough information to conclude whether this state-owned enterprise spends the remaining profits efficiently.

The Natural Resource Charter views such off-budget spending as unfavorable because it avoids the scrutiny, checks and balances built into the national budget process, thereby reducing accountability. Given these risks, the decision to give entities the license to spend revenues off-budget requires a clear and reasonable justification, which currently rests with the government. However, the Chamber of Accounts has the right to audit the spending practices of both IKODF and Kyrgyzaltyn. Since the Chamber of Accounts has either not produced or made public any audit reports as yet, it is impossible to analyze the efficiency of off-budget spending.

Like in many countries, the government distributes a portion of national taxes to local budgets. In addition, local budgets receive direct taxes and non-tax payments as well as equalizing and stimulating grants from the republican budget (a formula decides equalizing grants while criteria apply to stimulating grants). With regard to mining, the government passed a separate natural resource revenue-sharing legislation in 2012-2014 to address continuous conflicts around many mines between local communities and mining companies. While the central government still collects most taxes and fees from the mineral sector, some non-tax payments (along with property and land taxes) go directly to local budgets (table 8). These include license retention payment and a payment to develop and maintain local infrastructure (not payable with regard to coal, mercury or underground water resources).

A "payment for development and maintenance of local infrastructure," essentially a royalty, equals two percent of a mining company's gross income. While 20 percent of the non-tax payment for development and maintenance of local infrastructure goes to local budgets of areas where mines are located, 80 percent goes to the republican budget for distribution among all territorial units (*ayil aimaks*) via RDFs, which the Budget Code considers a budget investment. *Ayil aimaks* can receive financing from RDFs (established in the form of oblast and rayon RDFs) on a competitive basis upon submitting project proposals to not only construct and maintain infrastructure, but also to set up new enterprises with private investors to develop infrastructure. A final list of project proposals to receive financing is approved by supervisory boards consisting of civil society organizations (CSOs), heads of municipalities and representatives of government bodies (in the case of oblast RGDs) and local offices of different ministries (in the case of rayon RDFs).

98 Kumtor's Basic Operating Results in 2015.

Table 8. Key sources of local budget revenues

Source of revenue	
Share of national taxes: personal income tax, sales tax, patent tax	Received by all *ayil aimaks*
Property tax	Received by all *ayil aimaks*
Land tax	Received by all *ayil aimaks*
Payments from rent of municipal property	Received by all *ayil aimaks*
Part of municipal enterprises' profit	Received by all *ayil aimaks*
Share of mining taxes (usually 50% of royalties except gold, oil and gas)	Received by mining-affected *ayil aimaks*
20% payment for development and maintenance of local infrastructure	Received by mining-affected *ayil aimaks*
License retention payments	Received by mining-affected *ayil aimaks*
3% of tender objects value	Received by mining-affected *ayil aimaks*
7% of auction objects value	Received by mining-affected *ayil aimaks*

While the revenue sharing regime aligns with local authorities' budget responsibilities, and the national budget clearly indicates how much of overall revenue (including resource revenue) goes to local budgets, it is impossible to track how much money each local administration unit receives and how it spends it. The Budget Code requirement to publish budgets and their implementation reports on the web pages of local territorial units will take time to go into effect, since creating and maintaining web pages will require financial resources. However, local communities can request concrete information on local budgets and reports on their implementation from local municipalities in accordance with the Law on Access to Information Under the State and Municipal Authorities.

Table 9. Sources of financing for regional development funds

Oblast development funds	Rayon development funds
50% of non-tax payments equal to 2% of gross sales of gold (for gold deposits with reserves of more than 50 tons) and other mining objects of national importance	30% of non-tax payments equal to 2% of gross sales of gold (for gold deposits with reserves of more than 50 tons) and other mining objects of national importance
	80% of non-tax payments equal to 2% of gross sales of gold (for gold deposits with reserves of fewer than 50 tons) and other mining objects that are not of national importance
3% of the price of deposits sold through tender minus bonus and cost of geological information	3% of the price of deposits sold through tender minus bonus and cost of geological information
Funds from license retention payments for subsoil areas located on lands not belonging to ayil aimaks or cities	Payments equal to 2% of gross sales of mineral deposits(for local infrastructure) located on lands belonging to the forestry fund and land reserve
Voluntary contributions	Voluntary contributions

In addition to payments, local communities surrounding nationally important mines enjoy the social package mentioned in Precept 5. According to the Subsoil Law, companies possessing licenses for nationally important mines have to provide benefits for local communities in the form of infrastructure, employment, and vocational training.

Accounting, reporting and oversight of public spending

According to the Open Budget Index, the Kyrgyz Republic ranks higher than the global average on budget transparency. A parliamentary Budget and Finance Committee scrutinizes the government's proposals, which leads to significant amendments between first and second readings of the draft annual budget law. In addition, the government follows up on prescriptions from the Chamber of Accounts, which is the only independent actor to produce and publish annual analytical reports of budget execution. The parliament uses Chamber of Accounts budget execution reports and reviews of the government's budget proposals to press for changes in the budget's formulation and execution. However, the President can remove the head of the Chamber of Accounts without legislative or judicial approval, which undermines its independence. In addition, the Chamber of Accounts has insufficient resources to fulfill its mandate, and only a weak quality assurance system. In the absence of systematic independent audits and evaluations Parliament, other external actors and the public cannot conduct necessary oversight of public investment projects. *Ex post* evaluation is one of the weakest components of the Kyrgyz Republic's public investment management system.[99]

PRIORITY ISSUE 9

Sharing resource revenues with mining-affected communities provides a good opportunity to improve their living conditions. However, to do so effectively requires addressing several challenges. First, allocating a fixed percentage of resource revenues to subnational jurisdictions (20 percent of payment for infrastructure development) will lead to unpredictable and large increases and decreases in revenue transfers to resource-rich regions because of price, and, to some extent, production volatility. The resulting volatility, along with local authorities' low capacity to manage resource revenues, generates incentives for overspending during commodity boom periods and necessitates painful cuts during busts. The revenue sharing system ought to include incentives for subnational governments to spend fiscal revenues efficiently, for example, limiting their ability to borrow, or mandating that they save a portion of windfall resource revenues in a sovereign wealth fund. In addition, it may be necessary to introduce fiscal rules that set limits on annual spending levels, as discussed in Precepts 7 and 8.

99 The World Bank, *Kyrgyz Republic Public Expenditure Review Policy Notes. Public Investment Management* (2014) 4, accessed 10 August 2016, http://documents.worldbank.org/curated/en/589551468302388426/Kyrgyz-Republic-Public-expenditure-review-policy-notes-public-investment-management.

Second, the design of the revenue sharing system allows for concentrating large sums of money in small *ayil aimaks*, which can lead to conflicts with neighboring *aimaks*. This especially applies to *ayil aimaks* surrounding nationally important deposits, which enjoy both 20 percent of the payment for local infrastructure and a social package. The difference in local budgets' revenues will become even more obvious when companies start or increase production and commodity prices go up. One solution could be to revise the current revenue sharing system to ensure income equality between resource- and non resource-rich regions, since, according to the constitution, subsoil assets belong to all people, not just those living near mines.

Moreover, legislation defines utilization of RDFs broadly. To address the challenges with selecting projects, the Ministry of Economy introduced a definition of "infrastructure" in the draft Regulations on Regional Development Funds. However, the draft Regulation does not specify the type of infrastructure or how business entities (that local authorities establish), along with private investors, will develop or maintain it. Such challenges make the Chamber of Accounts' role especially important.

Precept 10. Private sector development

Priority issue for the Kygyz Republic	The government should make robust assessments to identify whether benefits of domestic value addition will outpace environmental risks

Rules. The NSSD 2013-2017 contains the main principles of the Kyrgyz Republic's economic growth and diversification. It has identified six areas that could build the country's enabling environment, including tax and customs policy, SME development and investment policy. The document also emphasizes that developing the financial sector, as well those of agriculture, tourism, mining, energy, and transport are key priorities for sustainable economic development. It includes a list of 76 key potential investment projects to prioritize.

No policy document or legal act recognizes the links, through infrastructural development and local content, between the mining sector and the rest of the economy. While the Law on Public-Private partnership (2012) regulates public-private partnership opportunities with regard to infrastructure, it does not apply to the mining industry.[100]

Institutions. The Ministry of Economy is responsible for the development and implementation of economic development policy, investment policy (including public-private partnerships) as well as policy with regard to business permits. Its functions also encompass assessment of investment projects for economic soundness and efficiency. The National Bank is another important state institution involved in private sector policy and regulation. It develops and implements overall monetary policy, including regulation of banks and other commercial institutions.

CONTEXT

The government should primarily use resource wealth to diversify the economy by creating an enabling environment that supports business activity. The resource sector can also benefit the private sector by creating jobs, buying local goods and services and building resource sector-related infrastructure that others can share.

Private sector enabling environment

Since the 1990s, poor access to energy, transport, and other essential services has hindered private sector development (the Kyrgyz Republic ranks 113 of 138 countries on quality of infrastructure, according to the 2016 Global Competitiveness Index). In response, the government launched a wide public investment program in 2013 to finance power and transportation infrastructure projects that the NSSD 2013-2017 specifies. From 2015 to 2020 the government plans to direct around USD 2 billion[101] to the public investment program, with

100 Article 3 of the Law on Public-Private Partnership.
101 International Monetary Fund. *Kyrgyz Republic Country report No. 16/186* (2016), accessed 7 October , 2016. https://www.imf.org/external/pubs/ft/scr/2016/cr16186.pdf.

the hope of generating long-term economic growth. However, based on publicly available information, the government does not seem to have a mechanism for tracking private infrastructure developments, and merely dovetails these investments into wider plans.

Access to credit is another important element of an enabling business environment. Despite the credit boom since 2012, finance remains expensive (like many low-income developing countries, the Kyrgyz Republic has a low aggregate domestic savings: only 18 percent of GDP), short term (average weighted loan maturity is under two years), and concentrated in a few sectors (trade, agriculture and, to a lesser extent, construction).[102] The financial sector in general is still highly dollarized, cash-based[103] and lacks diversity of financial instruments. These challenges are more relevant to local companies since foreign multinationals use capital from shareholders or other close affiliates abroad. In addition to commercial banks, companies have access to concessional loans from the Russian-Kyrgyz Development Fund, established in 2014 to support the Kyrgyz Republic's economic development during the transition period of Eurasian economic integration. As of January 2017, this institution has financed 13 projects (related to coal, building materials and silicon) totaling around USD 4 million,[104] which comprises about two percent of its lending portfolio.

The biggest challenges to doing business in the Kyrgyz Republic are corruption, tax regulations, policy instability, government instability and inefficient government bureaucracy.[105]

Local content in the mining industry

The mining industry in all countries is usually an "enclave," meaning their operations are capital-intensive and international, requiring connections to efficient global supply chains. Mining in the Kyrgyz Republic is similar, with relatively few connected industries. However, the lack of an enabling environment (weak infrastructure, finance, regulations and institutions) certainly does not help in developing local content around the mining industry, which, given the rising numbers of gold mining projects launching throughout the country, could contribute to the private sector development. Kumtor, the biggest mine in the Kyrgyz Republic, has only recently started purchasing materials from the domestic market.[106]

102 International Monetary Fund, *Kyrgyz Republic Country Report No. 16/55* (2016), 27, accessed 6 October 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr1655.pdf.

103 International Monetary Fund, *Kyrgyz Republic: Selected Issues* (2016), accessed 6 October 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr1656.pdf.

104 Russian-Kyrgyz Development Fund, accessed February 2017, http://www.rkdf.org/files/docs/100117.pdf

105 The Global Competitiveness Report 2016-2017, 228, accessed 19 December 2016, https://www.weforum.org/reports/the-global-competitiveness-report-2016-2017-1

106 International Monetary Fund, *Kyrgyz Republic: Selected Issues* (2016) 29, accessed 6 October 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr1656.pdf.

Sharing infrastructure

Globally, the extractive industry invests billions of dollars in infrastructure to support its operations around the world. One estimate suggests[107] the majority of extractive infrastructure could be shared with other operators in the industry, and about a third is suitable for sharing with users outside the extractive industry. If this is applicable to the Kyrgyz Republic, at least to some extent, it could help cover the infrastructure gap, facilitate private sector development and decrease costs for mining companies. However, mining companies do not coordinate enough to meet their infrastructure needs (mainly roads and access to power).

PRIORITY ISSUE 10

Most extractive companies in the Kyrgyz Republic focus on gold extraction, and three out of seven gold mining companies produce dore bead, which they then deliver to the Kara-Balta refinery. Since the refinery cannot process gold-copper concentrates, companies producing it have to export it to Kazakhstan and China (one company out of six produces both dore bead and gold-copper concentrate).

As in many resource-rich developing countries, numerous debates in the Kyrgyz Republic in recent years have addressed how to encourage companies to process their concentrate domestically and get more revenues from exported concentrate, including capturing value from untaxed associated minerals (e.g., copper). Introducing export duties is one option; banning exports to ensure domestic value addition is another.

While a common tactic by some governments, export duties and bans do not always work and often hurt countries by significantly reducing government revenues earned from the mining sector. For example, in 2014 Indonesia imposed an export duty and ban on exporting concentrates, only to see production and government revenues fall significantly. In January 2017, the government was forced to lift the export duty and ban.

Before taking any decision, the Kyrgyz government needs to thoroughly assess the economic efficiency of creating domestic value addition and any significant environmental risks. The government must determine whether the benefits of an export duty outweigh the loss in tax revenues, the strains on the country's power supplies and the significant environmental damage that domestic refining can cause.[108]

107 McKinsey Global Institute, *Reversing the Curse: Maximizing the potential of Resource Driven Economies* (2013).
108 Assessment of potential revenue, employment, and derived demand created along the value chain and at the same time consideration of potential costs for companies, including the opportunity costs of inputs (e.g., processing often requires significant amounts of energy).

Precept 11. Role of extractive companies

Priority issue for the Kygyz Republic	Companies should proactively engage with local communities to understand how upcoming projects will affect them.

CONTEXT

Extractive companies can contribute to governance in their host countries by meeting recognized international standards in executing their projects, even when the law does not require this of them. Where they contribute positively, extractive companies can support good governance in a country. Where they contribute negatively, they can entrench mismanagement and corruption.

The biggest mining companies in the Kyrgyz Republic are mostly headquartered in Australia, Canada, China, Kazakhstan, Russia, Turkey and the United Kingdom. These companies explore and extract gold and other metals, while primarily local companies extract non-mineral resources and coal. Some mining companies are members of business associations that protect their members' interests by actively engaging in public debate on business related issues, mainly regarding legislation. For example, the biggest foreign gold mining companies, including Kumtor Gold Company, are members of the International Business Council, which has a separate Committee for Mineral Resources. For more than five years, this committee has provided an effective communication platform for the biggest mining and consulting companies and independent experts. Chinese companies generally do not participate in public discussion and less information is available about their activities. The government has not estimated the percentage of Chinese companies operating in mining, but the number is considered to be substantial.

Generally, there is little publicly available information about mining companies and their activities, with the exception of a few, such as Kumtor Gold Company and KAZ Minerals. The authors of this report contacted several other mining and processing companies[109] to inquire about their corporate standards, monitoring and public engagement activities, but company representatives either did not answer phone calls or refused to respond to all the questions.

Trust

Local populations and municipal authorities tend to have unrealistic expectations of mining companies (especially foreign ones), regardless of the type of work they conduct (prospecting, exploration or exploitation). They expect a company to make local purchases or contribute to social and economic development and employment in their region. The fact that many community members refer to the Kumtor Mine as an ideal standard could partially explain this, although Kumtor's level is unattainable for most companies in the country.

109 Kyrgyzneftegaz OJSC, Full Gold Mining LLC, Vertex Gold Company LLC, Parity Coal LLC, Sharbon CJSC, Yiyang Industrial Company LLC, Kadamjai Antimony Plant OJSC and Kara-Balta Process Plant OJSC.

The lack of state policy to ensure mining companies involve local communities in decision-making with regard to their activities (except rules to hold public consultations during EIA described in Precept 5), means that approaches differ depending on a company's size and country of origin. Larger foreign companies, such as Kumtor Gold (Canada), KAZ Minerals (Kazakhstan), Alliance Altyn (Russia) and Talas Copper Gold (Australia), build lasting dialogues with all concerned parties in local communities, providing continuous access to information on their activities. The majority of small- and medium-sized companies (generally Chinese and local) only occasionally interact with the public. Interviews with representatives at mining companies revealed that none of them, not even Kyrgyzaltyn Joint Stock Company, had a stakeholder engagement policy. Some representatives responded that they understood the importance of public participation and were working to achieve it. However, these efforts are informal and occasional and the companies have not designated personnel to work directly with stakeholder groups. OSCE Academy research states that companies often use intermediaries rather than contacting communities directly. Mining activities, therefore, develop without much community input.[110]

Sustainable development and corporate integrity

Little information is publicly available with regard to mining companies' internal documents, with the exception of a few. For example, Kumtor Gold Company and KAZ Minerals have codes of ethics or policies that reference honesty, transparency and other requirements. The majority of mining companies in the Kyrgyz Republic do not seem to have such policies. Representatives at most of the companies this report's authors contacted said they do not have anti-corruption or bribery policies, and that there is no need for such a document as they have never dealt with corruption.

Well-established mining companies try to address local development priorities, by, for example, investing in social infrastructure, supporting development of human capital and building local supply chains (even in the absence of legislated rules). However, such practices are not widespread, especially with regard to subsoil use objects that the list of nationally important deposits does not include. As things currently stand, the actions of a few mining companies that meet international standards in executing their projects do not influence the development of overall good governance practices in the Kyrgyz Republic—though better experience-sharing with other companies through different mining associations could potentially shape the behavior and approach of the sector as a whole.

PRIORITY ISSUE 11

As mentioned above, many companies have no formal mechanisms for engaging with the community. In some cases, community engagement only begins after the company has started developing the deposit site.[111] The lack of communication between companies and local communities is a significant problem for both companies and the government, as, at times, local citizens block roads and organize

110 OSCE Academy, *Conflict Sensitivity in the Mining Sector of the Kyrgyz Republic* (2014), accessed on 15 June 2016, http://www.osce-academy.net/upload/file/Mining_report_final.pdf.
111 *Ibid.*

anti-mining demonstrations, thus not allowing companies to work. Given that national legislation does not ensure local community involvement in decision-making on resource projects (emphasized in Precept 5) and that government bodies lack the necessary financial and human resources for facilitation and mediation activities, companies should aim to establish effective and honest communication with citizens. Doing so will provide communities with a realistic understanding on how upcoming projects will affect them and how they may contribute to project design. For example, local communities often do not know the difference between prospecting, exploration and exploitation works, how these activities impact the environment, or what benefits the community may expect from each. The majority of companies fail to provide relevant information about their activities either directly to inhabitants or through local authorities. Systems allowing for community members to request information can be a useful complement to companies proactively releasing data. However, such systems should not constitute the primary way that citizens access information, as the process of submitting requests can significantly hamper access to information since information might not be released in a timely manner or certain important pieces of information may be missing from the public realm entirely. It is also important that marginalized groups participate in decision-making on an equal footing with other groups; such measures can prevent conflict from arising as a consequence of lack of inclusion.

One way for companies to ensure effective communication is to proactively disclose information about their activities. This includes a wide range of issues:

- Licenses and license agreements
- Payments to central and local budgets at the project level
- Production and export data
- Employment policy and total employment
- Environmental impact assessments
- Monitoring reports for environmental mitigation management plan
- Names of partners, contractors and sub-contractors working on projects in-country
- Anti-corruption policy

In addition to disclosing information, companies could organize capacity-building efforts for municipal authorities and local activists, to build long-term trust with communities.

Precept 12. Role of the international community

Priority issue for the Kygyz Republic	The international community should continue to support improvements in mining sector governance

CONTEXT

A wide range of governments and international organizations, including governments and regulators in the home countries where extractive companies are registered and/or listed, as well as international financial institutions, influence global policies that affect resource extraction. Key areas where the international community can promote higher standards include transparency, human rights and environmental and social protection. With regard to the Kyrgyz Republic, the international community could support both the government and civil society in addressing the challenges this report highlights.

In the Kyrgyz Republic, EITI is the only international standard employed by the government, civil society and international organizations to address transparency issues. However, because the government did not support EITI in 2012-2015, currently no international organization is willing to support the implementation of EITI. The limited support of the international community in general for the extractives sector only aggravates this situation. For example, in the 2012-2015 period, several institutions supported both the government and civil society organizations with regard to policy and institutional development, enforcing EITI standards and local conflict resolution; these included the German Corporation for International Cooperation (GIZ), the United States Agency for International Development, the World Bank and the European Bank for Reconstruction and Development (EBRD). But many of these donors have pulled out more recently because of the resource sector's highly political nature, the still unresolved issue around Kumtor gold mine[112], and the absence of western companies in the Kyrgyz Republic's mining sector. At the time of writing, the only international institution still providing support is GIZ.

Although a number of international organizations significantly support the Kyrgyz Republic with regard to human rights, environmental and health protection (e.g., the Delegation of the European Union in the Kyrgyz Republic, the U.K. Department for International Development, the German Embassy and the Organization for Security and Co-operation in Europe), none of them focuses specifically on the mining sector.

112 Since 2011 the Kyrgyz Republic has been trying to renegotiate the agreement to secure more benefits for the state

As for lender institutions, their role in the Kyrgyz Republic is not significant. This is because most mining projects are small- or medium-sized and receive financing directly from shareholders or other close affiliates, in which case lending standards are not strict and generally do not impose any major obligations on creditors other than returning loans. Financing agreements are always of a confidential nature and not disclosed to the public. Nevertheless, there are several mining projects, which may be in part receive financing from international financial institutions such as the EBRD. While the EBRD's financing of the Kumtor project is public knowledge[113], more research is necessary to establish whether other companies are receiving financing from local and/or international financial institutions.

PRIORITY ISSUE 12

The international community can support the Kyrgyz Republic in effectively managing its mining sector in a few different ways. It can promote and enforce public disclosure requirements in accordance with EITI requirements. Further, under the United Nations Guiding Principles for Business and Human Rights, the international community could support host states and companies in fulfilling their duty to protect human rights in the context of resource projects. Similarly, countries that host headquarters of mining companies (see table 9) can work to ensure that companies protect affected communities from the environmental, social and health impacts of extraction, while also avoiding corruption. Kyrgyz republic would do well to learn from the experience of other countries. For example, in 2014 Myanmar adopted the Guidelines for Social Responsibility in Outbound Mining Investment, with assistance from Organisation for Economic Co-operation and Development (OECD), GIZ, London-based NGO Global Witness, and the China Chamber of Commerce for Minerals, Metals and Chemicals Importers and Exporters (CCCMC). The guidelines draw on a number of international standards, including those of the International Finance Corporation and OECD. In addition, lenders that support resource projects should require due diligence procedures consistent with the UN Guiding Principles for Business and Human Rights to prevent human rights abuse. Furthermore, they should require due diligence, as well as regular monitoring and reporting on compliance with international environmental and social standards. Finally, donor organizations could help address the challenges this report identifies, which would substantially improve mining sector governance in the Kyrgyz Republic.

113 European Bank for Reconstruction and Development, accessed 5 August 2016, http://www.ebrd.com/work-with-us/projects/psd/centerra-revolving-debt-facility.html

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