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KYRGYZSTAN JANUARY-FEBRUARY REPORT

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Highlights

Parliament finally closed the chapter on a seven-month investigation and debate over operations of the country's largest gold mining enterprise, Kumtor Operating Company, accused of violating norms and requirements in the area of rational use of natural resources, environmental protection, safety of operations and protection of population. Parliament and a state commission headed by the economy minister concluded that the existing agreement between the Kyrgyz government and Canada's Centerra Gold Inc., Kumtor Gold Company and Kumtor Operating Company was not in line with Kyrgyz interests and needed reviewing.

Popular scrutiny of this business dispute is ascribed to the fact that the suspension of operations of this gold mining giant had already triggered a major GDP decline last year when foreign businesses operating in Kyrgyzstan unequivocally deemed this investigation an alarming development and a sign of trouble for investors.

Internal affairs

On 21 February, parliament reviewed findings of the state commission created to investigate and examine compliance by Kumtor Operating Company with norms and requirements in the area of rational use of natural resources,

environmental protection, safety of operations and protection of population. In the course of this review, members of parliament demonstrated an otherwise unusual concurrence of opinions and unity in their efforts to amend the existing agreement between the government and Canada's Centerra Gold Inc. Ata Meken leader Omurbek Tekebayev suggested that parliament consider repealing the law of 30 April 2009 that solidifies the contractual arrangement between the government and the Canadian gold mining company. Members of parliament representing the opposition Ata Jurt political party proposed a bill denouncing the 2009 Agreement, to be sponsored within 10 days. A member of the ruling SDPK, Muradyl Mademinov, called the 2009 Kumtor agreement "a criminal agreement against the people (of Kyrgyzstan)".

According to economy minister Temir Sariyev, who chaired the state commission to investigate and examine operations of the Kumtor Operating Company, the agreement between the government and Centerra Gold Inc., as signed in 2009, runs counter to the country's interests and had been signed to accommodate the private interests of the family of ousted president Bakiyev. Technically speaking, the agreement on the



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new terms of the Kumtor project was official, having been signed by then prime minister Igor Chudinov, but it was the ousted president's younger son Maxim Bakiyev who actually headed the Kyrgyz delegation.

Justice minister Almambet Shykmamatov noted that the agreement with Centerra Gold Inc. on the development of the Kumtor gold deposit did not take the laws of the Kyrgyz Republic into consideration. Furthermore, after the rectification of the new agreement in 2009, Centerra Gold Inc. was provided with unsubstantiated unilateral tax privileges. The minister also publicized a paragraph from the agreement whereby the government was obliged to block all and any initiatives from the Kyrgyz side concerning operations of the gold mining company at the Kumtor gold deposit until 2042.

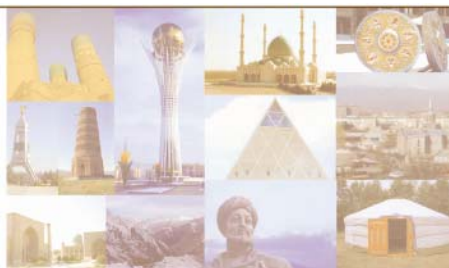
The head of the state inspectorate for technical and ecological safety of the Kyrgyz Republic Osmonbek Artykbayev informed the public and the media that, at the inception stage of the development of the Kumtor gold deposit, the Canadian company in question did not have any experience in gold mining and started the extraction operation without any feasibility study which is prohibited by Kyrgyz law. According to Artykbayev, Centerra Gold Inc. was able to capitalize and get listed on the Toronto Stock Exchange purely thanks to the Kumtor project. At the same time, Kyrgyzstan was forced to settle for an unfair distribution of net income throughout the project. This, he said, had to change. The state inspectorate identified numerous violations of technical and ecological safety at the Kumtor gold deposit as confirmed by international auditing firms and laboratories. It turned out that not only did Kumtor Operating Company's

management know of the existing and practiced violations but also concealed and suppressed information about them, which made it liable not only to the government of Kyrgyzstan, but also to bona fide foreign stockholders.

Mr. Artykbayev also noted that the management of the Canadian company had started eliminating smaller violations, although it appeared impossible to reach consent on the issue of the movement of the glacier and pollution and contamination of seepage and runoff that requires major capital investments.

In its resolution, Jogorku Kenesh (parliament) recommended that the government conduct negotiations with Centerra Gold Inc. and Kumtor Operating Company within three months and without suspending operations at the gold deposit, so as to return to the terms of the 2003 agreement. In the event that the parties fail to reach an agreement, parliament recommends that the government unilaterally denounce the 2009 agreement, repeal tax privileges, dissolve investment and concessions contracts, initiate court proceedings to reclaim lands, bill the company for the use of waters and propose to the Canadian government that the individuals who signed and implemented the agreement in question be jointly prosecuted by the two jurisdictions.

Russian media reports citing Centerra Gold Inc.'s director Ian Atkinson say that the company does not intend to amend the agreement and hopes to conclude fruitful negotiations with the Kyrgyz government. According to Mr. Atkinson, "it is necessary to



constructively discuss the situation around Kumtor and to find the political solution which would fit all shareholders, the government of Kyrgyzstan among them.” The solution, according to the head of the Canadian company, must be political. One should note that if the political solution implied is the kind of solution that was taken in the past by a very narrow circle of individuals affiliated with the ousted presidents of the Kyrgyz Republic, this “solution” would undoubtedly undermine all the efforts of the incumbent President and the government to combat corruption.

In the last few months, the Kyrgyz government has been focusing on changing its structure in an attempt to eliminate the duplication of functions of various governmental bodies and hinting at a possibility of budget cuts. By the end of February, the government consisted of 23 state bodies of which 16 were ministries. The circle of state agencies was increased with the addition of a new agency charged with local government affairs and interethnic relations.

In February, parliament passed an address to the Inter-Parliamentary Assembly of the Eurasian Economic Community, Inter-Parliamentary Assembly of Member States of the Commonwealth of Independent States, Parliamentary Assembly of the Collective Security Treaty Organization, Parliamentary Assembly of the Organization for Cooperation and Security in Europe and Parliamentary Assembly of the Council of Europe requesting assistance in the extradition of convicted criminals to Kyrgyzstan. Kyrgyz members of parliament expressed their deep concern with the fact that Belarus continues to renege on its international obligations to extradite former president Bakiyev and his brother

Janybek to serve their sentences, both having been convicted by the Bishkek garrison court of military justice. This court found the two men guilty of the capital offenses of organizing the kidnapping, brutal torture and brutal murder of three individuals. Kurmanbek Bakiyev was sentenced to 24 years in prison with confiscation of property and Janybek Bakiyev to life imprisonment with confiscation of property. However, all efforts by Kyrgyz law enforcement agencies, including a petition to Interpol, have failed to bring about the extradition of the convicted criminals to the Kyrgyz Republic. In accordance with generally accepted norms of international law and principles of democracy and human rights, as well as the unavoidability of court-mandated punishment, members of Jogorku Kenesh are calling on the members of parliament in the countries of the Eurasian Economic Community, the Inter-Parliamentary Assembly of the Commonwealth of Independent States, the Collective Security Treaty Organization, the Organization for Cooperation and Security in Europe and the Council of Europe to render strenuous assistance in resolving the issue of capturing and extraditing convicted criminals Kurmanbek and Janybek Bakiyev.

Foreign and international policy

In the run-up to the withdrawal of US forces from Afghanistan in 2014, Kyrgyzstan’s most important foreign policy issue is the presence, in one form another, of the US military servicemen on Kyrgyz territory. It is common knowledge that a US airbase has been deployed at Manas International Airport since December 2001 and that it has



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to this day been operating as a transit point for NATO ISAF forces.

In mid January, Robert Blake, US Assistant Secretary of State, briefly visited Bishkek to discuss with the Kyrgyz authorities -according to Voice of America- the possibility of extending the lease for the US military base, officially known as the Manas Transit Centre. The lease term expires in 2014, after which - according to repeated statements by President Atambayev- the Transit Centre will be closed pursuant to contractual terms. Before leaving for Central Asia, however, Robert Blake, in an interview, noted his wish “to convince regional leaders of Washington’s commitment to ensuring the security of the Central Asian countries”, as well as explaining that even though US military presence will perhaps become more limited after 2014, “we intend to continue our active economic assistance facilitating security and stability in Afghanistan and the entire region”.

On 17 January, following a meeting with President Atambayev, Blake said that “the US is discussing the Transit Centre in Kyrgyzstan, although I would prefer not to speculate about the possible outcome of this negotiation.” He described the Manas Transit Centre as an important regional hub of coalition forces in Afghanistan, one that that plays a serious role in establishing peace in Afghanistan. “We understand the President’s desire to establish a commercial and logistics hub at Manas and we’ve supported that effort and have given some advice about that,” said Blake. The Kyrgyz President, in turn, reiterated that “in 2014, the agreement between the governments of the two countries on the Transit Centre at Manas will expire, and, following the expiry of this agreement, Manas

airport should not retain a military component after 2014.”

Analysing the results of Blake’s visit, pundits expressed varying opinions, including an assessment of this visit as a failure and projecting a termination of all contacts between the two countries after the closure of the military base at Manas international airport.

The US Department of the State, in its publicized reports on aid given to Central Asian countries, reported a 13% budget reduction with cuts practically not affecting programmes designed to enhance national security. Overall, the US state department’s assistance to Central Asia would decrease from \$133.6 million in fiscal 2012 to \$118.3 million in the current fiscal year, while assistance programmes falling under the peace and security category would remain at the same level of funding, i.e., \$30.3 million (these programmes include assistance to national armed forces, law enforcement agencies, border protection services, etc.).

Kyrgyzstan would become the largest recipient of the US aid in Central Asia, with its overall aid package totalling \$47 million. The aid package in the area of security will grow from \$6.3 million to \$9.2 million; these funds, according to the US state department plan, are supposed to help “the new Kyrgyz Government in implementing the well-planned modernization of its security forces” and “enhance the Kyrgyz capacity in shoring up border security and combating such transnational threats as terrorism.” Joshua Kucera, a security expert specializing in security issues in Central Asia, Caucasus and Middle East, notes that the state



department does not oversee all US aid programmes; in particular, the share of US assistance provided via the US defence department is becoming more significant and reports say it is formed in a different way which is why it would be more difficult to monitor. The trend is nonetheless visible and certainly gets one thinking.

Economy and business

In its 2012 Transition Report: "Integration Across Borders," the European Bank for Reconstruction and Development publicized its key priorities in the Kyrgyz Republic in 2013. Firstly, the bank believes that the new Kyrgyz government needs to continue its ambitious plans to improve the country's business climate. Main vectors of these efforts, according to the bank, include strengthening governance and transparency, protecting private property, and reducing costs of doing business by radically simplifying the system of state regulation. Secondly, EBRD believes that the role of the government in the Kyrgyz banking system has to be toned down. "The main objective is to improve trust of the banking system by successfully and transparently privatizing two largest banks," says the report. The energy sector requires modernization and structural reforms, bank experts noted, stating their belief that the newly passed medium-term strategy for the sector in question needed to be implemented with a stress on improving public governance, corporate governance, transparency and operational efficiency.

According to EBRD, negative GDP growth in 2012 was a result of a declining growth of the mining industry and unfavourable climatic conditions that impacted the country's agriculture. GDP projections for the current

year will depend on the development of the Russian and Kazakh economies that will influence cash remittances from labour migrants and exports as well as the development of the Eurozone, which will in turn impact gold prices.

According to the joint statement issued by the National Bank of Kyrgyzstan and the government, in 2013 the Kyrgyz economy is expected to grow by at least 7%. This joint statement, signed on 31 January, identifies the main vectors of the government's economic policy in 2013, to wit: 1) recovering macroeconomic stability and ensuring sustainable economic growth at the level planned; 2) honouring the government's social obligations; 3) further developing the regional policy; 4) continuing integration processes as part of the Unified Economic Space; and 5) modernizing the system of public governance.

The statement talks about risks that can impact the national economy, including inauspicious trends of growth of global food prices. Thus, in the UN World Food Programme's estimates, in the medium and long run, food prices will remain relatively high, with the perspective in question covering the next decade. "Consequences of the negative impact of global food prices, in particular for wheat, as brought about by low harvests of grain in the past marketing year, can strengthen inflationary expectations in 2013 among economic agents and render additional influence on the macroeconomic situation," reads the statement.

Risks noted also included the dependence of the Kyrgyz domestic market for bread and



bakery products on imports of grain and flour and uncertainty of terms of trade with countries that are primary suppliers of electrical energy and gas.

The head of the state agency for geology and mineral resources, Ishimbay Chunuyev, when evaluating the 2012 geological season, admitted a failure of this sector in the past year. According to this senior official, there was no such season per se in 2011-2012. Chunuyev believes that such a situation in the industry did not emerge in 2012 but rather much earlier. Having familiarized himself with operations and performance of all companies in various regions of Kyrgyzstan, the director of the geological agency concluded that the state of industry was woeful. Here, for instance, in Jalal-Abad province, certain companies could have worked to full capacity but were prevented from doing so due to objective and subjective reasons such as road blockage and seizure of equipment by local residents, violations of water use, state of levees at rivers and non compliance with terms of licensing agreements. It is no wonder that in terms of receipt of direct investments in the development and extraction of mineral resources, in 2011-2012, the share of the mining sector turned out to be abysmal — a mere 7% of the total investments if one is to drop the Kumtor deposit from the calculations.

Speaking of the main problems in the industry, the head of the agency singled out untimely issuance of licenses, violations of ecological safety and environmental protection provisions such as a lack of special projects (designs) and expert examinations thereof,

which was affected by, inter alia, uncoordinated work of three agencies: the state agency for geology and mineral resources, the state technical inspectorate and the state environmental protection agency. The problems identified also included issues in protection of subsoils, industrial safety, cooperative governance, unsatisfactory preparation and disruption of auctions, lack of professional staff and frequent change of companies that held titles to subsoil use.

Chunuyev said that in 2013, his agency needs to form a capable and qualified commission on subsoil use, review applications from companies and licensing cases in a timely manner, facilitate timely geological exploration and investigation, and, repeating what has become a familiar refrain, eliminate corruption schemes in the area of licensing.

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