

A decorative graphic consisting of a grid of grey dots of varying sizes, with several dots highlighted in red. The dots are arranged in a pattern that roughly outlines the map of the Kyrgyz Republic.

# Agreement Under Pressure

## Gold Mining and Protests in the Kyrgyz Republic

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September 2014

- Kyrgyzstan's economy depends heavily on gold mining, mainly from output at the Kumtor mine run by the Canadian company Centerra. Yet, the mine is contentious due to social and environmental concerns. As a small, developing country, Kyrgyzstan is challenged to balance standards, oversight and securing revenues, while attracting needed foreign investment to the sector. Growing protests against mining are leading investors to suspend or shut down operations.
- Against the background of rising resource nationalism, the Government of Kyrgyzstan is negotiating a new agreement with Centerra. Parliament approved a draft which would swap the country's shares in the company for control of half of the mine. This signals a shift from a longer-term financial perspective in the mining company to shorter-term economic gain. There is no clear indication of how MPs will finally vote on the proposed agreement; several prominent politicians have advocated nationalizing the mine.
- Irrespective of the outcome of the negotiations, the Government must seek to use funds in a transparent and effective manner and should establish a specific fund for gold sector revenues. The fund should be managed by the Ministry of Finance and utilize stringent oversight mechanisms.
- The debate on Kumtor, however, hides more significant economic challenges. Non-gold sectors of the economy must be strengthened to mitigate the effects of the potential accession to the Eurasian Economic Union, and to support longer-term economic development.
- People living in areas affected by mining have legitimate concerns about social responsibility and corruption in the sector. The Government must seek to mediate between stakeholders and find better ways to share benefits.



## Contents

<b>1. Introduction</b>	<b>1</b>
<b>2. Background: Mining in the Kyrgyz Republic</b>	<b>2</b>
2.1 Brief History of the Mining Sector	2
2.2 Legislation	2
2.3 Mining Sector Strategy	3
2.4 Kumtor Deal	3
<b>3. Case Study: Anti-Kumtor Violence</b>	<b>4</b>
<b>4. Political Positions</b>	<b>6</b>
4.1 Ar-Namys (Dignity)	7
4.2 Ata-Jurt (Fatherland)	7
4.3 Ata Meken (Fatherland)	8
4.4 Respublika (Republic)	9
4.5 Social Democratic Party of Kyrgyzstan (SDPK)	10
4.6 Deputies' Groups	11
<b>5. Experts' Views</b>	<b>11</b>
5.1 The Proposed Agreement	11
5.2 Nationalization	12
5.3 Economic Development	13
5.4 Taking on Risk	14
<b>6. Challenges in the Mining Sector</b>	<b>15</b>
6.1 Corruption	15
6.2 Governance	16
6.3 Transparency	16
6.4 Environmental Pollution	16
6.5 Protests	18
6.6 Arbitration Cases	19
6.7 Work Stoppages	19
6.8 Improving Services	20
<b>7. Economic Opportunities and Challenges</b>	<b>21</b>
7.1 Military Airbases	21
7.2 Energy	22
7.3 Economic Issues Affecting Households	22
7.4 Regional Issues	23
7.5 Economic Integration – The Great Unknown	23
<b>8. Uncertain Future</b>	<b>25</b>
<b>Bibliography</b>	<b>27</b>

## 1. Introduction

Kyrgyzstan relies heavily on the Kumtor mine to keep the economy afloat, but political brinkmanship may be leading to more significant problems and could threaten stable economic development. The government's call to renegotiate the contract with the Canadian company Centerra Gold Inc. (henceforth »Centerra«), which owns the mine and conducts operations through its Kumtor Operating Company, has led to a series of failed proposals. Nationalist politicians have pushed for greater control or even to nationalize the mine to reclaim control over the country's main asset. Parliament finally approved a draft agreement in early February 2014 which gave hope that a solution would be found. Challenges, however, have continued to mount. State officials refused to approve Centerra's mining plan for 2014, causing the company to state it would halt operations by mid-June unless a solution could be found. Several days before the deadline, Centerra received permission to continue operations.

The focus on the troubled relations over the mine hides more significant economic challenges. As part of the proposed agreement, Kyrgyzstan will swap its stock in Centerra for 50 per cent ownership of the mine. This is a shift from a longer-term financial perspective to a short-term economic boost to the economy. Centerra has several other mining operations around the world. The change in agreements means that Kyrgyzstan will lose its financial benefits in Centerra. It is estimated that Kumtor will close in 2026, when the majority of gold reserves are expected to have been extracted. Thus, Kyrgyzstan will need to keep the mine operating as smoothly as possible and hope that the price of gold does not go down in order to achieve the economic gains it wants within the next twelve years, before the mine is closed.

The discussions concerning Kumtor and mining in general, however, are not being conducted in terms of a broader view of how the economy will manage after the closure of the mine. The country's economy is highly susceptible to shocks. Sectors such as agriculture and textiles are profitable, but not strong enough to meet domestic demand or support further economic development. Furthermore, the country's planned entry into the Customs Union (which will become the Eurasian Economic Union on 1 January 2015) brings additional

opportunities and challenges, but potential price hikes would have a significant effect on industries and the population alike.

This study thus examines the situation of the mining sector and broader economic issues in the Kyrgyz Republic. The authors use Kumtor as a case study, because the final decision on the agreement will serve as an example for the sector as a whole. As part of the research for this report, the authors conducted interviews with a wide range of stakeholders, including Members of Parliament (MPs), to understand how they view the proposed agreement. The authors also examine the country's economic challenges and the risks that over-reliance on mining may pose.

The study is divided into seven sections. First, the authors provide an overview of the mining sector. They briefly discuss the history, legislation, the country's mining sector strategy and the proposed agreement on Kumtor. Second, they provide a case study of Kumtor and the challenges that have emerged around the development of the mine. Next, the authors provide information based on interviews conducted with all political parties and deputies' groups in Parliament on the proposed agreement, together with their views on the mining sector in general. Furthermore, the authors examine the views of state mining regulatory and decision-making bodies and mining experts. These opinions provide a critical lens with regard to the positions that the parliamentarians advocate. The following section examines challenges in the mining sector. These are issues that represent obstacles to further development. Next, the authors examine a range of issues that are not widely discussed as part of the future of the mining sector, yet nonetheless represent important considerations for the development of non-gold economic sectors and challenges that the country must address together with the proposed agreement on Kumtor. Finally, the authors discuss the main points in this report and the outlook in the mining sector and for sustainable development.

## 2. Background: Mining in the Kyrgyz Republic

### 2.1 Brief History of the Mining Sector

The territory of the Kyrgyz Republic is rich in mineral resources, including antimony, coal, gold, lead, mercury, rare earth metals and uranium. There were two known gold deposits by the time the modern territory of the republic became part of the Soviet Union. In 1938 the Kyrgyz Geological Office was created to lead all the geological studies in the country. During the Second World War research was suspended, but gold extraction continued from a few sites. After the war, geological research resumed and included a large-scale evaluation of gold and silver resources (Bogdetsky, Ibraev and Abdyrakhmanova 2005).

The Kumtor deposit was identified in 1978, but Soviet geologists deemed that operations would be too costly and extraction methods available at the time would cause severe environmental damage. It was not developed until after independence when Kyrgyzstan could attract foreign investment to explore the deposit. None of the other deposits known are estimated to be as large as Kumtor. Furthermore, few sites have the same quality of gold ore as Kumtor.

The Kumtor mine represents the largest foreign investment project in the country, and the largest private sector employer. At the Kumtor Operating Company around 96 per cent of the 2,720 full-time employees are citizens of Kyrgyzstan.<sup>1</sup> According to Centerra, the main reserve pit has 3.6 million ounces of gold, and the total open pit has reserves of 9.7 million ounces of gold, proven and probable reserves according to the latest analysis by the mining company. In 2012, gold production from the mine contributed to 5.5 per cent of gross domestic product (GDP). The Kumtor Operating Company, which conducts the mining, pays a hefty range of taxes and pays into a development fund for Issyk-Kul province. In addition, the company funds social projects in nearby communities. According to Kumtor, from 1994 to 2012, payments within Kyrgyzstan exceeded USD 2.15 billion.

The mining sector, specifically Kumtor, is therefore an important driver of the country's economic develop-

ment. For a number of reasons, but chiefly because it is a strategic asset, some nationalist politicians have called for greater control over the mine or even nationalization. This move seeks to address former President Bakiev's failure to gain greater control of the mine. National strategy documents have supported their view. The country's National Sustainable Development Strategy notes that previous public policy measures »amounted to a dedicated removal of this industry out of the sphere of state control« (National Council for Sustainable Development 2013: 94). The nationalist drive, however, is pushing this debate as an issue of sovereignty and in the interests of the people, but this ultimately puts the emphasis on economics as opposed to financial investment.

### 2.2 Legislation

Over 100 laws and bylaws regulate the mining sector (Ministry of Economy 2013: 27). Of these, 13 main legislative acts regulate mining activities, which are specifically related to subsoil use, land use and the environment. The primary law governing mining activities in the Kyrgyz Republic is the Law »On Subsoil«. First introduced in 1997, amendments in 2012 were designed to lighten the »command and control« method over the mining sector that had been inherited from Soviet laws (Honkonen 2012: 13). This law outlines the procedures and duties of all engaged in mining activities. The amendments also outline the duties of the local state administration and local self-government authorities. Their duties include »providing licensees free access to licence area«, »discontinuing unauthorized mining« and »working with local people in order to discontinue illegal interference in the affairs of mineral rights holders«.<sup>2</sup>

President Almazbek Atambaev signed new amendments to the Law »On Subsoil« into effect on 27 May 2014. Among the amendments are provisions expanding the government's powers over issuing licences, broader use of social packages (a form of compensation the company agrees to give to communities affected by mining operations) beyond those sites that had a competitive bidding process and the introduction of a fund for land reclamation from the time exploratory work begins. Centerra and the Kumtor Operating Company are not

1. Information as of 19 August 2014. Information can be found at: <http://www.kumtor.kg/en/deposit/production-basic-data/> (accessed 19 August 2014).

2. Law of the Kyrgyz Republic No. 160 'On Subsoil' (9 August 2012), Chapter 2, Article 9, Paragraphs 2, 3 and 7, respectively.

fully controlled by these laws as the existing agreement sets out the specific regulations for their work.

In order to improve transparency in the mining sector, Kyrgyzstan launched the Extractive Industries Transparency Initiative (EITI) in 2004. This was done to improve governance and transparency in the extractive industries sector. The EITI Standard seeks to ensure that extractive industry companies fully disclose taxes and other payments to governments. Kyrgyzstan is seen as an EITI compliant country and reporting covers more than 95 per cent of the revenues of extractive industry companies in the country. EITI was also included in the 2012 version of the Law »On Subsoil«.

Another law being discussed, »On Glaciers«, could create further limitations for the mining sector. Although passed by Parliament in April 2014, President Atambaev sent it back for further revisions. One of the main points of the draft law would force companies to pay compensation for damage to glaciers. This would represent a specific challenge for Kumtor Operating Company as it manages an open pit mine and has been managing glacier movement into the mine since 1994 (Centerra 2014a). Plans for further mining would continue to remove parts of the glacier that are moving into the mine, but the new law would prohibit this and cause Kumtor Operating Company to mine underground as open-pit mining damages the Davydov glacier (Kutueva 2014). Centerra maintains that the existing agreements mean this law would not apply to their operations, but this has not been clarified by the respective government bodies.

### 2.3 Mining Sector Strategy

In addition to amending the main legislation, the government has developed a strategy for the mining sector until 2052. Covering all forms of mining, the strategy's authors, a group of mining experts led by the Head of the Kyrgyz Mining Association Valentin Bogdetskii, note that there are a number of challenges to overcome in order to achieve a more sustainable future for the sector. The authors call for mining policy to shift from the »distribution of profit« to the »distribution of benefit«. In other words, they recommend implementation of »complex social and economic development of local territories aimed at enhancing the quality of life; lessening internal

migration; increasing employment opportunities; attracting the local population for the delivery of goods, work and services; development of social infrastructure and small and medium businesses; and increasing local people's skilled and professional potential alongside preservation of the environment« (Ministry of Economy 2013: 66). The plan seeks to improve investment, production, payments for tax and social benefits within the country, and to increase the number of jobs.

There are, however, serious challenges that must be addressed if this vision is to become a reality. The strategy's authors note that government bodies need to be better organized and limit interference. There are cases when politicians speak about the mining sector without sufficient information. The authors note that this has a destabilizing effect: »The vacuum of knowledge amid high politicization results in the appearance of information, which is misleading to the general public and generates high estimations and expectations« (Ministry of Economy 2013: 52). This, the strategy's authors state, can lead to social unrest. The strategy's authors also identify the representatives of local self-government bodies as having a greater role to play in negotiations between communities and companies.

### 2.4 Kumtor Deal

There have been lengthy parliamentary discussions about the new Kumtor agreement. Parliament rejected the Memorandum of Understanding with Centerra Gold Inc. on 23 October 2013, which was based on an equal-stake joint venture in the mine, but included a clause that distributions otherwise payable to the Kyrgyz Republic are to be paid to Centerra. Parliament tasked then Prime Minister Satybaldiev to drive a new deal that would secure the state 67 per cent of the shares in the new operating company. On 12 November 2013, the leader of the Ata Meken (Fatherland) Party, Omurbek Tekebaev, initiated a motion to nationalize the Kumtor mine, but this was not adopted. Parliament later agreed to consider a proposed agreement in December 2013 that was similar to the rejected October proposal, but importantly without the costly issue of distribution repayment.

Under the proposed agreement, Kyrgyzstan would swap its 33 per cent holding in the parent company, Centerra,

for an equal stake in a joint venture of the mine, provisionally called the »Kumtor Project«. Kyrgyzstan would be able to increase its share up to 67 per cent in the mine after 2026, when main operations are expected to close and most of the proven and potential mineral reserves will have been extracted. Kyrgyzstan would also have the right to purchase the tailings for USD 1.

The proposed agreement is a shift from longer-term financial investment in a mining company to short-term economic gain while taking on greater responsibilities and accepting greater risk for the project. Centerra has a number of other mining projects around the world, from which Kyrgyzstan is profiting. Centerra has two producing mines in Kyrgyzstan and Mongolia. In addition, it has joint ventures in China, Mongolia, Russia and Turkey. At the end of 2013, Centerra reported revenue of over USD 944 million. The focus on taking more control over the mine is not based entirely on economics. It is part of a complex political and social vision of the country following the political and social violence in 2010. Nonetheless, whether this new arrangement will enable Kyrgyzstan to achieve its goals is uncertain. There is, however, a significant risk of continued social unrest if people do not see an improvement in their quality of life.

### 3. Case Study: Anti-Kumtor Violence

Conflict in the mining sector has risen since 2010 (Bogdetsky and Noikov 2012: 17). There have been tensions since Kumtor's restructuring in the 2000s, but public protest and violence is a more recent phenomenon. The anti-Kumtor protests have encouraged similar protests and violence in other parts of the country. Kumtor is examined here as a case study of the mining sector in general. What is decided about the mine will have an effect on the rest of the sector. Nonetheless, the specific details of the existing agreement between Kyrgyzstan and Centerra discussed here do not necessarily apply to other mines and the specific drivers of conflict are different for each site. Rather, the general issues examined here are significant for the sector as a whole.

The Canadian Cameco Corporation was the first company to invest in the development of the deposit. On 3 December 1992 it signed a General Agreement with the Government of the Kyrgyz Republic. Cameco acquired

a one-third interest in the Kumtor Gold Company, the owner of the mine. Kyrgyzaltyn, the state mining company, received the remaining two-thirds interest. Kumtor Operating Company, a subsidiary of Cameco Gold International owned by Cameco Corporation, operated the mine. Construction and development of the site started in 1994 and was completed in 1997, and production began only in the second quarter of that year (Gullette 2014).

In 2004 Cameco Corporation transferred its gold-related shares and loans to Centerra Gold Inc., a new Canadian-based company, but retained some shares in the new company. As a result of the restructuring and selling of shares, the government held around 16 per cent of shares in Centerra. In June 2009, under President Bakiev, Centerra negotiated a new terms agreement between Centerra, the government and the Cameco Corporation. In December 2009, according to the new terms agreement, Cameco transferred shares to Kyrgyzaltyn. At the same time, it sold its remaining Centerra shares, concluding its interest in the gold mining company. Throughout this process the government's overall share of the mining operations at Kumtor was 33 per cent of all shares, leaving Centerra and investors with the remaining shares. After the violent ousting of Bakiev in 2010, some in the new government felt that the agreement with Centerra and the reduction in shares was unfair and requested a renegotiation of the terms, while others have called for the mine to be nationalized. In February 2013 the government passed a decree requiring the agreement with Centerra to be renegotiated.

Demonstrations demanding a new agreement have not been confined to Issyk-Kul province, but have sparked support protests around the country. Protestors have demanded greater control of Kumtor or nationalization, and have also highlighted local inequalities that require greater government intervention. In one of the most significant demonstrations, parliamentary deputies of the Ata-Jurt (Fatherland) Party – Sadyr Japarov, Talant Mamytov and Kamchybek Tashiev – organized a rally to call for nationalization of the mine. On 3 October 2012, around 1,000 people gathered at Bishkek's Ala-Too Square, which rapidly developed into an attempt to break into Parliament after an inflammatory speech by Tashiev calling for the resignation of the Prime Minister and other top officials. All three organizers were ar-

rested and their jail terms became a source of continued public anger against the government.

The action taken by the Ata-Jurt party members encouraged other protest actions around the country. In May 2013 protestors blocked the road to the Kumtor mine, demanding that Centerra put more money into education and health care in the region and that the government cancel the operating agreement with the company. Two days later, the demonstrators cut power to the mine.

The riot police then moved in to break up the protest. The demonstration turned violent, resulting in 92 people being arrested and 55 people wounded. This spread to protests in the southern city of Jalalabad, Tashiev's stronghold. Claiming to act in support of the Issyk-Kul demonstration, protestors captured the provincial administration building. Their actions put pressure on the government and the Ata-Jurt party members were freed two weeks later, although the Supreme Court upheld the original decision to strip them of their parliamentary mandates.

In August 2013 two informal leaders of the May violence were caught on videotape blackmailing a Kumtor official. Bakhtiyar Kurmanov and Ermek Dzhunushbaev were both arrested, causing fellow residents of Saruu village to set up roadblocks. The two men were later sentenced to seven years in prison for their actions, which they denied, saying that they were trying to bring important issues to light and promote development in the region.

In October 2013 more demonstrations took place in the province capital, Karakol. During the protests, people stormed the Issyk-Kul Provincial Administration Office and took the Governor, Emil Kaptagaev, hostage. The captors demanded that Kaptagaev, although not directly responsible, should increase the country's share in Kumtor or nationalise the mine. During the negotiations, some reports indicate that Kaptagaev was reportedly doused with petrol and threatened to be set alight if he did not obey (Trilling 2013b). Eventually, the Governor was released. Some Saruu villagers who participated in the protest in Karakol have staged several more protest actions, including setting up roadblocks.

Since Parliament approved the draft agreement in February 2014, a number of political issues have caused further tensions. In May 2014, the State Agency for Geology and Mineral Resources stated that it would not approve the annual mining plan for Centerra. Although the President had not signed the draft Law »On Glaciers«, the State Agency was most likely preparing for the law and the open-pit mining would damage the Davydov glacier. Furthermore, it was not clear whether the existing agreements would exempt Kumtor.

Later that same month, police arrested the head of Kyrgyzaltyn, Dilger Japarov. He was accused of authorizing the payment of dividends from Kumtor Gold Company to its parent company Centerra. Japarov, who was Chair of the Board of Directors for Kumtor Gold Company, is implicated in breaking the Law »On Joint-Stock Companies«, as he did not inform the government that he would authorize the dividend payment. Kumtor Gold Company (2014) claimed that this has been a normal procedure in the past and Japarov should not be under arrest.

As the political problems and scandals mounted, Centerra announced that it would suspend operations at the site. It noted that it was unable to continue operations without the approval of its annual mining plan and related permits. The company stated it would retain minimum staff at the site to continue »to provide essential environmental and safety monitoring, security and essential maintenance of the mill and mine equipment« (Centerra 2014b). If the outstanding issues could not be resolved, the site would close on 13 June. Experts noted that this would be devastating for the country's economy (Kostenko 2014). Omurbek Tekebaev, head of the Ata Meken party, stated that this was tantamount to »blackmail« (Podol'skaya 2014). With little time to spare before the deadline, Centerra (2014c) announced that it had received all the necessary documentation and would continue mining operations uninterrupted. This particular episode seems to have been another aspect of political brinkmanship that has come to characterize the sector.

The stalemate between the government and Centerra has continued. Valentin Bogdetskii, Head of the Kyrgyz Mining Association, stated that the government has prepared a »quite good« agreement on the basis of the



proposal, but »has not yet been signed, as no one wants to take responsibility for their signature« (AKIpress 2014b). Centerra officials, however, have not come to Kyrgyzstan, fearing they could be detained on charges related to the distribution of dividends, for which Dilger Japarov is being tried. Centerra has sent a representative to Kyrgyzstan to hold talks with the government, and has suggested meeting in a third country to continue discussions.

#### 4. Political Positions

The renegotiation of the Kumtor agreement has been fraught with tensions. Politicians have argued for a range of options, but approval was granted by Parliament to explore joint control over the mine. While many in the industry hope that this is the final hurdle, it may be another phase in the renegotiation process.

As part of the research for this report, the authors interviewed the five political parties and four deputies groups that form Parliament to understand their views on the proposed framework agreement between the Kyrgyz Republic and Centerra. Interviews were conducted between 13 March and 5 June 2014. Below are summaries of the interviews with the heads or those designated to speak on behalf of their party or deputies' groups (listed in alphabetical order).

Parliament, as voted into power in 2010, comprises five parties: Ar-Namys (Dignity), Ata-Jurt (Fatherland), Ata Meken (Fatherland), Respublika (Republic) and the Social Democratic Party of Kyrgyzstan (SDPK); and four deputies' groups: Democrats,<sup>3</sup> For Reforms, Öñügüü (Development) and Yntymak (Harmony). The deputies' groups comprise MPs who have left their original party and have created their own group. No one party has a majority and as of 31 March 2014, the new ruling coalition comprises the parties Ar-Namys, Ata Meken and SPDK, as well as the deputies' group Yntymak. Those that are not in the ruling coalition comprise the opposition.

In the interviews, MPs refer to three options regarding ownership of the Kumtor mine. In February 2014, Parliament approved of a proposed framework agreement in which the government would swap its 33 per cent of Centerra shares and receive a 50 per cent holding in a joint venture operating company at Kumtor mine. Referred to sometimes as the »50/50 deal«, Centerra would control the other half of the operating company. Some politicians have advocated that Kyrgyzstan claim greater control over the mine, and argue for a 67 per cent holding of the joint venture, with Centerra in control of the remaining 33 per cent. Others argue for full nationalization. These views and visions of the republic's mining sector are discussed below.

The authors first present the views of the political parties and then those of the deputies' groups. They have done this because there has been no comprehensive examination of their views presented together throughout the negotiations with Centerra. The authors then provide an analysis of their views together with the views of other stakeholders to clarify the main issues for and against the proposed agreement.

Table 1: Summary of the views of political parties' and deputies' groups

Party or deputies' group name	Position on the proposed framework with Centerra
Ar-Namys (Dignity – party)	Supports 50/50 deal in the proposed agreement
Ata-Jurt (Fatherland – party)	No stated position
Ata Meken (Fatherland – party)	Supports 67 per cent control
Respublika (Republic – party)	Supports 67 per cent control or nationalization
Social-Democratic Party of Kyrgyzstan (SDPK – party)	Supports 50/50 deal in the proposed agreement
Democrats (deputies' group)	Does not support 50/50 deal in the proposed agreement
For reform (deputies' group)	Supports 50/50 deal in the proposed agreement
Öñügüü (Development – deputies' group)	No stated position
Yntymak (Harmony – deputies' group)	Does not support 50/50 deal in the proposed agreement

3. The deputies' group Democrats is not listed on Parliament's website (21 August 2014), but members have confirmed that it is a recognized deputies' group.



#### 4.1 Ar-Namys (Dignity)

Ar-Namys is a party still very much characterized by its leader and MP, Felix Kulov. A former vice president and prime minister of the Kyrgyz Republic, Kulov has a long political history. Prevented from running in the 2000 presidential election by then President Askar Akaev, he was imprisoned twice on the same charges. Released in the 2005 revolution, he joined President Kurmbanbek Bakiev to be his prime minister. However, due to differences over the new constitution, he left his position in 2006. Bakiev appointed him prime minister again in 2007, but Parliament rejected his candidacy. After that, he was a strong opponent of Bakiev, but did not take part in politics until after Bakiev's ousting in 2010.

Regarding the mining sector, Kulov was frank in his comments. He considered it to be in a deplorable state. He was supportive of the proposed agreement, because he regarded it as a good solution, better than the previous agreement and »legally correct« for both Kyrgyzstan and Centerra.

»This is a good decision... Many people don't understand that it's better, and instead speculate about [other options],« said Kulov. He, however, warned that the »devil is in the details« and stated that Parliament would need to consider a number of points in the final agreement. For example, he was concerned about whether the final agreement would only include the Central mining site, which Kumtor is developing now, and not other pits that are being developed or planned to be developed. He also wanted to have more information on the costs Kyrgyzstan might incur in the creation of the joint venture.

Kulov thought that an attempt to push for 67 per cent control of the joint venture or nationalization would lead to lawsuits. Nationalization would be bad for the image of the country, he argued, and it would have complex consequences. Kulov stated that Kyrgyzstan would need to have solid legal grounds in order to nationalize the mine. »One would have to prove that there was corruption [on the side of Kumtor and/or Centerra], and then according to international law we can nationalize [the mine]. But we shouldn't rush into a battle and start lawsuits without reinforcement,« he said. Kulov also noted, »If nationalization is done in the correct legal manner, it won't scare the other investors.«

Kulov acknowledged that protests are a significant concern for the mining industry. He said that communities affected by mining operations want objective information and their concerns about environmental pollution are contributing to protests. Kulov noted that many people are not experts in mining and they do not always understand complex mining procedures. »But, we must not ignore people because of their lack of understanding, undermine their opinion or try to lie to them,« he said. Instead, he argued, it is essential to explain the issues in a simple and comprehensive manner. He thought it was important to have clear laws and directions for companies, because investors should not be responsible for gaps in the legislation.

Kulov noted that corruption in the mining sector is a problem. He said there is a need to increase transparency and create a labour market structure that would hire better professionals and pay professionals higher salaries. He said the country needs to have a strong opposition that expresses its position within parliament's walls, not on the streets. A strong opposition within the parliament, he argued, would help maintain stability in the country.

#### 4.2 Ata-Jurt (Fatherland)

The Ata-Jurt party has played an important role in politics since its establishment in 2004. A group of opposition politicians founded the party in opposition to President Akaev. However, the party only came to power after the violent ousting of President Bakiev in 2010 and won the most seats in Parliament (although it now has fewer seats as some deputies left to join deputies' groups). The party was part of the ruling coalition in Parliament until the end of 2011 when the coalition collapsed. Since then, it has remained in opposition, adding a critical voice to ruling coalition decisions, and some of its members promote a nationalist agenda.

Ata-Jurt's position on Kumtor was made clear in October 2011 when then party leader Kamchybek Tashiev and several other party members staged a rally calling for the nationalization of the mine and then later stormed the Parliament building. Their arrest and imprisonment was a source of continuing protests and kept demands for nationalization in the spotlight. In the popular conscious,

they are still associated with promoting nationalization, but under the current leadership of Zhyldyzkan Zholdosheva, the official view is much more muted.

In a written response,<sup>4</sup> Ata-Jurt acknowledged that the mining industry was »one of the most important strategic industries in the republic.« However, the party noted that it did not have a joint position on the proposed agreement and opinions were split. Thus, the party did not provide an indication of whether they would oppose a 50/50 deal for the proposed agreement; instead, their letter focused on general issues on which they shared a consensus with other parties.

In their letter, the party noted that there was strong potential for the industry to develop. »The mining industry may certainly become a locomotive for breakthrough development of the country, turning it into an industrial leader,« claimed the party. However, they noted that, despite such positive prospects, the industry was in a »state of crisis«. They listed corruption, political instability and protests by people affected by mining operations as major obstacles for the industry to overcome. In addition to this, Ata-Jurt claimed, »Some politicians or informal leaders use the large number of illiterate and unemployed youth to blackmail and extort investors.« The party noted that these issues have scared off potential investors and forced them to close down working projects. As a result, the budget has contracted and the economy has not grown.

Ata-Jurt recommended that a common state policy be developed on mining and that action be taken to fight corruption, strengthen legislative foundations, improve transparency in the mining sector tendering process and improve mine workers' training. They also noted that more work must be done to explain to people the benefits of mining investments in their region.

The party noted that there must be stability and recognition of accountability. »There is a need to guarantee the safety of investments and investors«, stated the party. On the other hand, they noted, investors should recognize their responsibilities, obey the laws and promote environmental and technical safety, and hire local residents on their sites.

4. This was the only party in Parliament that did not meet the authors for a face-to-face interview.

### 4.3 Ata Meken (Fatherland)

Ata Meken has played an important role in Kyrgyzstan's political history since its registration in 1992, and has been outspoken on the Kumtor issue. In November 2013 party leader Omurbek Tekebaev initiated a movement in Parliament to nationalize Kumtor. This was not taken any further, but did serve to demonstrate the party's desire to secure greater assets for the country. Raihan Tologonov, an MP delegated by Tekebaev to speak on behalf of the party, said that the mining industry is one of the country's economic priorities. Ata Meken's aim was to restore »historical justice«, by regaining the 67 per cent stake in the operating company that Kyrgyzstan had in the first agreement signed in 1992.

If the government fails to reach such an arrangement, the party will vote against the 50/50 agreement. Tologonov said that Ata Meken supported the proposed agreement in the February parliamentary vote, because it was »an intermediate stage« in the negotiation process and was not a legally binding document. »We've reached a 50/50 result, but this is not the final [decision] ... We will insist on the restoration of historical justice, 67/33,« said Tologonov. He saw the Canadians' concessions as proof that Centerra had »deceived« Kyrgyzstan during conclusion of the previous agreements. »Otherwise,« he said, »they wouldn't backtrack now and agree to the joint venture and 50/50 deal.« Tologonov did not state, however, whether the party would push for nationalization if they could not get 67 per cent control of the mine.

If Kumtor is nationalized, Tologonov said that Kyrgyzstan can hire another mining company which will come with its own equipment and enable the country to continue developing the mine. »Gold mining is not rocket science; this is an ordinary process which employs specialists. Any mining company can do it,« he argued. To this he added that he was not concerned about international arbitration if the mine was nationalized. He thought that the country could pay any costs associated with arbitration procedures with the revenue generated by Kumtor. When asked about possible court restrictions on developing the mine during arbitration proceedings, he answered that Kyrgyzstan could simply »ignore« those orders. According to him, nationalization would not harm the country's investment climate. »If we throw [Centerra] out, all other investors will understand us. It won't influence [the invest-

ment climate], because all investors know that Centerra is not a fair company,» Tologonov stated. He also gave assurances that Kyrgyzstan would not face human resource shortages or lack of expertise, because »it's mostly Kyrgyz people who work at the key units at the mine, and they will just continue their jobs,« he said.

Regarding the challenges in the mining sector, Tologonov claimed that one of the most important issues was people's attitudes towards mining. He said that people's mistrust towards the mining industry and their protests were a result of their nomadic past. »The environment was the essential condition for our lifestyle [...] and this idea is still embedded in people's minds,« he said. This is why, in his opinion, the Kyrgyz are so careful to avoid »ruining the ecological balance«. Tologonov said that the government, local self-government and companies need to meet with people from communities affected by mining operations to explain what safety precautions companies take and what benefits mining can bring to the communities.

Among other challenges, Tologonov highlighted corruption. He thought that clear laws that define responsibilities and explained procedures would leave less room for misinterpretation and, therefore, corruption. He also called for the re-establishment of a ministry for mining, which would be home to all specialists for the mining sector and streamline the decision-making process.

#### 4.4 Respublika (Republic)

Formed in 2007, Respublika came to political prominence in the wake of the 2010 events when then party leader Omurbek Babanov became Prime Minister. The party has taken a moderate view on many issues, but has pushed for greater control over Kumtor.

Nazarali Aripov, the current party leader and MP, called for Kyrgyzstan to regain the 67 per cent share of the joint venture operating company. He saw the mine as important to the country's economy and future development, and would be better for the country to control the mine. In particular, he noted that in the party's opinion the proposed agreement did not reflect the interests of the people of Kyrgyzstan.

Aripov asserted that the proposed agreement does not have widespread support in Parliament. However, during the parliamentary vote on the proposed framework, four of the 16 party's MPs voted in favour of it. The difference of opinion is important, and may indicate that bringing party members to agree on one view will be a challenge.

The party leader stated his determination to change the Kumtor agreement so that Kyrgyzstan has 67 per cent of shares in the joint venture operating company. If this should fail, he is prepared to push for the nationalization of the mine, rather than accept the 50/50 deal. Despite the widespread fears that nationalization will damage the investment climate of the country, Aripov claimed that »it won't send any signal to investors; others will just continue working as they used to. It won't affect our investment climate in any way.«

Aripov was confident that if Parliament decided to nationalize the mine, Kyrgyzstan would be able to run Kumtor by itself, hiring mining companies on more beneficial conditions for the country. When asked about the financial resources needed for mining, Aripov answered that the country can take loans from a bank or find another investor. He also thought that Kumtor could bring income regularly, on a daily basis, and it would help sustain the mine. »We get tonnes of gold every year. Where does [the money] go?« Aripov asked, suggesting that the revenues generated from the mine could be used more effectively and that part of the money could be used to run the mine.

He said that if Kyrgyzstan nationalizes Kumtor, it could continue the operations of Centerra. »We will work just like Centerra works,« he said. The authors note, however, that Kumtor Operating Company does not earn money on a daily basis. It receives financial support from Centerra for most of the year until it can sell gold and pay back all of its loans.

Aripov stated that he did not think that Kyrgyzstan would face a human resources problem in case of nationalization. He argued that a majority of those who are employed on the mine are Kyrgyz citizens and would provide the workforce to continue operations at the mine.

Although Aripov talked about nationalization, he wanted to strengthen the country's investment climate. He noted this with the important proviso that external investment should be carried out »without damaging the Kyrgyz economy«, but he did not clarify this statement. The authors understand this to mean that investors should not be allowed to take control of strategic assets that can generate significant revenue for the country. In his discussion of challenges to overcome, Aripov discussed corruption as a systemic problem. He said, »Those who are in power now, they are involved in corruption [...]. Corruption is everywhere, in agencies, ministries, the government.« Aripov stated he does not expect any positive changes on this issue with the current government. As a way out of this situation, Aripov proposed to find »an honest and good leader« who would have the political will to fight corruption. He referred to this as »restoring order« in the economy.

#### 4.5 Social Democratic Party of Kyrgyzstan (SDPK)

The SDPK has been growing in political strength since it was registered in 1994. The former party leader, Almazbek Atambaev, is now President of the Kyrgyz Republic and many parties see him as advancing the interests of his party. The SDPK is a moderate party and has pushed for a 50/50 deal with Kumtor. Chynybai Tursunbekov, leader of the party and MP, stated that the mining industry was »just starting to develop« and had a lot of potential for the future. His view on the proposed agreement was that it was a »compromise«. He supported the proposed agreement and stated that it enhances Kyrgyzstan's ownership and economic position.

Pointing to the debates on the proposed agreement, he emphasized the importance of preserving the country's investment climate, and, therefore, the need for constructive dialogue and peaceful resolution of the »complicated issues« around Kumtor. He argued that those who press for nationalization tend to simplify the issue and called their moves »political populism«. Tursunbekov said, »Maybe some MPs believe that we can cut such a complicated knot with one stroke of a sword, but I think this is not right. There are two sides [to the situation], and there's a need for compromise.« He worried that nationalization could harm the investment climate

of the country in the future. »MPs who are ready to risk [nationalization...] do not think about the future of our country and people. Nationalization would negatively influence our investment climate,« he argued.

If the government nationalized the mine, Tursunbekov did not think it would be able to run the mine by itself. However, he was positive that the country would attract new investment. »There are other companies that would like to work on Kumtor. Gold is expensive and there's high demand,« he said.

Speaking more broadly about the mining sector, Tursunbekov said that protests are among the biggest challenges. He thought that communities affected by mining operations were a main driver of conflict because they often felt left out of the process and did not see any benefits from the mines coming to their communities. He noted that this issue has been addressed in the amendments to the Law »On Subsoil«. For example, the amendments included a requirement that 2 per cent of the mining company's revenue be paid into the local budget.

Tursunbekov also suggested that personal interests are behind some protests. Some politicians, he alleged, use protesters to »gain political advantage« or competing companies try to push licence holders out of the market. Sometimes, people initiate protests because they want to get a job at the mine. He hoped that provisions in the new amendments to the Law »On Subsoil« and public auctions held in the communities affected by the mining operations would help people to better understand the process and related issues.

Tursunbekov also spoke about other challenges in the sector. He said that corruption was a significant problem. Previously, he noted, decision-making processes took place behind closed doors, adding to people's frustration. This allowed corruption to thrive. He remarked that the current parliamentary system has attempted to enhance transparency and reduce corruption. He admitted, however, that decisions would take longer on mining-related issues.

#### 4.6 Deputies' Groups

The authors also interviewed members from each of the deputies' groups. Ravshan Jeenbekov from Democrats said that they do not support the proposed 50/50 agreement. Hadjimurat Korkmazov from For Reforms said that their group supports the proposed agreement. Mirlan Bakirov from Önügüü (Development) said that they did not have a stated position. Bakhadyr Suleimanov from Yntymak (Harmony) said that their group would be against the proposed agreement and push for greater control of the mine. He did not state whether they would push for 67 per cent or nationalization. Therefore, the authors have stated that Yntymak does not support the proposed 50/50 agreement.

### 5. Experts' Views

Parliament appears split on the 50/50 deal with Centerra over control of the Kumtor joint venture. Ar-Namys and SDPK, with the most seats in Parliament, support the proposed agreement, but Ata Meken and Respublika are against it. Ata-Jurt does not have a common position, or does not want to reveal its stance at this stage; however, the actions of previous party members indicate that many in their ranks support greater control or nationalization. Among the deputies' groups, only For Reforms indicated that they support the proposed agreement. Excluding this group, the other three deputies' groups have 11 seats in Parliament. They could become an important swing vote if a majority is sought by either side.

Other stakeholders the authors interviewed, however, supported the proposed agreement. They argued that to nationalize the mine would create additional problems for the country and development of the mine. In addition, it would damage investor confidence in the country. The authors examine these views in the following sections.

To gather a broader set of views, the authors interviewed a wide range of stakeholders, including:

- President's Administration
  - Department of Financial and Economic Analysis and Development Monitoring;

- Government bodies
  - Deputy Prime Minister, Economy and Investment;
  - Department for the Parliamentary Committee on the Fuel and Energy Complex and Subsoil Use – the department that supports the work of the parliamentary committee;
  - State Agency for Geology and Mineral Resources – the government body that oversees licencing and monitoring of mining activities;
- Companies
  - Kyrgyzaltyn – the state-owned gold mining company;
- Professional associations
  - Association of Miners and Geologists of Kyrgyzstan – association of professionals in the field of mining and geology;
  - Kyrgyz Mining Association – an independent public organization that promotes favourable conditions for the development of the mining sector in Kyrgyzstan;
  - Mining and Metallurgical Union of the Kyrgyz Republic – a union of 50 mining companies and 23,000 miners;
- International organizations
  - Extractive Industries Transparency Initiatives (EITI);
  - Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH; and
- Mining experts.

The following sections examine some of the main points that were raised in the interviews with the MPs and issues connected to them.

#### 5.1 The Proposed Agreement

Outside Parliament, there appears to be support for the proposed agreement in the mining sector. Jonathan Hornbrook, Project Manager for the GIZ's »Mineral Resources for Development«, noted that the proposed agreement »goes beyond the expectations of some experts in Kyrgyzstan«. Others were more conservative. Kylychbek Shakirov, deputy chairman of Kyrgyzaltyn, noted that »it is a step in the right direction, [...] but there [needs to be] a lot of work on the details.«

Parliament's approval of the proposed agreement can be seen as the positive outcome of intense negotiations during a series of social upheavals and scandals involving the mine. Hornbrook noted that, despite the concessions made by both sides, populist politicians have portrayed the deal in a negative way, pushing for nationalization and creating widespread dissatisfaction among the population with the Canadian company. »[This] could be seen as a good deal by both [the government and Centerra], and by the people, but because of the way it's been sold to the public, the image of the agreement has been spoiled,« he said.

Hornbrook further noted that the existing antagonisms mean that few voice their support for the mining sector. He said that people who support Kumtor »don't dare to speak up.« He acknowledged that no one wants a mine next door to their community, but this also depends on communication and interaction with those communities. Hornbrook argued, »[There needs to be] some serious politician to stand up and say we need mining; it should be one of the key drivers of the economic growth. That's the future, so let's do it in a proper way.«

The lengthy debates over the proposed agreement and other developments in the mining sector, however, have hurt Kyrgyzstan's holding in Centerra. The proposed agreement for the joint venture control of the mine would release Kyrgyzstan from investment worries. Kyrgyzstan has 77,401,766 shares in Centerra. At CAD 6.34 (USD 5.77) per share,<sup>5</sup> the country has over USD 446.6 million in the company. The shares have tumbled since September 2011 when Centerra stock peaked at CAD 23.07 (USD 23.11). Since then, gold prices have dropped causing a fall in share prices. By the time the government officially called for a renegotiation of the agreement with Centerra in February 2013, the price of its stock was CAD 7.61 (USD 7.47). This represented a fall of 67 per cent in value.

As the negotiations started, demonstrations began and the market lost confidence in Centerra's stock. After Parliament rejected the proposed 9 September 2013 agreement and Ata Meken party leader Omurbek Tekebaev announced that he would propose a parliamentary motion to nationalize Kumtor, the stock dropped further.

5. Information taken from the Toronto Stock Exchange on 21 August 2014. All other rates based on historical exchange rates.

On 21 November stock was only CAD 2.99 (USD 2.85). The price recovered to around CAD 5.47 (USD 4.99) per share by May 2014. However, with Centerra's announcement that it could suspend work the price dropped again to CAD 3.19 (USD 2.93).

The low stock price plays to Kyrgyzstan's advantage, diminishing their financial investment. If the price of gold recovers and production at Kumtor is good, this would bolster the nationalists' move and the focus on short-term economic gains. The existing agreement does not meet these interests and changes in political vision.

## 5.2 Nationalization

Despite the enthusiasm for the mine's nationalization, many argue that this should not happen. Valerii Dil, the Vice Prime Minister (Economy and Investment), stated, »Nationalization is a word that needs to be excluded from the vocabulary of a country that is developing market relations.« Dil thought that it was unreasonable for a country with few investors to isolate itself further. Others shared his views. The head of the Mining and Metallurgical Union, Eldar Tadjibaev, stated that demands for greater control were »[...] unrealistic, no matter how much we want it.« He and others commented that there could be significant economic consequences from the falling-out with Centerra. The company could file for losses against Kyrgyzstan with expensive court cases dragging on for years. Any stoppage in the mining process could compound these economic concerns.

Tadjibaev's view was shared by Nursulu Akhmetova, Head of the Department of Financial and Economic Analysis and Development Monitoring in the President's Administration. She acknowledged that nationalization is a popular option, but that it is unrealistic. »It's not difficult to pass a law on nationalization [of Kumtor],« she said. »But, there's a reality we live in, and there will be risks and consequences for the country – lawsuits, arbitration, financial losses, stoppage of production. And how do we provide pensions and salaries? How do we replace [Kumtor's contribution] to the budget?«

Although Respublika's Aripov is correct that most of the people that work at Kumtor are Kyrgyzstani citizens, Shakirov from Kyrgyzaltyn pointed out a limitation.



»First of all,« he said, »[Kyrgyzstan] would have a human resources problem [...]. After twenty years [of independence], we still don't have Kyrgyz specialists in top management positions [in the mining sector] with international experience. It's going to be difficult to manage logistics and production.« This contradicts the view of Tologonov from Ata Meken.

If professionals are difficult to find in Kyrgyzstan, would another company be willing to come into the country to take on the job? Shakirov argued that nationalization would have a long-term destabilizing effect. »If [Kumtor is] nationalized, other partners will be reluctant to work with [the country]. The price [of investment] will be higher, because there will be a high risk. Therefore, profitability [of the mine] will decrease. If another investor comes, it will be worse – worse in terms of the quality of work and more expensive. A weak investor will come. A good, strong investor will not come, because nationalization has taken place,« he said. The authors of mining strategy also take this view. They note, »the current public policy counteracts investment, rather than attracts it« (Ministry of Economy 2013: 34).

Others disagreed. Some mining experts stated that other companies will seek to take over the mine. They indicated that it is a business and companies will want to work on the mine, irrespective of what has happened with Centerra. As J. Edward Conway (2013) argues, it may depend on the way a company deals with all the individual stakeholders that allows it to operate in seemingly »risky« countries. Nonetheless, this will be the fourth agreement between the government and investors. Other investors may see too many risks investing in Kyrgyzstan and then possibly being taken to the brink of nationalization.

A company wishing to develop the mine would enter into a situation that is already highly politicized and encounter significant levels of distrust from the communities affected by the mining operations. It may be business, but a new company would need significant backing from the government and a comprehensive plan to engage with the local communities and a comprehensive compensation package. Kumtor already contributes 1 per cent of revenues to a development fund for Issyk-Kul province and supports community projects all along the southern shore of the lake. This raises the question

of whether business reasons would be sufficient to persuade another company to take over?

Despite the voices that do not support nationalization, it is important to note an important factor in its appeal. Those that advocate for nationalization demand that the Kyrgyz people reclaim control over their territory. One of the issues following the 2010 events was a rise in nationalism, which was a reaction to the apparent weakening of Kyrgyz sovereignty over the country (Gullette and Heathershaw forthcoming). The modern state was founded on the Soviet policy of establishing republics based on recognized ethnic groups that have a claim over a territory. After the June 2010 events, there was a feeling of a loss of control. Uzbeks had called for greater political control, yet some Kyrgyz felt that they had strong economic control in the south. Non-demarcated borders in the south have led to violence between residents in Kyrgyzstan and neighbouring countries as to who owns the land. Land given to China and Kazakhstan as part of border settlements had led to widespread anger at what people saw as the loss of their land. Foreign mining companies are not exempt. The extraction of minerals with revenues going abroad is widely perceived as another diminution of Kyrgyz control over their land. The loss of mineral wealth when there is high unemployment and widespread poverty provides strong arguments for nationalizing the mine in the interests of the people. Thus, the drive to obtain greater control of the mine is embedded in broader issues connected to identity, attachment to the land and people asserting their rights. This is beyond the scope of this analysis, but it is briefly offered here to indicate that mining politics and nationalization extend to other, more personal issues.

### 5.3 Economic Development

The mining industry, especially gold mining, is considered to be the strongest driver of the country's economy. Echoing a popular refrain, Shakirov has also called mining the »locomotive of Kyrgyzstan's economy«. But poor performance can also hurt the economy. This was evident in February 2012, when a strike by Kumtor workers caused a significant reduction in the country's GDP. As a reaction against a payment structure dispute, workers staged a walkout that was resolved 10 days later. As a result, there was no one to manage the glacier and



mining was delayed until the glacier could be removed from the pit. The World Bank (2012: 1) states that this caused a 5.6 per cent year-on-year contraction of real GDP in the first half of the year as a result of a 60 per cent fall in gold production.

However, one important question that has not been discussed thoroughly is whether swapping stock in Centerra for ownership of the mine is an economically advantageous move by the government. Valentin Bogdetskii, Head of the Kyrgyz Mining Association, argued that the proposed agreement reduces the dividends the country would receive through its stake in Centerra. He noted that after the Kumtor mine closes in 2026, Centerra will continue working and investing in other mines around the world. However, this investment policy does not satisfy the government, according to Bogdetskii, because the government wants to increase the national coffers. One mining expert added that if the government does follow this path and other sectors are not developed, the country will have significant problems, »Kumtor is a large mine, and to replace it you would need to open two or three other [mines] and that needs to happen within the next few years, or else 2026 is going to be a huge blow to the [country's] economy.«

Kyrgyzstan receives revenues from Centerra through dividends, despite the poor stock option. With the current dividend at CAD 0.16 (USD 0.15) per share annually, Kyrgyzstan earns almost CAD 12.4 million (over USD 11.3 million) per year.

Kyrgyzstan also earns revenue from Kumtor Operating Company through payments and taxes every year. In 2013 Kumtor Operating Company paid over USD 108.6 million in taxes to the national budget and the Social Fund, as well as other mandatory payments.

Also during this period, the Kumtor Operating Company made payments totalling more than USD 270.3 million inside Kyrgyzstan. These included payments for taxes, refining, domestic suppliers, infrastructure, charities and other costs. Between 1994 and 2013, Kumtor Operating Company made payments exceeding USD 2.42 billion (Kumtor Operating Company 2014).

In 2013 Kumtor Operating Company processed more gold than usual. This amounted to revenues of USD

810.9 million. However, the price of gold is lower than the peak of nearly USD 1,900 per ounce in 2011 (Goldman Sachs 2014: 75). Kyrgyzaltyn purchases all the gold and silver at the mine site and transports it to a refinery. Kyrgyzstan then has the option to store or sell the gold and silver.

Apart from the special Issyk-Kul provincial development fund to which Kumtor contributes, there is no fund especially dedicated to mining revenues and their use. The country's mining strategy briefly outlines the potential for several funds to promote development in the provinces, safety and young people (Ministry of Economy 2013: 71). A recent draft proposal of provincial and district funds is an example of such an initiative. However, without a transparent mechanism to monitor use of the mining revenues, the same frustrations with corruption and lack of information will continue.

This also indicates the need to diversify the drivers of growth. Citing the effect that the Kumtor workers walk-out had on the economy, the World Bank (2012: 3) notes, »Facilitating growth in the rest of the economy will help create additional income opportunities while also creating resilience against the supply shock witnessed in 2012.« They continue, however, that non-gold growth is heavily dependent on sectors with export demand. Yet, »these sectors need large investments and a significantly improved regulatory framework« (World Bank 2012: 3). Taking into consideration Kyrgyzstan's hopes of joining the Customs Union, this will require the country to identify ways to boost these sectors and protect them from potential price increases that could limit their contributions to employment and the economy.

#### 5.4 Taking on Risk

Kyrgyzstan is accepting more risk and responsibility in the proposed agreement. The country will receive a higher income from gold processing every year, but the amount will depend on the price of gold in world markets. If the price continues to remain low or drop further, what appears financially beneficial now may not provide the country with the profit margins it had hoped for. There are other standard costs – such as higher operating costs – that Kyrgyzstan would be liable for. These will reduce total revenues and the amount that will have

to be calculated against the estimated price of gold and work plans.

While it is impossible to tell what the price of gold will do, the path Kyrgyzstan is pursuing favours short-term economic growth until the closure of the mine in 2026. Politically it also demonstrates a popular shift towards nationalist tendencies. There is a risk that this could be short-sighted. Given the fluctuations in the price of gold, Kyrgyzstan could remain with a safer option maintaining its shares in Centerra, which has two operational mines and several interests in five countries. This would extend beyond the life of the Kumtor mine and would provide Kyrgyzstan with a longer-term financial outlook.

There are no other known mines in Kyrgyzstan that have the same proven reserves. Many of the other mines have suspended work due to unrest or other, more administrative reasons, such as licencing issues. Kyrgyzstan must look beyond the life of the Kumtor mine to ensure that the country has a stable financial future.

Gold buoys up Kyrgyzstan's economy. Other sectors are performing well, but need greater support to ensure that the country is able to diversify its economic input and not be tied so closely to gold. Although expected growth is good, the country still faces a number of significant challenges, particularly regarding infrastructure. Ultimately, there is a significant risk that the money from Kumtor will be used to fill gaps in the economy and to fund emergency measures in other sectors rather than being put to strategic use to address development challenges.

## 6. Challenges in the Mining Sector

Reforms have attempted to address some of the challenges, but have often fallen short of their goals. There are key areas in which our respondents indicated that increased attention is required in order to enhance transparency and stability in the sector. This is not an exhaustive list and does not necessarily indicate a specific order for addressing issues. It provides an overview of some of the challenges and additional considerations that are required when examining the future of the mining sector.

### 6.1 Corruption

Nearly all respondents noted that corruption – in many guises – is embedded in the system. Transparency International (2013), a corruption rating organization, rated the Kyrgyz Republic 150 out of 177 countries for its level of perceived corruption in its 2013 report. Recent efforts to address the problem have not succeeded. For example, even with amendments made to the Law »On Subsoil« and other efforts to stamp out graft, informal payments and other corrupt practices continue to exist in the mining sector. Since the establishment of a new government following the ousting of President Bakiev, officials have made efforts to demonstrate a crackdown on corruption. In the mining sector, such efforts have resulted in the imprisonment of a former head of the State Agency for Mining and Mineral Resources.

Hornbrook noted that the current decision-making process approaches corruption by viewing it as »if you don't do anything, you don't have corruption.« This is partly reflected, Hornbrook noted, in calls for a 50-year moratorium on mining in Talas province (Gezitter 2013). In this way, it has created administrative obstacles to mining, because if there is no mining there is no corruption, he claimed. He noted that there has been an impasse in the mining industry in the past few years and few, if any, new mine enterprises have opened.

Others acknowledged the potential for corruption in the current system. Kanatbek Ermatov, Advisor to the Head of the State Agency for Geology and Mineral Resources, admitted that there are problems when it comes to cooperation between subsoil users and relevant government agencies; this is noted especially when it comes to conducting an expert examination of the project documentation. The absence of a single system of evaluation of such projects, as well as the absence of a normative order for the review and approval of documents, leads to corruption. Moreover, technically unreasonable project decisions can be taken as a result of such a »corrupted conclusion«.

Ermatov stated that this year the State Agency has plans to hand over responsibilities requiring functional expertise in the assessment of companies and their work to private organizations. The private organizations will be required to obtain accreditation at the Accreditation

Centre. The Agency will supervise work, but not interfere, in an attempt to promote professional, independent assessments.

## 6.2 Governance

Many of the challenges in implementing and upholding the rule of law stem from weak governance and complex bureaucracy. Eldar Tadjibaev of the Mining and Metallurgical Union noted that seven government bodies supervise the sector. The interference of all these bodies and too little government attention to the sector mean that growth has slowed. Tadjibaev recommended that the government create a ministry to supervise the mining industry.

The establishment of a single state body to deal with mining was supported by others in Parliament. Muradil Dzhumadilde uulu, head of the Parliamentary Department under the Committee on the Fuel and Energy Complex and Subsoil Use noted that it is challenging for investors to work with many different state partners. He said, »One of the issues that needs to be addressed is the responsibility of government agencies. There are many agencies a company must deal with, but [if something goes wrong], you can't hold anyone responsible. They put [responsibility] on each other's shoulders. There's a need for one agency that can be held responsible.«

Greater responsibility and accountability is an important point, but not all agree. Karybek Ibraev, Head of the EITI Secretariat in Kyrgyzstan, argued that the creation of a ministry would not be a panacea for the industry's problems. He said that the problem was not necessarily administrative structure, but more the (lack of) transparency of decision-making processes and clear laws. He felt that the government should improve the laws governing the mining sector so that there cannot be different interpretations of those laws.

## 6.3 Transparency

Systemic corruption and weak governance have led to a lack of transparency in mining. Although EITI has found Kyrgyzstan to be compliant, it is still far from what many industry insiders consider to be a better function-

ing sector. One important aspect of this is that there has been less of a focus on sub-national EITI reporting (Valigura 2014). For example, Kumtor pays 1 per cent tax into a development fund for Issyk-Kul province. The effective management of the fund has been questioned and there have been allegations of corruption (Trilling 2013a). A report on the use of the fund has revealed that while some money went to schools, some of the money was also transferred to private companies and for repairs to administrative buildings (Yalovkina 2013). This creates a number of tensions and raises concerns about why mining revenues are not better managed.

In addition, there are no mechanisms to understand how the money is being used. For people living in communities affected by mining operations or those who experience challenges due to poor infrastructure and a lack of basic needs, the lack of government funding is frustrating. If such a transparent fund were created and utilized for development projects, such as those identified in the National Sustainable Development Strategy and provincial development plans, this might go some way to assuage public discontent.

## 6.4 Environmental Pollution

Environmental pollution is a primary concern for people in relation to mining operations. Community members point to adverse health effects and deteriorating crops as indications of pollution caused by mining, even though some of the mining companies have not reached the development stage and need for chemicals to aid the process. Ibraev noted, »especially in the villages that didn't have any mining experience, fear makes mountains out of molehills.« He added that the lack of knowledge about mining and ecology has contributed to people's fears and has caused misunderstandings. »Once people are better educated about mining activities, there will be a constructive dialogue,« he said.

Claims of environmental pollution have plagued Kumtor's operations. Many opponents of the mine point to an incident in May 1998 when a truck fell into the Barskoon River and leaked 1,762 kilogrammes of sodium cyanide into the river, which flows into Lake Issyk-Kul. Sodium cyanide is an inorganic compound used in the leaching process and, if used properly, poses little threat

to human health (Oxus International 2012). Some local residents claimed that they had suffered health problems as a result of the spill, but international experts concluded that there was little evidence that their illnesses were a direct result of their possible exposure to cyanide chloride (Hynes, Harrison, Bonitenko, et al. 1998).

Although reports on the environmental implications of Kumtor's operations are frequent, there have been a significant number of such reports since the renegotiation of the agreement started. While there have been some problems, such as the cyanide spill, analysis has not indicated that there are gross violations. Four reports have found no significant environmental hazards and the mining activities have been operating within European standards (Environmental Resources Management 2012; Nordmann 2012; Prizma 2012; and Stegnar 2012). The government Commission (2013), however, alleged that there are some irregularities.

The timing of these reports suggests that it was more than a regular monitoring and evaluation exercise, but rather an attempt to highlight Kumtor's violations of environmental codes to sow further disapproval among the population. In addition, security officials said they had found videos that exposed the environmental hazards and damage as a result of Kumtor's mining operations. The video »Uulangan Kumtor« (Kyrgyz, »Poisonous Kumtor«) outlined a number of environmental violations at the site that were affecting other parts of the country. It is believed, although no confirmation was possible during the research for this report, that some political groups opposing the Canadian's control of the mine produced the video.

The legacy of the spill and accusations such as those in the video create a charged political atmosphere in which it is difficult to separate fact from fiction. One mining expert said, »the problem is we don't always see an informed debate [in Parliament]. Discussions about an environmental disaster or catastrophe tend to get emotional. And without having clear facts, it's difficult to make a proper decision.« This is amplified in communities where residents fear being directly affected by environmental pollution.

Based on its findings, government agencies have pushed for financial compensation for alleged cases of environ-

mental pollution. In December 2013 a number of court cases were brought against Centerra for violations of the country's environmental code. First, the State Agency for Environmental Protection and Forestry under the Government of the Kyrgyz Republic filed a USD 304 million lawsuit against Centerra for alleged ecological damage. The Agency claimed that this was for »emissions of pollutants and waste dumps, particularly related to operations between 1996 and 2011« (Dzyubenko 2013). Then a new claim by the Green Party was filed at the Bishkek Inter-District Court for damages of approximately USD 9 billion »for alleged environmental damage arising from the Kumtor operations since 1996« (Centerra 2013). These allegations are similar to those that have been logged by the State Agency for Environmental Protection and Forestry and the State Inspectorate for Environmental and Technical Safety. However, the Bishkek City Court dismissed three previous appeals initiated by the State Inspectorate for Environmental and Technical Safety for issues at the Kumtor site, amounting to USD 152 million.

This does not mean that people's concerns are unfounded. In an interview, Amanda Wooden, Associate Professor of Environmental Politics at Bucknell University, noted, »The Kumtor mine is operating in a fragile mountain ecosystem, where this type of industry and at this massive scale is going to have an ecological impact, as mining officials recognize« (Varshalomidze 2014). The street politics of protests and demonstrations show that people's views are important and that they want their voices heard. The concern for the environment is a practical matter as pollution will affect health and livelihoods. However, people's concerns are sometimes dismissed as there is little or unsubstantiated evidence that environmental pollution or damage to glaciers has or will affect people and their surroundings. This does not mean it should not be an important point of discussion and work for current and future operations.

There is another significant concern that may be contributing to some people's fears: there has never been a successful closure of a mine in Kyrgyzstan. Uranium tailing sites are a testament to the environmental pollution of poorly implemented mining activities and the failure to securely store waste. The Second World War saw greater mining of uranium as part of the Soviet Union's nuclear programme (Stone 2005). There are several locations in Kyrgyzstan where secret uranium mills were

set up, but have since been deserted. Today, there are unsecured uranium tailing dumps that pose significant environmental and health hazards for the local area and residents, but also for the region. One such tailing dump in Mailuu-Suu, in southern Kyrgyzstan, could be dislodged by an earthquake and enter the waterways into the Fergana Valley (International Atomic Energy Agency 2007). Thus, communities affected by mining operations are concerned because they do not know what might happen after the mine closes.

### 6.5 Protests

As a result of general frustration with opaque practices and corruption in the sector, people protest against mining activities. There are a multitude of barriers they face to understand the mining sector better. Complex corporate and governance structures, technical knowledge of mining processes and, in some cases, minimal corporate social responsibility entail a total lack of or incomplete information available to communities affected by mining operations. Coupled with fears of environmental pollution and entrenched distrust, this has led to situations in which government bodies struggle to win back people's confidence.

Part of the problem, some experts said, is that resource nationalism has become a popular banner, complicating efforts to explain the role and importance of mining. Kylychbek Shakirov of Kyrgyztyn noted, »People don't fully understand the consequences of this [resource nationalism] movement. They also don't understand how investment is important in the mining industry. Even though Kyrgyzstan is a market economy, the mentality of people is not there yet.«

Others note that there are vested interests in promoting turbulence. The authors were not informed about specific examples, but the regularity with which they heard references to people stirring up protests is cause for concern. Certainly in some cases, community members are engaged in artisanal mining and have protested to prevent companies from developing the land (Kalybekova 2013). Orobek Duishev, Chair of the Association of Miners and Geologists of Kyrgyzstan, stated that some people are paid to protest. He said, »I ask people why do they participate in protests? They tell me they don't have

jobs, they don't have money, and at the protests they are paid. So if they are paid 500 soms [USD 9.63] per day, in ten days they make 5,000 som [USD 96.30] and they can afford to buy food for their families. Poverty is one of the reasons people take part in the protests.«

The Kumtor mine has also created high expectations for companies that want to explore and develop mines. Industry insiders told the authors that people think that mining companies will have similar amounts of money as Kumtor to pay for social packages to compensate the community for the mining operations and pay into other social development schemes. As Ibraev, Head of the EITI Secretariat in Kyrgyzstan, noted, the problem is that »People don't always see the direct impact of mining on their community.« Mining-generated taxes go into the national budget and little goes into local budgets, and smaller companies do not often hire local people to work on the site, all of which generates strong opposition to the mining operations.

Thus, some people may feel that their community is not being sufficiently compensated, and, in some places, this has resulted in demands to renegotiate the agreements with companies. Experts noted that the companies claim that the main hurdle to begin work is not the laws, but people. The more a company invests in exploring and developing a mine, the more vulnerable it becomes to demands from the local community. A joke in the mining industry sums up the problem, »In business you usually negotiate and then sign an agreement. In Kyrgyzstan, it's vice versa.«

Almost all experts pointed to protests and the need to work with communities as significant issues to overcome. Bogdetsii noted that while this is the case, the government thought that »this was not their problem, but rather the companies' problem; the companies need to deal with the local population themselves.« He argued that this was the government's position for a long time, but now they realize they must assist companies in working with communities. The distrust and antagonism of some communities towards mining companies, he noted, »has already acquired a systemic nature« and will be difficult to resolve.

Akhmetova from the President's Administration also highlighted the need to work with the population in

general. She said, »the government needs to work with the population and explain how investment influences their lives. They should explain how the budget works, and that even if there's no direct impact on the local budget, they're still benefitting via the national budget.« She continued by stating that the role of local self-government bodies should be increased and that they must work together with the central government. This has been a complaint in some communities, where residents say that their local self-government bodies are ineffective in mediating between companies and the community, and that national-level government bodies do not provide support (Gullette 2013)

## 6.6 Arbitration Cases

Apart from the ongoing negotiations with Kumtor Operating Company about a new mining agreement, the government is locked in a legal battle with Visor Holdings, an Almaty-based company that has a 60 per cent stake in JerooyAltyn, the licence holder of the Jerooy mine. Previously the then Ministry of Natural Resources cancelled JerooyAltyn's licence because they said the company had failed to start production on time (Mazykina 2010). Visor Holdings has sued the government for USD 400 million in this case and has made an arbitration claim with the International Center for Settlement of Investment Disputes in Washington, DC.

At the same time, the government has gone head with awarding the Jerooy licence through an open auction. The first auction began with a starting price of USD 300 million. It closed with no offers on 13 May 2013. The government has since stated that a new auction will be held with a starting price of USD 100 million (K-News 2013).

In another legal case, Stans Energy, a Canadian company, filed an arbitration claim in early November 2013 for nearly USD 118 million against the government in relation to the Kutessay II heavy rare earth elements project. On its website, the company announced that the government had impeded Stans Energy's ability to conduct activities at the site and forced it to terminate operations of Kutisay Mining LLC, the company's wholly owned subsidiary (Stans Energy Corp 2013). This raises yet more concerns for investors looking to become involved in mining activities in the country.

Industry insiders note that such legal battles may take years to settle. Based on the authors' interviews for this report and personal conversations, it appears that politicians are not concerned about arbitration cases and are not worried if this should happen in the case of Kumtor. From their point of view, there is little that Centerra or international arbitration courts could do to stop the country from continuing to develop the mine. This creates further unease for investors looking to work in Kyrgyzstan.

Recent court proceedings, however, have gone against Kyrgyzstan. On 30 June 2014, the Arbitration Court at the Moscow Chamber of Commerce and Industry (henceforth, »Tribunal«) awarded Stans Energy over USD 118 million in their case against the Government of the Kyrgyz Republic. Kyrgyzstan had appealed to a local Moscow Arbitration Court to not recognize the jurisdiction of the Tribunal, but the court ruled in favour of the Tribunal (Stans Energy 2014a). Stans Energy has now requested the Government of the Kyrgyz Republic to pay the full amount. If the government does not pay, Stans Energy has been awarded the right to »[seek] redress through other avenues« (Stans Energy 2014b). It is not clear whether the government has the opportunity to appeal, and if it does, whether it plans to do so.

The Tribunal's ruling is an important moment for the country. If it does not pay, what are the options open to Stans Energy? Some commentators have suggested that Stans Energy could try to claim its award by securing a verdict to obtain some of Kyrgyzstan's foreign assets. In this regard, it could attempt to gain part of Kyrgyzstan's shares in Centerra (Koven 2014). Another company, Sistem, which won a USD 8.5 million arbitration case in 2009 against Kyrgyzstan, is also seeking Centerra shares. A ruling in Canada has declared that Centerra shares could be seized in lieu of payment. If Centerra and Kyrgyzstan cannot finalize the proposed agreement, negotiations over the future of the mine may have to start all over again.

## 6.7 Work Stoppages

Other companies are also being effectively forced to close due to violence. In the past couple of years, this has led to the closure of at least two operations. For



example, Talas Copper Gold (TCG), a subsidiary of the South African company Gold Fields, has been the target of violence. In October 2011, 10 men on horseback beat up the security manager and attacked the camp with Molotov cocktails, burning down half the camp in the northern Talas province (Trilling 2011). TCG later negotiated a partnership agreement with the local community and dropped charges against the alleged attackers as a sign of good faith and willingness to cooperate with the community. However, other communities have blocked work on three of the sites for which it has licences. TCG has cited force majeure as the reason why it is unable to fulfil its work plans on these sites. The lack of work, the lower price of gold and changes in Gold Fields corporate structure have meant that TCG has been forced to minimize its operations (Trilling 2013c).

Z-Explorer, a subsidiary of the Australian Manas Resources company, has also experienced violence. Local residents have expressed their frustration with the company in the past and have blocked the road to the mine. In October 2013, around 200 people attacked the Z-Explorers site office at the Shambesai deposit in Batken province, southern Kyrgyzstan (Solovyov 2013). Tensions have forced Z-Explorer to stop work. The company announced on 19 March 2014 that they would suspend work until a constructive dialogue could start (Arykbaev 2014).

Mining experts told the authors that while the communities affected by mining operations have a right to be concerned and should engage in dialogue with companies, there are suspicions that the violence is being orchestrated by outsiders who want to halt operations (Gullette 2013). These external actors may be encouraging people to protest so that they can later become involved in the mining operations (or at least stop others from profiting). There is no concrete evidence that this has happened, but the widespread discussion of such practices does warrant consideration and may be a contributory cause of local violence against mining companies.

Ultimately, this means that more companies are suspending or stopping work, and more lawsuits are being filed. In a sector which many regard as a key driver of the economy, there are a significant number of lawsuits, which could have an effect on the country's investor status and may result in pay-outs to disgruntled companies.

## 6.8 Improving Services

There have been efforts to improve regulation and monitoring in the sector. One issue that the State Agency for Geology and Mineral Resources has addressed is the process of granting licences. The advisor to the head of the State Agency Kanatbek Ermatov highlighted that the agency now conducts auctions in such a way as to create a competitive environment and attract more investors. The State Agency is also conducting auctions in the villages near to the deposit sites. Thus, they are including the local population in the process and raising residents' awareness of the auctions.

The State Agency has also announced a plan for 2014. The plan includes measures to simplify the process for applying for rights of access to subsoil minerals, transparent procedures in the awarding of licences, creating conditions that would allow for new medium and large deposits to be developed, and increasing the income from the mining sector to KGS 30 million (around USD 579,000) (Moiseeva 2014).

These developments are a positive move, as experts have noted that many people do not trust the government to implement and enforce the laws. Jonathon Hornbrook of GIZ argued that the State Agency should be seen as a neutral body, and should be engaged in explaining issues to communities near deposit sites. Likewise, it should be able to address people's concerns about environmental pollution and provide factual information. He argued that if the State Agency is more engaged at the community level, it could help to minimize conflicts with mining companies.

The support required for the State Agency also raises concerns about financial costs that could be used for other sectors. Hornbrook stressed that government spending on basic social services, such as hospitals and schools, should not be considered the same as spending on the State Agency. There is a difference in the rate of returns. Mining has a bigger financial return over a short period of time, whereas the financial and social returns from hospitals and schools are long term and so less evident. »If you help the State Agency, [the country's ability to collect] taxes will increase and you will get more money. Today the agency is anorexic; they can't work,« said Hornbrook.



## 7. Economic Opportunities and Challenges

The proposed agreement may bring greater economic benefits in the short term, but how will it fit into the country's broader economic context? There are a number of significant economic challenges. While there are pledges of external support, there are also indications that sustainable economic development is far off. The importance of the mining sector to the economy demonstrates that other sectors are in desperate need of assistance. If the government cannot use the increased revenues effectively, there may continue to be a gradual decline, instead of prosperity.

Economic growth in Kyrgyzstan has been good, but a number of issues over the past few years have provided a rollercoaster ride for the economy. In 2009 Kyrgyzstan suffered from the effects of the global financial crisis and reduced economic performance from the energy crisis. The following year the ousting of President Bakiev and the violence in southern Kyrgyzstan reduced GDP by a further -0.5 per cent. As peace was established, there was positive economic growth, but it fell again in 2012 to nearly -0.1 per cent, largely linked to the strike at the Kumtor mine. In 2013, a good year for gold production, GDP rose 10.5 per cent. This five-year window on a major economic indicator demonstrates that the country is highly susceptible to external events; that political instability and violence can cause significant damage; and that non-gold sectors are not strong enough to support the economy.

Kyrgyzstan is strongly reliant on imports due to continued strong domestic demand. Imports are twice the level of exports, which is creating further problems. Re-exports are an important contributor to the economy, but even this has shrunk due to regional economic factors (Mogilevskii 2012). In general, this does not mean that sectors are underperforming, but rather indicates that the country's products are struggling in the global economy and gold dominates exports. The World Bank (2014) expects that the deficit will remain high.

In addition, a number of other factors need to be taken into consideration. The following sections examine some of the opportunities and challenges that exist in Kyrgyzstan and areas in which increased focus is required to ensure that the economy continues to grow both now

and after the projected closure of the Kumtor mine in 2026.

### 7.1 Military Airbases

One area providing substantial financial support was the Transit Center at Manas, the base from which America flew refuelling missions over Afghanistan. Unpopular among nationalist politicians, in 2014 it finally closed. However, each year it paid USD 60 million in rent to Kyrgyzstan. Including other payments and estimated local spending, the total received was USD 103.7 million for 2013. Since the base opened in 2001, America has paid over USD 809 million, not including payments for jet fuel (U.S. Embassy 2013).

Russia, however, still uses the airbase at Kant, not far from Bishkek, the capital. They have used it since 2003 under the Collective Rapid Deployment Forces of the Collective Security Treaty. In 2009, a new agreement was signed allowing Russia to use the base for another 49 years with the possibility for another extension for 25 years. Russia annually pays Kyrgyzstan KGS 300 million (nearly USD 5.8 million) for use of the base.

The closure of the Transit Center will also mean the loss of jet fuel contracts and payments in Kyrgyzstan. The economic knock-on effects may not be significant overall, but they will be felt by businesses and suppliers to the Transit Center. The government has said that it wants to create a cargo and passenger air transportation hub, but the plans and agreements for this are a long way off. There were plans that the Russian oil company Rosneft would buy the airport, but this was another deal that politicians said could not be given to a foreign country (Kalybekova 2014a), and it now appears to be off the table due to public resistance. However, Chinese groups have also indicated they are willing to invest over USD 1 billion in Bishkek and Osh airports (Rickleton 2014). Discussions are ongoing, but the government may see such an offer as too good to pass up, as the country's air transport locations are in desperate need of financial support.

## 7.2 Energy

In Kyrgyzstan, the energy sector is also widely viewed as a future driver of economic growth. Large-scale energy installations are under construction, but their revenue-generating potential will not be realised soon. Kambar-Ata-1, the country's largest hydroelectric power dam, a much touted boost to the energy sector, has conducted a feasibility study, and the Upper-Naryn cascade of four hydro power plants has begun construction (Kalybekova 2014b). The additional capacity it would give to the republic's energy sector and export potential to neighbouring countries and the Central Asia South Asia Electricity Transmission and Trade Project (CASA-1000) envisioning the export of electricity to Afghanistan and Pakistan is still a long way off. Toktogul Reservoir, the multi-year storage facility feeding the country's large-scale hydroelectric power station, providing around 93 per cent of electricity, is low.<sup>6</sup> The Ministry of Energy and Industry stated on 22 April 2014 that this is due to two factors. First, during the long winter of 2013/2014, Kyrgyzstan had the highest recorded levels of electricity consumption. Second, the river is in a low-water cycle and the inflow of water into the reservoir is low. The government has also halted export of electricity and seeks to import electricity from Kazakhstan and Tajikistan to help meet the shortfall. The government has said that the energy deficit will affect citizens in the winter of 2014/2015 (AKIpress 2014a).

The government plans to review electricity tariffs in autumn 2014. This is a sensitive topic, however, as the Bakiev government's disastrous energy tariff policy was one of the factors that led to widespread demonstrations, ending in his removal from office. At present, energy tariffs are heavily subsidised with household consumers paying KGS 0.70 (approximately USD 0.014) per kilowatt hour. Attempts to raise the tariff, however, will need to consider people's ability to pay for the electricity. Rates for hot water and heating have already risen in Bishkek. Furthermore, people are not prepared to pay for a service that often does not work properly. The lack of reliable services is a key issue, and until this can be fixed, the energy sector, especially in the provision of electricity, will continue to lose money.

6. On 21 April 2014 the volume was 8.5 billion cubic metres. Dead level, the point at which no electricity can be generated because the water level is too low, is 5.5 billion cubic metres.

## 7.3 Economic Issues Affecting Households

Rising inflation and high unemployment are pushing more families into poverty and requiring social benefits. The National Statistical Committee (2014: 9) noted that in 2013 the annual average rate of inflation was 6.6 per cent. Kyrgyzstan is a net food importer and lower international prices helped to limit the effect of domestic food price increases (World Bank 2014: 4). However, starting with the global food crisis in 2008, food prices have risen considerably in Kyrgyzstan. Prices of flour products have risen nearly 19 per cent since 2009. During this same period, the price of meat products has risen nearly 74 per cent. Furthermore, since 2008, the cost of sugar has also increased over 50 per cent. All of these products are an important part of the Kyrgyz diet and represents a considerable cost for household budgets.

Unemployment in 2011 was 8.5 per cent of the population aged 15 and older (National Statistical Committee 2012). In 2012, this stayed almost the same at 8.4 per cent. At the same time the average monthly wage increased (National Statistical Committee 2013c). In 2013, the average wage was KGS 11,079 (USD 229) per month. The unemployment and salary figures, however, hide a number of disparities. For example, self-employment accounts for around 68 per cent of total employment in rural areas. Analysts at the World Bank (Atamanov 2013: 7) note that self-employment is associated with higher levels of poverty. Furthermore, self-employment covers informal and low-paying jobs, often in the agricultural sector. In other words, it does not take into consideration the amount farmers may earn from their produce or whether that is enough for the family to survive on. The average wage figures are also distorted by relatively high wages in Bishkek.

Rising inflation with regard to the consumer food basket is partly tied to poor agricultural output. The agricultural sector, which provides a majority of employment in the country, saw slow growth from 2008 to 2012 (National Statistical Committee 2013a). However, weather is changeable and early snowfall, such as in September 2010, kills many crops. In general, the Food and Agriculture Organization (Fitzherbert 2000) has indicated that the amount of wheat harvested per hectare has fallen by around half since the 1990s. It is now roughly 2 tonnes per hectare. This is due to a number of factors, including

insufficient access to water, lack or absence of fertilisers and poor farming techniques. Wheat is part of the staple diet in the country but domestic production cannot meet demand. This means that Kyrgyzstan is a net importer of wheat.

Remittances sent home by migrants are a critical boost to the economy. In 2013, remittances amounted to USD 2.2 billion, which represents approximately 30 per cent of GDP. Nonetheless, approximately, 38 per cent of people in the country live in poverty, with the rural population particularly affected (National Statistical Committee 2013d). This has resulted in 45 per cent of children living in poverty, with many children living with other family members as parents work abroad. As a result, Kyrgyzstan has a low human development index (HDI) ranking (United Nations Development Programme 2013). In 2013 Kyrgyzstan had an HDI ranking of 125 out of 187 countries and territories, indicating that development is still lagging in certain areas.

As a result of the increase in poverty, the number of people needing social benefits to survive is increasing. The National Statistical Committee (2013b) indicated that the number of people receiving benefits grew from 2008 to 2012. Including monthly benefits for poor families with children, the number of people receiving benefits grew by 17 per cent during this five-year period (National Statistical 2013b: 38).

Remittances sent home to Kyrgyzstan by migrant labourers are not reducing poverty. If sanctions against Russia over the crisis in Ukraine take effect, they could hurt labour migrants, causing a reduction in remittances. The rise in poverty is also increasing the number of people seeking social welfare benefits. The government will need to increase spending in social welfare to reduce poverty and to support vulnerable people. The government must address this issue as accession to the Customs Union may mean an increase in the prices of consumer goods, which will create further problems for the economy.

#### 7.4 Regional Issues

Kyrgyzstan is still fairly susceptible to external shocks. This was witnessed this year, when the som, Kyrgyzstan's

currency, plummeted by nearly 10 per cent from the beginning of the year (based on daily exchange rates). This was caused partially by a 20 per cent devaluation of the Kazakh tenge and the weakened Russian rouble. Although the som has recovered, it is too early to say that it will remain stable.

In 2009 Kyrgyzstan experienced a range of challenges from the effects of the global financial crisis in Russia. The closure of the Cherkizovskii Market in Moscow in June 2009 resulted in many Kyrgyz citizens and other Central Asian citizens losing their jobs. That year also saw the level of remittances drop by a fifth. There were concerns that some of the more than half a million labour migrants would start to return to Kyrgyzstan where no jobs awaited them. In fact, many decided to stay and wait for jobs to return. The strategy worked, but there is no guarantee that the labour migrants would be so lucky if a recession set in or, again, that the sanctions against Russia as a result of the crisis in Ukraine will not affect low-paid jobs and unskilled workers. It is not yet clear what the knock-on effects could be for Kyrgyzstan, but it will create additional challenges for the economy.

#### 7.5 Economic Integration – The Great Unknown

On 12 May 2014 the Ministry of Economy announced the road map for accession to the Customs Union in 2015, which was approved by Customs Union members Belarus, Kazakhstan and Russia later in the month. The road map contains a long list of issues that Kyrgyzstan must resolve in this period, for which Prime Minister Joomart Otorbaev said the country needs USD 400 million to implement (RFE/RL 2014). Despite the government's stated intention to join the Customs Union, it remains to be seen how and to what extent joining the Customs Union will affect the Republic. There are many rumours about the possible benefits and detriments to the country. In the view of some economists (Ülgen and Levent 2011), Kyrgyzstan must focus on increasing the volume of exportable goods and diversifying the sectors exporting goods. Apart from gold, the country's agriculture and textile industries are driving exports, but these need greater support to make them internationally competitive.

The textile industry, for example, provides an opportunity to see what accession to the Customs Union could mean for Kyrgyzstan. From 2002 to 2012 textile exports increased ten-fold. Cheap fabrics imported from China and Turkey are used to develop garments for export, mainly to Kazakhstan and Russia. Together with the simplified weight-based customs clearance protocol, this has allowed the textile industry to become an important contributor to the economy. However, with the planned accession of Kyrgyzstan to the Customs Union, this protocol would be changed to an external value-based tariff, which is more than the current rate. As Nurbek Jenish (2014: 5) notes, »This would substantially increase the cost of apparel production in Kyrgyzstan and may result in Kyrgyz products becoming less competitive in [Customs Union] markets. Additionally, overall prices are expected to increase substantially after the country joins the Union. This would automatically increase the cost of labour and the unit cost of garment production.«

The National Institute for Strategic Studies (NISS) also examined a range of issues related to Kyrgyzstan's potential accession to the Customs Union, noting a series of opportunities and challenges. From their analysis, NISS also concluded that prices could increase following accession to the Customs Union. In addition, the lack of a modern infrastructure would further harm trade. However, accession would allow labour migrants to move more freely in search of work. In the view of the study's authors, this would possibly increase remittances to family members, but could also increase the brain drain and pose a number of social problems, especially for children who may not be able to join their parents abroad.

NISS also stated that while investors would have access to a larger economic territory to establish and develop businesses, »the decisions of state bodies that hinder or prohibit doing business, will create an unfavourable image of Kyrgyzstan, as a place where the rights of investors may not be recognized« (NISS 2014: 40). While NISS does not discuss this in relation to Kumtor, given the situation in the country at the time this analysis was conducted, the debates over the mine are probably an important factor in this view.

In 2013, the Minister of Economy Temir Sariiev said that Kyrgyzstan would create a special fund to accumulate USD 200 million annually for five to seven years to help

businesses (Denisenko 2013). This is an important measure, but without adequate measures in place, the Customs Union could quickly reduce revenue-generating sectors and increase unemployment. Any plans must also take into consideration a long-term view to improve the economic contributions of these sectors and others will have after the closure of the Kumtor mine in 2026.

The agreement between the Customs Union members on 29 May 2014 formally established the Eurasian Economic Union (EEU), which will replace the Customs Union on 1 January 2015. With the establishment of the EEU, it was touted that Russia has pledged USD 1.2 billion in financial support for Kyrgyzstan to smooth transition into the EEU (Temir 2014). Later, Russia's Foreign Minister Sergei Lavrov announced that Russia would give USD 500 million (RAI Novosti 2014). This is welcome news, but this may only soften the increase of price rises with entrance into the Customs Union. Furthermore, it will not resolve macroeconomic issues that will need to be addressed in order for the country to develop other sectors of the economy than just mining.

The proposed accession to the Customs Union puts Kyrgyzstan between a rock and a hard place. If it does decide to join the Customs Union, with President Atambaev said may happen before the end of 2014, then there will most likely be price hikes and a significant amount of adjustment in order to ensure that non-gold sectors do not collapse and continue to contribute to the economy. If Kyrgyzstan decides not to join the regional economic organization, then it could worsen the country's image with its neighbours. In which case, NISS states, »Kyrgyzstan positions itself (1) as a state that rejects its obligations, and (2) as a state in the centre of Eurasia which ignores (political) unification and its players« (NISS 2014: 8). However, Kyrgyzstan is still part of many other regional bodies; thus not joining the Customs Union may not be such a blow to the country's image, in the opinion of this study's authors. Nonetheless, either decision will create challenges for the country that need to be addressed in order to support longer-term development, especially of the non-gold sector of the economy.

## 8. Uncertain Future

The economic implications of the proposed Kumtor agreement and the broader context in which it will happen are significant issues for Kyrgyzstan. This is not to say that, if approved, the proposed changes will not improve the economy, but the current financial benefits and potential pitfalls of the proposed agreement with Centerra are many, with too many variables to identify whether it will be a success in the future. Irrespective of whether the existing or proposed agreement will ultimately prove more successful, this negotiation process has been disastrous for all stakeholders. This will serve as a lesson for other investors looking to work in Kyrgyzstan, despite the assurances of nationalist politicians. If the government wants to improve matters, it must start addressing key challenges now, and not wait until the next crisis arises in relation to Kumtor.

Four main points emerged from the interviews and events during the negotiation process which, at the time of publishing, was still ongoing, with no clear final outcome. First, there are few political parties and deputies' groups in Parliament that have a clear view of the proposed Kumtor agreement and the mining sector in general. Spokespersons for parties and deputies' groups indicate a general view, but some in the party ranks have different opinions. Thus, it is difficult to indicate how Parliament will respond to in the final agreement. It is clear that some will push the government to gain more control over the mine, and some may even push for nationalization. Such actions will create additional challenges and in the current context could cause more tension between the government and Centerra and potential disruptions to the mining process.

Second, irrespective of the final decision on the proposed agreement, the government must seek to use the funds in a transparent and effective manner. This could include establishing special funds and investments in order to contribute to development initiatives in the country. Examples of this in Kyrgyzstan, however, have underperformed and may have allowed corruption to flourish, such as with the Issyk-Kul provincial fund to which Kumtor contributes 1 per cent of its revenues (Trilling 2013a). Special funds often seek a separate management structure and may not include the Ministry of Finance, or other responsible government body, in the


management or oversight of the fund distribution. All revenues generated from Kumtor go into the national budget which has established monitoring and distribution procedures, is subject to scrutiny by Parliament and the Chamber of Accounts, and is monitored by the International Monetary Fund.

In August 2014, the government drafted a regulation »On the Regional Development Fund«. <sup>7</sup> This would establish special funds at provincial and district levels in areas with mining activity to promote the improvement and maintenance of infrastructure, finance social and economic development, and support other local events. The fund would be governed by a Supervising Committee, which comprises national and local government representatives and members of not-for-profit organizations.

While this is a positive move, it may not address the use of mining revenues, for which a new fund could be created. A fund with a clear management and monitoring system that incorporates many of the structures that currently exist in the oversight of the national budget could provide a focal point enabling people to see the growing income and understand how the mining-generated funds are being used. A sovereign wealth fund, for example, could be created out of the revenues from Kumtor and other gold mining activities in the country. This could then be invested to promote greater economic resilience for the future. If the proposed agreement is approved, such a fund would allow Kyrgyzstan to maintain a longer-term financial portfolio, while developing the mine for short-term economic gain.

Norway's sovereign wealth fund, which is based on its surplus oil revenues, provides an example. Caner and Grennes (2010) note that it is an example of a transparent sovereign wealth fund. Norway created a fund in 1990 within its central bank and provides information on how the money is being invested and used. The fund gives the Norwegian government flexibility to manage fluctuations in oil prices and to manage its spending of oil-generated revenues. There are lessons here for Kyrgyzstan, especially in using a fund to manage revenues and to help it to limit its susceptibility to rapid price changes, thereby strengthening its fiscal policy.

7. This is in accordance with the Law »On the introduction of amendments and additions to several legislative acts of the Kyrgyz Republic«, No. 149, 17 July 2013.



The authors of this study offer the Norwegian example as a type of fund that could be considered to help Kyrgyzstan to strengthen its economy in the longer term. This is particularly important given the potential challenges of regional economic integration, the weakness of non-gold sectors, high levels of poverty and other issues that face the country. The concern is that if the proposed agreement is approved and the funds are not well managed or people do not see investments in their communities, then social unrest is likely to continue and the government could be a target of people's frustration.

protests against Kumtor may turn into protests against the government.

Third, the government must develop a plan to improve other sectors to contribute to the economy. They should identify steps by which the economy can make the transition to the post-Kumtor period. In the debates about gaining greater control over the mine, there have been few – if any – public discussions on what will happen after the mine has closed. This must become a priority, and politicians must contribute to sustainable economic plans.

Fourth, the government must facilitate dialogue between all stakeholders to identify opportunities and overcome challenges in the sector. In particular, there must be more engagement with communities affected by mining operations. Overcoming mistrust and establishing agreements will be challenging, but it is important to identify acceptable ways to share benefits. This is crucial for greater stability and cooperation. Without this, Kyrgyzstan will slip down the list of potential countries for foreign investors.

The conclusion of negotiations on the proposed Kumtor agreement will have a significant impact, reaching far beyond the mine. For better or worse, it will lay out a particular path for the future of the mine and the country's economic development. Irrespective of the outcome, the government must examine the broader context in which the decision on the proposal will be made and the effects it will have. The government must establish measures to ensure non-gold growth and to protect Kyrgyzstan from neighbourhood economic events (or its integration in the Customs Union); otherwise the country will struggle to ensure longer-term economic development. Whatever is decided, unless the government can improve the mining sector and use the revenues to improve social welfare and address other challenges, the





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