

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR THE KYRGYZ REPUBLIC

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EXECUTIVE SUMMARY

During the last two years the Kyrgyz Republic has continued to make progress towards implementation of the principles of multi-party democracy, pluralism and market economy. The country has many political parties, including genuine opposition parties, and a vibrant network of non-governmental organisations within a developing pluralistic civil society. Notwithstanding these positive trends, there are problems reflecting the lack of maturity of democratic institutions. Political tension since the beginning of the year and the killing of five protesters in March 2002 resulted in increased social and political unrest. This led to the resignation of the entire government in May. These events revealed the urgent need for a genuine dialogue between various political actors of the country.

Over the past two years, macro-economic performance in the Kyrgyz Republic has improved. Tight monetary policy has stabilised the exchange rate and inflation fell to 3.8 per cent in 2001. GDP is approximately US\$ 1.5 billion with GDP per capita of approximately US\$ 300. Preliminary estimates report GDP growth of 5.3 per cent in 2001. Nevertheless, this headline figure hides significant difficulties. Industrial production growth, net of the Kumtor Goldmine, has been close to zero. In contrast the agricultural sector expanded by more than 4 per cent for the third consecutive year. Growth rates have not been sufficient to significantly reduce poverty levels and poverty remains widespread.

The Kyrgyz Republic continues to be plagued by its high public debt level, but important progress has been made to avoid a further deterioration. The fiscal deficit has been reduced to 6 per cent of GDP in 2001 from 9.6 per cent in 2000. The authorities also rescheduled their debt service payments to the Paris Club and were granted some reduction in interest payments. As a result, debt service payments until 2004 are low. While the IMF foresees a gradual reduction in public investment and an increase in fiscal revenues, further debt restructuring is still required. According to the IMF, the Kyrgyz Republic will need to seek debt restructuring, in order to achieve a sustainable debt level.

With a gradual decrease in public investment, private investment will have to fill the gap. This will require continued improvements in the investment climate and enhanced co-operation with neighbouring countries. Excessive bureaucratic interference in businesses, corruption, and a weak judiciary continue to discourage investments. The capacity of the agricultural sector to grow is hampered by poor demand for its products, caused largely by regional trade restrictions.

Progress on structural reforms has been mixed over the last 2 years. Some advances have been made in rebuilding the banking sector since 1998. More broadly, little has been achieved on corporate governance issues and reducing corruption. Key privatisations, which have been on the government's agenda for the last few years, have not been successful (e.g. Kyrgyz Energo). A stake in Kyrgyz Telecom has been offered for sale to a strategic investor through two international tenders but there were no acceptable offers.

In line with the difficult investment environment and transition challenges facing the Kyrgyz Republic, and in line with the reform matrix adopted by the Government in April 2002 to improve investment, the EBRD will continue to work to (a) promote a

healthy Micro and SME sector, (b) facilitate privatisation of the remaining major state enterprises, (c) support the development of the financial sector, (d) help attract investment to key natural resources projects and (e) through policy dialogue with the government help develop and improve transparency, governance and the investment climate. Given the high public indebtedness of the country, we will, in line with the government priorities, concentrate on the private sector and refrain from sovereign projects, although blending grant funds with EBRD finance may allow limited public sector investments where there is a particularly high transition impact.

The Bank's activities will be based on the following operational objectives.

- **Privatisation and the Enterprise Sector** - The Bank will promote privatisation of key state entities such as telecom and possibly power distribution. Privatisation of the energy sector is key to reducing the quasi-fiscal deficit of the sector (estimated at around 7 per cent of GDP in 2001) and to attracting necessary resources to maintain related infrastructure. Given the decline in public investment, the need for a healthy private sector capable of creating employment becomes even more pressing. The Bank will support private enterprises, both local and foreign owned, through its Micro and Small Enterprise loan programme and through the Direct Investment Facility (DIF). Technical assistance will be used selectively to promote investor engagement in appropriate sectors of the economy. These programmes will be managed to ensure appropriate regional coverage and to support the agricultural sector. The Bank will also seek to provide specific support for SMEs in the tourism sector.
- **Financial Sector** - To increase the capitalisation of the banking sector and to enhance the availability of investment finance for the enterprise sector, the Bank will seek opportunities to facilitate the entry of new investors into the financial sector. The privatisation of the two state owned banks could provide opportunities to support this process. For the foreseeable future, the Central Asia Risk Sharing Facility will be a key element enabling the Bank to continue and expand its provision of MSE and the Trade Finance Programme in the Kyrgyz Republic.
- **Natural Resources** - In the past three years the large Kumtor Goldmine has significantly increased production, and the operating company has recently announced that it is evaluating plans to extend the life of the Kumtor Goldmine by an additional 5 years. With the exception of Kumtor, development of the remaining sizeable gold and other mineral deposits in the Kyrgyz Republic is constrained by their relatively small scale, the lack of interested, financially strong sponsors and unfavourable terms negotiated in the mid-nineties when gold prices were higher than present levels. Should gold prices stabilise at higher levels, strong and reputable international mining sponsors may emerge, thus providing opportunities for financing by the Bank.

While targeting these objectives, the Bank will liaise closely with other IFIs to ensure complementarity of actions and consistency in policy dialogue in the context of the Comprehensive Development Framework adopted in 2000 by the Government and the recently adopted National Poverty Reduction Strategy for 2003 to 2005.

The proposed strategy responds to the economic realities and the transition challenges of the Kyrgyz Republic and yet reflects the Bank's objective to expand its activities in

the country through its focus on the private sector. All EBRD operations in the Kyrgyz Republic are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

ABBREVIATIONS

Asian Development Bank	(ADB)
Asian Development Fund	(ADF)
Acquired Immunodeficiency Syndrome	(AIDS)
Advanced Mobile Phone Service	(AMPS)
Business Advisory Services	(BAS)
Central Asia Risk Sharing Facility	(CARSF)
Country Assistance Strategy	(CAS)
Community and Business Forum	(CBF)
Central and Eastern Europe	(CEE)
Canadian International Development Agency	(CIDA)
Commonwealth of Independent States	(CIS)
Consolidation Structural Adjustment Credit	(CSAC)
Debt and Bank Resolution Agency	(DEBRA)
Department for International Development	(DFID)
Direct Investment Facility	(DIF)
Demir Kyrgyz International Bank	(DKIB)
Environmental Action Plans	(EAPs)
European Union	(EU)
Foreign Direct Investment	(FDI)
Flora and Fauna International	(FFI)
Foundation for International Community Assistance	(FINCA)
Gross Domestic Product	(GDP)
Global System for Mobile Communication	(GSM)
Gesellschaft für Technische Zusammenarbeit mbH	(GTZ)
Human Immunodeficiency Virus	(HIV)
International Chamber of Commerce	(ICC)
Information and Communication Technology	(ICT)
International Development Agency	(IDA)
International Finance Corporation	(IFC)
International Financial Institution	(IFI)
International Monetary Fund	(IMF)
Islamic Movement of Uzbekistan	(IMU)
Islamic Development Bank	(IsDB)
Information Technology	(IT)
Joint Stock Company	(JSC)
Kyrgyz Agribusiness Company	(KAC)
Kreditanstalt für Wiederaufbau	(KfW)
Kyrgyz Som	(KGS)
Kyrgyz Investment and Credit Bank	(KICB)
Kumtor Operating Company	(KOC)
Kyrgyz Telecom	(KT)
Limited Liability Company	(LLC)
Multilateral Investment Guarantee Agency	(MIGA)
Mining Minerals and Sustainable Development	(MMSD)
Maximum permitted emission	(MPEL)
Micro and Small Enterprises	(MSE)
National Communications Agency	(NCA)
National Environmental Action Plan	(NEAP)

Non-governmental organisations	(NGOs)
National Telecommunications and Information Administration	(NTIA)
Office for Democratic Institutions and Human Rights	(ODIHR)
Organisation for Economic Co-operation and Development	(OECD)
Organisation for Security and Co-operation in Europe	(OSCE)
Private Enterprise Partnership	(PEP)
Poverty Reduction and Growth Facility	(PRGF)
Poverty Reduction Strategy Processes	(PRSP)
Rural Advisory Development Service	(RADS)
Shanghai Co-operation Organisation	(SCO)
Swiss Agency for Development and Co-operation	(SDC)
Small Enterprise Assistance Fund	(SEAF)
State Secretariat for Economic Affairs	(SECO)
Small and Medium Sized Enterprises	(SME)
Saving and Settlement Company	(SSC)
Technical Assistance for CIS Countries	(TACIS)
TurnAround Management	(TAM)
Technical Co-operation	(TC)
Trade Finance Programme	(TFP)
United Nations Development Programme	(UNDP)
United States Agency for International Development	(USAID)
Value added tax	(VAT)
World Bank	(WB)
World Trade Organisation	(WTO)

1. THE BANK'S OPERATIONS TO DATE AND CURRENT PORTFOLIO

1.1 Overview of Activities to date

The Bank has been actively involved in the Kyrgyz Republic in both the private and public sector. As at 31 July 2002, the Bank's net cumulative signed investments totalled EUR 174 million (disbursements were 84 per cent of cumulative commitments). The private/state sector portfolio ratio is 52/48. Public sector projects consist of two operations for the upgrade of the electricity transmission network, a project for the modernisation of the telecommunications network and the restructuring of an agribusiness company. Private sector projects consist of a gold mine, SME and MSE Credit lines, two start up banks with IFI and strategic investors, a hotel, a shoe factory and five small equity projects financed under the Direct Investment Facility (DIF). Considerable technical assistance has also been provided to the Kyrgyz Republic (totalling some EUR 14.6 million), including through the TurnAround Management (TAM) programme.

Table 1: Net Cumulative Business Volume by Industry (EUR million)

(as at 31 July 2002)

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Natural Resources	1.0	460	38	31	8	22%
	Power and Energy	2.0	84	63	63	0	36%
Sub-total Energy		3.0	544	102	93	8	58%
Financial Institutions	Bank Equity	1.5	18	2	0	2	1%
	Bank Lending	2.0	33	32	32	0	18%
	Equity Funds	0.1	8	2	0	2	1%
	Small Business Finance	0.1	1	1	1	0	0%
Sub-total Financial Institutions		3.7	59	36	33	4	21%
General Industry	General Industry	0.1	4	3	0	3	1%
Sub-total General Industry		0.1	4	3	0	3	1%
Specialised Industries	Agribusiness	4.0	28	15	15	0	9%
	Prop Tour and Ship	1.0	26	9	8	1	5%
	Telecoms Informatics & Media	1.0	28	10	10	0	5%
Sub-total Specialised Industries		6.0	81	34	33	1	19%
KYRGYZ REPUBLIC TOTAL		12.8	689	174	159	15	100%

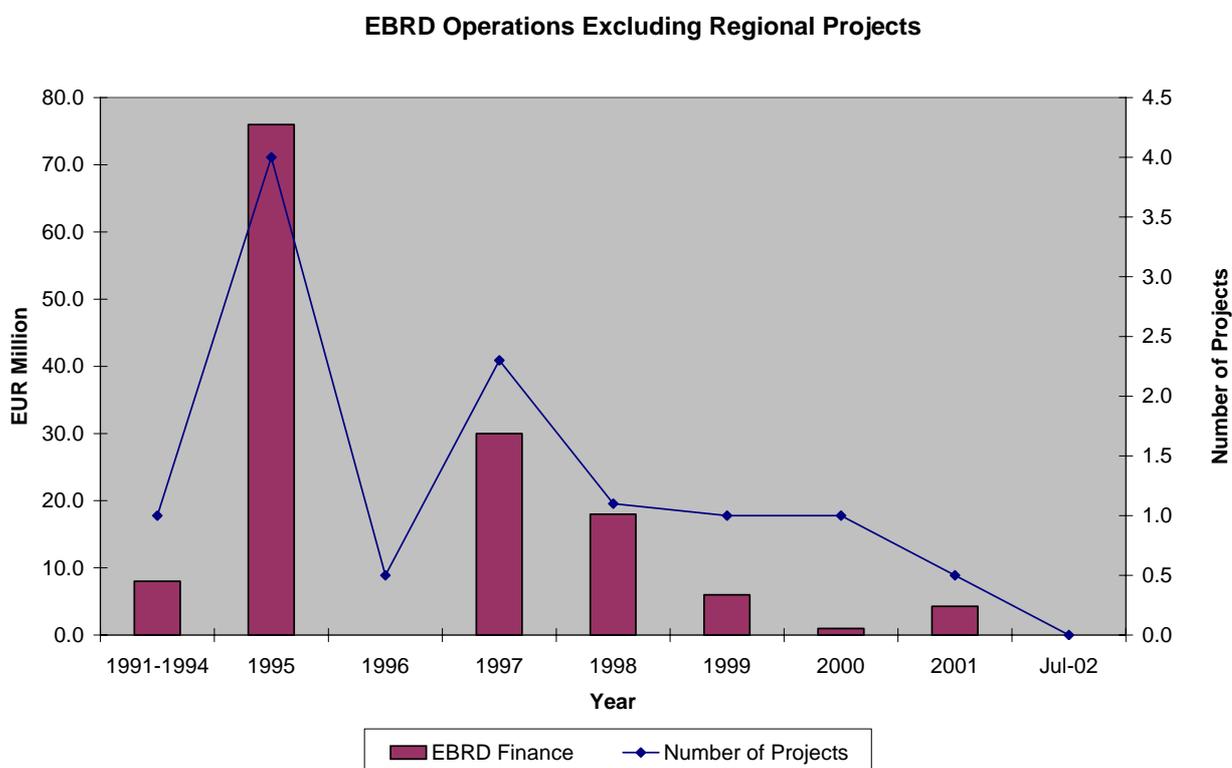
Annual commitment and disbursement volumes have been low in recent years, partly due to the fall out from the Russian crisis of 1998, the Bank's subsequent decision to refrain from public sector projects, and high official debt levels. Based on the current pipeline and other projects under discussion, it is anticipated that commitments for 2002 will be EUR 3 million and that commitments will increase by a further EUR 5 million per year during 2003 and 2004.

The Bank has had reasonable success in attracting complementary financing into the Kyrgyz Republic. The new Central Asia Risk Sharing Fund will enable the Bank to further leverage its financing, particularly under the Trade Finance Programme (TFP)

and MSE credit lines. The Kyrgyz Investment and Credit Bank (KICB) project is expected to attract an additional US\$ 19 million of foreign capital in equity and debt, Bishkek Hyatt Hotel has mobilised US\$ 12 million, Demir Bank has mobilised US\$ 1 million and the Kumtor Goldmine mobilised an additional US\$ 420 million. In total the Bank helped mobilise a further EUR 515 million of co-investment from sponsors and other co-financiers, representing a multiplier of 2.96.

The power and energy sector (public) accounts for 36 per cent of total commitments, and the financial sector (which includes the sovereign guaranteed SME Credit lines) 21 per cent. The single largest private sector exposure is to Kumtor Goldmine with US\$ 10 million outstanding following a recent pre-payment. Equity investments account for only 8.6 per cent of net cumulative commitments, which reflects the difficult legal environment for equity investments and the scarcity of foreign direct investment. In geographic terms, the Bank's portfolio is concentrated in the North of the country.

Chart 1



1.2 Transition Impact of the Bank's Programme

The Bank has played an active role in moving transition forward in the Kyrgyz Republic. The success of the Bank's activities has however varied both in time and across sectors. In the industrial sector the Bank's impact has been limited, largely due to the continuous decline of that sector of the economy. The marked exception has been the involvement in the Kumtor Goldmine. In the infrastructure sector, the Bank has focussed its efforts on assisting the restructuring of utility companies, improving the regulatory framework and promoting tariff reforms. Despite these efforts, progress has been slow. The Bank's involvement in the financial sector has been overshadowed by the banking crisis in 1998. While the impact of the Bank's financial

sector projects implemented prior to the crisis, has been at best mixed, the Bank has played an active role in rebuilding the sector over recent years.

The Bank has perhaps had least success in the agribusiness sector, despite the important contribution that sector has made toward the recovery of the Republic's economy. The Bank has played a key part in the development of the Telecommunications sector by providing technical assistance funding to prepare a new Telecommunications Law that was enacted in 1998. The Bank has continued to support the independent regulatory body (National Communications Agency), which is considered to be one of the best in the Region. In supporting privatisation, the Bank has had less impact, notably because its advice to undertake additional reforms prior to launching an international tender for Kyrgyz Telecom was ignored with consequent lack of success in finding a suitable strategic investor. However, the Bank continues to engage the government and the recent appointment of new advisors by the government is a hopeful sign that a well-considered and transparent tender process can be successfully completed for that enterprise.

1.2.1 General Industry

The industrial sector in the country continues to shrink. The Bank has tried to mitigate this trend both by actively seeking investments into light manufacturing companies and by providing technical assistance through the TAM programme, funded by donors. During the last two years the Bank has been active in taking equity positions in small enterprises through the DIF programme. It is too early to assess the success of these projects.

The positive exception to this general picture has been the Bank's involvement in the Kumtor Goldmine. The gold mine is currently the main hard currency earner in the country and accounts for more than a fourth of all export earnings. The project has been influential in shaping key parts of the regulatory framework for the natural resources sector, although further regulatory reform is required for the Republic to be perceived as a relatively attractive investment climate by major mining companies.

Implementation of the Kumtor Environmental Health and Safety system is now widely considered to be a success. Notwithstanding this, EBRD will remain engaged in related NGO capacity building and in monitoring the mine carefully (see Annex 8 which describes the Community and Business Forum (CBF) which was developed following the Kumtor cyanide spillage to contribute to social and environmental improvement).

1.2.2 Financial Sector

The impact of the Bank's early investments in the financial sector (disbursed prior to 1999) was effectively negated by the banking crisis in that year. Many of the sub-borrowers under the SME I line had payment difficulties and defaulted. Four out of five participating banks went into liquidation. As the SME I line was advanced to the NBK it is being serviced from state resources. The subsequent SME II credit line has effectively been cancelled.

In the aftermath of the crisis, the Bank has continued to look for opportunities to support the rebuilding of the financial sector. Some success has been achieved through an active role in establishing and capitalising KICB and through an equity investment in Demir Kyrgyz International Bank (DKIB). Furthermore the reformulation of the SME II credit line into an MSE facility is now providing one of

the few sources of external finance for this important segment of the economy. The availability of the Central Asia Risk Sharing Facility (CARSF) has enabled the reformulated facility to be provided on a non-sovereign basis. The Bank has been active in extending its Trade Finance Programme (TFP) to the Republic and is now working with four Kyrgyz banks, again with support from the CARSF. The TFP not only enables provision of financing for trade transactions but also helps the local banks to integrate into international banking markets.

1.2.3 Infrastructure

In the infrastructure sector, the results of the Bank's involvement are mixed. The financing of the transmission line to the Kumtor Goldmine made the mine possible and has therefore indirectly contributed to the Bank's transition impact. The Talas transmission line project may in due time lead to similar success through the exploitation of the Jerooy Goldmine, should a qualified sponsor emerge. However the impact on the power sector itself has been less successful. While the Bank's power projects have helped with corporatisation and restructuring, both privatisation and tariff reforms of the sector have been slow. According to the World Bank, the quasi-fiscal deficit of the power sector still accounted for around 7 per cent of GDP in 2001.

In the telecommunication sector the recommendations and advice of the Bank, if followed during 1999, would have allowed for a transparent international tender for privatisation of Kyrgyz Telecom. However the approach followed by the government resulted in an unsuccessful tender and a subsequent dispute with the privatisation adviser which is only now being resolved. The Bank's involvement with Kyrgyz Telecom has however been directly instrumental in the implementation of a market oriented regulatory environment for the sector.

1.2.4 Agriculture

The least successful sector for the Bank has been the agribusiness sector. The only project in this sector financed by the Bank (Kyrgyz Agribusiness Company) failed, resulting in liquidation. That was partially due to the design of the project but also due to the adverse environment in the sector at that time and the inability of the Bank to enforce its rights in the courts. Political interference in the management of the company was an additional negative factor. Although the agricultural sector is mainly responsible for output growth in the country over the last few years, the Bank has not yet been able to find appropriate investee companies.

1.2.5 Regional Dimension

To redress regional imbalances the Bank has actively tried to increase its presence in the south of the Kyrgyz Republic, so far without success. However, in selecting partner banks for the micro lending and trade finance programmes, the Bank has provided an emphasis on including banks with a branch network in the South.

1.3 Financial Performance of the Existing Portfolio

The Bank's current portfolio is listed in Annex 2. Of the sub-loans from the SME 1 Line of Credit (US\$ 10.5 million backed by a sovereign guarantee), some four per cent have been formally classified as write-offs and about 45 per cent are experiencing difficulties, mainly caused by the sharp local currency depreciation in 1999. There are, however, no arrears on the payments from the remaining

participating banks to the Central Bank (the Borrower) or from the Central Bank to EBRD.

Two operations have run into serious problems, namely the Kyrgyz Agribusiness Company (KAC) and Bistyle (a shoe factory). KAC encountered management difficulties and, following two attempts at restructuring, was placed in liquidation. The Bank's loan exposure has been converted into a sovereign loan in response to a government obligation to buy back assets that had originally been contributed as in-kind capital. The equity investment in Bistyle, is fully provisioned and the Bank is taking legal action against the majority shareholder which is now dominated by a hostile owner. The remainder of the portfolio continues to have satisfactory financial performance, despite difficulties encountered during construction on the Hyatt Hotel project.

1.4 Lessons Learnt

The failure of the Kyrgyz Agribusiness Company (KAC), the collapse of the banking system in Kyrgyz Republic during 1999 and the poor repayment record under SME I, the weak utilisation of funds under the SME II project and the problems with Bistyle have each provided important lessons for the Bank's current and future operations.

In the case of KAC, there were basic flaws in project design. The pilot for testing the concept was too optimistic, management was poor and the extent of political intervention in the company's operations was not anticipated. Difficulties realising collateral showed that inadequate progress had been made in reform of the legal system and in the building of legal institutions. The Bank's experience and that of DKIB show that lenders cannot safely rely on debt recovery legislation or the court system. Despite a good body of corporate and insolvency laws, major reform is needed in the judicial system, and in the building of legal institutions (e.g. a pledge registry) which are necessary to effectively implement these laws. The design of KICB and the MSE focussed on the critical need for good lending appraisal and structures so that security realisation is not a major consideration in assessing borrowers.

Capital erosion following the Russian financial crisis seriously damaged many of the projects and sub-loans financed by the Bank, demonstrating the vulnerability of the Kyrgyz economy. The primary lesson is that hard currency lending must be undertaken with rigorous attention to sound banking principles in countries with a high degree of exchange rate volatility.

In designing SME credit line projects, the Bank should take full account of the approaches followed for the more successful projects, such as the Russia Small Business Fund and Kazakh Small Business Programme. The SME II line has been restructured into an MSE line and this more focussed approach should yield enhanced benefits for the local economy and banks. The new facility is better targeted at the average size of Kyrgyz companies and allows the banks to hold more diversified portfolios.

Bistyle highlights the difficulties of being a minority shareholder in a small local company and also underlines the need to have a committed entrepreneurial manager/owner involved in any project where the Bank takes an equity. TC support cannot substitute for this manager/owner commitment.

2. OPERATIONAL ENVIRONMENT

2.1 The General Reform Environment

Political Environment: *despite setbacks progress towards political pluralism.*

The Kyrgyz Republic is making progress towards multi-party democracy and pluralistic society. Despite setbacks in the democratic process, the country continues to feature favourably in the regional context in terms of overall advance towards political pluralism. There is an established multi-party structure of the society and a well functioning network of NGOs. Civil society in the Kyrgyz Republic is relatively strong.

During the year, there were public protests against the selective prosecution of opposition politicians. During these protests in March 2002, police killed five demonstrators. The events have opened genuine opportunities for strengthening the country's democratic framework. The social unrest in the mostly poor southern regions underscored the need to speed up reforms, especially in the areas directly affecting socially vulnerable groups of the population.

A new government was formed at the end of May and some reformist ministers have been appointed to key positions. The government initiated, together with the President's administration, several important laws and undertook measures which helped to restore stability.

Being directly affected by the incursions of armed terrorists in 1999 and 2000, the Kyrgyz Republic was keen to support the anti-terrorist effort led by the United States in the aftermath of September 11. At the moment the country plays an important role in anti-terrorist campaign by stationing a significant contingent of the US-led allied troops on its territory.

Regional Co-operation: *progress in regional co-operation will be essential for growth.*

Heightened regional tensions and an adverse external environment exacerbate already difficult country circumstances. Central Asia is a region with complex ethnic, trade, water and energy relations. All of these factors have the potential to destabilise the region.

The trade in water and energy has led to recurrent disputes between the Kyrgyz Republic and Uzbekistan and to a lesser extent Kazakhstan. The root of the problem lies in the fact that there are no objective markets for water or gas in the region and any trade among the countries takes the form of complex and difficult to verify negotiated settlements. During Soviet times the Kyrgyz Republic's reservoirs stored water in winter for release during summer for irrigation in neighbouring countries. The Kyrgyz Republic used to be supplied with energy during the winter months from its fossil fuel rich neighbours against supplying the water and electricity in summer. Following independence, implementation of these arrangements became much more complex, given each state's own resources, needs and priorities. Under annually negotiated bilateral agreements Kazakhstan and Uzbekistan purchase power from the

Kyrgyz Republic during periods that will coincide with the release of the water. The power is paid for on barter terms rather than hard currency. These agreements have, over time, been subject to financial, technical, and political concerns and constraints. These ad-hoc arrangements have, on occasion, resulted in supply disruptions for the Kyrgyz Republic and necessitated unscheduled winter drawdown of its reservoirs to meet domestic consumption needs. Collaborative regional efforts to improve the security of delivery of water and energy resources to the region is a pressing issue.

Access to outside markets is vital for a small country like the Kyrgyz Republic. Unfortunately trade in Central Asia is restricted by many barriers. Corruption in the customs services remains widespread. Trade opportunities with Uzbekistan are further complicated by the fact that the country does not have a convertible currency and has numerous restrictions on imports. Improving this relation is particularly important for the south of the Kyrgyz Republic (separated from the north by a significant mountain range) for which Uzbekistan is the only viable outlet in winter times.

Further pressure arises from a rising income disparity with respect to Kazakhstan. Illegal migration from the Kyrgyz Republic has become widespread. A recent agreement on migration between the two countries is a first step to address this issue.

Labour Issues: *basic labour rights are recognised.*

The laws of the country provide for the right of all workers to form trade unions and there are no reports that the government was trying to obstruct the formation of independent unions. The Federation of Trade Unions of the Kyrgyz Republic, an umbrella trade union organisation, is active in raising concerns with the government regarding the impact of the privatisation process on working class living standards. All basic labour rights – to strike, to organise and bargain collectively, and those concerning prohibition of forced and compulsory labour, prohibition of child labour and minimum age of employment – are recognised in the Constitution, Labour Code and laws of the Kyrgyz Republic. There were reports of individual cases of violation of labour standards whereby school children were asked to participate in cotton and tobacco harvest, girls were trafficked for the purpose of prostitution, and some Kyrgyz citizens were forced to work without pay on tobacco farms in Kazakhstan. The parliament has a special commission overseeing the labour code enforcement concerning education, women's affairs, the family and the minors. The Kyrgyz Republic ratified a number of major International Labour Organisation treaties such as conventions on abolition of forced labour, minimum wage, right of association, right to organise and collective bargaining, equal remuneration.

Social conditions: *poverty rates and regional imbalances getting worse.*

The Kyrgyz Republic remains the second poorest country of the former Soviet Union, both in terms of per capita income and poverty incidence. Absolute poverty is very high: according to the World Bank 18 per cent of the population live below the line of extreme poverty (food only poverty line), while 52 per cent were considered to live below the more general poverty line (general food and non-food poverty line) in the year 2000.

Families with many children, as in the rest of Central Asia, are at a particularly high risk of poverty. Poverty is higher in rural areas, however regional (oblast) differences in poverty are so pronounced that they dominate the difference between rural/urban location. Poverty and consumption levels deteriorated substantially after the Russian Crisis. Paradoxically, positive growth in recent years have not increased average consumption levels which have continued to fall according to Living Standards Survey Indicators.

Inequality, although having increased sharply in the early 1990's, does not account for the recent diverging trends in GDP growth and poverty. Instead, recent patterns of growth can partially account for the low response of poverty to growth. Gold mining and agriculture have been the most dynamic sectors over the past 5 years, supported by informal services. Despite the fact that gold mining and related industries have accounted for about 11 per cent of GDP over the past three years, weak linkages with the domestic economy and declining gold prices have resulted in an insignificant contribution of this sector to domestic income. Similarly agricultural activities have not contributed significantly to poverty reduction. This sector has been absorbing the bulk of the labour shed in other sectors for almost a decade. It registers the lowest productivity rates in the entire economy and the prices for its output have been falling because of the lack of a sizeable market. In general, farmers unable to generate marketable surplus (and the bulk of farming is for self-consumption) live in poverty, while farmers that raise and sell crops or livestock tend to be better off. Increasing agricultural productivity, including through promoting a more balanced rural growth, will be key to successful poverty reduction.

Although some growth has been registered in trade and (private) transportation, the bulk of other services have been stagnant including formal services such as energy and telecommunications. In fact, the contribution of small and medium enterprises (SMEs) to GDP, the key force behind manufacturing and formal service activities in other parts of the region, has contracted in the Kyrgyz Republic from 18.1 per cent in 1997 to 13 per cent in 2000. While part of the SME contraction was compensated by growth in other sectors, its overall contraction has increased the dependence of the country on agricultural income aid and has reduced employment opportunities.

However, in an international comparison with countries of similar income levels the Kyrgyz Republic still compares favourably in terms of social indicators such as life expectancy, infant mortality or literacy. The ability of the Republic to maintain these positive achievements, largely inherited from the Soviet Union, is undermined by strained public finances.

Legal Issues: *implementation of legal and administrative reforms a key issue.*

The Kyrgyz Republic has made considerable progress in its legal transition reforms. However, it still needs to develop functioning legal institutions and procedures that fulfil the expectation of investors for a successful transition to a market-oriented economy.

Commercial law advances have come to a point where the investment climate from the eyes of local entrepreneurs is favourable in comparison with that of other CIS countries. Some of the legislation that the Kyrgyz Republic has adopted is viewed as

among the most advanced and creditor-friendly of the CIS countries. However, the main concern is the lack of public confidence that contractual rights will be upheld.

Integrity Issues: *serious issue in administration and judiciary.*

The general perception of legal practitioners remains that commercial laws in the Kyrgyz Republic suffer as a result of corruption, an unprofessional and untrained judiciary system, and the lack of institutional mechanisms to enforce personal rights.

According to the latest Corruption Perceptions Index (CPI) of Transparency International (CPI-2002), Kyrgyz Republic scored 2.2 points (on a scale ranging between 10 (highly clean) and 0 (highly corrupt)).

The Bank continues to require full transparency with regard to ownership and control of enterprises seeking its involvement, in order to promote the resolution of integrity issues as well as to mitigate reputational risk. Further, policy dialogue for enhanced and transparent regulation of those sectors with significant integrity risk is an ongoing area of Bank engagement.

Environmental aspects: *focus on good environmental practice and new technologies.*

The National Environmental Action Plan (NEAP), adopted by the government of Kyrgyz Republic in 1995 for 1995-97 period, remains a guiding document as its objectives demonstrate a long-term perspective. The NEAP and two other policy documents (the Ecological Safety Concept and the Strategy for Sustainable Human Development) set the following as environmental priorities: (i) reduction of urban air pollution; (ii) water resources-use efficiency (in particular, related to irrigation systems) and waste water treatment; (iii) forestry management; (iv) bio-diversity protection; and (v) hazardous substance management. Environmental legislation developed rapidly during the 1990s in Kyrgyz Republic. The new legislation is strongly influenced by the practices of the former Soviet Union and does not necessarily replace the corresponding legal instruments that had been applied during the former Soviet Union, so the new legal instruments may be added to old instruments that continue to be valid. The country adheres to the environmental standards used in the former Soviet Union. The approach to emission standards is based on the maximum permitted emission (MPEL). The ability to monitor or inspect emission is very limited.

All EBRD operations in Kyrgyz Republic are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans (EAPs) into the legal documentation in order to address issues raised during due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects. In line with the difficult investment environment and transition challenges facing the Kyrgyz Republic, the Bank's operations focus on support of micro, small and medium enterprises and key infrastructure and natural resources development in particular. The Bank's environmental approach to the Kyrgyz Republic, therefore, should focus on these areas particularly by demonstrating the benefits of good environmental practice and the introduction of new technologies. Among the existing portfolio, the Bank continues to closely monitor Kumtor Goldmine project which was involved in a pit wall failure in July 2002 (immediately after the incident, the Board was informed).

The lost-time accident frequency in the past couple of years of the gold mining project has been better than North American mining industry standards.

2.2 Macroeconomic conditions relevant for the Bank's operations

Output: growth remains concentrated in mining and agriculture. The Kyrgyz economy has grown strongly in the aftermath of the Russian crisis. Average growth in 1999-2001 has been around 5 per cent. However, the expansion is highly concentrated in the natural resource sector and in agriculture. Anecdotal evidence and strong money demand growth also suggest that the informal sector has been growing strongly in recent years. Little recovery has yet been detected in manufacturing. While the positive trend in agriculture appears to be continuing in 2002, gold production at Kumtor fell by 18 per cent in the first five months of 2002 year compared to the same period of last year. (Kumtor accounts for about 35 per cent of industry). The fall in gold production is related to a recent accident at Kumtor that is expected to disrupt production for around four months. As a result industrial production has fallen by 10 per cent year-on-year in the first five months of 2002.

Agriculture has been growing by an average of around 6 per cent over the last three years. This growth is mainly due to the fact that the sector absorbs most of the labour that continues to be set free in other sectors. Productivity in the sector however is falling. Rising supply of agricultural products is not fully met by demand with the result of falling prices for agricultural products. The Republic now has the lowest prices for agricultural products in the CIS. Expanding demand would depend on raising the export potential, which is limited because of regional trade restrictions. Furthermore the Republic has seen little of an expansion in agro-processing which would be vital to increase the export potential of the sector to the rest of the world.

Investment in the Kyrgyz Republic is falling as the public investment programme has been reduced and private investment struggles to compensate for this fall. However, lower total investment should not automatically imply lower growth of the economy. While growth net of Kumtor was mainly driven by the agricultural sector, this sector had received almost no investment. Putting it differently, the economic return on past investments in the Kyrgyz Republic has been very low. Increasing this return is the main task that needs to be tackled if the country is to achieve sustainable growth. This will require reforms in the way public investments are targeted as well as improvements in the investment climate that will allow private investors to reap higher benefits. It is true that not all of the main defects of the Kyrgyz investment climate are under the control of the Republic, because market access to the neighbouring Republics is a major issue. However, bureaucratic harassment, weak court systems and corruption are as much to blame for the meagre investment volumes. The high indebtedness of the country, which threatens long term macro-economic stability, also plays its role. These issues need to be addressed before private investments will substantially increase.

Monetary Policy and the Exchange Rate: low inflation and stable exchange rate. Following the shock of the Russian crisis the central bank has succeeded in recent years in stabilising the exchange rate and reducing the inflation rate. Average inflation for the year to May 2002 was below 4 per cent. Given that food prices in the Kyrgyz Republic are very seasonal, this effectively means deflation for a number of months. As a result of tight monetary policy (broad money grew by 10 per cent),

together with growing money demand and a significant shift in the external balance, the exchange rate has actually appreciated from 49.5 Som/US\$ in April 2001 to currently around 47 Som/US\$ or 5 per cent. There is some pressure for a real trend appreciation of the Kyrgyz Som in line with that of the Russian Rouble. Unlike other central banks in the region, the Kyrgyz central bank is targeting inflation and not the exchange rate unless this would be in conflict with the monetary aggregates agreed upon under the IMF agreement.

Fiscal Policy: *substantial improvements but the tax base needs to be broadened.*

There have been significant improvements in the fiscal sphere over the last two years. The fiscal deficit was reduced from almost 12 per cent of GDP in 1999 to 6 per cent in 2001. This consolidation was achieved by reducing the public investment programme by more than 1.1 per cent of GDP, by reducing interest expenditure on foreign debt through debt renegotiations and by a boost to revenues of 2.2 per cent of GDP. However, there is still a need to broaden the tax base, especially with respect to the agricultural sector. In 2000 the agricultural sector accounted for 36 per cent of GDP but the land tax, which is the only tax directly paid by the sector contributed only 2.2 per cent of total revenues. Both the extension of value added tax (VAT) on a full rate to agricultural products and an increase in the land tax is needed to reach a broader and fairer tax base. Both measures are politically difficult. The current IMF programme is based on a continuation of last year's trends. A primary deficit of 0.5 per cent of GDP is to be achieved by 2004 from 4 per cent last year. In the process, the public investment programme is expected to be cut by another 2 per cent of GDP to 4 per cent of GDP and revenues are projected to rise by another 1 per cent of GDP. The programme is over performing so far in 2002, mainly due to better collection of VAT.

Balance of Payments: *very dependent on debt negotiations and gold prices.*

The overall external balance of the country has risen substantially over the last year. The current account deficit has been reduced from US\$ 103 million in 2000 to US\$ 89 million in 2001 and is likely to be closer to US\$ 30-40 million in 2002. The trade balance rose in 2001 due to sharply reduced imports, partially as a result of the reduction in the public investment programme, while exports actually fell in 2001 compared to 2000 due to lower electricity exports to Uzbekistan. In the first five months of 2002 exports have been falling further because of a reduction in gold production at the Kumtor Goldmine. However the effect on the current account is likely to be more than compensated for by a further improvement in the service balance and because of lower interest payments this year after the Paris Club restructuring. As a result of the improvements in the current account, reserves grew by US\$ 20 million in 2001 and are likely to continue to grow in 2002.

Foreign Debt and Debt Service: *still precarious despite recent efforts.*

The Kyrgyz Republic's foreign public debt remains excessive at around 115 per cent of GDP. Even more worrying is the speed with which this debt was accumulated, given that the country was almost debt free a decade ago. Apart from the intra CIS debt, of which most was accumulated in the first year of the country's existence, the debt has been built primarily through balance of payments and budget support. Debt associated to these two issues accounted for 51 per cent of the total by end-2000. Much of the resources borrowed under this part of the debt was spent on maintaining social services at levels similar to those maintained in the Soviet Union but far higher than in countries of the Kyrgyz Republic's income level. A second important component of

the public debt has been on-lending and guarantees to enterprises, which accounts for 37 per cent of the total public debt. The loose framework for issuing government guarantees during the first half of the 1990s led to government involvement in high risk, commercial-type projects. A large number of these guarantees have been called, representing 20 per cent of the total public debt. The remaining 17 per cent of public debt in this category, represents on-lending under the public investment programme. To date, the bulk of this programme has supported mainly infrastructure investments.

The stabilisation or reduction of the debt ratio will depend on reducing the public sector deficit but even more on the ability to outgrow the debt and debt write-offs. While the Paris Club did not grant any principle debt write off last year, it declared that it would look at a possible write off in 2004 when the current rescheduling package runs out. A crucial element of any debt reduction strategy must be to reduce the quasi-fiscal deficit in the electricity sector, which has in the past been about 7-10 per cent of GDP.

Due to the Paris Club agreement, debt service payments will be low until 2004 and will mainly consist of payments to the multilateral institutions and to commercial creditors.

2.3 Progress in Transition and Remaining Challenges

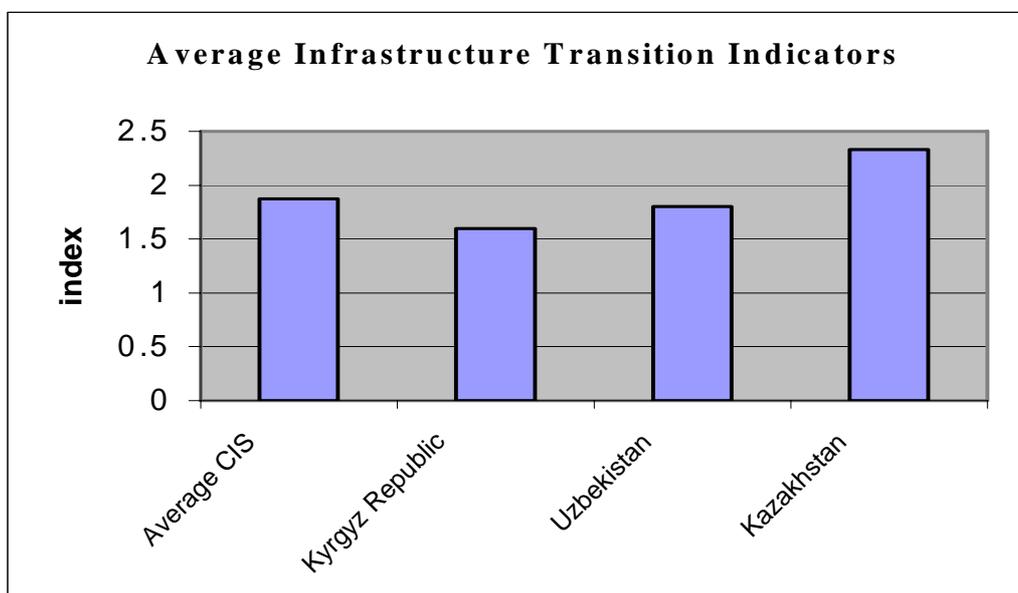
Progress in transition has been uneven in the Kyrgyz Republic. While good progress was made in the early parts of the 1990's in terms of liberalisation and small and medium size enterprise privatisation, progress thereafter has been slow. This is particularly true for reform elements that involve institution building. Infrastructure reforms have been on the agenda for a number of years but have only started to gain some ground in the last year. While the central bank is committed to improving governance in the financial sector, its powers to implement the reforms are frequently limited by the lack of political backing. Corruption levels in the country are high and pose a threat to any long-term development. Public governance reforms need to be at the forefront of future efforts to boost growth. A country like the Kyrgyz Republic which is not overly endowed with natural resources, is small and landlocked between countries that are not the most liberal, has to work extra hard on its domestic investment climate to raise the attractiveness of its economy.

In the past the Republic has benefited from substantial financial resources, provided by bilateral and multilateral creditor. Given the already precarious debt level, the Republic will need to attract more resources through market based channels to allow it to achieve a sustainable growth path. While it will be some time before there will be substantial foreign investment from OECD countries, neighbouring countries are a more likely source of investment for the immediate future. Attracting those flows could also improve regional co-operation, the lack of which is a major drag on the Republic's development.

Infrastructure Reforms

The Kyrgyz Republic inherited an infrastructure from Soviet Union times that required extensive investment and upgrade. Given the economic conditions of the country, the Republic has difficulties in financing even the maintenance of (not to speak of improvements to) this infrastructure. A substantial part of the debt accumulated over the last decade is connected to infrastructure investments. Given the restrictions on further public borrowing, the financing of the sector will have to

change fundamentally with a view to enabling the companies to generate their own revenues. However, for a long time the Republic has been slow in implementing reforms that would enable the utility companies to recover their costs. In fact in mid-2001 the Republic was lagging all other CIS countries but Turkmenistan, Belarus and Tajikistan if progress is measured by the EBRD's infrastructure transition indicator.



In 1997 the parliament deferred the privatisation programme for utilities companies because of concerns about the transparency and effectiveness of privatisation over the last decade. Putting it differently, the Republic continues to waste precious resources by not using energy more efficiently. However some progress has been made over the last year. Energy tariffs were raised to an average of US\$ 0.02/Kwh, bringing the national power company closer to full cost recovery. However progress must be toward providing targeted subsidies to vulnerable income groups if the pace of tariff reforms is to be sustainable.

In April 2000 in line with conditionality imposed by the EBRD, IMF and WB, Kyrgyzenergo was unbundled into generation, distribution and transmission. Sector restructuring is being finalised and legal unbundling of generation and transmission is complete. The government has declared its intention to press ahead with the privatisation of the distribution companies. Experience from other countries show that a private distributor appears to be better placed to raise collection rates. In 2000 only 45 per cent of electricity bills were collected in cash, the fifth lowest share in the CIS.

The reform, restructuring and privatisation of the national telecommunications company has stalled in recent years. The government, against the advice of EBRD and World Bank, proceeded with a flawed strategy to sell a majority share, retaining Raiffeisen Bank as advisor, on a success fee basis, with the expectation of getting a buyer prepared to pay a significant price. After a long and unsuccessful privatisation attempt that led the Kyrgyz Republic to an International Chamber of Commerce (ICC) arbitration hearing of claims for reimbursement of costs from Raiffeisen Bank, a settlement is near agreement.

The government has now appointed Central Asian Industrial Enterprises LLC to advise and manage a new attempt at privatisation to be completed by the first quarter of 2003. The main terms and conditions of the tender have already been established, with 51 per cent of shares to be sold.

Privatisation and Enterprise Reform

Despite a high rate of privatisation in the SME sector, the state still retains important stakes in a number of sizeable industrial enterprises, often characterised by high levels of indebtedness, lack of working capital and inadequate management and marketing techniques. Good corporate governance is still to be developed, and its role fully comprehended. However, the stock of viable large-scale enterprises at this stage is limited and mostly restricted to the utility companies, the airline, the mining industry and the tobacco industry.

The establishment of the Kumtor Goldmine, in which the Bank participated has so far not triggered any further major investments in the mining sector in the country. This is at least partly due to policy failures with respect to the negotiations with potential investors.

The establishment of other large-scale companies is to a large extent restricted by the small market size of the Republic and its limited access to other markets. However, given the success in primary agriculture, it is surprising that there is not more of a recovery in the agro-processing sector, a segment of the economy, that is doing well in much of the rest of the CIS. The domestic investment climate must be at least partially to blame for this.

Financial Sector Developments

The Russian financial crisis and the Som's sharp devaluation in 1999 seriously damaged the Kyrgyz banking system, resulting in the closure of a large number of commercial banks and a major reduction in the capitalisation of the banking sector. Despite recent efforts to re-capitalise the system and strengthen supervision the system remains fragile and under-capitalised, with 18 commercial banks having a total share capital of about US\$ 33 million as of the beginning of 2002. Seven banks, including the three largest, have been placed either under administration or into liquidation since the first half of 1999. The largest contribution to a re-capitalisation has come from the establishment of a new bank (KICB) with share capital of US\$ 7 million. However, recent moves by two Kazakhstani banks to acquire majority stakes in Kyrgyz banks, provides prospects for a significant strengthening of the sector.

The absence of a local capital market or access to medium/long-term funding sources is a major constraint for the Kyrgyz banks. Deposits, which are the main source of funding, account for 76 per cent of the total liabilities of the banking system at the beginning of 2002 and of this only 10 per cent has a maturity over 180 days.

There are currently four foreign-owned banks in Kyrgyz Republic, where the Bank is a shareholder in two (DKIB and KICB). The only state-owned banks are Kairat Bank and Saving and Settlement Company (SSC). The government has agreed with IMF that these two banks will be privatised and is actively working on this at present with progress expected during 2002.

The central bank has increased minimum authorised capital requirements to KGS 300 million for newly opened banks. Existing banks were required to increase their paid in capital to KGS 100 million by July 2001. These requirements were intended to force banks either to merge or to seek new investors. At the moment however, the requirements have been partially deferred.

Improvement of the Investment Climate

The Foreign Investment Council in which the Bank participates and an ongoing survey of small and medium-sized enterprises conducted by the Bank have noted that levels of corruption, weaknesses in the judicial system and an inefficient licensing, custom and tax system negatively affect Kyrgyz Republic's investment climate. A substantial reform of the public sector is urgently needed and is part of the structural reforms required under the IMF programmes. There has been much policy dialogue and discussion in recent years on this key issue but little tangible improvement is evident to date. However the time based matrix of reform actions adopted by the Government covering finance, administration, law, information technology, infrastructure, marketing and sectoral development has identified key impediments to economic development. Government ministries and state agencies have been assigned specific reform agendas which, if implemented, should result in improvements in the investment climate.

2.4 Access to Capital

Access to medium to long-term finance is limited in the Republic. The financial sector has been unable to attract significant savings to support domestic investment. Deposits in the banks account for around 4-5 per cent of GDP and credit extended by the banking system is around 3 per cent, much too low to support economic development. A further re-capitalisation of the banking system is most likely the best way forward to raise the trust of the population into the banking system. Most Kyrgyz enterprises fall into the small to micro segment and credit lines by donors constitute probably the single most important source of finance for these enterprises. Given the public debt levels, IFI and bilateral support for the financing of the private sector is unlikely to increase. The availability of foreign funds from sources other than IFIs or bilateral creditors is currently rather limited. Although FDI inflows have risen from around US\$ 28 million in 2000 to US\$ 39 million in 2001, this level remains significantly less than the inflows of about double that amount over the years 1995-98. The country (and within it, most companies) is too small to easily raise funds from OECD countries. An exception to this is possibly the mining industry. However, recently there appears to be renewed interest from Russian and Kazakh companies to enter the Kyrgyz market.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

In line with the difficult investment environment and transition challenges facing the Kyrgyz Republic, EBRD's main priorities will be to:

- Promote a healthy Micro and SME sector.
- Facilitate privatisation of the remaining major state enterprises.
- Support the development of the financial sector.

- Help attract investment to key natural resources projects.
- Help the government develop and improve transparency, governance and the investment climate through policy dialogue.

While targeting these objectives, the Bank will liaise closely with other IFIs to ensure complementarity of actions and consistency in policy dialogue. The proposed strategy responds to the economic realities and the transition challenges of the Kyrgyz Republic and yet reflects the Bank's objective to expand its activities in the country through its focus on the private sector. All EBRD operations in the Kyrgyz Republic are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans into the legal documentation in order to address issues raised during due diligence, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investment projects.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Privatisation and the Enterprise Sector

Transition Goals

The Bank will promote privatisation of key state entities such as the national telecom company and possibly power distribution. Given the decline in public investment, the need for a healthy private sector capable of creating employment becomes even more pressing. Ensuring availability of appropriate forms of finance for financially viable enterprises remains the Bank's key operational objective in the Kyrgyz Republic. The Bank will support private enterprises, both local and foreign owned, through its Micro and Small Enterprise loan programme and through the Direct Investment Facility financing mechanisms, alongside the TFP, in pursuit of this objective and will continue to seek opportunities to support direct foreign investment. EBRD will investigate possibilities to structure public sector projects by blending grant funds with EBRD finance, where there is a particularly high transition impact and consistent with IMF restrictions on debt. Technical assistance will be used selectively to promote investor engagement in appropriate sectors of the economy. These programmes will be managed to ensure appropriate regional coverage and to support the agricultural sector. The Bank will also seek to provide specific support for SMEs in the tourism sector.

Operational Priorities

Agriculture: Agriculture provides the Kyrgyz Republic with its main source of employment and growth. Improvements in the business climate in this particular sector in recent years should help the Bank identify viable investment opportunities either directly for large enterprises, or through financial intermediaries, for SMEs. Increased interest from agribusiness companies in the CIS might provide opportunities for financing and enhance the ability of Kyrgyz agribusiness companies to penetrate regional markets.

Power and Energy: Privatisation of the energy distribution sector, raising collection rates and tariff increases towards cost recovery are key to reducing the quasi-fiscal deficit of the sector (estimated at around 7 per cent of GDP in 2001) and to being able to finance maintenance of the infrastructure. The recent unbundling of the energy sector gives opportunities to promote efficiency, introduce new capital, and help the

fiscal balance. The Bank has proposed its involvement in the privatisation of several distribution companies through a pre-privatisation loan. The main issues to be resolved relate to the geographic scope of each distribution company, tariff policy and social considerations. The Bank will also support the government's on-going programme to develop a number of small and medium-sized hydro power stations, including the Issyk-Ata, Tash Kumyr, Shamaldusay hydro power stations provided that the projects are structured with private participation.

Municipal Infrastructure: Municipal and environmental infrastructure are in pressing need of improvement, with major investment required in city transport, waste and water and district heating. However the municipal structures are weak and incapable of assuming responsibility for financing. Despite the need for infrastructure projects in the Kyrgyz Republic, the necessity to structure them as sovereign operations and the IMF restrictions on debt prevents the Bank from providing commercially priced finance. While, this aspect of transition will primarily be supported by the other IFIs, in areas where EBRD has particular expertise, the Bank will investigate the possibilities of blending EBRD finance with grants to structure a concessional project.

Transport: The ready availability of concessional finance for transport from ADB and World Bank makes Bank financing in state-owned transport entities very unlikely in the immediate future. Nevertheless, the transition challenges in the sector are significant, and particularly important for this land-locked and relatively remote country. Therefore the Bank will remain vigilant to identify niche opportunities to pursue its mandate.

Telecommunications: There is a major need to encourage and support the privatisation of key state entities such as telecom. In November 1994, the Bank extended a US\$ 9.4 million 15-year sovereign guaranteed loan to Kyrgyz Telecom (KT) then recently established as a state-owned enterprise responsible for the development, maintenance and operation of the national telecommunications network of the Kyrgyz Republic. At present the Bank, in co-operation with the World Bank, is closely monitoring the overall performance of KT, the progress being made on the regulatory framework and steps undertaken to privatise the company. A new advisor has been appointed to manage the sale of a share of the telecom company and assist with the privatisation. The Bank will co-operate with the new advisor and will consider participation by way of equity, pre and post privatisation financing. The Bank is also seeking other transactions, including use of the DIF facility and existing credit lines, in the private sector to facilitate development of competition in communications infrastructure and services.

Tourism: Due to the small size of most projects in this sector, it is expected that any additional Bank support in property and tourism will be channelled through, KICB, DIF or SME Credit Lines..

3.2.2 Financial Sector

Transition Goals

The Bank's key goal is to increase the availability of financing for the private sector via banks, at the same time strengthening and improving the financial sector. To this end the Bank will seek opportunities to facilitate the entry of new investors into the financial sector wherever possible. The Central Asia Risk Sharing Facility will be a

key element enabling the Bank to continue and expand its provision of MSE and the Trade Finance Programme in the Kyrgyz Republic in the foreseeable future.

Operational Priorities

The Bank's operations in the financial sector will be focused on the following:

- KICB's ongoing operation and development;
- Implementation of the new MSE Credit line with selection of additional participating banks;
- Participation in capital increase of Demir Bank Kyrgyz Republic;
- Potential equity investment in furthers private banks, most likely alongside Kazakhstani strategic investors;
- Development of trade finance business by including more qualified Kyrgyz Banks in the Trade Finance Programme; and
- Participation in privatisation of the Saving and Settlement Company (the former Sberbank in the Kyrgyz Republic), a state-owned bank.

3.2.3 Natural Resources

Transition Goals

In the past three years the large Kumtor Goldmine has significantly increased production, and has recently announced that it is evaluating plans to extend the life of the Kumtor mine by an additional 5 years. Following the recent repayment of our senior loan we are discussing further financing opportunities with the sponsor. Development of the remaining gold and other mineral deposits is constrained by the relatively small scale of the remaining gold deposits, and the lack of financially strong sponsors and unfavourable terms negotiated in the mid-nineties when gold prices were higher than present levels. Should gold prices stabilise at higher levels, strong and reputable international mining sponsors may emerge, thus providing opportunities for financing by the Bank.

Operational Priorities

- The Kumtor project has demonstrated to the international community the viability of mining projects in the Central Asian region. The Bank will continue to monitor environmental, health and safety aspects of the Kumtor project against the benchmark of best international practices of the mining industry.
- With the commitment of the government to the need for strategic partners, the Kyrgyz Republic should be able to attract the investment, technology and management skills to further develop its mining industry. The Bank will continue to seek means for participating in the development of mining projects that are economically viable. The Bank will strive to maximise forward and backward linkages with local SME's.

4. CO-OPERATION WITH OTHER IFIS

4.1 Asian Development Bank

The Asian Development Bank's (ADB) activities in the Kyrgyz Republic began in 1994. As of 31 March 2002, ADB had approved 20 loans totalling US\$ 522 million, all from the Asian Development Fund (ADF). In addition, 46 technical assistance grants have been approved amounting to US\$ 28.24 million. The major part of ADB

lending so far has been for projects aimed at fostering economic growth. However, in view of the high priority now given by both the Kyrgyz government and ADB to poverty reduction, a significant portion of ADB financed projects are directed to addressing poverty and unemployment. ADB's portfolio is performing well and implementation of approved loans and TAs is proceeding substantially on schedule.

4.2 European Commission (TACIS)

The assistance of the European Commission is organized through the TACIS and Food Security programmes as well as activities in the area of civil society development:

TACIS Programme

The Indicative Programme for 2000-2003 has been agreed with the Kyrgyz authorities and focuses on the following areas:

- **Support for institutional, legal and administrative reform.** The objective is to support the Kyrgyz authorities reforming various legal, administrative, executive and educational bodies and to support the development of civil society by providing technical assistance to NGOs, associations and institutions as well as to support the implementation of the Partnership and Co-operation Agreement between the EU and the Kyrgyz Republic and international commitments incurred through the accession to WTO. In this context, it should be noted that the Chairman of the Kyrgyz Securities Commission has recently requested the Bank's help for legal reform projects regarding corporate governance and financial markets, which request is currently being considered by the Bank.
- **Support to the private sector and assistance for economic development.** The main objective is to develop and strengthen the private sector in Kyrgyz Republic. This will be done through improving the investment/business climate for local and European enterprises and promoting trade, through improving the legal and regulatory framework, through enhancing diversification of the economy, through developing the SME sector as well as improving the banking sector.
- **Infrastructure Development.** The objective is to continue assistance to the restructuring of the energy sector and the development of transport and telecommunications in order to promote internal and external trade and in order to reduce the dependency of Kyrgyz Republic.

Food Security Programme

The overall objective the Programme is, on one hand, to contribute to the macro-economic stabilisation and adjustment framework of the country through a balance of payment support. On the other hand, to promote a number of key reforms through conditionalities, particularly in the area of reforming the Ministries of Agriculture, Water and Agro-Processing and Labour and Social Protection, and to improve the overall food security of the population of the Republic. The total amount committed by the European Commission for the Kyrgyz Republic under the new generation Food Security Programmes is worth EUR 35.5 million of which EUR 30 million has been already disbursed. The FSP financial support represents 3 per cent of the republican budget and 0.5 per cent of GDP.

EC activities in the area of civil society development

The European Commission is going to provide assistance to the development of the Kyrgyz civil society through three programmes: (a) European Initiative for Democracy and Human Rights (EIDHR) (b) Co-financing with European Development NGOs (objective: poverty alleviation) and (c) Decentralised Co-operation (objective: poverty alleviation). First projects are expected to start early 2003.

4.3 International Monetary Fund

On December 6, 2001 the International Monetary Fund (IMF) approved a three-year programme for the Kyrgyz Republic supported by an arrangement under the Poverty Reduction and Growth Facility (PRGF), with an access of SDR 73.4 million. On approval, the Kyrgyz Republic received a disbursement of SDR 11.72 million. The first review of the programme was completed on July 1, 2002, making the Kyrgyz Republic eligible to receive a second disbursement of SDR 11.72 million. The key issues under the programme relate to the adoption of appropriately tight fiscal and monetary policies, while ensuring that levels of social spending are consistent with the achievement of the objectives specified in the Interim National Strategy for Poverty Reduction. Other important measures under the program relate to the strengthening of the banking sector, and the adoption of a credible strategy to address the country's external debt problem.

The Bank will maintain its collaboration with the IMF, in particular on sovereign limits, fiscal policy and macro-economic programmes.

4.4 Islamic Development Bank

The Islamic Development Bank (IsDB) has thus far approved a total of 14 project with a value US\$ 64.4 million, but has no joint projects with EBRD. Ten projects have been completed and the IsDB is working on the remaining four: a 220 KV Transmission Line project and the construction of the Bishkek-Osh Road. The IsDB approved increase of its contribution in the cost of consultant up to 96 per cent. The request for utilisation of remaining savings is awaited from the government. expansion and upgrading of Osh Airport, and the reconstruction of Taraz-Talas Suusamyr road project.

4.5 United Nations Development Programme

The United Nations Development Programme (UNDP) portfolio amounts to US\$ 3 million (to 2002). The primary objectives of the programme are:

- Support to central governance including: support to parliament; civil service training and public administration; and functional review of various government structures, ICT for development.
- Support to local governance including: decentralisation and preventive development in the South.
- Support to social governance through: poverty alleviation through empowering local communities; support to NGOs and civil society; gender mainstreaming; and HIV/AIDS prevention
- Environment protection through: Global Environmental Facility/LIFE small grants programs; and national studies on climate change and bio-diversity.

4.6 World Bank Group

Between 1994 and April 30, 2002, the International Development Agency (IDA) has approved 24 projects totalling approximately US\$ 614 million (after cancellations), of which about US\$ 442.5 million has been disbursed. Six structural adjustment credits have already been completed, which provided quick disbursing support for the government's economic reform programs in privatisation, enterprise restructuring, agricultural policy, financial sector, public sector resource management and pension reform. Four investment operations have also been completed supporting reform and rehabilitation of the telecommunication sector, social safety nets, health, and rural finance.

The World Bank Group's operational objectives for the next 12 months are to support completion of a full Poverty Reduction Strategy through focused analytical work and technical assistance, the enhancement of portfolio performance, and the ongoing structural reforms in energy, business environment, public expenditure management, health and water and sanitation and agriculture. The Bank will also undertake a Public Expenditure Review, a Pension Note Update, and a Poverty Assessment. A CAS for the fiscal years 2003–2005 will be prepared upon completion of the government's full Poverty Reduction Strategy Paper, expected to be finalised in fall 2002.

International Finance Corporation (IFC)

Under the Extending IFC's Reach Initiative, IFC has undertaken promotional and business development activities with small and medium-sized enterprises and approved three investments of US\$ 470,000, US\$ 300,000 and US\$ 1.4 million for agribusiness, packaging and pasta production projects respectively. IFC is playing a catalytic role in the development of SEAF-CAESIF, a regional equity fund that will provide equity, quasi-equity and debt financing as well as technical and managerial assistance to growth-oriented SMEs.

The IFC's strategy for the Kyrgyz Republic will focus on the following areas:

Financial sector:

- in partnership with EBRD, institution-building efforts in the private banking sector (Kyrgyz Investment and Credit Bank, Demir Kyrgyz International Bank);
- creating sustainable micro-finance facilities that build upon the structure of existing organisations such as FINCA International, in which the IFC invested US\$ 1.0 million to support micro-enterprises;
- in partnership with EBRD, providing lines of credit to selected local banks for on-lending to micro and small enterprises (MSEs) linked to technical assistance program.
- development of leasing activities through technical assistance to create appropriate regulatory framework and creation of model institutions.
- provision of equity capital through a new regional early stage equity investment fund (SEAF-CASEF);

IFC is also looking for opportunities in mining, business environment and agriculture (through the Swiss funded PEP initiative), tourism and infrastructure.

IFC - EBRD Co-operation

Along with the EBRD, IFC made a parallel senior loan of US\$ 30 million and subordinated loan of US\$ 10 million in the US\$ 452 million Kumtor Gold mine and has provided equity of US\$ 0.45 million to Demir Bank in parallel with the Bank's investment. IFC also participated in the capitalisation of KICB, with a stake of 20 per cent representing US\$ 1.4 million, and each institution has a board member. IFC is collaborating closely with EBRD on the Micro and Small Enterprise Finance Facility.

Multilateral Investment Guarantee Agency (MIGA)

MIGA has supported the development of private sector in Kyrgyz Republic by extending guarantees to foreign direct investments in four projects in the manufacturing, services, and mining sectors. As of June 30, 2000, the total amount of foreign direct investment facilitated, as a result of MIGA guarantees, is over US\$ 360 million. MIGA has also provided capacity building in foreign investment techniques to the State Committee on Foreign Investments and Economic Development, in an initiative supported by the Swiss government. MIGA plans to continue to assist the development of Kyrgyz Republic through its guarantee program and capacity building..

5. BILATERAL SOURCES

Canada

Funding for Canadian co-operation efforts with the Kyrgyz Republic is provided through the Canadian International Development Agency's (CIDA) Programme of Co-operation with Central and Eastern Europe (CEE). The programme in Central Asia began in 1995. By 2001, cumulative disbursements reached US\$ 25.1 million for Central Asia. The program responded initially to technical co-operation needs faced by Canadian commercial interests (e.g. mining in the Kyrgyz Republic). Over time, it placed increasing emphasis on the enabling environment in order for viable transition to take place. CIDA now targets most of its projects in Central Asia on the natural resources sector, including water, agriculture, and climate change. Climate change issues are a growing area of interest. The areas of focus for current projects in the Kyrgyz Republic include: technical training, agriculture, governance and climate change. The Kyrgyz Republic is supported through a budget covering all eight Central Asia and Caucasus countries, including Turkey at US\$ 4 million per year. This is supplemented with additional funding through CIDA's regional programming. In fiscal year 2001-02 CEE Branch disbursements to the Kyrgyz Republic totalled approximately US\$ 1.5 million. The Canadian Government is presently reviewing programming priorities for the region with recommendations expected for 2002.

Germany

Between 1993 and 2002 Germany committed around EUR 135.5 million in bilateral aid to Kyrgyz Republic. EUR 98.6 million was provided within the framework of the Official German Financial Co-operation via the Kreditanstalt für Wiederaufbau (KfW) e.g. in the fields of SME support, tuberculosis treatment, mother and child health care, rehabilitation of small hydropower plant and electricity supply for Bishkek. EUR 36.9 million was committed for several technical co-operation projects mostly via Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) mbH especially in the fields of SME support, vocational training, export and investment support and promotion of co-operatives according to the Raiffeisen model.

As the main focus for the further bilateral development co-operation between Germany and Kyrgyz Republic is arranged "economic reforms and establishment of a market economy".

Japan

JBIC (former OECF and JEXIM) provides concessional loans and has provided or is committed to providing six loans, totalling Yen 25,665 million including the Social Sector Adjustment Programme (Yen 2,318 million), co-financed with WB, a loan of Yen 5,454 million for the Bishkek Manas Airport Project and two loans of Yen 3,016 million, and Yen 5,250 million to purchase road maintenance equipment and civil engineering for the Bishkek-Osh Road Rehabilitation Project co-financed with ADB.

Grant aid of Yen 5,999 million has been provided from FY1994 to FY1999. Technical co-operation of Yen 2,853 million has been put in place during the same period.

Switzerland

Since 1993, the Swiss Agency for Development and Co-operation (SDC) and the State Secretariat for Economic Affairs (SECO) have provided technical and financial assistance over CHF 75 million in support of the Kyrgyz Republic. Furthermore, about CHF 6 million are committed to regional programmes also in favour of the country. The current Swiss programme focuses on promoting reform and transition in the macroeconomic, private sector, energy and water, health, agricultural, forestry as well as governance sectors. Key projects financed on the basis of grant assistance include the rehabilitation of electricity sub-stations.

General budget support is being provided, accompanied by Technical Assistance to improve the public debt management. Technical assistance is being provided to the Rural Advisory Development Service (RADS), to major projects in the forestry sector, to promotion of dialogue within communities in Ferghana Valley, and to the Legal Advice for Rural Citizens (LARC) project which strengthens the legal culture particularly as regards to land issues. Further efforts include the support of community development in primary health care in the context of the Manas health reform and the promotion of small and medium sized enterprises via financial as well as non-financial intermediaries.

Turkey

Kyrgyz Republic and Turkey have signed a framework agreement in order for Turk Eximbank to extend a credit line to National Bank of Kyrgyz Republic for US\$ 75 million (guaranteed by the Government of Kyrgyz Republic) of which US\$ 48 million has been utilised. In addition, Turk Eximbank is dealing with short and medium-term insurance business as well as short-term suppliers credits.

Due to the heavy burden on the budget after the global economic crisis and especially the Russian crisis combined with the natural disasters in the south region of the country, the debt of National Bank of Kyrgyz Republic was rescheduled in 1998. The repayment problems later resulted in a further rescheduling in 2001 and finally a Paris Club arrangement on "softened Houston terms" via a flow treatment in 2002."

United States

In the financial year 2002, the U.S. government will provide an estimated \$43 million in assistance to Kyrgyz Republic, including \$35 million in FREEDOM Support Act funds. US government-funded assistance programmes are focused mainly on economic reform, democratic reform, social transition and regional energy and environmental initiatives. The U.S. government is also providing some security assistance. Through the United States Agency for International Development (USAID) and advisors from the U.S. Treasury, the United States is providing long-term technical assistance to the Government of Kyrgyz Republic. This assistance is designed to help Kyrgyz Republic implement its World Trade Organisation (WTO) agreements and obligations, to adopt international accounting standards and to provide advice on sound public financial policy and debt management. The U.S. funds numerous training and exchange programmes for short-term professional or long-term academic training. Democracy programmes focus on increasing citizen participation in economic and political decision making, planning civic initiatives at the local level and development training for lawyers, NGO leaders and others. The U.S. is also contributing almost \$3 million to the EBRD's efforts to support the development of micro, small and medium sized entrepreneurs in the Kyrgyz Republic.

United Kingdom

The UK Department for International Development (DFID) commenced operations in The Kyrgyz Republic in 1992/93 and to date has spent GBP 6 million. The allocation for 2002/03 is GBP 3 million.

Although not a major donor, The UK (through DFID) has built strong links with the World Bank and ADB and has influenced the approach of both in a collaborative water project, which will cover the whole of The Kyrgyz Republic. For several years, DFID has also been collaborating with the World Bank on health projects, and are now the main bilateral donor in the sector. Other DFID projects include assistance with tariff policy and utility reform, working with livestock producing communities to help them create sustainable livelihoods, helping to develop the NGO sector, and assisting the Kyrgyz National Statistical Committee build capacity in support of the Comprehensive Development Framework and Poverty Reduction Strategy Processes (PRSP).

DFID is providing the Kyrgyz with technical support for urgent work on the PRSP, in order to help with the prioritisation and proper costing of the paper, expected to go to the World Bank and IMF Boards in the autumn of 2002. DFID are also collaborating with the World Bank and Kyrgyz authorities in the design of a US\$ 30 million Bank Governance loan. This will facilitate reforms of the civil service and public administration, including expenditure management systems. DFID is provisionally planning a significant contribution to fund technical assistance in support of the loan.

ANNEX 1 – SIGNED PROJECTS

(In million EUR as of 31 July 2002, excluding regional projects)

Op Name	Regional/ Direct	Total Project Value	EBRD Finance	Debt	Equity
AIG Silk Road Fund	Regional fund investment	7.5	1.5	0.0	1.5
Bistyle (formerly Investment in New Kadam)	Direct	0.7	0.6	0.0	0.6
DIF - Ala-Archa	Direct	1.6	0.8	0.0	0.8
DIF - BDC-Vytas	Direct	1.4	0.7	0.0	0.7
DIF - Besser Kyrgyzstan	Direct	1.3	0.6	0.0	0.6
DIF - Issyk-Ata Hydro Power Station Rehabilitation	Direct	0.9	0.4	0.0	0.4
DIF - Kalipso	Direct	1.1	0.6	0.0	0.6
Demirbank - Kyrgyzstan (equity)	Direct	9.2	0.4	0.0	0.4
EFES - EBI	Regional fund investment	0.2	0.2	0.2	0.0
Hotel Kyrgyzstan	Direct	23.9	8.1	8.1	0.0
KAC Revised Investment	Direct	6.1	6.1	6.1	0.0
KAC Revised Investment	Direct	0.8	0.8	0.8	0.0
Kumtor	Direct	460.2	38.4	30.5	7.8
Kyrgyz Agribusiness Company	Direct	20.1	7.5	7.5	0.0
Kyrgyz Agribusiness Company : Divestment	Direct	0.9	0.8	0.8	0.0
Kyrgyz Investment and Credit Bank (KICB) (debt & equity)	Direct	8.6	1.6	0.0	1.6
Kyrgyz MSE - Inexim Bank	Direct	1.0	0.8	0.8	0.0
Kyrgyz Telecommunications	Direct	27.9	9.5	9.5	0.0
Kyrgyzstan - SME Line of Credit II	Direct	20.4	20.4	20.4	0.0
Kyrgyzstan Credit Line	Direct	10.7	10.7	10.7	0.0
Regional TFP: JS Commercial Bank "Kyrgyzstan" (AKB)	Direct	1.0	0.0	0.0	0.0
Regional TFP: JSC Bank Eridan	Direct	0.8	0.8	0.8	0.0
Talas Transmission Network Improvement Project	Direct	26.5	25.1	25.1	0.0
Transmission Network Improvement Project	Direct	56.5	37.8	37.8	0.0
KYRGYZ REPUBLIC TOTAL		689.2	174.4	159.2	15.2

ANNEX 2 – CURRENT PORTFOLIO STOCK

(In million EUR as at 31 July 2002)

Op Name	Primary SIC Name	Portfolio	Undrawn Commitment	Operating Assets
Direct				
Bistyle (formerly Investment in New Kadam)	Non-classifiable Establishments	0.6	0.0	0.6
DIF - Ala-Archa	Building, Development and Land	0.8	0.0	0.8
DIF - BDC-Vytas	Professional Services	0.7	0.0	0.7
DIF - Besser Kyrgyzstan	Non-classifiable Establishments	0.6	0.0	0.6
DIF - Issyk-Ata Hydro Power Station Rehabilitation	Electric Power Generation	0.4	0.0	0.4
DIF - Kalipso	Non-classifiable Establishments	0.6	0.0	0.6
Demirbank - Kyrgyzstan (equity)	Depository credit (Banks)	0.4	0.0	0.4
Hotel Kyrgyzstan	Accommodation	7.6	0.0	7.6
KAC Revised Investment	Food Manufacturing	4.9	0.0	4.9
KAC Revised Investment	Support Activities for Crops (seeds, fertiliser manufacturing, distribution)	0.7	0.0	0.7
Kumtor	Metal Ore Mining	7.8	0.0	7.8
Kyrgyz Agribusiness Company	Support Activities for Crops (seeds, fertiliser manufacturing, distribution)	0.0	0.0	0.0
Kyrgyz Agribusiness Company : Divestment	Support Activities for Crops (seeds, fertiliser manufacturing, distribution)	-0.0	-0.0	0.0
Kyrgyz Investment and Credit Bank (KICB) (debt & equity)	Depository credit (Banks)	1.6	0.0	1.6
Kyrgyz MSE - Inexim Bank	Depository credit (Banks)	0.8	0.8	0.0
Kyrgyz Telecommunications	Broadcasting and Communications	6.7	0.0	6.7
Kyrgyzstan - SME Line of Credit II	Depository credit (Banks)	20.4	20.4	0.0
Kyrgyzstan Credit Line	Depository credit (Banks)	9.8	0.0	9.8
Regional TFP: JSC Bank Eridan	Depository credit (Banks)	0.8	0.8	0.0
Talas Transmission Network Improvement Project	Electric Power Transmission	19.8	1.4	18.5
Transmission Network Improvement Project	Electric Power Transmission	18.9	0.0	18.9
Direct Total		103.9	23.3	80.7
Regional				
AIG Silk Road Fund	Equity Funds	1.5	0.7	0.8
EFES - EBI	Beverage Manufacturing (includes bottle manufacturing)	0.2	0.0	0.2
Regional Total		1.7	0.7	1.0
REPORT TOTAL		105.6	23.9	81.7

ANNEX 3 - TC PROJECTS

(In million EUR as of 31 July 2002)

TAM				
Manufacturing	1	23,269	23,269	ECP
	3	171,000	142,269	ECT
	2	140,557	107,829	FLN
	3	144,468	144,341	HOL
	1	70,280	39,441	ITA
	4	215,111	215,111	JAP
	1	10,204	10,204	SWI
	3	27,398	27,398	UKB
	1	15,220	7,758	UKD
Sector Total:	19	817,507	717,620	
Group Type Total:	19	817,507	717,620	
BAS				
Manufacturing	1	168,582	168,582	FRB
	1	15,339	15,339	GER
	1	156,572	156,572	JAP
	1	165,037	165,037	SWI
Sector Total:	4	505,530	505,530	
Group Type Total:	4	505,530	505,530	
OTHER				
Commerce, Tourism	1	399,376	399,376	JAP
	1	44,348	38,643	UKD
Sector Total:	2	443,724	438,019	
Community/Social Services	1	19,677	0	ECT
	4	452,295	452,295	JAP
	1	74,844	74,844	UKB
	1	100,000	99,503	UKD
Sector Total:	7	646,816	626,642	

Energy	1	40,622	40,622	AUS
	1	155,367	155,367	CAN
	1	80,006	80,006	CAN2
	2	392,169	392,169	SWI
Sector Total:	5	668,164	668,164	
Extractive Industries	2	144,108	144,108	JAP
Sector Total:	2	144,108	144,108	
Finance, Business	37	3,954,698	2,941,261	ECT
	1	34,822	34,822	FIN
	1	45,187	45,187	HOL
	1	25,000	25,000	IRL
	13	4,339,900	2,600,020	JAP
	1	36,400	0	NLT
	1	122,459	122,459	SWE
	3	148,000	0	SWI
	1	18,977	18,977	TAI
	1	104,595	104,595	TUR
Sector Total:	60	8,830,037	5,892,321	
Manufacturing	1	109,136	109,136	CAN
	4	439,614	290,528	ECT
	1	59,573	59,573	ISR
	3	305,762	294,285	JAP
Sector Total:	9	914,084	753,522	
Telecommunications	2	534,484	534,484	ECT
	2	798,462	798,462	JAP
	1	86,465	86,465	USTDA
Sector Total:	5	1,419,411	1,419,411	

Sector	Number of Commitments	Commitment Amount	Disbursement Amount	Funding Source
Transport, Storage	1	38,353	38,353	HOL
	1	194,472	194,472	JAP
Sector Total:	2	232,825	232,825	
Group Type Total:	92	13,299,169	10,175,012	
Report Total:	115	14,622,206	11,398,161	

ANNEX 4 – POLITICAL ASSESSMENT

The Kyrgyz Republic is continuing to make progress towards implementation of the principles of multi-party democracy, pluralism and market economy. Despite serious setbacks in the democratic transition, the country has re-stated its commitment to making progress towards building functioning democratic institutions. There are many political parties, including genuine opposition parties, relatively strong civil society and, in terms of advance towards political pluralism, the country continues to feature well in the regional context.

The March 2002 events underscored the urgent need for a genuine dialogue between all the political actors - the government, the opposition and members of the civil society - as the way forward on the path of democratic transition.

The events accelerated the process of political reforms and opened opportunities for strengthening of the framework aimed at rebuilding confidence in the democratic process.

Political environment

The Kyrgyz Republic has many political parties and a developed network of NGOs. Civil society is relatively strong and is perceived by many observers to be the strongest in Central Asia. The presidency dominates the government, however, the parliament has become more independent.

The last presidential and parliamentary elections took place in 2000. According to the OSCE/ODIHR, which monitored the elections, both sets of elections did not fully comply with the OSCE requirements. The major deficiency, noted by the monitors, was the prevention of some candidates from competing in the elections on a fair and equal basis.

President Askar Akayev was re-elected for a five-year term in October 2000. In 1998 the country's Constitutional Court ruled that he was eligible to stand in the year 2000 since his 1995 election had been the first under the post-independence Constitution of 1994.

Since the beginning of the year political tension in the Kyrgyz Republic has significantly increased. The circumstances surrounding the arrest of the Kyrgyz parliamentary deputy Azimbek Beknazarov concerned the observers who saw a link between the arrest of the MP and his criticism of the government policies on ceding territory to China in a border dispute. Since the arrest of Beknazarov, the OSCE, the EU, individual governments and human rights groups appealed to the authorities on his behalf.

In March thousands of Beknazarov supporters took to the streets in the Aksy district of Jalalabad region in the south of the country demanding the release of the parliamentarian. The police opened fire on the crowd killing five protesters. The events of 17-18 March rocked the small nation for several months by continuous demonstrations, acts of civil disobedience, pickets of government buildings and a blockade of the strategic Bishkek-Osh highway. The demonstrators' demands

included acquittal of Beknazarov so that he could keep his seat in the legislature and punishment of those liable for March shootings in Aksy.

Social discontent, poverty and unemployment in the southern oblasts of the country were among the primary reasons explaining growing numbers of protesters, bringing the country to the brink of civil confrontation. A large section of the population in the south is living below the poverty line. In this context, the Bank's SME and micro-finance programmes may significantly contribute to strengthening stability in this region.

The Kyrgyz Republic has long-standing North-South rivalries within the country. The industrially developed North has traditionally filled in key government posts causing discontent in the mostly agricultural South. A fine line is required to maintain balance not to revive these potentially destructive rivalries.

An additional complication was related to the complex ethnic situation in the south which has a significant share of the Uzbek population. Living memories of tragic inter-ethnic clashes between the Kyrgyz and Uzbeks in Osh in 1989 have had a positive 'deterrent effect' during the unrest in neighbouring Jalalabad. This played a role in preventing spillover of the unrest to the city of Osh. Adding to the difficult situation, in early May a new 10-year sentence was handed down to the country's former Vice President Feliks Kulov, a prominent figure of the Kyrgyz opposition.

The growing social unrest and related tension led to the resignation of the Prime Minister and the entire government on 22 May. A new government, headed by Nikolay Tanayev (an ethnic Russian, who was a first deputy Prime Minister in the previous government), moved swiftly to undertake measures geared towards regaining domestic stability. .

First of all, in a commendable move, the government repealed a restrictive Decree No. 20 of January 2002.. This decree required mandatory registration of all printing equipment. The decree, which was intended to combat the dissemination of religious extremist leaflets, had an opposite effect by creating a tool for curtailing the freedom of expression and freedom of religion.

In June the government proposed a Law on Rallies (On the Freedom of Holding Peaceful and Unarmed Meetings and Demonstrations), adopted by the parliament, which allowed the Kyrgyz citizens in many specified cases to gather peacefully and unarmed without authorities permission. At the end of June an appeal court acquitted Azimbek Beknazarov of criminal charges.

As a result of a dialogue with political parties, NGOs and members of the civil society, the Kyrgyz President launched a Constitutional Council to prepare amendments to the country's Constitution. The purpose behind the move was to establish a presidential-parliamentary model by sharing some of the Presidential powers with the legislature and the government.

Acquittal of Beknazarov, combined with the government's dialogue with opposition and members of the civil society and creation of the Constitutional Council, had a positive effect on restoring stability. However, the issue is to build effective mechanisms to maintain stability and ensure civil rights and liberties guaranteed by the country's Constitution.

Rule of law and human rights conditions

Since the collapse of the Soviet Union, the Kyrgyz Republic stated its commitment to democracy, market economy and rule of law based on human rights. Over the last two years the authorities have undertaken measures strengthening the legal basis for democratic reforms. This included holding local elections, the work on the new draft laws on political parties, freedom of religion, national minorities, the comprehensive prison reform and extension of the moratorium on the death penalty.

The government's human rights record is uneven, although the Kyrgyz Republic continues to feature favourably in the regional context. According to independent human rights monitors, most of the violations were linked to cases of harassment of the political opposition and independent media. The US State Department characterised the government's human rights record for the year 2001 as "poor", although the report also noted some improvements.

Since the beginning of the year the opposition called on the government to relax its controls on the independent media. Several media outlets critical of the government policies experienced difficulties. The legal basis for creating obstacles on the way of the independent media was the mentioned Decree No.20, which later in the year was repealed.

The government indicated that the decree was initially adopted to prevent printing and distribution of religious literature of such groups as Hizb-ut-Tahrir (Party of Freedom), a propagandist group calling for the creation of an Islamic state. The group is active in Central Asia but primarily targets Uzbekistan, Tajikistan and the Kyrgyz Republic.

The Kyrgyz Republic has ratified the main UN human rights instruments. The country has undertaken legal and judicial reform efforts. The responsibility for the prison system has been transferred from the Ministry of Interior to the Ministry of Justice.

In May 2002, in the aftermath of the tragic March events, the Kyrgyz President declared the idea of "The Kyrgyz Republic-country of human rights" and put forward the initiative to form a public Council of Democratic Security in order to protect human rights in the country and to elaborate a Democratic Code of the Kyrgyz Republic. These ideas are yet to find their implementation.

External relations

In the aftermath of September 11, the Kyrgyz Republic has emerged as one of the important allies of the United States in the US-led anti-terrorist campaign. At the end of December 2001, the Kyrgyz parliament approved an agreement between the US and the Kyrgyz Republic allowing the US to use the airport "*Manas*" in Bishkek and other facilities for military and humanitarian purposes, with regard to the anti-terrorist

operation in Afghanistan. At the moment about 2,000 allied troops (about half of which are American soldiers) are stationed at the base.

In 1999 and 2000 the country was directly affected by international terrorism and religious extremism as a result the incursion of the armed terrorists based in Afghanistan and operating from the territory of neighbouring Tajikistan. The successful operations of the US-led anti-terrorist coalition, have significantly reduced the external threat emanating from the IMU (Islamic Movement of Uzbekistan). However, according to Kyrgyz officials, the danger is not fully eliminated as there are remnants of the terrorist group capable of infiltrating the territory of the Kyrgyz Republic (and aiming to reach Uzbekistan) from the areas close to the Tajik-Afghan border.

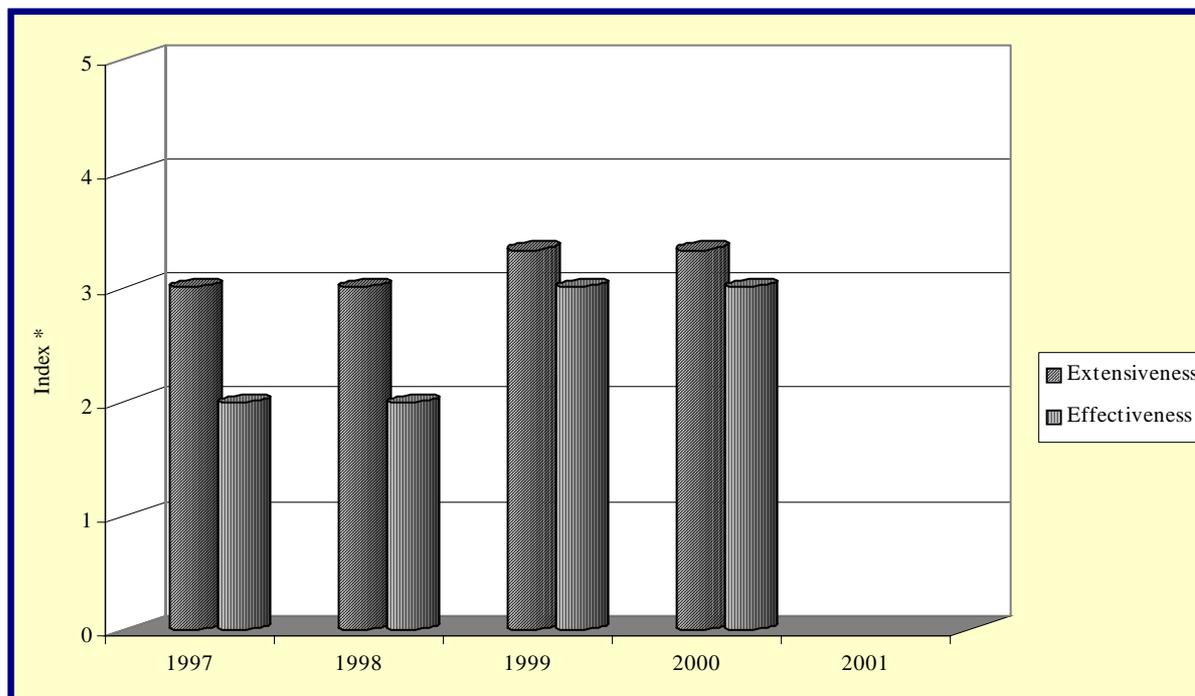
The Kyrgyz Republic strives to implement a balanced foreign policy seeking friendly relations with its larger neighbours – Russia, China, Kazakhstan and Uzbekistan. The country is an active member of various regional groupings from the Central Asian Co-operation organisation among the four Central Asian states, excluding Turkmenistan, to the Shanghai Co-operation Organisation (SCO), comprising Russia, China, Kazakhstan, Uzbekistan and Tajikistan. Both SCO and the CIS identified Bishkek as a location for their anti-terrorist centres.

ANNEX 5 – LEGAL TRANSITION

COMPARATIVE ASSESSMENT OF THE KYRGYZ REPUBLIC'S COMMERCIAL LAW

Assessment Over Time

Extensiveness and Effectiveness of the Kyrgyz Republic's Commercial Laws¹.



Source: OGC Legal Indicator Surveys; 1997 - 2000.

*Note: Indicators along the y axis range from 1 (little progress) to 5 (substantial progress)

Note: No data for the Kyrgyz Republic for 2001.

Commercial laws of the Kyrgyz Republic have advanced considerably in the past five years but have yet to reach a standard that is considered internationally acceptable. Although the corporate and foreign investment laws are wide ranging, there is a lack of legislation for commercial transactions and legal institutions.

The EBRD Legal Indicator Surveys tends to show that the effectiveness of commercial laws has advanced while extensiveness has remained stable. A significant liberal reform was the amendment to the Constitution introducing private ownership of land during the October 1998 referendum. In addition, the Kyrgyz Republic became, in late 1998, the first CIS country to join the WTO, and the country continues to maintain one of the most liberal trade regimes in the region and benefits from substantial support from the international community. For the Kyrgyz Republic to be embedded in a sufficient legal infrastructure, it is necessary to widen the scope of rules for economic activity. This enhances the predictability of the outcome of

¹ The EBRD conducts a Legal Indicator Survey each year to measure the progress in legal reform in Central and Eastern Europe, the Baltic States and the Commonwealth of Independent States, as viewed by local lawyers and academics. The results of such survey are based on responses to the questionnaire sent out to lawyers practising in any given country. The survey represented their perception of the country's legal system and, in particular, the degree to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and to which extent these laws are implemented and enforced (effectiveness).

disputes and encourages respect for the rule of law. Building sound legal institutions such as a computerised pledge registry is essential in this sense.

LEGAL SECTOR ASSESSMENTS

Bankruptcy

The Law on Bankruptcy dated 15 October 1997 (the “Bankruptcy Law”), as amended, covers the liquidation of commercial entities as well as the bankruptcy of individuals engaged in business activities. A debtor is defined as insolvent when he/she fails to pay his debts, refuses to pay, or is unable to pay, or when his/her liabilities exceed his/her assets (Art. 9 of the Bankruptcy Law).

In addition to governing creditor-initiated liquidations, the Bankruptcy Law provides that a voluntary liquidation can be initiated by the resolution of an insolvent enterprise. However, the law fails to state what form this resolution must take. The best answer is that it must be in the form specified by the charter of the company (provided this is in compliance with the general legislation).

Finally, out-of-court liquidation may be initiated by the company or by its creditors owning more than 40 per cent of the debts. Newspaper advertisements are required and a creditors’ meeting must be called and attended by at least 51 per cent of the creditors (calculated by amounts of the debts) who must vote for liquidation and the appointment of the liquidator (this decision must be taken with the favourable vote of 51 per cent of the creditors).

The commencement of the liquidation (which is different from the initiation) freezes all legal actions against the debtors and his property, including the accumulation of tax and other penalties. The Special Administrator (or Liquidator), appointed by the Court or by the meeting of the creditors, must sell the property “in the shortest possible period” following proper advertisement. He is not liable if, having advertised, he sells at loss or at a price with which creditors or debtors disagree. No taxes are payable on his sales. He may also disclaim onerous obligations or property (but is still liable to compensate the relevant party if he disclaims an obligation).

On 6 December 2001, the Executive Board of the IMF endorsed the Kyrgyz Republic's three-year economic program and approved a Poverty Reduction and Growth Facility (PRGF) arrangement in support of that program. As part of the PRGF arrangement, the Bankruptcy Law was amended on 21 June 2002. The amendment provides that the Debt and Bank Resolution Agency (DEBRA) shall now be the only authority to carry out Special Administration procedures with respect to banks and financial-credit institutions licensed by the National Bank of the Kyrgyz Republic.

Upon liquidation, the amount to be distributed among the creditors shall constitute the proceeds from alienation of the unsecured assets minus expenses of the bankruptcy procedure (the net sale proceeds). After secured creditors’ claims have been satisfied, the net sale proceeds shall be distributed with the following priority:

- (a) claims of citizens for personal injury;
- (b) wages and similar payments for not more than three months;
- (c) unsecured creditors;
- (d) tax and other budgetary amounts;

- (e) penalties imposed by creditors in classes (c) and (d) [interest and penalties are suspended at the commencement of liquidation];
- (f) shareholders.

As written, the Bankruptcy Law is one of the most advanced and creditor-friendly in the CIS. However, implementation of the Bankruptcy Law has been slow, despite the downturn in the economy; pre-tax profits in medium-sized and large enterprises outside agriculture fell by 57 per cent in 1998. Loss-making enterprises survive in part by running up tax and payment arrears, particularly to public utilities in the energy sector.

Slow court actions and incompetence of the judicial corps in dealing with a wide body of new laws are rapidly being addressed. Increasingly, judges must pass difficult examinations on current laws, and the judicial corps is becoming more professional and more independent over time.

Concessions

The rules governing concessions in the Kyrgyz Republic are largely contained in the 1992 Law on Concessions and Foreign Concessionary Enterprises (the “Concession Law”). Sector-specific rules can be found in the 1997 Mining Code, the 1998 Oil and Gas Law and the 1994 Law on Water.

The Concession Law applies to foreigners and joint ventures only. Domestic investors are not included in the list of concessionaires by the Concession Law. Some further rules related to concession arrangements with foreign investors can be found in the 1997 Law on Foreign Investments. A State Committee for Foreign Investment and Economic Development was established in 1998 to provide centralised regulation, administration and oversight of, in particular, tender offers and concessions involving foreign investors.

The Concession Law provides a non-exhaustive list of objects that can be subject to concessions including natural resources, land, other property and activities. The Concession Law leaves it to the Government to list areas and objects in which concessions cannot be granted or are limited.

The term of a concession agreement can be from 5 to 50 years. The government retains title over the concession property and the concessionaire retains the rights on the product and income derived as a result of concession.

The Concession Law, together with the sector specific regulations, covers concessions procedures in basic terms, distinguishing between public tender, which is supposed to be used for all concessions, and direct negotiation, which is only allowed in the natural resources sector.

Disputes related to concessions agreements can be resolved either in the courts or by arbitration (including international) as agreed among the parties. Concession agreements can be assigned to a third party or used as security by the concessionaire in order to procure financing.

Some of the shortcomings of the Concession Law include conflicts among (i) its provisions, (ii) special sector laws and (iii) municipal regulations. In addition, the language of the Concession Law presumes that it is always the concessionaire who pays a concession fee and never vice versa which makes the framework inflexible, in particular for public services concessions.

Capital Markets

The Law On Securities Market came into force in 1998. It regulates issuance and circulation of securities, scope and procedures of disclosure of information by the issuer to investors. The Kyrgyz stock exchange was formally set up in 1994, while the State Commission for Securities Market was established by a presidential decree in 1996. According to the Presidential Decree No. 121 "on Measures for Further Development of Organised Market of Securities" dated 10 May 1999, sales of shares in open joint stock companies can be effected only by brokers and dealers through stock exchanges. Despite these developments, the Kyrgyz capital market is still at very early stage of development and the effectiveness of the existing legal framework remains to be tested in practice.

Since 1997, the Kyrgyz Republic has undertaken an ambitious pension reform programme with the introduction of the Law "On State Social Insurance". The reform programme aimed at reducing the financial obligations of the state's budget. The programme focused on strengthening the link between contributions and benefits and ensuring the financial stability of the pensions system. So far, the reform has been successful at making pension funds financially viable.

Corporate Governance

The Law "On Business Partnerships and Companies" was adopted in 1996, which is supplemented by rules issued by the State Commission for Securities Market. Under the current legislation, a joint stock company, which has more than 50 shareholders or whose shares are listed at the Kyrgyz Stock Exchange, shall have its share registry maintained by an independent registrar licensed by the State Commission for Securities Market. A company is required to hold annual general shareholders' meeting no later than 1 April of the following fiscal year. Extraordinary general shareholders' meetings can be held at any time at the initiative of shareholders owning 20 or more per cent of voting shares in a company or at the initiative of the board of directors, management, audit commission, or external auditor of the company. The quorum at a general shareholders' meeting is 60 per cent of votes out of total voting shares of the company. Shareholders can participate at general shareholders' meeting in person or by proxy. Companies are required to publish their annual reports, although the current legislation is silent on the minimum level of information that should be published.

The Law "On Business Partnerships and Companies" is inadequate in terms of regulating several important aspects of company operations. The current legislation is insufficient in regulating disclosure of information concerning activities of the company, in dealing with issues concerning company transactions with affiliated persons or transactions involving conflict of interest issues. Currently, a draft Law "On Joint Stock Companies" is being considered by the Parliament of the Kyrgyz Republic and expected to be adopted soon.

Secured Transactions

The Law on Pledge was enacted on 27 June 1997 following two years of preparation with EBRD's active participation and technical assistance. Regulations on Pledge Registration were subsequently enacted by the Ministry of Justice in a resolution of 15 July 1997. Secured transactions are also governed by some sections of the Civil Code of 1 January 1996, and it seems that the Civil Code will prevail in case of conflicting provisions.

Security over movable assets can be of two kinds: (i) possessory (where the possession of the collateral is transferred to the creditor) and (ii) non-possessory (where the debtor may retain the collateral during the life of the security and use it). A non-possessory pledge ("firm pledge") must be registered in order for the creditor to gain preferential rights in the pledged property against third parties. Security over immovable assets is regulated by the Civil Code, the Mortgage Law and the Pledge Law.

Although the Kyrgyz Republic has a comprehensive legal framework for charges over movable assets, it will only be fully operative when a computerised system of registration is introduced. There are no signs of this being undertaken by the Kyrgyz authorities and the latest information on the treatment of secured creditors was not encouraging. It seems that the reform momentum has been lost. Kyrgyz authorities should be encouraged to re-open the legal reform and to pursue the implementation work in this area. In a nutshell, the law "on the books" is among the most liberal ones in Central Asia. Yet, its practical implementation is fraught with difficulties.

- 1) *Secured debt* - There are no restrictions as to the type of debts that can be secured. Also, it seems possible to secure debts described generally, debts not yet existing (future or conditional), debts expressed in foreign currency, and even fluctuating pools of debt.
- 2) *Secured assets* - The law gives a wide definition of property that can be pledged. There is no requirement in the law for detailed description of pledged property. After-acquired assets may be pledged, as well as goods in turnover, such as inventories, raw material, semi-finished goods, and finished products. However, in practice a detailed description of the pledged property seems sometimes to be necessary.
- 3) *Creation and registration formalities* - A pledge may be created by contract, either by a separate pledge agreement or through a clause in the agreement which creates the secured debt. The pledge agreement must be in writing, and must also be notarised when the secured debt requires a notarised contract or if any of the parties so demands. In the case of non-possessory pledges, the pledge must be registered in the Pledge Registration Office. Registration is effected through filing of a pledge notification with the Registration Office and recording of its information on the Single State Registry data system at the Pledge Registration Office run by the Ministry of Justice. At present, the registry is paper-based and the centralised, computerised registry system provided for in the law has still not been developed. It is unclear whether the current paper-based registry functions in practice.

- 4) *Priority* – In principle, registration of the pledge grants the creditor preferential rights in the pledged property against third parties. The creditor will in principle recover ahead of all other creditors but after the execution costs (the same applies in bankruptcy since the pledged property is excluded from the bankruptcy estate ("liquidation mass") upon the request of the creditor according to the Bankruptcy Law. Priority of claims is also determined by the time of registration. However, a recent decision of the arbitrazh court ruled that if a creditor obtains a court judgement for his debt, his claim will override the claims of prior registered secured creditors. This decision severely undermines the benefits of registration.
- 5) *Enforcement* - Enforcement without judicial proceedings is possible 30 days after delivery of a notice of seizure to the debtor (who could appeal against such seizure to a court). The creditor can obtain realisation by selling the assets provided that the time, place, terms, and manner of the sale are commercially reasonable for the kind and condition of the property. The law provides a framework for rapid realisation but the efficiency of the enforcement procedure in practice is unsure. In fact, there are recent reports that if processed through court proceedings, many pledges are found unenforceable because of the lack of appropriate regulations on the enforcement of the creditor's rights. Corruption of the judiciary creates additional difficulties. Moreover, enforcement costs are also reported to be too high (more than 10 per cent).

Telecommunications

The telecommunications sector in the Kyrgyz Republic is currently regulated by the National Communications Agency (NCA) and is governed by the Telecommunications Law of 1998 (the "Telecom Law"), which was drafted with EBRD technical assistance. The Telecom Law reflects all modern principles in western telecommunications regulatory thinking, creating NCA as an independent regulator with the power to enforce competition, monitor licensing conditions and introduce tariff policy. NCA carries out the telecommunications policies set by the Ministry of Transportation and Communication (the developed through its department of communication, known as the NTIA (National Telecommunications and Information Administration). NTIA also currently operates Kyrgyz Telecom, covering electrical connections; Kyrgyzpochtasy, covering postal services; and also the republican industrial union, covering radio-relay main lines and TV and radio broadcasting.

Under the Telecom Law, all telecommunication services and local networks are already liberalised with the exception of international and long distance voice telephony. Majority state-owned JSC Kyrgyz Telecom (KT) currently possesses an exclusive right until January 2003, though establishment of alternative infrastructure is permitted for as long as it does not carry voice telephony. The KT licence has recently been reissued to reflect the planned withdrawal of KT's exclusivity in January 2003, in accordance with the government's WTO commitments. It is understood that a new licence will be issued to KT in January 2003, when existing licence expires.

Among the major responsibilities of NCA are (i) licensing and certifying in the telecommunication area; (ii) supervising the quality of telecommunication services

and equipment; (iii) promoting competition in the communication area; (iv) allocation of radio frequencies to different classes of users and services; (v) developing national communication standards; (vi) co-ordinating in the area of communications; and (vii) development and execution of a national plan for numbering. NCA is also responsible for monitoring KT to ensure that the company does not exploit its monopoly position.

The provision of various telecommunication services including data communications and/or Internet services is currently subject to an individual licensing regime whereby new entrants cannot launch their activities without the prior award of an individual licence. Internet access is increasing and there are now over seventy public Internet access sites throughout the Kyrgyz Republic with some apparently offering Internet phone calls with very low charges. KT has been given a licence to provide Internet service in rural areas – this opportunity was originally offered to independent Internet companies but was turned down.

Tariff re-balancing is underway and a tariff plan covering the next two years is being implemented. This plan is now being further developed to cover the period up to 2007.

Cellular services are offered by Katel² (operates the AMPS standard) and Bitel (operating the GSM standard). As part of the development of the sector, it is understood that the government are considering offering a second GSM licence as part of the privatisation of KT. Paging services are offered by at least four companies (Areopag, Smartcom, Geliopage and Katel.), most of which are joint ventures with U.S. partners.

LEGAL TRANSITION ASSISTANCE

None at this time.

² Joint venture between Kyrgyztelecom and a U.S. partner

ANNEX 7 – ENVIRONMENTAL CBF UPDATE

The Community and Business Forum (CBF) was first developed in 1999 with the aim of increasing dialogue between business and community in the Kyrgyz Republic, to bring about long-term social and environmental benefits. In particular, the CBF worked to constructively re-engage a variety of stakeholders following a truck crash in May 1998 that resulted in the partial release of a load of cyanide into a river while on-route to the Kumtor Goldmine.

Grant funding for the CBF was provided by the UK's Department for International Development (DFID) and was mobilised through the EBRD and IFC. Following an open tender, Flora and Fauna International (FFI), an international environmental NGO, was selected to establish a forum to promote informed debate, to increase credibility and transparency of environmental performance, - particularly of the Kumtor Goldmine - and to engage and empower local communities in the Issyk-Kul region. A series of participatory workshops and meetings with local stakeholders allowed the formulation of the CBF project, its mission statement, identification of key local priorities, and adaptation of activities. This CBF enabled the real (rather than assumed) needs of key stakeholders to be clarified and acted upon.

After two years of operation a participatory evaluation was conducted in July 2001. Over 90 per cent of the respondents noted that the accessibility and credibility of information provided had improved. Interviewees noted positive changes in the understanding and dialogue between different stakeholder groups, a greater voice for local communities, and increased discussion of issues including the relationship between mining (and other business) and sustainable development. The associated small grants programme proved particularly successful in engaging local communities and NGOs, enabling them to bring tangible benefits to their communities, and to gain experience in grant and project management.

The CBF provided further opportunities for local communities and NGO representatives to participate in global initiatives. This included opportunities to comment on the World Bank's Extractive Industry Review process and an invitation for the National Manager of the CBF to join the Assurance Group of the Mining, Minerals and Sustainable Development project.

Key lessons from the CBF project include:

- A participatory approach to project development (as well as implementation) ensured that the CBF acted to meet the expressed local needs and achieved local ownership.
- The CBF was adaptable and used a wide range of different approaches to achieve greater than expected benefits.
- Facilitation by a neutral but active third party provided effective mechanisms to engage all key stakeholders.
- The involvement of a wide range of actors, including IFIs, business and an international NGO, as well as local and national communities, was important to increasing the scope and effectiveness of this project.
- The use of site visits and meetings involving community representatives and local NGOs with peer-credibility achieved more effective and widely accepted monitoring and review of the focal mine's environmental performance.

Conclusions

Overall, the outcomes of the CBF were seen to be tangible and positive, and included effects that were unforeseen at the beginning of the project. Outcomes included:

- increased understanding between the different groups.
- an increased voice for local communities.
- enhanced NGO capacity and experience, particularly at local levels novel and proactive approach to the evaluation of local and national-level mining and sustainable development issues.
- development of opportunities for further sustainable development activities.
- a tangible example of action, and an ongoing structure to build further work upon.
- opportunities for novel collaborations and organisational learning opportunities for IFIs, business and international, national and local NGOs.

As a case study the CBF raises issues relating to the reconciliation of different local, national and international priorities and perspectives through active dialogue, and the search for solutions that encompass social, environmental and economic sectors. It addresses the evolving roles of different institutions (including NGOs, IFIs and mining companies) in relation to social responsibility, and the application of voluntary initiatives in situations of conflicting interests. It presents a study of how an initiative to undertake positive engagement between one company and local communities was stimulated by a serious accident and the advocacy of national and international NGOs, and in turn led to increased empowerment of stakeholders and opportunities to engage a wide range of groups.