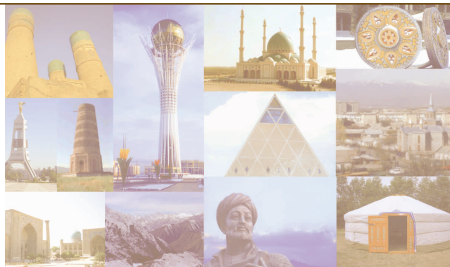


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CASA ASIA



JULY 2012



KYRGYZSTAN

MAY-JUNE

Bimonthly article

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10 June 2012 was marked by commemorations of the day of tragic events that took place in the south of the country two years ago. The country's capital, as well as the towns of Osh and Jalal-Abad hosted commemorative events with the participation of the country's senior officials.

The most resonating foreign policy-related and domestic economy-related events of May-June included the signing of agreements with the Chinese government concerning investments in Kyrgyzstan's energy industry. The construction of high-voltage overhead lines will enable the Kyrgyz Republic to create an autonomous energy system rather than depending on regional neighbours in the issue of the transit of electrical energy.

Internal affairs

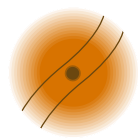
In late June, parliament ended its second session and gave an account of its 83 sessions and the passing of 250 laws, 192 of which were signed by the President. Before leaving for the summer recess, members of parliament passed a package of draft laws to counter corruption spearheaded by the law "On Countering Corruption." This normative document strengthens the legal and institutional framework for the fight against the main problem of public governance in the country and, more importantly, provides a definition of corruption that defines the latter as an exclusively criminal act. In addition to adopting the new law, parliament passed amendments to the Criminal Code, Criminal and Procedural Code, Code on Administrative Liability, laws "On Civil Service," "On Municipal Service," "On Local Government," "On Public Procurements," "On Declaration and Publication of Information about Revenues, Liabilities and Property of Individuals Holding Political and Other Special State Posts as

well as of their Close Relatives," "On Prosecutor of the Kyrgyz Republic," etc. The amendments passed by legislators are supposed to facilitate the establishment of a unified system of prohibitions and restrictions aimed at preventing corruption.

The very parliamentary corps fell victim to the ever-increasing pendulum of forceful methods for combating corruption. On 22 July, the prosecutor general's office, assisted by special forces of the state national security committee, indicted a member of parliament's Ata Jurt political party and the former mayor of Bishkek Nariman Tyuleyev, charged with embezzling \$1.4 million in state money as part of the procurement of 200 buses for the national capital's public bus stock. Should he be found guilty, Tyuleyev faces between 8 to 15 years in prison with his MP status not protecting him from criminal prosecution under articles concerning the large-scale embezzlement of public funds.

The initial attempt by the prosecutor general's office to question Tyuleyev, now in custody, not only failed, since other members of parliament "wrested their colleague" from the grip of the prosecutor general's office and literally took him out of the building, but also demonstrated a total neglect for the law on part of those responsible for creating laws, ie, the lawmakers. The whole farce of Tyuleyev's "liberation" acutely showed the aspiration of legislators to refrain from reckoning with the law thus questioning the very principle of the rule of law in Kyrgyzstan. In fairness, it should be noted that thanks to the efforts of the court and prosecutor's office, Tyuleyev was eventually put into the temporary detention isolation facility of the Bishkek directorate for internal affairs where he announced his hunger strike and refused to acknowledge the charges brought against him.

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In May, the anti-corruption service of the state national security committee (ACS SNSC) announced the conclusion of the case concerning the massive embezzlement perpetrated by the former Alfa Telecom, the nation's largest telecommunications operator, 49% of which is owned by the state. According to ACS SNSC, in 2011 the company management withdrew \$6 million to their off-shore bank accounts in the British Virgin Islands, of which \$2 million was later transferred to Hong Kong, \$2 million to Lichtenstein and the remainder of the funds used in Kyrgyzstan. The former managers had earlier been arrested and placed into the SNSC investigative isolation facility and charged with embezzlement and wasteful spending of state property, fraud and corruption.

Activities of ACS SNSC also spread into regions of Kyrgyzstan. In May, the service issued criminal charges against the mayor of the town of Naryn, who used KGS 1.395 million in municipal funds to purchase equipment for sponsor assistance without any bidding or agreement with the town council. In Chui and Issyk-Kul provinces, state companies distributing energy to retail consumers use, as intermediaries, tens of private companies affiliated with civil servants which results in the increase in the price of kilowatt per hour for consumers while the intermediaries, in the Chui province alone, secure annual net income of more than KGS 400 million.

Over a period of several months, ACS SNSC initiated 152 criminal cases, of which 100 were launched against civil servants and 52 against individuals who committed economic crimes, crimes associated with the production, transportation and distribution of drugs and organized crime. Pursuant to the analysis conducted by this specialized service, corruptive actions are most prevalent in the area of public procurements and the participation of front companies in biddings announced by state bodies.

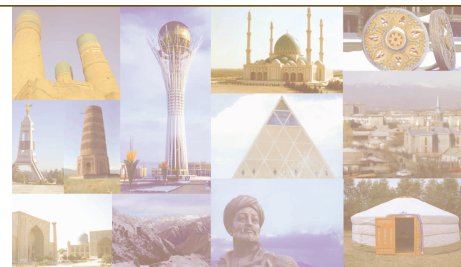
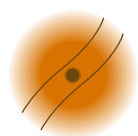
According to the internal affairs ministry, the three most corrupt governmental agencies in the country are the state registration service, the state tax service and the healthcare ministry, in that order. Yet the state penitentiary service announced that despite the scale of the anti-corruption campaign, only three people are actually serving their sentences after being convicted under corruption-related articles of the Criminal Code.

On 2 June Kyrgyzstan commemorated the two-year anniversary of the tragic June 2010 events when interethnic clashes in the south of the country resulted in the deaths of over 400 people. The country's President signed a decree instituting 10 June as Osh and Jalal-Abad Remembrance Day. The main mourning and commemorative activities were held in the town of Osh where the majority of victims resided. The town opened a new monument – Kolokol mira (Peace Bell) – to which town residents brought wreaths and flowers to commemorate the dead and surviving victims. President Atambayev, who spoke before a crowd of town residents, called for forgiveness and the unity of all citizens of the country irrespective of their ethnic background.

The Aikol Manas monumental complex was unveiled on 11 June in the town of Osh dedicated to the legendary Kyrgyz hero Manas. It is worth noting that during the unveiling ceremony, the mayor of Osh spoke of the unity of the Kyrgyz people and called on them to stop splitting themselves into northerners and southerners, which can obviously be viewed as a major progressive step compared to his earlier openly nationalistic rhetoric. For local politicians, however, the ethnic marker clearly remains the most prevailing argument and asset, which does little to facilitate the mitigation of tension that simply takes a more tacit and hidden form.

Foreign and international policy

The President's official visit to China in early June



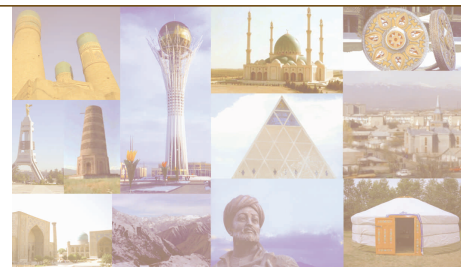
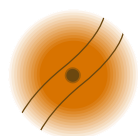
sums up the outcome of 20 years of diplomatic relations between the two neighbours since Kyrgyzstan gained its independence and is concurrently an important step on the path towards the country's energy security. During the visit, President Atambayev met with Chinese President Hu Jintao, Premier Wen Jiabao and the chairman of the national committee of the Chinese People's Political Consultative Conference Jia Qinglin and other senior government officials. In their joint declaration, the two countries stressed their mutual political trust and pledged to maintain close contacts between their respective governments, develop cooperation between their legislative branches and political and public associations, develop intergovernmental and inter-agency commissions and strengthen collaboration between their respective defence agencies, and, most importantly for the Kyrgyz Republic, expand joint investment projects in energy, transportation, mining and agriculture.

The Chinese side issued its official consent to pledge \$390 million to build the Datka-Kemin high-voltage overhead lines (HVOL), which together with the earlier loan agreement worth \$208 million will enable Kyrgyzstan to retransmit energy from the south to the north of the country without employing the Soviet-designed and made Central Asian energy circle. The use of the Central Asia energy circle by and for the Kyrgyz Republic means transiting energy across the territory of Uzbekistan and Kazakhstan in order for it to be delivered to the north of the country and having to pay for the transit, in addition to which the neighbours in question tend to use the transit lines for political purposes. In addition, according to pundits, the construction of HVOL and the Datka substation will facilitate the implementation of a much broader reaching and wide-scale project to retransmit energy surplus from Kyrgyzstan and Tajikistan to Afghanistan and Pakistan.

The project for the construction of the Sino-Kyrgyz-Uzbek Trunk Railroad was also mentioned as it has strategic value for the Chinese side. Kyrgyzstan's minister of economy and anti-monopoly policy believes that this long-discussed project will enable the country to participate in a wide range of capacities including a concession enterprise or a joint venture. As for the increase of the country's state debt, since the construction loan is expected to be taken under government guarantee, the minister believes that the ensuing ratio of national debt of 50% of GDP does not represent that much of a threat. However, this opinion does not seem to be shared by all politicians and experts in Kyrgyzstan.

The two countries also signed an agreement to construct a petroleum refinery in the town of Kara-Balta in the Chui province of Kyrgyzstan. China's National Petroleum Corporation suggests investing \$250 million in this venture, the aim being for the plant to be able to produce 20,000 tons of petroleum products by late 2012. In September 2013, the plant is expected to start operating at full capacity and supply 800,000 tons of petroleum products to the market, which will significantly reduce Kyrgyzstan's dependence on Russian petroleum imports. Additionally, the Chinese company plans to build a petroleum-transporting pipeline from the town of Shymkent (Kazakhstan) to Kara-Balta (Kyrgyzstan), and then from Kara-Balta to China. The volume of petroleum supplied can reach 10 million tons, of which up to 3 million will be used in the Kyrgyz Republic.

Immediately after the end of the official visit, President Atambayev took part in the summit of heads of Member States of the Shanghai Cooperation Organization in Beijing. Assessing the results of the summit in his interview with the Xinhua newswire, the Kyrgyz President accentuated that the intensification of the financial and economic component of SCO had to become the main vector in the organization's development and that the



Kyrgyz Republic placed emphasis on the issues of the expedited creation of the SCO Development Bank and Development Fund. It is worth recalling that the freezing of these projects way before the summit in Beijing was trumpeted by Russian media as a major diplomatic victory for Russia which opposes the rise in China's stature in the organization and emphasizes the priority of military and political aspects of SCO operations. Even though this delay does not have any great significance for China since this country solidifies its influence via direct investment, for such countries as Kyrgyzstan, the diversification of loan sources is the most important component of foreign policy efforts. For instance, the total failure of Kyrgyz attempts to secure a loan with the anti-crisis fund of the Eurasian Economic Cooperation could be compensated by an application to appropriate SCO institutions. The most successful outcomes of the summit include the adoption of 10 joint documents, the granting of observer status to Afghanistan, the granting of dialogue partner status to Turkey and the transfer of the SCO chair from China to the Kyrgyz Republic.

May saw a special meeting of heads of Member States of yet another regional organization to which Kyrgyzstan is party. The presidents of Russia, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan met in Moscow for an anniversary session of the Collective Security Council of the Collective Security Agreement Organization, devoted to the 20-year anniversary of the signing of the Collective Security Agreement and the 10-year anniversary of the creation of the organization. Based on results of the session, a Declaration of Heads of Member States of the Collective Security Agreement Organization was adopted where collective approaches to key issues in international and regional security were spelled out.

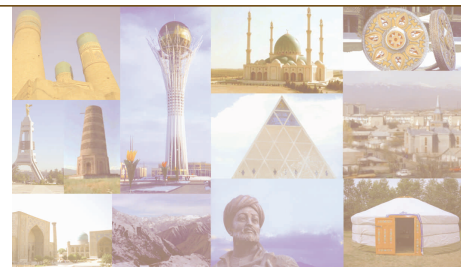
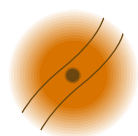
Economy and business enterprise

May-June 2012 saw a decrease in the growth rate

of the Kyrgyz economy, which the government says is associated with problems at the nation's largest gold mining company Kumtor which accounts for half the country's industrial GDP and 10% of the state budget's revenue side. According to prime minister Babanov, GDP growth without taking Kumtor into account totalled 3.6%, which is still less than the projected 7.5%. The most severe decline in economic growth occurred in the goods production sector where the decrease reached 20%. Conversely the services sector saw growth of 5%.

The problems associated with gold mining at the country's largest gold mine stem from a variety of factors, firstly, the drop of prices for stocks of Centerra Gold Inc., in which Kyrgyzstan has a 33% interest, the reduction in the volume of gold extraction and the political struggle between the prime minister and his parliamentary opponents resulting in the campaign to privatize Kumtor.

In late June and following vicious debates, Jogorku Kenesh (parliament) finally rejected the proposal to nationalize Kumtor, a project that had been charged with violating environmental regulations and standards plus the safety of operational processes and the social protection of the population. However, by virtue of their resolution, MPs created a state commission that was instructed to assess the environmental, industrial and social damage inflicted by Kumtor's operations by 1 October, as well as initiating a review of the agreement between the Kyrgyz government and Centerra Gold Inc. concerning the transition from stock ownership to the allocation of finished goods, a review of the formula applied in the course of revenue distribution, concession agreement and tax regime applied, an increase in contributions to environmental activities, and an increase in the number of the Kyrgyz representatives on the board of directors of the operating company.



The Kyrgyz government, under pressure from parliament, repealed the two-year-old decision to allot new lands to Kumtor and demanded an international audit of the company and the preparation by October 2012 of a new, mutually beneficial agreement between the Kyrgyz Republic and Canada's Centerra Gold Inc. In turn, the management of Centerra Gold Inc. said Kyrgyzstan's parliamentary demands were unsubstantiated and inconsistent with reality as its operations had already been audited and no violations of Kyrgyz standards had been identified.

It is a weird coincidence that the issue concerning the nationalization of Kumtor was raised by parliament's opposition immediately after Kumtor announced that it was allocating \$21 million to the newly created micro-finance company under the patronage of the prime minister. Simultaneously, the stock price at the Toronto Stock Exchange continued to decline reaching CAD 7.22 per share, resulting in the decrease of \$421 million in the value of the Kyrgyz interest compared to 1 May 2012. According to the Kyrgyz Government, the fall in prices of the Centerra Gold Inc. shares is directly related to the nationalization efforts. Moreover, the nationalization may result in a loss of funds exceeding the country's GDP and endless lawsuits and litigation in international courts.

The European Union mission that visited the capital of Kyrgyzstan in early June failed to add optimism as it declared that the agreement on the allocation of \$5 million to support the state budget of the Kyrgyz Republic for 2013 may be rejected owing to the country's failure to honour obligations concerning the reform of the system of social protection of the population as a whole and its failure to increase the guaranteed minimum income. The refusal to support the expenditure side of the state budget may be yet another blow to Omurbek Babanov's cabinet which has been accused of slowing down the economic

growth rate and lambasted for its inability to fill the revenue side of the state budget and honour the government's promises to increase social benefits. Near the end of their spring sessions, members of parliament attempted to dismiss the current government. The ruling coalition nonetheless managed to repel the first wave limiting its losses to the firing of 12 heads of divisions of the state tax service and several deputy ministers.

Positive accomplishments of the Kyrgyz government in previous months include the passing by parliament of a draft law "On the State Bank for Development" that is supposed to occupy a special place in the national banking system since it will ensure the access of the country's companies to medium and long-term loans at low interest rates. The government expects to establish the bank in question as a legal form of a corporation (a joint-stock company) with a 100% controlling interest in the bank's charter capital. The initial budget is expected to total KGS 50 million which will presumably be allocated from the proceeds of the sale of Kyrgyz assets in Centerra Gold Inc. and loans received under the guarantee of the National Bank of the Kyrgyz Republic. Unlike the Kyrgyz government, Alexander Kramer, resident director of the World Bank Kyrgyz Republic Country Office, expressed his doubts over the success of such a bank referring to international practice and called the World Bank's involvement in the funding of such a project highly implausible.

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