

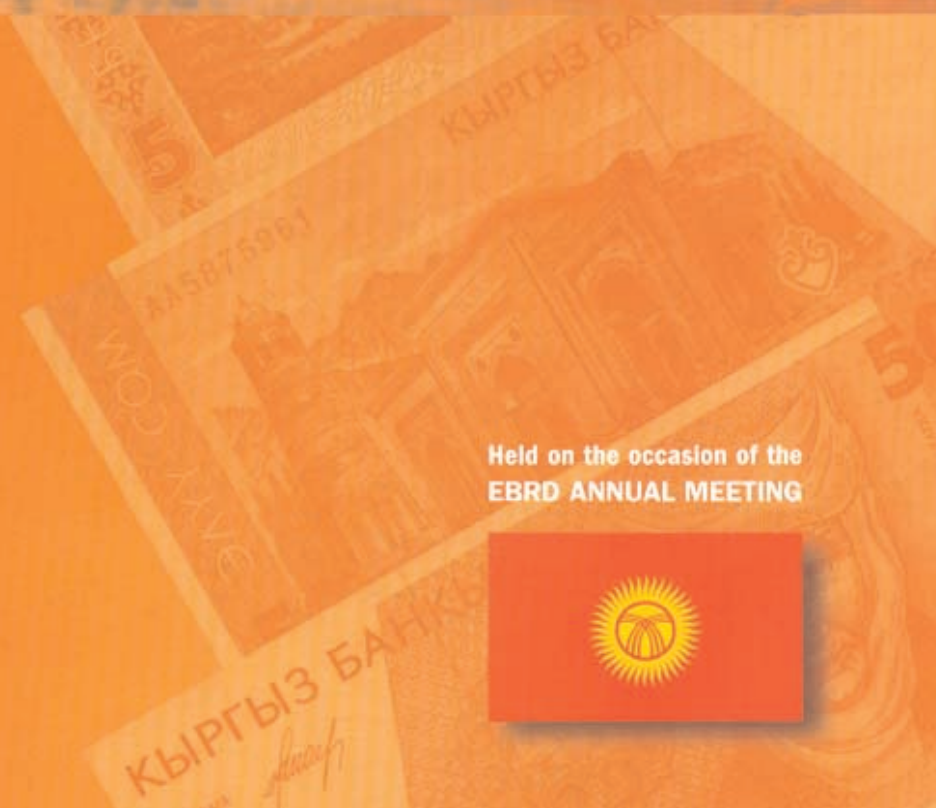
Kyrgyzstan



BUSINESS FORUM
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Investment Profile

2001



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EBRD ANNUAL MEETING



Contents



	page
Introduction	2
Map of Kyrgyzstan	4
Economic summary	5
Selected economic indicators	7
Investment climate	8
Foreign direct investment	8
Investment policy and incentives	9
Privatisation and restructuring	10
Markets and trade	11
Taxation and social expenditures	12
Major sectors of the economy	13
Agriculture	13
Mining and metallurgy	15
Energy	16
Case study: Talas transmission network improvement project	17
Telecommunications	18
Transport	19
Other	20
Financial sector	21
Banking sector	21
Non-bank financial institutions	22
Case study: Kyrgyz Investment and Credit Bank (KICB)	23
EBRD activities in Kyrgyzstan	24

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Introduction

After achieving rapid transformation progress by Central Asian standards, Kyrgyzstan's economy was badly shaken by the external shocks of the Russian and Asian financial crises of 1998. However, the economy largely recovered in the course of 2000, and investor confidence started to revive. A new three-year programme agreed with the IMF aims at improving a difficult fiscal situation, largely caused by a burden of external debt. Kyrgyzstan is the only Central Asian country to have been accepted as a member of the World Trade Organisation (WTO), though its continued recovery will depend in the immediate term on continued trade with Russia and Kazakhstan.

Kyrgyzstan was the first Central Asian Republic to declare independence in 1991. It is a small country, but has a strategic location bordering Kazakhstan, Uzbekistan and China, and is not far from the huge market of India. It has a predominantly agricultural economy, but has been one of the most progressive in the CIS. Kyrgyzstan has abundant energy resources, an inexpensive and well-educated labour force, and good potential for agriculture, food processing, consumer industries and tourism.

A successful start to transition

Kyrgyzstan has implemented the most liberal and democratic transition path in Central Asia in terms of macroeconomic stabilisation and restructuring. It has a very liberal trade regime, no foreign exchange controls, and has been accepted into the WTO. In the process of macroeconomic stabilisation, a unified exchange rate system has been achieved and inflation has been reduced. Small-scale privatisation has been completed, and reforms in the telecommunications and energy sectors are under way. Substantial progress in tightening fiscal policies has been achieved, including initial modernisation of the tax system and a comprehensive reform of the budgetary procedures and intergovernmental relations. The monetary policy framework and instruments have been overhauled, in parallel with successful reform of the financial sector. Non-tariff barriers have been removed and export taxes have been eliminated on all goods.

Kyrgyzstan has also made progress in attracting foreign investment. The government has adopted a new law on foreign investments in the Kyrgyz Republic, introduced special incentives for investors, established a liberal exchange rate regime, and supported all initiatives to attract foreign investment. The guarantees that are provided to foreign investors such as national treatment, freedom of transfers

and protection against nationalisation meet western and international standards, although implementation could be further improved. The establishment of the Advisory Council on Investment Policy (ACIP) in 1999 has been a positive move to ensure dialogue between investors and government, and to address issues relevant to the investment climate.

The legal and regulatory systems have been modernised and most core economic legislation conducive to the development of a free market, has been or is in the process of being, adopted. Initial efforts to strengthen the capacity of the judiciary system to interpret and enforce the new laws are underway, but more systematic reform is needed to strengthen the country's institutional and enforcement capacity.

Challenges ahead

Kyrgyzstan's medium-term outlook could be promising if the government is able to tackle the constraints faced by the economy such as high external debt, the state of public finances, low private investment levels, a run-down public infrastructure network, and insufficient restructuring of the real sector. Against this background, the Kyrgyz government is cooperating with international financial institutions to achieve further reforms and a stable macroeconomic situation.

One of the key challenges to be met is the servicing of the country's high level of foreign debt. Negotiations have been held to reschedule repayments to two big lenders, Russia and Turkey, of whom Russia has agreed to reschedule, while talks with Turkey are still ongoing. The high debt burden accumulated in previous years, exacerbated by devaluation of the som (KGS) against the US dollar in 1999, has led to a difficult fiscal situation. The most recent three-year programme to be agreed with the IMF emphasises further fiscal adjustment, and is complemented by substantial support from the Asian Development Bank and the World Bank.

Further improvements to the investment climate are also needed if the country is to attract or retain foreign investment. The areas requiring attention include further reform of the civil service, including staff reductions, higher wages, and the strengthening of the accountability of public sector officials and agencies; tax reform in order to raise revenues; cuts to public investment; and harmonisation of taxes. It is also essential to eliminate inconsistencies in the regulations, such as the law on pledge, that hamper lending. Investors are also deterred by a lack of progress in combating corruption. The country has a vital need to improve legal effectiveness through an independent, well-trained judiciary.

Another challenge for the government is to give momentum to large-scale privatisation and restructuring. Plans are underway for the privatisation of the telecommunication services, energy distribution networks and the national airline. Kyrgyzstan has been able to implement a successful privatisation plan for small and medium-scale enterprises, and the country could offer good returns for prospective investors when large-scale enterprise privatisation is conducted. Finally, better targeting of social expenditure is needed to alleviate poverty, and the government is cooperating with the IMF on this and other issues.

Domestic policy and international relations

President Akayev is the only Central Asian president who is not an ex-communist official. He was re-elected in the October 2000 presidential elections for a third five-year term. His commitment to democratic and economic reform since transition began has led to considerable international support. However, the last presidential elections were criticised by OSCE observers for failing to meet full international standards. Following amendments to the 1993 Constitution that strengthened the presidency, it remains the main decision-making body in the country.

Despite criticism of electoral procedures, the OSCE observers confirmed that democratic development in Kyrgyzstan is still comparatively viable, despite increasing challenges. Kyrgyzstan has a relatively well developed multi-party structure and a vibrant pluralistic civil society. However, the democratic process in Kyrgyzstan is being monitored by the international community to ensure that its development continues. After being re-elected

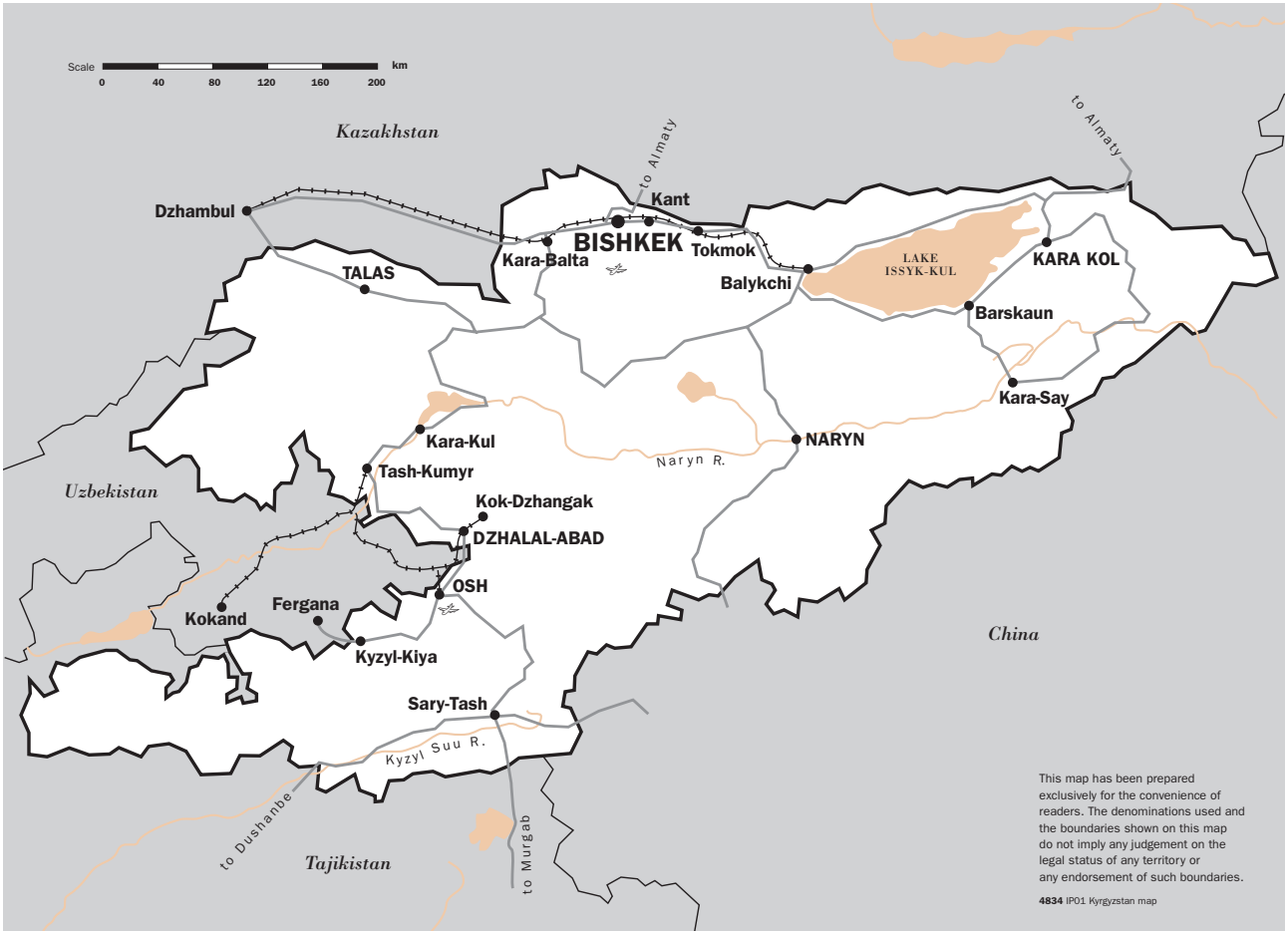
in October 2000, President Akayev launched a major reshuffle within the government and its agencies, restructuring public administration. The size of the government apparatus was drastically reduced from 17 to 12 ministries, and the number of government agencies was cut from 42 to 29, to streamline their functions, downsize the civil service, and more importantly to ensure effective governance.

Kyrgyzstan is a member of the Eurasian Economic Community, formerly the CIS Customs Union, together with Russia, Kazakhstan, Tajikistan and Belarus. Its WTO membership provides the country with certain privileges although it also causes problems with some of its neighbouring partners within the Eurasian Economic Community due to clashing trade privileges such as cheap re-exports. (See *Investment climate: Markets and trade* below.)

Located at the heart of Asia, Kyrgyzstan hosts – on 94 per cent of its territory – Central Asia's most dramatic mountain scenery, with the highest and most spectacular parts of the Tien Shan and Pamir Alay ranges, as well as the world's second largest alpine lake, Lake Issyk-Kul. Apart from the Fergana valley, the only important lowland areas are the Chui (where Bishkek is located) and Talas valleys, where the majority of the population is to be found.

The population is about 4.8 million, consisting of approximately 60 per cent ethnic Kyrgyz, 20 per cent Russian and other Europeans, and 20 per cent various other peoples including Kazakhs, Uzbeks, Azeris, Tajiks, Dungans, Koreans and Tatars. The official language is Kyrgyz, which belongs to the Turkic language group. In order to provide further assurances to the non-indigenous population, the parliament also recognised Russian as an official language in March 1996.

The Kyrgyz were ruled by the Khanate of Kokand until the arrival of Tsarist troops who captured Bishkek in 1866. Central Asian people were granted the right of self-determination by Lenin after the 1917 revolution. But Soviet nationalities policy in the early 1920s, under the direction of Stalin, saw Soviet rule enforced from Moscow by Red Army troops who crushed Muslim revolts throughout Central Asia after the Russian civil war. In 1924, Kyrgyzstan was absorbed into the Russian Federation, but was given Union Republic status in 1936.



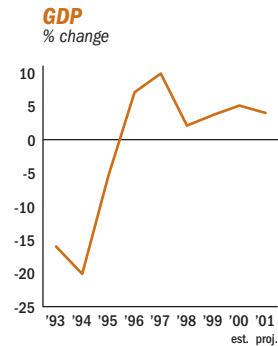
Economic summary



Following the negative impact of external shocks in 1998-99, the Kyrgyz economy started to show signs of recovery in 2000. The national currency stabilised, the trade balance improved and the economy recorded a noteworthy 5.1 per cent GDP growth. The economic recovery of the country's main trading partners, including Kazakhstan and Russia, also contributed positively to the economy. However, the fiscal situation remains weak largely due to a high level of foreign debt that will be difficult to service in the future, unless further structural and institutional reforms are introduced.

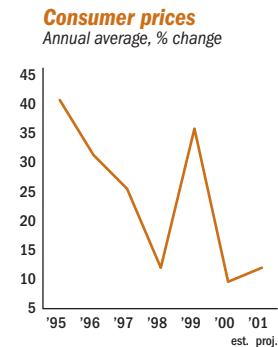
GDP growth

According to EBRD estimates, Kyrgyzstan achieved a notable 5.1 per cent GDP growth rate in 2000, compared to 3.7 per cent in 1999, indicating that the economy has overcome the effects of external shocks experienced in 1998 and 1999. Increases in industrial output were the main driving force behind GDP growth. Industrial output grew by 6.4 per cent in 2000, while agricultural production rose by 3.9 per cent. Gold production also contributed to the growth rate. Recovery in the Russian and Kazakh economies, Kyrgyzstan's two main trade partners, also played a role in increased growth. In 2001, GDP growth of 4 per cent is projected, provided prospects for Kyrgyzstan's leading trade partners remain positive.



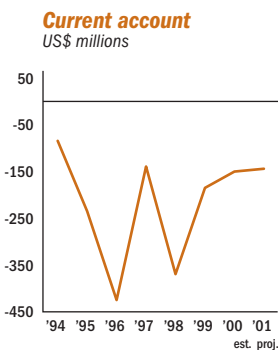
Inflation

In 2000 inflation was reduced to its lowest level since independence. EBRD preliminary estimates give an annual average consumer price inflation rate of 9.6 per cent, as opposed to 35.8 per cent in 1999. Output recovery and a tight monetary policy helped to stabilise the currency and kept inflation in check. The high inflation rate of 1999 was caused mainly by depreciation of the som (KGS) following devaluation of the Russian rouble in 1998 and later of the Kazakh tenge. A 12 per cent annual average inflation rate is projected for 2001.



Current account

The estimated current account deficit reached US\$ 150 million in 2000 (according to EBRD estimates), down from about US\$ 185 million in 1999. The trade balance was also negative in 2000 (US\$ -68 million) although it represents some improvement on the 1999 figure of US\$ -84 million. The estimated value of exports reached US\$ 505 million in 2000, up from US\$ 462 million in 1999, while imports amounted to US\$ 573 million, compared to US\$ 546 million in 1999. A high cotton price, rising demand from Russia and Kazakhstan, and competitiveness caused by devaluation increased exports solidly, allowing the trade deficit to be reduced. However, fluctuating relations with neighbours including Kazakhstan and Uzbekistan, resulting in occasional import tariffs imposed on mutual exports, continue to affect regional trade balances.

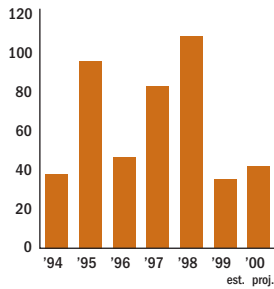


Source: EBRD, January 2001

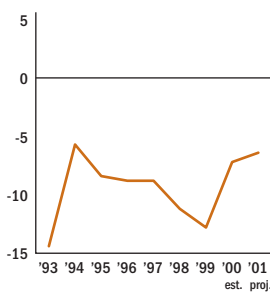
Foreign direct investment and privatisation

According to the Kyrgyzstan National Statistics Committee, FDI in 2000 amounted to US\$ 56 million. EBRD preliminary estimates give a figure of US\$ 42 million, compared to US\$ 35.4 million in 1999. Although Kyrgyzstan has an advanced regulatory framework to attract foreign investors, weaknesses in implementation of the legislation have had a negative effect on FDI, the increase of which will require further institutional and structural reforms.

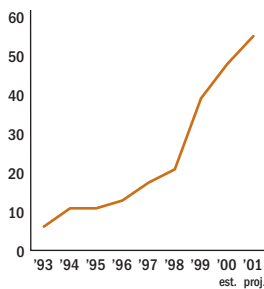
Total FDI
US\$ millions, cash receipts, net



General government balance
% of GDP



Exchange rate
Annual average, som per US\$



Source: EBRD, January 2001

Large-scale privatisation is proceeding very slowly. Privatisation of strategic public monopolies encountered delays in 2000, mainly due to political instability caused by the election process and economic difficulties, which have affected investors' interest. The main enterprises scheduled for privatisation in 2001 are the telecommunications monopoly, at least one energy distribution company, and the national airline. Speedy privatisation of these enterprises will be essential to boost investor confidence in Kyrgyzstan.

Government balance

The estimated government balance in 2000 was -7.2 per cent of GDP, compared to -12.8 per cent in 1999. The fiscal situation remained difficult in the first part of 2000 when revenues fell short of expectations, but by the end of June revenues had improved. However, with a decline in tax revenues as a share of GDP, the deficit has been primarily financed by borrowing from bilateral creditors and multilateral financial institutions, which has increased external debt. Kyrgyzstan's budget for 2000 included debt repayments of over US\$ 80 million, which represents more than 40 per cent of total state revenues. Expanding the tax base and improving tax administration together with a reduced expenditure target and possible debt restructuring will be crucial to reducing the budget deficit. The 2001 budget foresees US\$ 237 million in revenues and US\$ 226 million in expenditures. The country will have to service US\$ 105.4 million in foreign debt in 2001.

Exchange rate

The som (KGS) largely stabilised in 2000 with an annual average rate of KGS 47.8 to the US dollar, compared with KGS 39 in 1999. The estimated year-end rate was KGS 48.4 to the US dollar, compared with KGS 45.5 in 1999. Following the devaluation of the Russian rouble in 1998 and later of the Kazakh tenge, the som depreciated more than 100 per cent against the US dollar, but stabilised during 2000, helped by tight monetary policy and improving external balances.

Relations with the IMF

Kyrgyzstan is the only CIS country to have accepted undertaking the IMF's conditions for capital and current account convertibility. In 1998, the IMF approved a new three-year loan for Kyrgyzstan under an Enhanced Structural Adjustment Facility (ESAF), since renamed the Poverty Reduction and Growth Facility (PRGF), equivalent to SDR 73.3 million (about US\$ 94 million) to support the government's economic programme for 1998-2000. In February 2000, the Fund approved the second-year programme under the PRGF in an amount equivalent to SDR 21.5 million (about US\$ 29 million) in support of the government's economic programme for the year 2000. After reviewing implementation of the second annual arrangement, the IMF released two more disbursements in September 2000 in a sign of support for the government's economic programme, bringing total disbursements under the programme to about US\$ 58 million. A new three-year programme under the PRGF will be launched in 2001.

The IMF is advising Kyrgyzstan to increase budgetary revenues through a wider tax base and reduced public expenditures, to take the necessary measures to resolve the external debt problem, and to speed up structural reforms, especially large-scale privatisation and the necessary legal and regulatory framework to support it.

Selected economic indicators									
	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 proj.
GDP (% change)	-16.0	-20.1	-5.4	7.1	9.9	2.1	3.7	5.1	4.0
Consumer prices (annual average % change)	772.4	228.7	40.7	31.3	25.5	12.0	35.8	9.6	12.0
Current account (in US\$ millions)	na	-84.3	-234.8	-424.8	-139.2	-369.4	-184.9	-150.0	-144.0
General government balance (% of GDP)	-14.4	-5.7	-8.4	-8.8	-8.8	-11.2	-12.8	-7.2	-6.4
Trade balance (in US\$ millions)	na	-86.1	-122.0	-251.7	-16.0	-220.0	-84.0	-68.0	-55.0
Total FDI (in US\$ millions, cash receipts, net)	na	38.2	96.1	46.8	83.0	108.6	35.4	42.0	na
External debt stock (US\$ millions)	na	413.8	763.9	1,151.2	1,356.1	1,472.6	1,718.7	1,848.7	1,942.7
Unemployment (% of labour force)	na	3.1	4.4	6.0	4.3	4.3	5.4	na	na
Exchange rate, annual average, som per US\$	6.1	10.8	10.8	12.8	17.4	20.8	39.0	47.8	55.0
Gross reserves, excluding gold (end-year, US\$ millions)	na	67.3	66.3	85.3	169.2	147.5	205.2	225.1	277.1

Source: EBRD, January 2001



Investment climate

Kyrgyzstan is one of the most investor-friendly countries in the region with a comparatively advanced legal framework and a sustained commitment to encouraging investment. However, difficulties faced in implementation of the regulations remain a major challenge, which continued to affect the investment climate and FDI levels in 2000. However, Kyrgyzstan is cooperating with IFIs to restructure the economy and carry out further reforms, which in turn should encourage investors. The State Property Fund is continuing to carry out the privatisation programme, which is supported by IFIs and offers investment opportunities particularly in telecommunications and energy.

Foreign direct investment

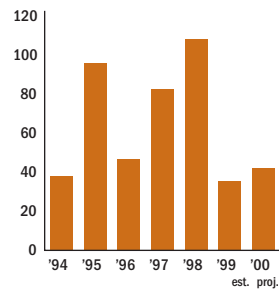
Net foreign direct investment (FDI) in 2000 totalled US\$ 42 million according to EBRD preliminary estimates, compared to US\$ 35.4 million in 1999. It is not expected to grow substantially in 2001. However, the State Committee on Managing State Property and Attracting Direct

Investment is cooperating with IFIs to prepare the necessary legal ground and amendments to the existing law in order to attract more investment.

FDI has to date been moderate, chiefly oriented toward trade, restaurant services, industry, transportation, communications, and the financial sector. Kyrgyzstan possesses abundant natural resources including significant deposits of gold, rare minerals and non-ferrous metals. In addition to opportunities in mining and hydro electric energy, foreign investment in electronics, leather tanning and finishing, hardwood furniture, food processing, cultural and eco-tourism, apparel, and jewellery production is likely to yield good returns.

Kyrgyzstan has attracted about US\$ 450.1 million in direct investment since 1994. At the start of 2001 there were an estimated 2,650 joint ventures and foreign companies in Kyrgyzstan. Among the major investors are Reemstma (Germany), through the Reemstma-Kyrgyzstan tobacco company, Plaskap Bishkek (a Turkish joint venture producing plastic bottle tops), the Central Asian Group (trade, banking, construction materials), and Hyatt (US) through the Hyatt Regency Bishkek hotel, which is under construction. Coca-Cola (US) bottles its soft drinks locally, and Canadian gold-mining firm Cameco has formed the largest western joint venture in Kyrgyzstan, the Kumtor Operating Company. Joint ventures play a leading role in gold mining, sugar and pasta manufacturing, petrol retail, and tea packaging. Currently, joint ventures with foreign investments

Total FDI
US\$ millions, cash receipts, net

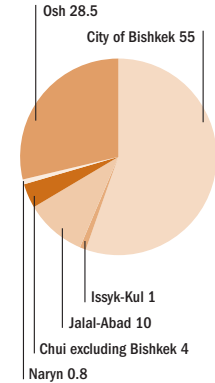


Source: EBRD, January 2001

produce one third of all Kyrgyz industrial output and export about 16 per cent of this output. Some law firms and other service organisations have also opened offices in Kyrgyzstan.

There have been some delays in implementing the privatisation programme, particularly for large enterprises. However, in 2001 the programme is likely to go ahead with privatisations in the energy, transportation and tourism sectors. The services

Breakdown of FDI by region
1999 & January-March 2000, per cent



Source: National Statistical Committee

Origins of foreign direct investment (US\$ thousands)

Country	1997	1998	1999
UK	13,353	20,879	19,154
US	10,007	32,523	19,154
Turkey	17,569	15,436	23,253
Canada	31,402	8,527	4,868
Korea	343	13,930	760
Italy	1,943	3,746	3,938
Switzerland	1,216	2,962	3,283
Japan	514	9,751	167
France	37	3,389	332
TOTAL	86,343	136,301	108,562

Enterprises with foreign investments

	1997	1998	1999
Number of registered enterprises	3,272	3,991	4,691
Value of industrial production, KGS million	4,975	6,936	10,058
Exports, US\$ million	105	97	68
Imports, US\$ million	231	317	222

Source: National Statistical Committee

and financial sectors are also among promising areas for future foreign investments.

The most active countries in Kyrgyzstan in terms of investments are Turkey, the UK, the US, Italy and Canada.

Investment policy and incentives

Kyrgyzstan aims to create a favourable investment climate and is making an effort to provide beneficial conditions to foster further investment. To this end, the country pursues policies aimed at reducing the inflation rate, providing profit tax incentives for companies with foreign investments as well as exemption from payment of VAT and taxes on the import of technological equipment and associated spare parts, and granting favourable terms for credits in foreign currencies received from foreign banks and credit institutions.

Kyrgyz foreign investment legislation guarantees protection for foreign investors from expropriation, nationalisation, and similar actions. It also protects against bureaucratic delays within the Kyrgyz government structure. However, laws affecting business in Kyrgyzstan are not absolutely explicit and are not always implemented consistently. The interpretation of laws by different agencies can at times vary.

Former tax holidays and other incentives for foreign investors were eliminated in accordance with standards preferred by IFIs. However, in an effort to encourage foreign investments,

Advisory Council on Investment Policy

The Advisory Council on Investment Policy (ACIP) was established under the authority of the Prime Minister of the Kyrgyz Republic in a common initiative with foreign investors. It includes representatives of the largest organisations and companies operating in Kyrgyzstan, both foreign and domestic, including Demir Kyrgyz International Bank, Coca-Cola Bishkek bottlers, CAMCO Corporation, Hyatt-Regency, Reemtsma Tobacco, Norox mining, the Central Asian American enterprise support fund, Jalal-Abad refinery, Elwest dairy, GTZ and the EBRD. Its role is to analyse the situation in the republic and make recommendations and proposals to the Kyrgyz government for improving the investment climate. President Akayev, who strongly supported the establishment of the ACIP, led its first meeting in March 1999. Regular meetings have been held since, with working groups in the field of foreign investment laws, fiscal and custom issues, and bureaucratic barriers addressing their conclusions directly to the Prime Minister. The activity of the ACIP is due to resume in spring 2001 following the government reshuffle.

Kyrgyzstan is providing a range of new tax incentives.

Following the establishment of the ACIP (see box), important progress has been made in providing tax relief for businesses and investors. Kyrgyzstan has reduced the tax burden on repatriation of profits by foreign investors to bring it in line with the tax rate for domestic investors. Foreign investors are subject to a profit tax of 30 per cent with some exceptions and variations. Income from securities is taxed at 15 per cent.

Protection of property rights is developing rapidly. The regulations allow 99-year leases on property, which is adequate for most business purposes. There is no major obstacle for foreign rental of land for residences or factory sites. A Central Land Registry has been developed and will further facilitate land transactions. Private land ownership has also been introduced, but privatisation of land often stimulates heated debate in parliament, which initially imposed a five-year moratorium on all land transactions. However, following the President's appeal to parliament on 28 December 2000, the moratorium was withdrawn by presidential decree. In January 2001, a new law was adopted which offers better regulation of land management and introduces more flexibility in the pledge of lands. Foreign entities are still forbidden to own land, including farmland. Kyrgyzstan also adheres to agreements on intellectual property rights.

A broad base of effective commercial laws is now in place. However, the implementation of regulations and court procedures needs to be further developed, as the courts are only now coming to terms with this extensive body of legislation. The court system is in need of reform. Court actions are slow, and there is a lack of public confidence in judges who need better training and better wages. A full separation of the judiciary and the executive is also needed. Although bureaucratic procedures have yet to be streamlined, by the standards of the former Soviet Union, procedures are often smoother and more transparent than in some of the other CIS countries.

Corruption is widespread. Kyrgyzstan has been carrying out an anti-corruption programme launched at the end of 1998, and many cases are under investigation. Nevertheless, non-selective implementation of controlling measures against bribery and other such economic crimes is greatly needed.

Kyrgyzstan has not practised expropriation. Foreign investors have the legal right to compensation in the case of government seizure of assets. However, asset valuation can lead to disputes between government agencies. Therefore, a fair basis for compensation in any case of expropriation could be difficult to achieve.

Although going to arbitration in western Europe would entail expensive legal costs, contracts often include a clause on the application of binding international arbitration. However, choice of a neutral entity appointed specifically for a contract in Kyrgyzstan or at least in a nearby location could reduce such costs. So far, there is no mechanism to allow a successful party to enforce an arbitral award through the Kyrgyz courts.

The State Committee on Managing State Property and Attracting Direct Investment

To assist foreign investors with a variety of issues, an Investment Promotion Agency (IPA) was established under the State Committee on Foreign Investment and Economic Development (Goskominvest) to provide administrative, consultative and information services to potential investors. The IPA was intended to streamline and develop the most transparent investment process in the region. However, following a major government reshuffle at the end of 2000 and early 2001, Goskominvest was replaced by the State Committee on Managing State Property and Attracting Direct Investment, which will conduct similar functions to those of Goskominvest as far as foreign investments are concerned. This new body, and also the co-ordination of external aid and technical assistance, have now been transferred to the Ministry of Finance to ensure consistency and a centralised view on foreign debt issues. These functions are to:

- attract foreign investment;
- look for investment partners;
- identify investment opportunities;
- provide investment legislation information; and
- coordinate international funding and technical assistance.

The State Committee on Managing State Property and Attracting Direct Investment

Tel: +996-312-227 706

Fax: +996-312-660 236

E-mail: spf@bishkek.gov.kg

Privatisation and restructuring

Small-scale privatisation continued in 1999 and early 2000. A total of 178 state-owned enterprises were transformed either into joint stock companies or sold directly. However, little progress was made in privatising large state monopolies. Kyrgyz Telecom is a case in point. Privatisation of 40 per cent of Kyrgyz Telecom did not go ahead as planned, although a tender took place, due to lack of interest under the conditions set by the government and also government delays. In the energy sector, a restructuring and reform plan for Kyrgyzenergo, the energy monopoly, to divide

it into separate generation, transmission and distribution companies has been adapted. One of the four distribution companies is being prepared for privatisation. An important part of this reform included tariff changes, raising electricity prices in

Free Economic Zones

There are four free economic zones (FEZ) in Kyrgyzstan: Bishkek, Naryn, Karakol and Maimak. They have been established in major transit areas and in special zones located close to railway stations and customs posts along the Chinese border. The most active is Bishkek, as a result of the greater concentration of companies. The FEZ in Naryn covers 47,000 square kilometres, equivalent to one quarter of the whole country. The FEZs have facilities for warehousing, wholesale export-import trade, banking, industrial manufacturing for export, and transportation. Goods entering and goods traded within these zones are duty free anywhere within Kyrgyzstan. Goods can also be sold to third countries free of double taxation. Under a recent government decree, FEZs are banned from the production and sale of petroleum, liquor and tobacco products. FEZs have attracted more private foreign investments than any other areas of Kyrgyzstan. However, more foreign investment in the FEZs is needed, and the government provides a wide range of incentives for foreign investors. They include:

- exemption from several taxes, duties and payments for the whole period of operation in the FEZ;
- exemption from customs duties for exported goods manufactured in the FEZ, goods imported into the FEZ, and goods destined for trans-shipment and re-export;
- exemption from quotation and licensing for exports of goods;
- simplified customs procedures;
- simplified registration procedures;
- direct access to utility suppliers;
- no duties on imported capital goods;
- no import duties on raw materials and components; and
- free export of equipment and supplies when no longer required.

Enterprises in FEZs

	Unit	1997	1998	1999
Registered enterprises	Number	341	515	573
Persons employed	1,000	1.8	2.7	3.3
Value of industrial production	KGS million	235	435	747
Export	US\$ million	15	11	12
Import	US\$ million	26	57	35

Source: National Statistical Committee

January and April 2000 in accordance with the approved tariff increase programme, making these enterprises more profitable and more attractive to foreign investors. (See *Major sectors of the economy* below.)

Further delays in the privatisation of strategic public monopolies occurred during 2000 partly due to frequent government reshuffles and to the electoral cycle, but also because of ongoing economic difficulties, which have decreased investors' interest.

In 2001, the privatisation of Kyrgyz Telecom, the telecoms monopoly, and the energy distribution companies will be on the agenda, as well as the tourist facilities at Lake Issyk-Kul, the national airline, and the state gas company, Kyrgyzgas. In the banking sector, Kairat Bank will be restructured as a prelude to privatisation and the Savings Bank will be sold. The successful conclusion of these sales will be key to improving investor confidence in the country.

Markets and trade

Kyrgyzstan has implemented a successful trade liberalisation policy, and has been rewarded with WTO membership. It has the most liberalised trade regime among the CIS countries.

The Kyrgyz currency, the som (KGS), can be freely traded in exchange offices and banks at official rates.

As WTO membership requires that domestic policies be consistent with international practice, it is likely to provide better legal standards as well as giving impetus to the transition to a market-based economy. WTO membership also provides a member country with an open quota for inexpensive re-exports, which has been a source of complaint by Kazakhstan and Uzbekistan, who are not yet members.

Major trade partners, QIII 2000

Import partners	US\$ millions	Export partners	US\$ millions
Russia	41.1	Uzbekistan	47.9
Uzbekistan	12.3	Germany	33.9
Kazakhstan	14.6	Switzerland	15.6
USA	9.5	Kazakhstan	12.4
China	8.8	Russia	10.5
Germany	7.4	Azerbaijan	10.2
Turkmenistan	7.1	China	9.5
Turkey	5.3	UK	4.3

Source: National Statistical Committee

Value of imports and exports by sector, 1999 and January-September 2000

Sector	1999 export value, US\$ 000	Jan-Sept 2000 export value, US\$ 000	1999 import value, US\$ 000	Jan-Sept 2000 import value, US\$ 000
Manufacturing	396,878.7	348,189.0	568,291.5	368,944.9
Electricity	52,042.3	79,106.3	2,840.6	2,568.2
Oil and gas	1,598.2	1,403.5	118,711.9	83,293.5
Ferrous metallurgy	1,570.8	3,690.5	9,481.3	7,561.0
Non-ferrous metallurgy	217,226.7	178,131.7	22,862.3	8,663.9
Chemicals	6,579.3	7,409.5	24,510.8	23,849.5
Fuels	300.9	355.9	14,239.4	12,807.6
Machine building	46,811.1	38,597.4	202,444.9	117,458.0
Lumber and paper	742.9	657.9	19,138.0	16,891.7
Construction materials	8,188.5	6,327.1	11,000.8	5,849.4
Light industry	32,282.1	18,793.5	38,614.7	27,677.0
Food industry	19,136.5	9,734.0	54,244.1	33,743.0
Medical industry	1,530.4	619.5	42,264.6	22,284.9
Other manufacturing	8,869.1	3,362.1	7,938.1	6,297.3
Agriculture	56,786.4	34,996.5	31,447.9	22,072.2
Other	170.5	5.5	0.5	0.5
Total	453,835.6	731,379.9	599,739.8	391,017.5

Source: National Statistical Committee

There is a reduction of 50 per cent of duties on imports to WTO member countries. As a WTO member, Kyrgyzstan is also under obligation to develop domestic institutions and reduce the role of the government in the economy.

The WTO provides access to a forum for impartial and binding dispute settlement, which is applied in case of trade disputes with other member states. However, implementing WTO rules has caused some disagreements with Kyrgyzstan's neighbours, such as Uzbekistan and Kazakhstan who are not WTO members, but are among the country's main trade partners. Both countries have occasionally closed borders and trade routes with Kyrgyzstan and raised taxes and tariffs on Kyrgyz exports, thereby affecting regional trade, including trade with Russia. However, being the first among the CIS countries to become a WTO member gives Kyrgyzstan some advantages in negotiating some concessions from other countries such as Uzbekistan and Kazakhstan who are also seeking WTO membership.

To gain the full benefits of WTO membership, Kyrgyzstan will need to continue to liberalise its trade regime and to support it by strengthening the legal system and market-based economic framework. Kyrgyzstan is already preparing amendments to its law on foreign investments.

Foreign exchange is widely available, and the som is freely convertible. Currently, the National Bank of Kyrgyzstan conducts weekly inter-bank currency auctions where competitive bids determine market-based transaction prices.

Taxation and social expenditures

Taxation

A comprehensive tax code enacted in 1996 was updated in 1999. Amendments provide a uniform tax system, including income, profits, excise, customs, land, and vehicular tariffs. However, the tax system is burdensome, sometimes involving complex and time-consuming accounting. Payroll taxes such as social fund payments, which are used for the national pension system, among other things, are also complex. There is a lack of transparency as even basic laws, tax rates and regulations are seldom published, mainly due to government budget restrictions. The tax authorities sometimes appear to single out particular entities for tax inspections although there is no

evidence of discrimination against foreign investors. However, current assistance programmes, such as the establishment of a legal information centre, are seeking to rectify some of these problems.

Some basic tax rates are as follows:

- VAT at 20 per cent monthly or quarterly;
- Income tax up to 35 per cent monthly deducted from employees' salaries;
- Foreign workers' income tax at 10-40 per cent;
- Road fund tax at 0.8 per cent of the cost of goods and services sold quarterly;
- Emergency Fund tax 1.5 per cent monthly;
- Social Fund 31 per cent monthly of minimum wage multiplied by the number of employees (as at June 2000, the minimum wage was KGS 100 or US\$ 2.1 per month);
- Employer's share 7 per cent, deducted from the employee's wage;
- Royalty tax at up to 30 per cent on mineral extraction and processing; and
- Natural resources usage tax.

Social expenditures and pension system

Social spending, including expenditures of the social fund, makes up 28 per cent of the government budget and 7 per cent of GDP. However, poverty rates are high and protection of the poor is weak. The current IMF programme is designed to protect social expenditures from further fiscal cuts. Improved targeting is of key importance if high payroll tax rates are to be reduced in the future. In February 2000, the IMF approved the second-year programme under the current PRGF programme that covers 1998-2000. The government is cooperating with the IMF and the World Bank to develop a new Poverty Reduction Strategy Paper to be completed by March 2001. (See *Economic summary: Relations with the IMF* above.)

Kyrgyzstan is undertaking an ambitious pension reform in cooperation with the World Bank. Under the reform programme, the country aims to increase the retirement age, which is critical to the success of the programme, preserve the base pension and create individual pension accounts. The World Bank estimates that the reformed system will be financially viable over the medium term with a phasing out of budgetary transfers. (See *Financial sector* below.)

Major sectors of the economy



The Kyrgyz economy is undergoing gradual transformation to recover from the negative effects of the Russian crisis. The agricultural sector recorded growth in the first nine months of 2000 and provided a higher contribution to the GDP, maintaining a growth trend that started in this sector in the mid-1990s. Fluctuating trade relations with neighbours such as Kazakhstan and Uzbekistan have affected the development of the leading sectors and of exports. Mining and light industries play a considerable role in the economy, as Kyrgyzstan is rich in minerals. However, the services sector, created since transition began, may have the most potential as it is not burdened with any inheritance from the centrally planned Soviet economy.

Agriculture

Over the year 2000, agriculture has recovered its role as the backbone of the Kyrgyz economy. It has increased its share in the overall economy, benefited from economic reforms such as the freeing of prices, the restructuring of state agricultural enterprises, and the extension of land use rights. However, the sector is held back by lack of modern equipment, poor financing and low quality infrastructure. Yet the overall agricultural sector expanded about 10 per cent in 2000 and provided a higher rate of contribution to GDP (about 45 per cent in 2000, compared with about 38 per cent in 1999). It accounts for 50 per cent of employment. The sector has a role to play in helping to alleviate poverty in the country.

Agriculture is a priority development sector for the government, which aims to increase production levels to meet domestic needs and export any surplus. Increasing net export income in agriculture would consolidate the sector's position in economic development. Stimulating an active agribusiness sector through improved efficiency is another government objective.

Land reform

The government has embarked upon a land reform programme although it sometimes faces parliamentary challenges. However, the amendments to the Constitution allowing private ownership has led to a significant increase in productivity and was an important step in implementing the land reform. Ninety per cent of all farms are now privately owned. Steps are being taken to ensure that the right to use land is legally safeguarded and transformed into a property right, allowing land to be freely transferred, inherited and used as collateral. A comprehensive application of land tax to the actual land value would substantially improve state revenue collection. Kyrgyzstan has large areas of under-utilised or unused agricultural land, particularly in the north. Better use of land could be promoted by imposing a more comprehensive land tax that increases the cost of not using land productively.

A US\$ 9.42 million Land and Real Estate Registration Project is

being implemented with the support of the World Bank, which, among other IFIs, is advising the government on extending land reform and on the sale of land held by the Land Redistribution Fund, the agency responsible for land reform, in order to reach its targets in agriculture. Dissolution of state and collective farms and newly emerged varied farm ownership require operation and maintenance responsibility, an issue which will be addressed by the World Bank project. The project aims to develop markets for land and real estate and encourage more intensive and effective use of land through a solid registration system. Under the project, a total of 50 local offices will be opened under the State Registration Agency, GosRegistr. Land reform is advancing, making it easier to lease land. It is set to further contribute to the development of the agricultural sector, which has grown relatively quickly over the past three years. Reforms in this sector relating to the ownership of land seem to be yielding results.

The main agricultural product is grain, followed by vegetables, cotton and tobacco. Adverse weather conditions and an unprecedented drought in the region yielded lower than expected production levels in 2000. However, some crop yields increased. In 2000, the area sown to tobacco increased to 14,700 hectares from 12,200 in 1999.

Food and drink processing

Wimm Bill Dann (Russia) plans to invest US\$ 5 million in the development of milk and juice production in Kyrgyzstan. The company, which has dairy plants across Russia, already holds 42 per cent of shares in the Bishkeksut dairy plant and is aiming for a controlling stake. Coca-Cola, the world's largest soft drinks producer, opened a plant in 1997 with a capacity of 24,000 glass bottles and 7,000 plastic bottles per hour. The total investment was around US\$ 20 million. Additional investment of around US\$ 15 million was made in 1998. Coca-Cola's investment comes 5 per cent from its US-based parent, 90 per cent from a Turkish affiliate and 5 per cent from the Kyrgyz side.

Tobacco processing is an attractive area for foreign investors. A German-Kyrgyz joint venture, Reemtsma-Kyrgyzstan, is manufacturing cigarettes to meet the country's annual cigarette demand, estimated at 7 billion. After the acquisition of Kyrgyzstan's only cigarette production plant in 1998, Reemtsma started building a new factory, which is scheduled for production start up in 2001. As a result, sales have more than doubled compared to 1998, and Reemtsma has gained the market lead with a share of about 35 per cent.

There are several government projects under way to boost agribusiness, supported by international financial institutions. The Agriculture Area Development Project, worth a total of US\$ 45 million, to which the Asian Development Bank (ADB) has contributed a concessional loan equivalent to US\$ 36 million, aims to develop agribusiness in the Chui region in the north. The balance of costs is being met by the government and beneficiary farmers. Of the total project cost, US\$ 7 million will be used to develop agribusiness, US\$ 12.5 million to strengthen agribusiness materials and technology, and US\$ 21 million to upgrade the irrigation systems. The Chui region has been selected for investment because it accounts for 30 per cent of the country's agricultural output, has high potential for agricultural growth and is the focus of other investments designed to raise farm productivity. Agriculture in Chui depends on irrigation, but there is a lack of well-regulated water inflows. This project aims to increase the income of farming households threefold to US\$ 50 per hectare of irrigated land over the next decade. It complements a World Bank project to provide other agricultural support services. The two IFIs are forming a joint implementation unit for drainage and irrigation, and the World Bank is considering extending a US\$ 8.4 million credit line for the further development of irrigation systems in Chui Valley. The ADB will extend some US\$ 180 million credit over the next three years for the development of the agro-industrial complex in Kyrgyzstan. Kyrgyzstan's Agricultural Financial Corporation also extends cheap credits to farmers.

In June 2000, both the Land Registration Project and an on-farm irrigation project were approved by the World Bank. The World Bank's ongoing irrigation project is worth US\$ 20 million. The project is designed to improve the irrigation system on 160,000 hectares across the country's administrative regions.

Comprehensive Development Framework

Kyrgyzstan is also a pilot country in the World Bank's Comprehensive Development Framework (CDF). The CDF takes a holistic approach to development and seeks a better balance in policy making by highlighting the interrelationship between all elements of development – social, structural, human governance, environmental, economic, and financial. Under this approach, the Kyrgyz government is designing and defining its Kyrgyz 2010 Vision with the active participation of key domestic actors – parliament, civil society, the business and international communities – and is developing the first National Poverty Reduction Strategy. The objectives of the World Bank's assistance programme for the Kyrgyz republic in agriculture is basically to facilitate restoration of economic growth, particularly in the rural sector. To this end, The World Bank has various projects, among which is an Agricultural Privatisation and Enterprise Adjustment Credit to support the government's programme to demonopolise agro-conglomerates, develop land markets, and eliminate remaining trade and price distortions.

Cotton and textiles

Large state-owned enterprises in the wool, silk and cotton industries will be privatised under the large-scale enterprise privatisation programme. The wool, cotton and silk industries are dominated by a number of large enterprises located in the industrial centres. The most important production sites are Bishkek (woollen yarn and fabrics), Osh (cotton fabric and silk), and Tokmok (wool scouring and yarn manufacture).

Camco Corporation (UK), which owns a controlling stake in the Kasiet Spinning factory, aims to increase production to 3,500 tonnes a year, and also aims to diversify its activities in the country. Henrich Glaiser Textile Company (Germany) has built a cotton oil plant in the south, with a processing capacity of 10,000 tonnes of seeds per year. The company started its operations in Kyrgyzstan in 1998, since when it has invested about US\$ 15 million.

Crop yields, as at September 2000

Crop	Total harvest, tonnes	% change over 1999
Cotton	72,300	+100
Tobacco	25,000	+20.9
Grain	1,390,000	-5.7
Vegetables	585,700	+16

Mining and metallurgy

The industrial sector is dominated by mining and metallurgy, which make an important contribution to the economy. Mining alone contributed about 21 per cent of GDP in 1999. Kyrgyzstan has substantial coal deposits, two significant gold deposits and many medium and small sized ones, as well as deposits of mercury and antimony, marble quarries and mineral resources used in the ceramics industry. There are also rich tin and tungsten deposits as well as other polymetallic elements. The most important sub-sector is gold mining and processing, which is also the only sub-sector to have attracted foreign investment. Most of the gold production is exported.

Gold mining

Kyrgyzstan has important gold reserves and is the tenth largest producer and seller of gold in the world. Kumtor, the biggest gold mine, extracts about 18 tonnes of gold annually. During January-August 2000, it produced 12.9 tonnes of gold, up 6.6 per cent year-on-year. It is run by the **Kumtor Gold Company**, a Kyrgyz-Canadian joint venture and has the seventh largest gold reserves in the world. Cameco Gold (Canada) holds 30 per cent in the venture, and state-owned Kyrgyzaltyn 70 per cent. Financial support has been provided by a bank syndicate consisting of Chase Manhattan as the lead manager, the EBRD and the International Finance Corporation (IFC). The EBRD has advanced a US\$ 30 million senior loan and a US\$ 10 million subordinated loan to the Kumtor Gold Company for the development of Kumtor gold deposit, located in the Issyk-Kul region. Kumtor has underground reserves of an estimated 200 tonnes. It aimed to increase production to 20 tonnes a year in 2000, up 6.8 per cent from 1999. The joint venture is a major earner for the country, contributing roughly 6 per cent of GDP each year. The Kumtor project has demonstrated to the international community the viability of mining projects in the Central Asian region, and will help Kyrgyzstan attract investment, technology and management skills to further develop its mining industry.

The EBRD has also provided grant financing for a mining expert to assist the Kyrgyz government in the promotion of private foreign investment in a number of smaller viable mining investment opportunities and to assist Kyrgyzaltyn in the appraisal and negotiation of joint venture proposals.

The **Jerooy gold deposit** has been accessible and open to foreign investment since the commissioning of a high power transmission line and substation in the Talas region, north

western Kyrgyzstan, financed by the EBRD. (See *Energy* below). Kyrgyzstan's second largest deposit, Jerooy is believed to contain 66 tonnes of gold and is being exploited by the Jerooy Gold Company, a joint venture between Kyrgyzaltyn, Oxus Resources (UK), and Normandy Mining (Australia). Oxus and Normandy (Normandy owns 25 per cent of Oxus) have set up a company, Norox Mining, to participate in the joint venture. The mine has an operating life of an estimated 11 years, producing an average 6 tonnes of gold per year.

According to a "Soviet feasibility study", the Taldy Bulak Levoberezhny gold deposit holds about 34 tonnes of C1 and 41 tonnes of C2 grade gold, plus probable gold reserves of 50 tonnes. To develop the Taldy Bulak gold lode, in 1996 a joint venture was set up, JSC Taldy-Bulak Mining Company, in which Malaysian mining company Berhard owns 48 per cent of the shares.

Various foreign companies are exploring Kyrgyzstan's gold reserves. Hemco-Kyrgyzstan, a subsidiary of Hemco (US) plans to explore the Kuru Tegerek gold and copper deposit in the south. The project, due to start in spring 2001, is estimated to cost a total of US\$ 54 million. The reserves of the deposit are estimated at 7.5 tonnes of gold and 28,000 tonnes of copper. Barrick Gold (Canada) and Mideco (Japan) are also involved in geological prospecting in southern Kyrgyzstan. Kazakh mining investors are also very interested in northern deposits neighbouring their country. About US\$ 4 million in foreign investment was invested in geological prospecting in the country in 2000.

Metallurgy and ore processing

The volume of metallurgy in total industrial production is about 41 per cent. Almost all production is exported. Sub-sectors include the processing of gold, mercury, antimony, molybdenum and its alloys, silver and uranium.

Kyrgyzstan plans to double its uranium production over the next few years, through cooperation with Russia and Kazakhstan. Under a trilateral agreement between the three countries, raw material from the Chui-Sarisu uranium deposit in Kazakhstan will be transferred to the Kara-Balta Mining Complex for processing, and then transported to Russia for further processing. The Kara-Balta Mining Complex processes about 450 tonnes of uranium per year, operating at 35 per cent of capacity. Kyrgyzstan has signed an agreement with the Russian Atomic Energy Ministry for the development of Kyrgyz uranium deposits, including Zarechnoye. The uranium oxide will be processed and supplied

to Russia. Uranium production dropped 31.8 per cent in the first half of 2000 over the same period in 1999. Total output in 1999 was 460 tonnes, a 30.6 per cent increase over 1998.

Energy

Kyrgyzstan's giant power plants were originally built to meet the needs of the Soviet military-industrial complex, but the country can no longer make full use of these resources and lacks the necessary transmission grids, substations, and other infrastructure, which would require large investments. Restructuring and privatisation of the energy sector is now under way.

Kyrgyzstan has vast water resources originating from its mountain rivers, which are currently used at a capacity of about 10 per cent. Hydroelectric energy accounts for 20 per cent of the country's total exports. With the rapidly increasing energy needs of neighbouring countries, this sector offers opportunities for investment.

Generating capacity and potential

The country has 16 hydro power plants and two thermal plants with a total capacity of 14 billion kilowatt hours (kWh) per year, although at full capacity this could rise to 163 billion kWh, on a par with that of developed countries. The Toktogul hydroelectric power plant on the river Naryn alone has the capacity to provide for all domestic electricity and heating needs. It generates 1.5 billion kWh of electric energy a year, but could produce twice as much at full capacity. Given average world electricity prices of US¢ 50 per kWh, Toktogul has the potential to generate electricity worth US\$ 750 million a year, more than double the entire Kyrgyz budget. There are also other power plants on the river Naryn. The Kyrgyz government has an ongoing programme to develop a number of small and medium-sized hydro power stations and, on the recommendation of the IFIs, is seeking private participation in these projects. Significant investments into new hydro power stations also continues.

Electricity output increased by 22 per cent in 1999. A third of the increased production was exported to Kazakhstan and Uzbekistan, while the rest was used to economise on fuel imports. Kyrgyzstan continues to rely on neighbouring Kazakhstan and Uzbekistan for much of its gas and oil requirements, and supplies of gas from Uzbekistan have been repeatedly interrupted over the past years by payments disputes. Kyrgyzenergo, the state-owned energy company, exported more than US\$ 50 million worth of electricity to Uzbekistan and Kazakhstan in 1999, and energy exports grew by 30 per cent in the first nine months of 2000 over the same period in 1999.

Energy sector restructuring and privatisation

With World Bank and EBRD support, Kyrgyzenergo is being divided into generation, distribution and transmission units. The distribution network has been split into four regional distribution companies, of which at least one is on the privatisation agenda for 2001. One of the conditions of the World Bank programme is that electricity and heating tariffs are raised to cost-recovery levels by 2001, as the present unrealistic tariff structure has been an obstacle to development of the sector.

Privatisation is being carried out in three stages. The first stage, which is almost completed, requires the transfer of assets to local authorities and the formation of a consortium to complete the construction of Kambar Ata Hydropower Plant 1 and 2. The second stage envisages the privatisation of two service companies and of small hydroelectric stations with a capacity of 30 megawatts, as well as the transfer of their social infrastructure to the local authorities. The final stage will see the formation of Bishkekteploset as a joint stock company responsible for the Bishkek heating network. This stage will also involve setting up three companies to handle production, transmission and sales, and another five regional companies to operate the transmission grid.

Regional cooperation in energy resources

Three countries, Kazakhstan, Kyrgyzstan and Uzbekistan, are heavily dependent on each other for their energy needs and for sharing water resources. For instance, the Dostyk canal, which provides water for the irrigation of cotton crops, is divided between all three as well as Tajikistan. The Kyrgyz Ministry of Agriculture and Water Resources signed an agreement with Kazakhstan in September 2000 for joint use of Kyrgyz hydroelectric facilities and to cover any costs incurred as a result of water used by each side. The agreement will come into effect in 2001. Kyrgyzstan, Kazakhstan and Uzbekistan also have an agreement on the joint use of water and power resources on the Naryn-Syrdarya river system and its cascades. Volumes of power and commercial details of the agreement are updated on an annual basis. Kazakhstan's Energy Grid Operating Company has commissioned a bridge reactor with a total capacity of 180 MW at the Zhambyl-500 substation. It will link up the Tashkent-Zhambyl-Shymkent (Kazakhstan)-Bishkek intersystem grids, ensuring reliable electricity supplies between the neighbouring countries.

In October 2000 Kyrgyzstan and Uzbekistan made a gas for water agreement, under which Uzbekistan will deliver 700 million cubic metres of gas to Kyrgyzstan. Kyrgyzstan will make 50 per cent of the payment by providing Uzbekistan with water for 2.2 billion kWh of electricity production.

Talas transmission network improvement project

To ensure a more reliable electric power supply to the Talas region in north-west Kyrgyzstan, in December 1997 the EBRD extended a US\$ 24.7 million sovereign-guaranteed loan to Kyrgyzenergo. The state-owned power company Kyrgyzenergo is responsible for power generation, transmission and distribution, as well as national heating systems in Kyrgyzstan. The total cost of the project was US\$ 30.2 million, with co-financing provided by Kyrgyzenergo, the Swiss government and EC Tacis.

Through this project the EBRD set a major precedent in the Central Asian energy sector by contributing to the ultimate privatisation of a key service provider. The loan was designed to support progress towards private management of power distribution, one of the first such events in the region. The EBRD's focus is to improve the quality of power supply to both residential users and small and medium-sized industries in a promising area for tourism. Privatising the distribution system will also improve collection of electricity payments, reduce commercial losses, attract investments and encourage private financing in the sector.

The Talas project consists of the construction of about 80 kilometres of 220-kilovolt power transmission line to connect the Talas region to the main Kyrgyzenergo power transmission grid. Some 150 jobs are believed to have been created as a result of the loan, mainly for construction works. In the longer term, the future development of private industrial and commercial activities, including a gold mine, silver mines and agro-industries will generate employment in the region.

By the beginning of 2001, the project had been physically completed on time and below the budget. In addition to technical and commercial benefits, implementation of the project ensured the development of expertise in managing complex power projects, international reporting and management information systems and operational/financial management of the project and company.

In 2000, an EBRD-funded privatisation adviser was selected through a competitive tender to assist the State Property Fund and the utility in the restructuring of the power distribution sector and the private operation of at least one distribution company. In line

with conditions for the Talas sector restructuring, in 2001 the Kyrgyzenergo shareholders meeting decided to establish four distribution companies. The privatisation adviser will now prepare to offer one of the four companies for private operation.

The environment is also expected to benefit from the project through reduced cutting of wood for heating, thus preventing deforestation. In addition, the project will lead to reduction in air pollution, especially in homes due to substitution of electricity for high polluting fuels such as coal.

The project is the EBRD's second loan to Kyrgyzenergo. The first, for transmission network improvement, agreed in May 1995, was completed ahead of schedule at the end of 1997 and below cost estimates and supports the development of the Kumtor gold mine by providing it with a reliable electricity supply. Under the first project, the government converted the state power holding company to a commercial joint stock company. Kyrgyzenergo also established a commercial management information system with the assistance of international experts, and increased tariff levels.

Telecommunications

Reform of telecommunications is relatively well advanced. A new telecommunications law was enacted in 1998 and an independent regulator established. However, tariffs remain well below cost-recovery levels and the government is being advised by IFIs such as the IMF, the World Bank and the EBRD to raise the rates to a more realistic level. The telecommunications market is open to both foreign and domestic investors. A National Communications Agency, established as an independent regulatory agency, supervises the sector to guarantee fair competition.

The market is dominated by the national telecommunications operator, JSC Kyrgyz Telecom, which is undergoing privatisation. A tender for the sale of 40 per cent of Kyrgyz Telecom, specifying investment commitments of at least US\$ 500 million, was run in the third quarter of 2000. At the end of October, the government prepared a new tender, after finding the earlier bids too low, amending the terms of the previous tender and dropping the requirement for a compulsory investment of US\$ 450 million in the company over the next 10 years. However, the investors will be required to increase the telephone line capacity by 500,000. The EBRD and the World Bank are considering investing in Kyrgyz Telecom once all legal issues have been resolved with the past bidders, which would make the company more attractive to investors. Kyrgyz Telecom is now slated for privatisation in 2001. By January 2000, national telephone penetration had reached nine lines per 100 persons, representing a density of 25 per cent in Bishkek and 6 per cent in the rest of the country.

Following its reorganisation in 1997, Kyrgyz Telecom's first modernisation project was to build a digital network. A new satellite (standard "A" type) earth station, with compatible switching, digital microwave and optic transmission equipment, has been built by Intelsat (US). Intelsat will also set up a digital data transmission system in the Osh region as part of a regional (Osh-Batken) telecommunications modernisation programme worth US\$ 8.7 million. The Kuwaiti government financed the project in cooperation with Kyrgyz Telecom.

Another project that is nearing completion is the construction of the Trans-Asian-European fibre-optic communication line (NRL), which will connect Kyrgyzstan to modern international communication systems and other networks. The NRL will connect Shanghai (China), and Frankfurt (Germany) passing through Poland, Turkey, Iran, Kyrgyzstan, Uzbekistan and Kazakhstan. Siemens (Germany) will take part in a different project to connect the Kyrgyz networks to transnational fibre optic networks.

Internet services

Major improvements in telecommunication systems have increased the number of Internet users in Kyrgyzstan. According to the State Committee on Managing State Property and Attracting Direct Investment, Kyrgyzstan has the highest number of direct Internet subscribers in Central Asia, about 7,000 in July 2000, up from about 3,000 at the end of 1999. Two companies lead the market, Elcat and Asiainfo. However, competition is increasing. By July 2000, Kyrgyzstan had eight commercial Internet service providers (ISPs). Kyrgyz Telecom plans to become an ISP in the near future. It will further increase competition, reducing the prices which are currently at around US\$ 30 per month for unlimited access. It plans to introduce by-time telephone tariffs for Internet use, which could lead to its wider popularity. The total modem pool for ISPs is around 500 modems. For corporate clients, providers offer a dedicated channel. There are also two non-profit ISPs: KyrNet, funded by the Soros Foundation, and FreeNet, sponsored by USAID and IREX. Non-profit providers give access to NGOs, educational and scientific institutions and mass media. The Kyrgyz government is also active in the Internet area. It is taking part in a UNDP project entitled Governance Strengthening and Public Administration Reform under which a Public Administration Information Net has been created to connect all state organisations, some educational institutions and libraries to an Intranet which has access to the Internet via Elcat.

According to the Ministry of Transport and Communications, there are about 8,000 modern computers in state organisations and local administrations in Kyrgyzstan. Annual growth in the number of Internet users of about 7,000 is estimated in the coming years, and the total is believed to have reached 10,000 by the end of 2000.

There are currently 270 registered domains in the country. Domain registration is carried out by Asiainfo. State organisations, educational institutions, companies, NGOs, banks, the stock exchange, and mass media all have web sites. There are also electronic versions of several papers, magazines, and radio stations, and free e-mail servers. Electronic commerce is not yet fully developed and will require a better electronic payments system, more Internet users, greater purchasing power, and more efficient delivery systems before it can take off. However, the government has launched a training programme entitled "Experts of the 21st Century" under which the whole educational system will be reformed accordingly and schools will be equipped with computers.

There are also operators providing mobile cellular communications, radiotelephony and paging, independent TV and radio stations. Although Kyrgyz Telecom has an exclusive licence for inter-city and international communications until 2003, other services are provided on a competitive basis. There are two

cellular phone operators, Katel, a Kyrgyz-US joint venture, which provides AMPS standard services, and Bitel, which operates GSM standard cellular communication services.

Transport

The development of secure, reliable links, by road, air and rail is a high priority for the country's economic progress. Ambitious projects are being identified and implemented to improve all aspects of transportation in a direct move to boost economic activity. The IFIs are also involved in various transport projects.

Road transport accounted for about 60 per cent and railways for 40 per cent of shipping for Kyrgyz exports in the first half of 2000. Seventy per cent of imports were shipped by rail, and 28.9 per cent by road.

Development of a regional transportation system

Kyrgyzstan is affected by the interdependent structure of Central Asia's transport networks. Any disruption to cross-border transport services can have a damaging effect on trade and travel. Therefore, development of a regional transportation system is of priority among the Central Asian states, who need to focus on upgrading their transport networks to increase trade with each other and other neighbours such as China, Iran, Turkey and Pakistan. Economic links between the Central Asian countries are hampered by the awkward legacy of the Soviet-era transport system. Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan need to adapt a transport network that was in place when the five former Soviet republics were oriented exclusively toward Russia.

There were no rail or pipeline connections to the south as all transport links led north to Russia or through the Caucasus. The fact that transport networks in Iran, Pakistan and Turkey have also long been oriented to the south towards ports on the Indian Ocean and the Mediterranean Sea, rather than towards Central Asia, has further complicated the situation. Such physical difficulties stand in the way of a rapid expansion of intra-regional trade and the development of new outlets for Central Asian trade on world markets. This physical structure and the northern orientation of the transport infrastructure are influencing post-independence trade flows. Oil and gas exports from Kazakhstan and Turkmenistan, for example, continue to flow to the CIS, despite some disadvantages.

The most urgent area for reorientation is the rail network, which was the most important part of the old Soviet transport system. The Central Asian republics are linked to one another and to the rest of the FSU by a few key routes, which do not always take republic borders into account. The railway from Osh, the second largest city in

Kyrgyzstan, to Bishkek passes through Tajikistan, Uzbekistan and Kazakhstan before re-entering Kyrgyzstan just before Bishkek. However, railroads, like pipelines, are expensive to build, and networks are only being modified slowly. To give another example, Turkmenistan is limited by a pipeline network that runs through Russia, leaving it dependent on formerly Soviet customers who have often failed to pay their bills for gas. Kazakhstan and Kyrgyzstan have also had disputes over unpaid rail transit bills, leading to closure of common borders. For lack of alternative routes, Kazakh oil is transported through a Russian pipeline company. A large proportion of oil from the Tengiz field is shipped by train to the Baltic ports or across the Caspian Sea by barge and then by train to Black Sea ports as the only, expensive alternative.

The poor condition of roads is another problem for increasing trade volumes. The least limited mode of transport and least bound by history is by air, but it is expensive. Although the aviation networks are still dominated by intra-CIS flights, the national airlines have established some international routes and are making steady progress in this respect.

In order to tackle these problems, more investment and cooperation are needed in the maintenance and upgrading of roads, railroads, and pipelines before the existing system comes close to collapse. Improving the roads will yield the most immediate benefits. The Lugovoye-Bishkek-Balykchy railway route and the Andijan-Osh-Irkeshtam road route have been singled out as priority projects by the relevant governments. They have also agreed to set up working groups to coordinate the implementation of each project and help resolve any issues involved.

The leading IFIs are also involved in regional transport projects. The EBRD and other financial institutions including the Asian Development Bank and the Japanese Overseas Economic Cooperation Fund have been instrumental in trying to rehabilitate much of the infrastructure. The main initiative for the whole region is the TRACECA programme, launched by the EU eight years ago to create a Europe-Caucasus-Asia transport corridor – the revival of the Great Silk Road. The programme is regarded as being of the utmost priority for the development of future trade and acts as an umbrella for projects benefiting from multilateral and bilateral financing. Its aims are to be achieved through close economic integration of the participating nations, as well as rehabilitation of existing, and establishment of new transport infrastructure that is economically viable and environmentally safe. This includes pipelines, railways, air-traffic routes, and telecommunications lines. Ideally, the future corridor will connect Almaty, Bishkek, Ashgabat, Baku and Tbilisi to Japan and China to the east, and France, the UK and Spain to the west. The EU estimates that annual freight turnover via the new Silk Road will double to 34 million tonnes by 2010.

Road

A number of priority investment projects have been identified to modernise Kyrgyzstan's road network. Among the major highway projects are:

- Reconstruction of the Bishkek-Osh highway, linking the north and south of Kyrgyzstan;
- Reconstruction of the Osh-Sarytash-Irkeshtam highway (under the TRACECA programme);
- Reconstruction of the Osh-Isfahan (Iran) highway (under the TRACECA programme);
- Reconstruction of the Bishkek-Torugart road which will eventually establish a link between Kazakhstan, China and Pakistan;
- A link road around Lake Issyk-Kul which will help increase tourism;
- Reconstruction of the Jambyl (Kazakhstan)-Talas-Susamyr highway, linking the Chui, Osh and Jalal-Abad regions, the north and the south of Kyrgyzstan; and
- Reconstruction of the Almaty-Bishkek-Tashkent highway. Kazakhstan and Kyrgyzstan are undertaking a joint project to improve the quality of the Almaty-Bishkek highway. The project will be supported by the Asian Development Bank, which will extend a US\$ 65 million credit, with financing of US\$ 22 million from the Kazakh government.

The World Bank is providing concessional financing of US\$ 22 million for a local urban transport development programme designed to modernise public transport infrastructure in Bishkek, Osh and Jalal-Abad by rehabilitating roads and developing financing mechanisms for road maintenance. The Kyrgyz government will contribute US\$ 2.2 million to the project.

Rail

Joint construction projects are being explored for the Kemin-Almaty railroad link. A new railway link to China is also under serious consideration linking Osh with the province of Xinjiang, China. It will be further extended to China, where a railway route as far as to Kashgar-Korla was put into operation by the Chinese authorities in 2000.

Air

Manas airport, which serves Bishkek, has installed new immigration control systems at a cost of US\$ 1 million. A major upgrade of the airport was completed at the end of 1999, with construction firms Hochtief (Germany) and ITI (Italy) taking part. The airport now serves as an international transit point for passenger and cargo traffic. Modernisation of Manas airport was financed by OECF (Japan). A similar immigration control system will also be installed at Osh Airport, the country's only other international airport.

Easterlink Lanker (UK) is considering buying a 75 per cent stake in Aba Joldoru (Kyrgyzstan Airlines), the national carrier. If the deal gains government approval, Easterlink will win a 25-year management concession, assume the airline's debts, and seek credits for investment to prepare the company for privatisation. The airline's financial position has improved since 1999 and in the first half of 2000 it made a net profit of US\$ 230,000. Its main problem is an outdated fleet, to update which US\$ 200 million is needed. Original government plans to privatise Kyrgyzstan Airlines ran into opposition from parliament. However, the government has slated privatisation of Kyrgyz Airlines for 2001.

Currently, there are two international companies providing dependable, regularly scheduled international air service directly into Bishkek. Turkish Airlines via Istanbul and British Mediterranean (a franchise/subsidiary of British Airways) via London/Tbilisi each run services twice a week. Lufthansa is currently running its own Almaty-Bishkek ground shuttle, and plans to launch a thrice weekly regular flight to Bishkek via Tashkent. Kyrgyzstan National Airlines connects Bishkek with Istanbul, Moscow, St Petersburg via Omsk, and Novosibirsk. TRANSAERO (Russia) connects Bishkek with Moscow and Kiev. Kyrgyzstan plans to increase its international air links. Talks are under way between Kyrgyzstan and Malaysia to establish regular flights between Bishkek and Kuala Lumpur to boost trade and tourism.

Other

Services

The services sector is the most promising area of economic activity in Kyrgyzstan. It offers good investment opportunities, as it is the most developed in Central Asia. Trade, finance and tourism in particular offer strong potential without requiring huge capital investments. Given Kyrgyzstan's relatively advanced reforms, it has the potential to become Central Asia's financial centre. With foreign expertise backed by foreign investment, the services sector could boom, bringing in net currency revenues for the country.

Light industry

Kyrgyzstan has a good base for light industry, which has promise for future economic development. It includes the production of textiles, knitwear, leather shoes, and a wide assortment of consumer goods. Kyrgyzstan is well supplied with raw materials such as cotton, wool, silk cocoons, and tanning materials, but is in need of foreign investment to develop the production base. According to the State Committee on Managing State Property and Attracting Direct Investment, an investment of US\$ 17 million is needed for the production of wool, cotton, and silk thread. Light industry has the potential to become an important sector for investors. Low labour costs and the liberal trade and exchange system offer advantages for labour-intensive industries.

Financial sector



Kyrgyzstan's banking system is small and suffers from a lack of public confidence as well as poor corporate governance. The central bank, the National Bank of the Kyrgyz Republic (NBKR), is making efforts to tighten regulations. Privatisation is planned for the two largest banks. A newly founded commercial bank, with EBRD support, is set to introduce western standards to the sector. The capital markets remain underdeveloped.

Banking sector

At the beginning of 2001, total capitalisation of the banking sector was around US\$ 21.4 million. Kyrgyz banks are far from functioning as financial intermediaries, as Kyrgyzstan is largely a cash society. With depositors having lost their money in failed banks, confidence in the banking system is low, and there is an apparent preference for keeping money “under the mattress” rather than in bank deposits. According to official statistics, 58 per cent of all the money in circulation is currently outside the banking system. The ratio of deposits to GDP is very low at 8 per cent.

Lack of a deposit insurance scheme also affects depositors' confidence. A draft law on setting up a deposit insurance scheme has been awaiting approval by the parliament since 1999. The banks are hesitant to contribute premiums to such a scheme due to perceived risks and do not want to pay cost compensation. The fact that various restructuring efforts undertaken by the NBKR did not go ahead as planned has added to public lack of confidence in the banking system and led to further dollarisation of the economy.

At present there are too many banks chasing too limited a level of capital and too few deposits. The banks are also burdened by a high level of bad debt. However, although the ratio of problem loans to total loans increased in the third quarter of 1999 to 25 per cent, it declined to 19 per cent in the second quarter of 2000. Although the net exposure of commercial banks to foreign exchange risk increased sharply in the first half of 1999, the commercial banks have taken steps to reduce their net exposure by increasing their foreign exchange assets. By the end of the first quarter of 2000, foreign exchange assets exceeded liabilities.

Management problems and insider loans have also had a bad effect on the sector. However, the liberalisation of the financial markets has increased the banks' ability to engage in a broader range of activities and has provided the necessary basis for a

smooth transition to a market environment from the Soviet-style state bank mentality and lending to state enterprises.

There are 22 commercial banks, of which all but two are private. The state-owned Kairat Bank was placed under the NBKR's control after failing in 1999, bringing the number of banks that have been placed under forced administration by the NBKR to six. Subsequently, three of them were liquidated, while the remaining two banks eventually recovered. At present only one bank is under the temporary administration of the NBKR. Although an international tender was opened for the privatisation of the Savings Bank in 2000, it has been postponed by parliament, implying that political pressure is hindering reform of the sector. Three of the 22 commercial banks are wholly foreign owned: KyrgyzDemir Bank (owned by Demir Bank of Turkey which is currently for sale, along with the IFC, the EBRD and FMO), Bank of Asia (owned by two private individuals from South Korea) and the National Bank of Pakistan, which opened in late 2000. There are a total of 155 commercial bank branches throughout the country, 48 of which are owned by the Settlement and Savings Company.

Banking sector reform

The NBKR is the main independent supervisory body for the financial and banking sector. The NBKR has powers to supervise the commercial banks, prepare draft laws concerning the sector for parliamentary approval and may decide as and when necessary to place any bank under its control or liquidate it. The NBKR is cooperating with the IFIs on sector reform to promote good practice in the banking sector. (See box.)

The minimum capital requirement set by the NBKR since August 2000 is KGS 50 million, or about US\$ 1 million, which is to be doubled by 31 July 2001. However, consolidation of the sector has not followed the raising of the minimum capital requirement as expected. The NBKR has not been able to enforce compliance with the capital requirements, partly because of political interference by those with vested interests.

Financial sector development support programmes

Efforts to improve the internal structure of the banking system are being supported by international financial institutions, working in cooperation with the NBKR. Under the provisions of the current Poverty Reduction and Growth Facility programme (see *Economic summary*) the IMF is advising the Kyrgyz government on financial sector reform as part of the general macroeconomic and structural reform. The NBKR is advised to strengthen liquidity forecasting by initiating short-term liquidity management and to develop a comprehensive restructuring strategy.

The World Bank is running a Financial Sector Technical Assistance Project worth US\$ 3.4 million that aims to strengthen the capabilities of key financial and regulatory institutions and to assist in the establishment of new, temporary institutions that will effect the restructuring/liquidation of major banks. It is also providing financing for a number of technical assistance activities designed to implement reforms in the financial sector, including advice on pension reform.

The Asian Development Bank has three financial sector projects under way at a total cost of US\$ 36.7 million, aiming to improve the efficiency of financial intermediation by promoting a sound, well-functioning and resilient banking system, to finance external audits of selected commercial banks, and broaden and deepen the role of the capital market to exploit alternative sources of funding.

After severe difficulties in 1998 and 1999 due to the Russian financial crisis and the ensuing currency depreciation, the NBKR took a number of measures to ensure stability and confidence in the banking sector and to rehabilitate and restructure it. However, its efforts to apply a case-by-case approach to restructuring did not yield the desired results. A recent important development has been the introduction of National Bank Bills in June 2000. This will provide an important instrument to manage the money stock, and also appeal to the commercial banks. Although reserve requirements have remained unchanged at 20 per cent, the compensation paid on bank's required reserves has been steadily reduced. In the past, the NBKR fully compensated banks for required reserves at the rate of each respective bank's weighted average cost of deposits. The level of compensation is now only 55 per cent.

In 2001 the NBKR intends to take measures to increase the reliability of commercial banks and to strengthen public confidence in them, and has declared stabilisation of the banking system as a priority task. To this end, it aims to ensure improved analysis of the financial condition of the banks, take necessary measures regarding troubled banks, and further develop the legislative and normative base regulating banking activity, through amendments to the existing laws and their proper enforcement. It also aims to improve the internal management of the banks, to privatise the Settlement and Savings Company and to restructure Kairat Bank.

The capacity of the banking sector to lend is limited. However, the founding of the Kyrgyz Investment and Credit Bank (KICB, see case study) is expected to revive the entire banking sector. It will not only provide a source of credits, but will also trigger some consolidation in the banking sector, and will be a foreign-owned but Kyrgyz bank, rather than a subsidiary of a foreign bank. By introducing western banking practices it is expected to have a demonstration effect on other banks, leading to development of the entire sector.

Non-bank financial institutions

Capital market development is at a very early stage. There are about 29 insurance companies in operation, but they are very small. The government is considering setting up some state-owned insurance companies. There are also about 14 investment companies, some of which were established during the voucher privatisation scheme. However, they are mostly inactive.

The stock exchange is small and limited, with little active trading. Although about 70 to 80 companies are listed, only 10 of them trade in very low volumes. In 1999 a presidential decree was issued restricting over-the-counter market transactions and stipulating that all transactions involving shares and registered securities should be provided by stock brokerage companies.

There is one state-owned and one private **pension fund**, and Kyrgyzstan has substantially reformed the pension system in line with World Bank recommendations. The reform has focused on strengthening the link between contributions and benefits and ensuring financial sustainability of the pension system.

Case study: Kyrgyz Investment and Credit Bank (KICB)

Strengthening the financial sector remains a key challenge in Kyrgyzstan. To help Kyrgyzstan achieve this goal, a number of IFIs and bilateral agencies, in cooperation with Kyrgyzstan, are establishing a new investment bank, the Kyrgyz Investment and Credit Bank (KICB). KICB will have a full banking licence and will develop as a full corporate bank providing commercial lending and other services to the Kyrgyz private sector, though the initial focus will be on commercial and project term loans, trade finance, short-term working capital and corporate deposits. The bank will be funded by equity and credit lines from IFIs and other agencies to be phased in gradually, as well as by deposits. Ultimately it is expected to have funds of up to US\$ 20 million available for lending.

KICB will have an estimated start-up capital of US\$ 7 million. The principal shareholder with management responsibility is the Aga Khan Fund for Economic Development with a 30 per cent shareholding. Deutsche Entwicklungs Gesellschaft (DEG, Germany), the IFC and the EBRD will have equal shares of 20 per cent. The Kyrgyz government will have a 10 per cent share. The Japan-Europe Cooperation Fund is providing US\$ 3 million to fund the bank's start-up costs and to pay for expatriate management and banking experts in the first three years.

KICB will be established as an effective commercial bank, designed to develop a profitable and balanced loan portfolio, and also other fee services, such as trade guarantees and documentary credits. A core group of local professionals will be trained by the expatriate staff and other short-term specialists who will help set up procedures and systems. The staff of KICB will be trained to recognise good investment opportunities, and companies with good ideas and sensible business plans and help these companies to develop. The bank is expected to have transition impact by supporting an increase in the availability of private sector financing through the banking system. The introduction of term lending and other corporate services will demonstrate the potential in this area to existing local banks. The presence of the EBRD and other shareholders will encourage other bank investors into the market. KICB will not only provide support to the country's developing commercial and industrial sectors but also set an example for other banks to follow. The management team for KICB is in place and the licensing process is nearly complete. The equity capital should be subscribed by the end of April 2001 at which stage the bank will be fully operational.

Conducted in stages since 1997, this reform has been successful in increasing contributions (in August 2000 pensions increased by 20 per cent) and reducing benefits, thereby completely freeing the system of the burdening effects of the generous Soviet social security system and relieving the state budget. Although the state-owned pension fund still posts a deficit, a surplus is expected to be achieved by 2005. This surplus is to be used to reduce contributions and allow individuals to shift the freed-up resources to privately managed pension funds. The NBKR has requested IFI assistance to develop private pension funds. Some pilot projects are under consideration, particularly in cooperation with credit unions, which are developing rapidly, rising to about 190 in 2000 from only 83 in 1998. Although they are active, their funds are small. The main challenge will be to establish cooperation between various funds, and to develop them in rural areas.



EBRD activities in Kyrgyzstan

As at 30 December 2000, the European Bank for Reconstruction and Development (EBRD) had signed 12 investments in Kyrgyzstan with a total commitment of € 170.3 million. Four are in the public sector, with one project aimed at the modernisation of the telecommunications network, two projects focusing on upgrading parts of the electricity transmission network, and one project concerning agribusiness.

The private sector projects include two credit lines for small and medium-sized enterprises (SMEs), the development of the Kumtor gold mine, investment in BiStyle shoe factory, the refurbishment of an existing hotel in order to launch the Hyatt-Regency Hotel Bishkek, the establishment of Kyrgyz Demir Bank and a new bank KICB, and the trade facilitation programme for Kyrgyz commercial banks. The progress made with these investments was partly a result of the EBRD's technical cooperation programme, which has been targeted at the financial sector, natural resources, agribusiness and critical infrastructure bottlenecks (such as electricity transmission and distribution; modernisation of telecommunication).

Overview of EBRD activities and key objectives

The EBRD's fundamental objective in Kyrgyzstan continues to be the development of a dynamic private sector with a particular focus on SMEs, in consistence with the realities of the Kyrgyz economy. The Bank has focused on promoting:

- the reform and strengthening of the financial sector;
- the development of SMEs;
- public sector investments as a means of alleviating critical bottlenecks, or indirect support of the development of the private sector; and
- support for foreign direct investment, joint ventures and privatisation.

Key priorities:

Financial sector

After the successful implementation of the first SME credit line, a second credit line was signed with the National Bank of Kyrgyzstan in July 1998. In line with the previous SME credit line, resources are channelled through local participating commercial banks to finance SME projects. In 2000, the Bank decided to restructure its second credit line in order to introduce a micro-finance component, well adapted to the actual needs of the SMEs.

Further priorities include investments to increase the overall capitalisation of selected private sector banks, the successful launching of the newly implemented Kyrgyz Investment Credit Bank, able to provide middle-term financing, a participation in

the privatisation of the Saving & Settlement Company along with a strategic investor, and the development of trade finance capacity.

Privatisation

Implementation of the Enterprise Investment Demonstration Programme is under way to facilitate the full privatisation of selected medium-sized former state enterprises through the provision of equity, term finance and measures to improve management. The EBRD will continue with its efforts to work with the government to adopt best practice privatisation programmes in key sectors, such as telecommunications, finance and power distribution.

Agriculture and agribusiness

The EBRD will continue its attempts to identify opportunities in input supply, distribution and agro-processing using various financial tools and facilities such as the Direct Investment Facility, etc.

Energy and natural resources

The Talas power transmission project started its construction phase in 1998 and was completed in August 2000 to facilitate the commissioning of the Jerooy gold mine planned to proceed in 2001. The EBRD would like to support the financing of the gold mine. A privatisation initiative in the power distribution sector is likely to develop as a condition of the Talas transmission line project. The Bank will continue to work on a number of projects in the mining, oil and gas sectors with the potential for significant impact on the economy.

Signed projects as at 31 December 2000

Telecommunications

Kyrgyzstan's first loan from the EBRD, agreed in June 1994, was for US\$ 9.4 million to modernise the telecommunications infrastructure. The borrower was Kyrgyz Telecom, the state-owned telecommunications enterprise. One of the main aims of the project was to encourage the corporatisation of Kyrgyz Telecom to enable it to operate in a new commercial environment, and the loan was supported with technical cooperation funds of US\$ 1.5 million to develop the necessary organisational, financial and strategic planning skills within the

company. Another aim was to establish an effective regulatory and policy framework for further development of the telecommunications sector.

The loan was used to make priority investments to provide international access and to upgrade transmission links between the capital Bishkek and other cities within Kyrgyzstan. It was co-financed with the World Bank's International Development Association, which made a parallel loan of US\$ 18 million.

The Bank is also involved in the preparation of mobile communications projects, along with strategic investors.

SME Credit Line

In February 1995 the EBRD made a loan of US\$ 10.5 million to the National Bank of Kyrgyzstan to administer a credit line for SMEs. The project, which has been fully disbursed, aims to support both the private sector and the banking sector by providing foreign currency financing to eligible private domestic enterprises and by supporting the development of local commercial banks, which on-lend to local enterprises.

The first SME credit line was successfully implemented, and in July 1998 a second credit line (US\$ 20 million) was signed with the National Bank of Kyrgyzstan. Both projects have a large technical cooperation programme, which helps enterprises develop and implement their investment projects, supports the institution-building of the local participating banks, and helps the National Bank of Kyrgyzstan to implement the project.

Transmission network improvement projects

In May 1995 the EBRD made a sovereign loan of US\$ 38 million to the Kyrgyz Energy Company to finance the upgrading of the electricity transmission network in the Issyk Kul area of Kyrgyzstan (which includes the Kumtor gold mine). The project included the construction of a new power line to ensure a reliable supply to Kumtor and to improve the quality of the supply to other consumers in the region. The EBRD has also provided technical cooperation to assist in the commercialisation of the Kyrgyz Energy Company. The project was completed five months ahead of schedule and more than US\$ 4 million below the original cost estimate.

In December 1997 the EBRD made a second loan of US\$ 24.7 million to the Kyrgyz Energy Company to improve the transmission and distribution network in the Talas region. The project supports private involvement in power distribution in Kyrgyzstan as part of a restructuring of the power sector. Co-financing was provided by the Swiss government and EC TACIS. The project was successfully completed in October 2000.

Kumtor gold mine

The EBRD has advanced a US\$ 30 million senior loan and US\$ 10 million as a subordinated loan for the development of the US\$ 450 million Kumtor gold mine. The Kumtor operation continues to lead EBRD's mining portfolio in terms of good environmental and safety performance, the latter exceeding the Canadian industry average performance.

Following the cyanide spill in May 1998, the Bank launched the TC programme and the "Community and Business Forum" was established as an independently funded and facilitated initiative to develop an informed dialogue process. The programme was successfully operated in 2000 and as result of it, IFC signed the contract for Year 2 using DFID Trust Funds.

Kyrgyz Agribusiness Company

In 1995 the EBRD committed US\$ 9 million for the creation of the Kyrgyz Agribusiness Company (KAC), a private company set up to provide essential agricultural goods, farm equipment, storage facilities and extension services. The project has encountered serious difficulties and the Bank initiated bankruptcy procedures in accordance with Kyrgyz legislation. Based on the Kyrgyz government's request, the Bank's loan was restructured into a US\$ 6.8 million sovereign guarantee debt in 2000.

Demirbank

In November 1996 the EBRD made an equity investment of € 0.4 million in Demirbank, a Turkish bank, which was the first foreign bank in the country. The equity investment was co-financed by FMO and the International Finance Corporation.

Hotel Kyrgyzstan

In November 1997 the EBRD committed a loan of US\$ 8 million to Italkyr, a Kyrgyz joint-stock company supported by the international hotel operator Hyatt International Corporation. The loan will be used to reconstruct Hotel Kyrgyzstan, an existing hotel located in the centre of Bishkek, converting it into a five-star international standard hotel, at a total project cost of US\$ 27 million. This will provide the country with vital accommodation for international business travellers, thereby supporting private sector development and foreign investment. The hotel will also support the development of the nascent tourism sector.

The project will support the privatisation of Hotel Kyrgyzstan, which was formerly owned and operated by the state. Representing the first limited-recourse financing of a sizeable hotel development in Central Asia, the project will not benefit

from any sovereign or export credit guarantees, and will have a strong demonstration effect for financing other hotel developments in the region. The project also includes technology transfer in the construction industry and the development of skills in customer services, marketing and catering management for hotel employees. This project will be fully completed in March 2001.

Enterprise investment demonstration project

In December 1997 the EBRD's Board of Directors approved equity and loan financing of € 1.3 million for investment in selected local companies with significant commercial potential, with the aim of assisting in their transformation into competitive and profitable market-oriented companies. The selected companies so far are a shoe factory and a woollen textile producer; others are under consideration. The transformation will demonstrate to local industries and prospective investors the value of modern management and financial management practices.

This is the first project to help locally owned Kyrgyz enterprises become market-oriented companies. Through its combination of investment and technical cooperation, this project will develop modern industrial technology, management, marketing and accounting skills in the investee companies. A further objective is to prepare these companies for attracting private foreign investors.

Kyrgyz Investment Credit Bank (KICB)

In July 2000 the EBRD's Board of Directors approved the KICB project. KICB is expected to provide medium-term debt financing in the range of US\$ 250,000 to US\$ 1.0 million to private sector enterprises with strong balance sheets in local terms, with well considered business plans, specific and justifiable proposed applications of funds, strong management, and good growth prospects. Where appropriate, co-lending opportunities will be developed.

KICB is capitalised at US\$ 7 million. Aga Khan's AKFED is the main investor, along with EBRD, IFC, DEG and the Kyrgyz government. It is anticipated that credit lines from various sources, including IFIs, will be channelled through KICB so that the total resources of KICB will be in excess of US\$ 20 million after one to two years.

Trade Facilitation Programme

In 1999 the EBRD launched a new Trade Facilitation Programme covering all 26 of the Bank's countries of operations. This streamlined new programme is designed to meet the needs of the changing environment in central and eastern Europe and the Commonwealth of Independent States (CIS).

The principal objective of the trade facilitation programme is to issue guarantees in favour of international confirming banks to guarantee all or part of the obligations of local issuing banks acceptable to the EBRD and arising under eligible trade finance transactions. In November 2000 the EBRD approved TFPs for two commercial banks in Kyrgyzstan (Demir Kyrgyz International Bank and Eridan Bank) for the amount of US\$ 1.5 million.

Contact names

David Hexter

Business Group Director for Russia and Central Asia
European Bank for Reconstruction and Development
One Exchange Square
London EC2A 2JN
United Kingdom
Tel: +44 20 7338 6617
Fax: +44 20 7338 7590

Michael Davey

Country Director
EBRD Resident Office
10a Abay Street
8th Floor
480013 Almaty
Kazakhstan
Tel: +7 3272 632 247
Fax: +7 3272 811 424

Fernand Pilonel

Head of Office
Kyrgyzstan Resident Office
26 Geologicheskaya Street
720005, Bishkek
Kyrgyzstan
Tel: +996 312 53 00 16
Fax: +996 312 66 62 84

Signed projects as at 31 December 2000 (in € million), exchange rates as at 31 December 2000

Operation name	Sector	Total cost	EBRD debt	EBRD equity	EBRD total
Private sector					
Kyrgyzstan Credit Line	Finance	11.0	11.0	0	11.0
Kyrgyzstan Credit Line II	Finance	20.9	20.9	0	20.9
Kumtor Gold Mine	Natural Resources	472.3	31.3	7.8	39.1
Kyrgyz Agribusiness Company	Agribusiness	22.4	8.5	0	8.5
Demirbank	Finance	9.4	0	0.4	0.4
Hotel Kyrgyzstan	Tourism	24.5	8.4	0	8.4
Bistyle (formerly investment in New Kadam)	Manufacturing	1.4	0.7	0.6	1.3
Kyrgyz Investment Credit bank	Finance	19.5	3.0	1.3	4.3
Trade Facilitation Programme	Trade finance	1.5	0	0	1.5
Subtotal		582.9	83.8	10.1	95.4
Public sector					
Kyrgyz Telecommunications	Telecommunications	28.6	9.8	0	9.8
Transmission Network Improvement Project	Power and Energy	58.0	38.8	0	38.8
KAC restructuring	Agribusiness	6.3	5.3	0	5.3
Talas Transmission Network Improvement Project	Energy transmission	29.7	25.8	0	25.8
Subtotal		122.6	79.7	0	79.7
Total		705.5	163.5	10.1	175.1
of which private					54.5%
of which public					45.5%

