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Local Content Development in Mining

Opportunities and Challenges in Kyrgyzstan

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1. Executive Summary

Mining as an industry has been described as one wing of the Kyrgyz economy. It accounts for 8% of GDP, 11% the State budget and provides almost half of the industrial output of Kyrgyzstan (Mogilevskii, 2016).

In spite of the already import contribution of mining to the Kyrgyz economy, an even larger benefit to more stakeholders could be realized through the increase in local procurement and local content.

When a mine is to open in a community a community immediately expects two benefits: employment opportunities at the mine, and to be able to sell goods and services to the mine. In general, local employment is more straightforward as there are strictly defined requirements for skills, education and experience that must be met for professional positions, and unskilled jobs that do not have such strict requirements can be filled by those with a minimal level of work ethic.

With no current legislative requirements in place, mining companies have taken a range of approaches to local procurement, from strategic to opportunistic, with varying degrees of success. Often times this can depend as much on the level of scrutiny attached to the mine and how local procurement is communicated as the overall impact or benefits. The type of mine is also impacting community expectations, those being higher for gold and other precious metals than for coal or construction materials such as lime.

In order to achieve the benefits that stakeholders, including government, communities and mining companies expect, a more strategic approach to local content and procurement is required. Although many challenges exist, such as the nature of the goods and services available or produced in Kyrgyzstan, the benefits that can be achieved are too great to be ignored, and can greatly enhance the economic impact from mining in Kyrgyzstan, and help to reduce conflict that currently exists.

This report, compiled through stakeholder interviews, literature review and personal experience in Kyrgyzstan, describes the activities that have been undertaken to date by mining companies, the challenges that are faced at the current moment, and lays out a number of steps that can be taken by stakeholders in order to increase local content in the mining sector in Kyrgyzstan.

The recommendations as they stand can be taken up by stakeholders individually, but in order to achieve full potential from local content development, a more cohesive and strategic approach is warranted. In this regard, it is proposed to hold a stakeholder forum on the basis of this report, whereby stakeholders can debate and discuss the issues, challenges and opportunities from their point of view, and hopefully come to a collective decision as to how best to proceed in a strategic and industry wide manner.

2. About this Report

a. Objective

This report was prepared at the request of German Development Cooperation (GIZ) as part of their Mineral Resources for Development program to support the development of local content in the Kyrgyz mining sector. Since 2015, GIZ has been implementing this program in Kyrgyzstan, Kazakhstan and Tajikistan with the aim of bringing economic benefits through sustainable mining of raw materials.

The study has been designed to provide an updated overview of both the achievements and challenges for local content development in the mining sector in Kyrgyzstan, within the context of the Kyrgyz economy. As a topic that is growing in importance globally, there is an abundance of international practices that could be used as examples for Kyrgyzstan and which provide a foundation of knowledge and experience from which to develop an approach that is realistic, achievable and sustainable.

The recommendations are based on analysis of data and information, and review of current practices, both local and international. Recommendations are in two forms: concrete actions to be taken by various stakeholders and, areas for further study based on the decisions that will be made by stakeholders. Increased local content is the end goal, but there are many paths which lead to that goal: through encouragement and dedicated corporate social responsibility programs, incentives or legislation, consensus based or prescriptive, gradual or rapid.

This document should be considered as a guideline to first steps, and to stimulate stakeholder consensus: a framework for increasing local content for mining companies, that creates jobs, reduces conflict and brings benefits to all stakeholders. The

steps to reach that goal, best taken through a multi-stakeholder consensual approach, may change the nature of some of the recommendations and as such, this report should be used as a starting point from which this initial consensus is formed. Depending on the outcome of initial stakeholder meetings, a wider group of stakeholders will need to be involved due to the broad nature of this topic.

A round table session is planned for June 2016, where on the basis of this report stakeholders may discuss, debate and ideally develop a consent as to the way forward that will benefit all stakeholders.

b. Scope

The scope of this report is focused on local procurement, and specifically value creating activities on the national and local level that comes from locally produced goods.

However, as a means to promote economic development in Kyrgyzstan, reduce conflict in the mining sector and promote a more positive investment climate that benefits all stakeholders, other parallel topics also become important either as enabling or limiting factors, or as elements which could be aligned that would help to expedite the development of local procurement. Such factors include local employment, skills development, infrastructure, tax regimes and legislative frameworks such as state procurement and sub-soil legislation.

These elements are discussed in this report as elements which can be considered for alignment in terms of overall development of local content in the Kyrgyz mining sector.

c. Methodology

Stakeholder engagement has been a key component in the development of this report in order to understand the current situation in relation to local content. As a broad topic that is not fully defined, local content programs must be participatory in order to ensure a realistic representation of the current situation is reflected, but also to ensure that recommendations that have been developed are robust, realistic and implementable within the context present-day Kyrgyzstan.

Stakeholder meetings were held with a wide range of domestic and international stakeholders representing government, mining companies, suppliers and international organizations. A standard questionnaire was used that was tailored to each group and the results were subsequently analyzed. A full list of the interviewees is contained in Appendix 4: Interviews.

Several companies turned down meetings as they felt that at the current time they did not have any procurement activity and so nothing to add to this issue, and several supplier companies did not want to be interviewed “on the record” or be listed in the report, however their opinions are included without reference.

The report contains a high level overview on the current state of the Kyrgyz economy, including the main contributors to employment, the GDP and the State budget. We did not attempt to do an in-depth analysis at this stage at the local level or even the national level to determine the exact local linkages between mining and non-mining activity. Such an exercise would require extensive field work and input from mining companies in terms of current levels of procurement by item. This exercise will be better suited at a later stage, after an agreement between all stakeholders on the strategy has been agreed.

d. Audience

This report, while developed primarily for use by GIZ, can also be used as a guide for all interested stakeholders: government, mining companies, suppliers and other organizations. It contains many references to tools, guides and data that would be useful for further developing an approach for managing a local content / local procurement program.

3. Local Content

a. Introduction

This chapter introduces the concept of “local content” and provides some background as to this concept for the purposes of this report. Although theoretical in nature, given the wide variation of understanding and uses of the word globally, this section is important to ensure that this report is read within the context in which it was intended. Indeed, throughout the course of the preparation of this report, it became very clear that various stakeholder groups are all using different definitions for or, have differing understandings of, local content.

b. Local procurement

In its most straightforward definition for mining companies, local procurement is a self-explanatory concept: the purchase of goods and services from a local business within the same geographical region as the mine site.

This relatively simple definition masks the nuances involved and can actually lead to a great deal of misunderstanding and even conflict if all stakeholders are not aligned with a common understanding. The term 'local' can have very different meanings to different people, and it is often this difference in expectations which will cause issues.

c. Local procurement vs local content

Whilst it may seem possible to interchange local content and local procurement, the terms do have very distinct differences that change both the spirit and essence of what is trying to be achieved.

Local content differs from local procurement in that goods and services are not only procured from local sources, but also produced locally. This key distinction has a major effect on the economic impact that can be gained from local content, over purchasing from resellers or importers of goods. Locally produced goods create more employment opportunities and result in more taxes being raised by government.

This distinction can become ever more challenging with complex supply chains, where components or raw materials come from one country or region, and some further assembly or value added activities or processing occurs in another.

Many companies or governments internationally use these two terms almost interchangeably and with vastly differing definitions. In fact, there is no agreement as to what constitutes "local", "local procurement" or "local content" and this fact makes comparing programs and data difficult, if not impossible.

d. Social programs or procurement?

One of the challenges of local procurement or local content relates to how it is seen within a company, and where the initiative sits from an organizational point of view. In addition, as Kyrgyzstan lacks an industrial base which could supply goods to mining companies, such as trucks and other equipment, the focus of local procurement tends to be on agriculture and other smaller goods that can be procured locally.

Whilst all companies need to procure goods and services, the function of a procurement team is to purchase goods and services that meet requirements of quality, delivery and sustainability at the best possible price with minimal effort by the company. A lean supply chain with long term, dependable business partners provides many business benefits, including flexibility, reliability and cost efficiencies.

In this case, the notion of local procurement and local content is often an antithesis to the procurement role. As local suppliers (including in Kyrgyzstan) often have challenges relating to quality and business efficiency, there is a role for the mining company in training and capacity building of the suppliers. Therefore, there is a great deal of time and resources required, both in straight costs and also human resources, to properly implement a robust local procurement program. It must be a long term commitment by the company, as once such a program has started, it cannot simply be stopped due to financial constraints (caused by low commodity prices for example) as conflict could erupt in the communities.

The challenges faced by companies in working with or developing local content are covered later in this report, but we found during interviews that where companies are actively working on a local content agenda (only private companies that are not state owned) there is at least some shared involvement between procurement, HR and community relations, sustainable development or similar functions within the company.

e. Defining "local" for Kyrgyzstan

A key component of success for the development of a local content program in Kyrgyzstan will be how "local" is eventually defined. There are many examples to follow, and run the spectrum from requiring local registration, full local ownership, management and workforce, to broader definitions that allow for foreign ownership.

The scale of "local" plays an even greater role in Kyrgyzstan, as residents in one region, or even village, may not see a company registered in a neighboring oblast or village as "local", if they are located geographically further from the mine site.

In developing a definition for local content for Kyrgyzstan, the following principals should be considered:

1. Locally registered: In Kyrgyzstan, the physical place of registration determines to a great extent where taxes are paid to. For rural communities this is an important factor as the addition of a small number of companies can have a great impact on local budgets.
2. Local ownership: the amount of ownership, expressed in a percentage, held by local citizens or locally registered business entities. This can also include a requirement for a local joint venture partner. This factor will determine how much of the profits of the company will remain in-country.
3. Local management: as management generally are higher paid, higher skilled positions, consideration should be given as to how many local citizens are in management positions within the company, as an overall proportion of the workforce. Over time local workers generally should be expected to take on more and more management functions.
4. Local employees: this indicator refers to the proportion of the overall workforce (including management) that are local citizens, which provides for direct jobs and increased tax revenues. In the context of Kyrgyzstan this category takes on added importance, as the oblast or region levels (in terms of origin or place of registration) must also be considered.
5. Size / scale / type of the operation: the scale of the operation and type of activities also must be considered in the context of a broader market for their goods or services. Blanket criteria may not be appropriate for all instances for example when you have work that requires highly skilled or unique experience or that requires a large customer base to be profitable.
6. Local value added: how much of the value of the product comes locally, for example raw materials are imported into Kyrgyzstan, but fabrication or assembly are completed in Kyrgyzstan.

So while it may seem logical to give preference to companies that are wholly locally owned, the ownership must be considered in terms of the other elements. For example, a company or subsidiary manufacturing goods locally that is 100% foreign owned but using mostly local management and employees would add more economic value to Kyrgyzstan than a company that is 100% locally owned but is acting simply as a re-seller. Likewise, a high number of foreign management staff also may be beneficial if they are filling key roles, or are also having a coaching role within the organization that helps to develop local staff or managers.

In order to achieve a balance, many companies categorize local companies and use these categories in their procurement scoring, providing additional benefit to local companies where all other criteria are equal. This scoring system will also allow for some flexibility in considering higher pricing, smaller quantities or other areas where local suppliers may be at a disadvantage.

An example of such a system could be:

Level 1: Full foreign ownership with a representation office or manufacturing located in Kyrgyzstan

Level 2: Partial foreign ownership with an office or manufacturing located in Kyrgyzstan

Level 3: Full local ownership with an office or manufacturing located in the oblast where the mine is located

Level 4: Full local ownership with an office or manufacturing located in the region where a mine is located.

In practical terms, it is not feasible or even possible to locate a manufacturing site in each region of the country. Such enterprises require large capital investments, skilled labor, attention to quality control, availability and source of raw materials and access to consistent energy source as well as a broad customer base.

By operating multiple sites, any sort of economic advantage gained by a capacity of scale would be lost, and the products would be too expensive and not commercially viable. Examples of this for the mining industry would be grinding media and lime, both of which are produced in Kyrgyzstan but in centralized locations that are determined by the needs of the business.

4. Mining industry lifecycle

Mining projects operate in distinct lifecycles that greatly influence the types and quantities of goods and services required by a mine. This section will look at this in a high level manner, so as to aid in future stakeholder discussions to ensure expectations are realistic at each stage of the mining lifecycle.

Exploration	Feasibility & Construction	Operation	Closure
2 - 10 years	2 - 5 years	2 - 100 years	10 + years

The requirements of a company changes drastically during each phase of the lifecycle, and will limit the types of goods or services that can be procured locally due to the changing requirements for different skills, products or services at any one stage.

A company decides to progress through each stage based on the economic returns presented (impacted by reserve quantities, access to finance, commodity prices, alternative opportunities, etc.) and the licensing / permitting process, which generally means a company must fulfil certain requirements to move through to the next stage. When considering the investment needed into local content in terms of new companies on the local level, it is not likely that a company will invest into this until a business decision has been made and permits have been received to begin operating the deposit.

a. Exploration

During exploration, procurement needs are extremely limited. Exploration companies provide most of the services required at this stage, and in Kyrgyzstan 300-400 such companies are registered. Local procurement is mainly ad-hoc at this stage and limited to some locally procured services such as accommodations, food, fuel etc.

LOCAL COMPANY REGISTRATION TO DELIVER BENEFITS DURING EXPLORATION

SEVERAL REGIONS IN KYRGYZSTAN ARE REQUIRING EXPLORATION COMPANIES (REGISTERED IN BISHKEK) TO RE-REGISTER LOCALLY FOR TAX PURPOSES AND INCREASE THE LOCAL HIRES WHILE THEY ARE WORKING IN THE REGION.

Often times mining companies outsource their exploration activities to these specialized firms, who would then also deal with procurement to meet their needs at that time with little oversight or control by the main mining company. At this stage, local benefits come more from hiring or local people for either skilled or unskilled positions. Development programs could include training of local community members to take advantage of opportunities from higher paying skilled positions.

In Kyrgyzstan however, this exploration stage is when a company is most at risk. Local communities have high expectations in terms of social packages and benefits, but companies are least able or most hesitant to provide anything in addition to what is legally required, as they are not yet generating any revenues and no mining licenses have been issued and project financing may not yet be assured.

b. Feasibility and construction

This stage presents greater opportunities for local content even when project design and construction is completed or managed by international engineering firms. One challenge with international firms is that they don't necessarily have extensive local market knowledge and generally do not have incentive or interest in developing a local procurement program. With contracts that are very rigid, any delays would trigger penalty clauses so to avoid these, construction companies will always go with their preferred suppliers whenever possible.

Thus, in construction phase the main goal is to simply build the mine as quickly and efficiently as possible and begin generating revenues.

Working with local communities is possible for unskilled labor or when experienced construction, mechanical or transport employees are available. However, given the nature of the licensing and permitting process, companies will not invest strategically into developing local skills until they have all required permits and permissions to proceed. By that time, it is too late to start such programs and therefore they will usually go with experienced companies.

c. Operations

The operational phase offers the most opportunities for local content, but then it is the limitations of the local or national economy to supply the required goods and services. An operational mine requires a wide range of goods and services as well as a range of personnel. This report focusses mainly on operational aspects of mining.

d. Closure

The closure phase also offers opportunities for local procurement of services, some highly skilled, but other elements can use relatively unskilled labor for take down of the infrastructure.

Here local procurement and production must consider another element, that being dependence on a mine. The risk of developing companies tied to one enterprise is that after closure, these suppliers also will have to close, causing an even greater negative impact on the economy. All local procurement strategies must consider these post-closure impacts and work together with local communities to reduce these risks well in advance.

5. Benefits of local content

The benefits of local content are well documented from a number of sources, including case studies, and this report does not intend to delve into this area in great detail because of this.

The benefits are important to consider however, given the investment of time and resources that will be required to develop a local content program that is inclusive of all stakeholders. In the short term for Kyrgyzstan, an approach that is more related to encouragement as opposed to legislative or prescriptive in nature would be more advantageous, and so these benefits can be used in the context of encouraging participation of the stakeholders and setting of realistic and achievable goals while maintaining expectations.

a. Government benefits

For government the tangible and direct benefits of increased local content are clearly related to increased employment opportunities and taxes. Through strategic development of a local content program a robust and diverse economy can be built, which is also a benefit, as dependence on the extractives industry would be reduced over time

Secondary benefits relate to a reduction in the costs of unemployment, external migration (and “brain drain”) due to lack of job opportunities,

In terms of the informal economy, official statistics estimated the size of the informal economy at 19.9% in 2010 (excluding agriculture) (Asian Development Bank, 2014). This same study quotes a 2011 report by the Center for International Private Enterprise that estimated the informal economy at greater than 50%. By integrating more companies into formal supply chains, the proportion of the informal economy also should be reduced as companies and individuals see more benefits through access to markets.

b. Business benefits

Despite the fact that many companies see local procurement as more of a social or development program, real business benefits can be gained from increasing local procurement.

Business continuity

Working with suppliers that are located relatively close to an operation means that there is reduced risks relating to interruption of supply. When there are changes due to technical specifications or specific requirements, it is much easier and quicker to deal with local suppliers.

Quality and cost

Quality control is much easier when dealing face to face directly with suppliers than with those located far away with no physical contact. Although for new suppliers issues of quality may be a challenge, this is where close cooperation with international donor organisations will be of great benefit through capacity building programs and implementation of programs such as ISO 9001 Quality Management Systems.

Social license to operate

A term that can be vague or over-used at times, in the context of mining in Kyrgyzstan it holds real meaning. The challenges faced by mining companies, especially in early stage exploration, is well documented, and more than one mining project has been stopped by local communities. By having a clearly defined and articulated local procurement strategy, the future community benefits could be laid out from the start of the project, which could help to secure community support, maintain realistic expectations and reduce the need for short term social payments.

c. Community benefits

Community benefits mirror those of government in many ways, in terms of employment opportunities and local tax collections. However, these benefits will generally be felt more acutely and be more visible at the local level due to the scale. The secondary benefits also can be greater and more widely felt across the community, as higher employment and higher levels of tax revenues then allow for local governments to provide higher quality services to all community members

The potential for local conflict would be reduced through a more collaborative and productive relationship, and even change the entire nature of the relationship. Currently, local communities are frequently requesting donations to cover basic expenses like school furniture and books, musical instruments, etc. due to lack of funding. Through increased income and tax generation from a strategic approach to local content, the community can become more self-sufficient and become a partner supporting the success of the mine.

Outward migration, and the socioeconomic costs that are associated with this, could be reduced by providing additional employment opportunities in the home communities.

6. Current Practices

a. Legal framework

Currently there is no legal framework for local procurement or content in Kyrgyzstan for the mining industry, and hence no legally binding requirements for companies to purchase goods and services locally.

The State Geological Agency has begun placing requirements in tender announcements that companies must purchase goods and services locally where they are of equivalent quality and pricing of those that can be purchased internationally, however this is a tender requirement and not backed by any specific legislation.

The government admits that local content has not been used as effectively as it could be in its draft Mining Strategy (Ministry of the Economy of the Kyrgyz Republic, 2013), and sees local content as a means to reduce local conflict with the community as well as provide for increased economic benefits from mining investment. However, the strategy does not specify any activities to be followed in order to develop local content apart from examining its potential, in line with World Trade Organization obligations.

b. Current number of licenses

According to the State Agency for Geology and Mineral Resources, there are currently 1,694 licenses issues for mineral and oil and gas use in Kyrgyzstan (The State Agency on Geology and Mineral Resources of the Kyrgyz Republic, 2016).

While this number may indicate a great deal of activity in the mining sector in Kyrgyzstan, especially the operational mines, it also outlines a further challenge given the diversity of operations in terms of scale and types of minerals, as well as the ability of the local economy to supply the goods and services needed by these types of enterprises.

In Kyrgyzstan when a discussion around mining is started, many think of the highly publicized Kumtor mine, however it must be remembered that this is a world class gold mine and most other mines in the country are much smaller and require much

smaller quantities of goods and services. Their smaller scale also means that they have less personnel to dedicate to the issue of local procurement, especially with no legislation or financial incentives to do so.

Not included in this list, and potentially a material source of local purchasing, is artisanal mining, especially for gold. This activity is regulated in Kyrgyzstan nationally, however licenses and oversight is done on the local and regional level. Accurate statistics are difficult to come by, and illegal artisanal mining is an issue in some regions, especially where there are large amounts of placer gold present, such as in Naryn and Jalalabad Oblasts (Kalybekova, 2013). Formalization of the small scale / artisanal mining sector could also support the development of local content given the lower complexity and smaller scale of purchasing that is required, which is better aligned to the current Kyrgyz industrial production.

c. Government initiatives

Given its mention in the Draft Mining Strategy and feedback in interviews, it is clear that the government of Kyrgyzstan understands the importance of local production and purchases in the mining industry, as it relates to both the economic benefits and the role it plays in reducing conflict. Currently, there are two main government bodies that are dealing with the issue as part of their regular portfolio of responsibilities: The Ministry of the Economy and the State Agency for Geology and Mineral Resources under the Government of the Kyrgyz Republic.

Currently in tender announcements for sub surface rights includes a clause containing certain requirement for local procurement. The full standard text found in several recent tenders (The State Agency on Geology and Mineral Resources of the Kyrgyz Republic, 2016) reads:

“... conduct procurement goods (inventory items), conforming to the quality standards, works and services on the territory of the Kyrgyz Republic, necessary to ensure the activities of the licensee, with the exception of the procurement of goods, works and services which cannot be produced and provided in the Kyrgyz Republic. At the same time, all other things being equal, mainly conduct the procurement of goods, works and services produced in the territory of [Oblast] region”

The wording of this requirement is due to Kyrgyzstan’s membership in the World

Trade Organization, which prohibits favouring local goods and services over foreign goods and services if alternatives with better pricing or quality can be found internationally.

There was conflicting information as to how or even if this is enforced by government. Four recent tenders have been held with such wording and it was stated that presumably companies therefore are aware of these requirements when they bid on these deposits. However, knowing that there is no formal enforcement or legislative requirements it is not sure to what extent a local content program will be formalized by these companies.

Early in the mining lifecycle local procurement opportunities are extremely limited, and therefore payment of taxes locally is one way to reduce conflict in the community by providing local benefits until a mine has begun operations and can start to procure more goods and services. One company interviewed stated that an agreement had been reached with their drilling contractor whereby the contractor would pay taxes from this contract into the local budget in the region where the work is being conducted, as opposed to the location of actual registration. And Kemin Region also requires exploration companies to register locally for tax purposes while they are operating locally. These good practice examples demonstrate the flexibility that is available in the tax system and would support the short term interests of the both the company – providing a positive economic impact from its activities even during exploration – and the community – that would benefit from increased tax revenues even from early stage activities. In this manner conflict could be reduced in communities if the benefits received from these increased local tax payments from exploration activities were communicated to local communities, and would provide for a suitable platform to allow for better dialog between the company and community on future local content needs.

As part of the interview process, two state owned entities (Kyrgyzaltyn and Kyrgyzkumyr) were interviewed which both stated that they follow strict guidelines for government procurement. These guidelines have no system or methodology for considering or favoring local purchases. The law “On State Procurement” (Parliament of the Kyrgyz Republic, 2011) states the following guidelines:

Ensuring maximum effectiveness and efficiency of procurement;

Increasing the participation and development of competition between suppliers (contractors) in the process of procurement;

Ensuring equitable treatment of all suppliers (contractors) participating in competitive bidding;

Ensure openness and transparency of procurement procedures.

In these cases, State owned companies currently have no flexibility in their ability to consider local procurement in their purchasing decisions. Any strategy for local content development will need to consider the opportunities for state owned enterprises as these should not be excluded as they deny local communities the benefits of local procurement and may cause communities to deny future access to state companies over private companies. On this front, government should be leading by example.

d. Private companies

Interviews showed that there was a range of practices involving local procurement amongst mining companies. One main limiting factor however is the stage of development of the company. Those that are involved in exploration require much less in terms of goods and services than those in construction or operation and often rely almost exclusively on contractors who are then responsible for procurement.

All companies interviewed stated that a lack of products manufactured locally was the main limiting factor relating to local content. Fuel, which is one of the main costs of an operating mine, reagents, chemicals, machinery and vehicles, are all not produced locally, although they can be purchased for the most part through local distributors, resellers or official agents. Depending on the quantities required, it is often easier for companies to purchase directly from the manufacturer of such goods, considering the logistical and regulatory requirements to import to Kyrgyzstan.

For smaller operations, importing chemicals and reagents can be a challenge given the permits and licenses and the quantities involved, so purchasing these items locally through a reseller makes sense, although this adds very little secondary benefits to the economy as a whole and would benefit only a limited number of people (the business owner and likely a small workforce required for such an operation). Because of this lack of manufacturing base the focus quickly shifts to locally produced goods and products, focused mainly on agriculture and sewing.

Of the companies interviewed, Kumtor Gold Company has the most formalized system of local procurement, starting with a formal policy on the matter. This should also be considered in the context that Kumtor has a unique waiver on customs duties and VAT on items it imports into the country (which is balanced with a higher tax rate as compared to other locally registered companies).

The draft policy, developed in 2013, defines “local” as it relates to Kumtor and proposes tender scoring to benefit companies that are registered 1) on the south shore of Lake Issyk-Kul in Ton and Jetty-Oguz regions, 2) companies registered in other regions of Issyk-Kul Oblast and 3) registered in other oblasts of Kyrgyzstan. This scoring allows for reasonable pricing differences (i.e. higher pricing from local companies) which may be offset due to their geographical location, in effect, providing preferential treatment for local suppliers. In addition, pricing is given a certain percentage discount in comparison against imports to make up for VAT and duties that may be paid by importers, again to favor local companies against imports.

A great deal of effort is required by Kumtor in order to implement this policy, both in terms of time and resources. Suppliers require visits by procurement in order to verify conditions, as well as ensuring that they can meet the production and quality requirements. Test samples are ordered and trialed at site in order to further determine suitability under operational conditions.

Ongoing work by Kumtor includes the requirement by international purchasers to provide evidence that equivalent goods are not available locally (local manufacture as opposed to imports) and local purchasing teams that survey the local market for new opportunities.

A prime consideration of Kumtor is the supplier replacement factor. It is not ideal to replace existing local suppliers, with whom there is often a longstanding relationship, with another local supplier. The key task is to replace imports, which do more to benefit the local economy and also create less conflict when shifting from one local supplier to another.

In addition, Kumtor has held numerous information sessions, both in Bishkek and Issyk-Kul Oblast for potential suppliers for them to understand better company requirements and the obligations of suppliers if they want to supply Kumtor. Apart from being a valuable source of information for potential local suppliers, it also is a way to provide direct access to company procurement teams and counter perceptions that procurement at such a company is closed to all but a select few.

Other companies undertake a less methodical approach to local purchasing but given the time and cost of a full scale local purchasing program, this is more in line with the abilities of companies to undertake given current market conditions and requirements. Whilst companies all stated that they know what is available locally, there seems to be little done in the way of systematic surveys or mapping of the opportunities, as well as identifying the gaps in local capacity that could be closed with some investment of equipment or training.

State owned mines such as Kyrghyzaltyn or Kyrghyzkomyr are not able to follow any sort of local procurement / local content guidelines or strategy, as they are strictly tied to state purchasing regulations which make no allowances to consider this aspect (Parliament of the Kyrghyz Republic, 2011). They are guided by principals of price and quality and location of the supplier (i.e. an allowance for being from the local community) is not possible.

7. Challenges for Local Procurement

This section presents a range of challenges faced by stakeholders in further developing local content. In many cases these affect economic development in Kyrghyzstan as a whole, and not only limited to those related to the mining sector. This underlines the importance of and need for broad economic and legislative reforms across the Kyrghyz economy and highlights the challenges to development of local content specifically for the mining sector.

Communities and local businesses share many of the same challenges due to the expectations of communities around the mine to become suppliers. The categories overlap, but are discussed separately as many of the goods and services required by a mine are not possible to come from locally-based companies for a number of reasons, and therefore a more centralized business covering a larger area and including a larger number of mining company clients is important for sustained economic growth.

a. Communities

Top 3 challenges

1. Lack of understanding as to the requirements of a mining company leading to unrealistic expectations
2. Capacity of local communities to supply goods and services sustainably in the quantities required at a consistent quality
3. Access to affordable funding for local SMEs

Conflict can erupt if mining companies do not share the benefits across all of society, especially as perceived by communities based on their expectations. In addition, the way people are very protective of what they perceive of as their opportunities at their mine, it is challenging to bring people or companies in from different regions of the country.

When a mining company begins to operate in a region, the first thoughts amongst community members relate to local employment and local procurement. Local employment in this regard is more straight forward as there are clearly defined criteria for qualifications and experience that are transparent and understandable.

When it comes to local procurement, mining companies require a certain quantity of goods and services, not all of which are available on the local market. What is available may not be available in sufficient quantities at the level of quality that is required, or in deliverable in sustainable supply without interruptions.

Whilst agriculture is clearly the main area in which mining companies can increase local procurement, this also comes with challenges. Mines require food that is certified and of a certain standard and in certain quantities. They also must be able to purchase this without interruption and with minimal hassle. In this case, it is easiest to work through a food distributor that will deal with these issues and supply the mine what it needs, when it needs it. Lacking a centralized supply channel, local communities will be at a disadvantage and only be limited to staple items such as potatoes.

Also with agriculture, value added or processed products also could be in demand, but such facilities are generally lacking in local communities that could provide processed meats, fruits or vegetables. With meat it is more straight forward as there is always available livestock, but with fruits and vegetables the seasonality presents a challenge for smaller local producers and as such, cannot provide items uninterrupted year round.

There does not there seem to be much in terms of formal and structured dialog between mining companies and the community to discuss future needs of the mine that would allow a local businessman to invest and begin to provide a certain good or service.

The ability of local communities to supply goods and services at the community

STRAINING RELATIONSHIPS

WHEN A LOCAL PRODUCER OF FISH WAS AWARDED A CONTRACT THAT THEY COULD NOT FULFIL, THEY ATTEMPTED TO BUY FISH WITHOUT THE MINING COMPANY'S KNOWLEDGE FOR REAR OF LOSING THE CONTRACT. THEY APPROACHED ANOTHER FISH PRODUCER, BUT WERE NOT AWARE THAT THIS PRODUCER WAS A LONG TIME SUPPLIER TO THE MINING COMPANY. THIS RESULTED IN A NEGATIVE IMPACT BETWEEN THE MINING COMPANY AND THE EXISTING SUPPLIER WHO FELT BETRAYED AFTER BEING A CONSCIOUS SUPPLIER, AND THE LOCAL PRODUCER LOST THE CONTRACT CAUSING TENSION IN THE COMMUNITY AS THE COMPANY WAS SEEN TO NOT UNDERSTAND OR SUPPORT LOCAL BUSINESS

level is limited, especially in terms of manufacturing or providing specialized goods. Without a dialog between the mine and the local business community, there is no understanding of what is required, in what quantities and at what price.

Communities often use the argument that the mining company should support only locally owned and operated businesses exclusively, and sometimes this also comes with threats or hints of a threat, that if the company does not purchase from this specific local business, there could be issues for the mine.

Conflict in this way can erupt, as accusations between the two suppliers as to who is more representative of the community, who supports the community more etc. If a compromise is found and the order divided, often times the quantities are reduced for the suppliers to the point where it is no longer profitable. And then a third company comes along and the process is repeated.

Two interviewees, from the mining and development sectors, commented that due to the challenges relating to access to

finance, often it is the community members who are already relatively wealthy who can afford to self-finance a business or can access financing given the costs and collateral requirements. This viewpoint was also reflected by the Asian Development Bank (Asian Development Bank, 2014). In this case, conflict situations may be exacerbated when community members perceive that only the wealthy individuals are able to take advantage of local content development.

Communities in Kyrgyzstan often feel a great sense of ownership of a mine, and thus it is challenging to have a supplier serving mines across different regions as this can cause conflict. A cluster approach could be taken whereby different regions can provide one or several goods or services nation-wide, and thereby ensuring that access to other markets could be achieved, if not the local mine.

b. Small and medium enterprises

Top 3 challenges

1. Access to finance
2. Lack of skilled or qualified specialists
3. Lack of ability to compete with larger, established businesses

Although Kyrgyzstan has taken many steps to make starting a small business easier, especially with the ease and low cost of the "one-stop shop" encompassing business registration, tax identification number, other challenges remain in place for small and medium enterprises in Kyrgyzstan (World Bank, 2016).

Access to finance is a major issue facing SMEs in Kyrgyzstan and an issue that impacted stakeholders in different ways is. Banks are geared towards lending for trade and in 2013 almost half of Commercial loans in Kyrgyzstan went to finance this sector, with only 15.4% of loans going to support agricultural activities, and 7.5% to industry (Asian Development Bank, 2014). Borrowing is expensive and a review of web sites of 5 major banks in Kyrgyzstan during the preparation of this study showed an average interest rate of 17% per annum with maximum term of 5 years.

On top of the high interest rates, collateral is another major issue facing small businesses when applying for credit. As many small borrowers do not have the ability to place collateral (can be up to several times the value of the loan, in the form of property or vehicles, etc.) then there is no ability apart from informal loans from friends or relatives to start a business.

One solution to overcome the issue of access to finance is the formation of credit guarantee schemes (CGS). These are guarantees are provided on loans to borrowers to cover costs related to defaults, thus replacing or reducing the need for collateral.

Lack of skilled or qualified specialists

Human resources considerations play a role both in terms of local content and for employment at mines. Although not a prime focus of this report, local employment is one of the key expectations of communities when a mine begins operations, and attention to this issue helps in the reduction of conflict between the community and the mine. This is especially true during the exploration phase, when employment opportunities are greatly limited.

Currently during exploration, hiring of local people is undertaken for unskilled positions and where available, for more skilled positions as well.

As already mentioned, this is the stage in a mine's lifecycle when the potential for conflict is high, but the ability for companies to bring a large impact is low. In

taking a strategic sector wide approach, it would be possible to include development of occupational standards and competency profiles for exploration related jobs.

This participatory approach to skills training, owned by industry, would allow for the development of updated standards packages that could be approved by the Ministry of Education and delivered through training institutions across the country. As courses are designed to be modular, it would not take years of training and people could be employed rather quickly. As many exploration companies either work on contract for a limited time in any one region, or hope to sell a deposit on to a company that will bring it into production, they generally do not hold long-term attachments to any one region. As a national strategic program, this type of program cannot be delivered by exploration companies (that are focused short term on any one region) but needs to be driven at the national level with the participation of all stakeholders.

More related to local content, business skills are also generally lacking especially in rural communities and where local people may not have a full understanding of the requirements of mining companies. Mining companies can play a role in supporting training programs for local communities around business training or specific courses related to manufacturing and agriculture. These are best delivered through partner organizations who have the specific skills and experience necessary.

Lack of ability to compete against larger, established businesses

In the context of local content, a close relationship needs to be formed between the mining company and businesses in the host community. In this regard it means that the mining company must be willing or able to share long term strategic -and often confidential- commercial information, something that is not always a realistic expectation.

In terms of supporting a strategic approach to local content development, the mine must make clear to local suppliers and the communities what goods and services they will require that could be produced locally.

Many mining companies announce tenders on their web sites or through other means, but this system may not favor local providers as the requirements may be difficult or challenging for local companies. During a review of websites, it was found that several companies do not even have any tender information on their site, or a link to procurement information.

As noted earlier, state owned enterprises must follow strict national procurement regulations. This process, which is beneficial from the point of view of reducing corruption risks in state purchases, has a negative impact on local purchases. Therefore, no consideration can be made relating to a preference for local suppliers. In addition, the system requires submission of documents through the electronic portal (www.zakupki.gov.kg) with documents in a strict format, and any errors result in disqualification. For small local companies the system can be confusing or not accessible and therefore favors larger, more sophisticated suppliers who can monitor the web site and have experience in applying for government tenders.

c. Mining companies

Top 3 challenges

1. Lack of clear incentive or benefit to increase local purchases, when there are no tangible links between local purchases and social license to operate (often the opposite)
2. Kyrgyzstan has a low industrial base from which local purchases can be made, apart from food
3. Local procurement and development of local enterprises requires great investment of time and people, and skills that mining companies do not inherently have

Currently, mining companies have little incentive in Kyrgyzstan to purchase locally, apart from a community relations

perspective, and in fact there are valid reasons that dissuade the practice. Whilst license to operate and better community relations are often cited as prime business drivers for increased local procurement, companies often face large challenges when attempting to implement such a program.

Companies are facing a very difficult situation in terms of local procurement as no matter what they do, they are open to criticism. Simply doing nothing in terms of local purchases leaves the community dissatisfied, and if they attempt to purchase locally, it often does not meet expectations that communities had. Companies

STRAINING RELATIONSHIPS

EVEN PEOPLE FROM VILLAGES
TRAVEL FROM THE REGIONS TO BISHKEK
TO BUY PRODUCE AS IT IS CHEAPER THAN
BUYING IT LOCALLY”

understand that investment is needed and they do invest into local business, however this can also open the door to criticism that one group or business is being favored, and others then begin to also want similar opportunities.

Several stakeholders commented during interviews about conflict situations and other issues that arose in communities due to local purchasing by the mine, and for various reasons, including:

Perceived favoritism towards one supplier or company and pressure to switch suppliers every few years, without consideration of the business challenges and risks this presents.

Supporting existing businesses with proven track record versus helping to start new companies (a perception in the community that “the mine is helping people who are already rich and don’t care about the people”)

Threats by business owners to block roads if the company did not purchase from them (even though the company was buying similar goods from a local company already, just not his company)

Community claiming that the company ignores them, even though the local supplier cannot produce the required goods in quantities that are required

Community complaints about environmental issues that would disappear if the company purchased goods from a specific company

Use of prosecutor or other official organs to pressure the company to switch suppliers by opening investigations that clearly are driven by business competitors, or using community “activists” to complain about a supplier to drive them out in order to favor another supplier

Community demands to purchase from a local reseller when the company already buys the same goods direct from the manufacturer at much lower prices (once again if refused, claims that the community is being ignored)

Company is forced to remain with a supplier that is producing low quality goods or not compete with changes in market pricing only because of conflict potential

One consideration when looking at local purchase and local content is related to replacement versus replication. When looking to increase local purchasing from local producers, a company should be seeking to replace imports. Often however, once local communities see a successful business supplying a certain good or product, they replicate this business and then you get issues of too many suppliers offering the exact same goods. Competition is always healthy, and for companies

CHEESE PLEASE

DURING AN ISSUE THAT SUSPENDED EXPORT OF CHEESE FROM KYRGYZSTAN, EFFECTIVELY CLOSING THEIR MAIN MARKET, LOCAL CHEESE SUPPLIERS WERE LOOKING TO A MINING COMPANY TO TAKE ON ALMOST THE WHOLE PRODUCTION RUN, EVEN THOUGH IT WAS MANY TIMES MORE THAN THEIR CONSUMPTION

it is also beneficial to have more than one supplier available, but when several suppliers are aiming to supply 100% then this is how conflict arises. At the same time, other goods could be provided but nobody is supplying these because the communities simply do not know that this opportunity exists due to lack of dialog.

As described in Section 8, the industrial sector in Kyrgyzstan has seen a decline since independence and the range of goods produced is very limited. In addition, of the main purchases required by a mine during normal operations: fuel, chemicals, reagents and food, only the agricultural sector is in any position to supply mines using locally produced products. Fuel and chemicals are all imported and simply not produced in Kyrgyzstan, however lime, a material used in gold production, is available.

This means that most other purchases that can be done locally, such as personal protective equipment (PPE), fabricated parts, are smaller ticket items, perhaps needed in lesser quantities, may not have a material impact on the economy. Farmers (or any business for that matter) must have alternative markets to supply their products as a mine cannot take 100% of supply. Not only does this create dependencies on the mine, it can also lead to a false economy and actually slow development. For meat products, a mine will only purchase certain cuts or products, and therefore a market must exist for the rest of the animal. Sanitary norms must be strictly followed otherwise it is the mine that will be penalized.

Mines are small cities, and just as you would not supply a city by purchasing in small quantities from a large number of suppliers if it can be avoided, nor can a mine operate in such a manner. Therefore, it is extremely difficult for a mine to purchase in small quantities food products (e.g. 10kg tomatoes from farmer 1, 15kg from farmer 2 and so on). This requires a large commitment of resources and time to manage. Lacking one supplier that can fulfil all the needs of the mine, and without a central point of contact for mines to deal with that can arrange for quantity, sustainability, quality and other related issues, buying large scale from local communities will always be a challenge.

One stakeholder also commented that even with a contract to supply the mine, it is not unheard of that a farmer will ignore the contract and not supply as agreed if someone else comes along and offers a better price. This type of instability also causes additional issues for a mine, and such issues would not likely occur with a long term partnership with a food distributor.

One of the key considerations for any company is the commercial terms related to local purchasing. While some leeway may be made for local purchasing, companies cannot be expected to pay much higher than market rates without some clear benefits (better community relations) or incentive (tax credits for example).

Before starting to implement such a program, companies must develop a strategic approach, starting with a definition of “local” which considers not only business drivers, but availability of local goods and services, how this will be organized in the company and consider the resources that will be required. It is easy to underestimate the time and cost that will be required to implement such a program, and efforts to pool resources between companies in this area would greatly improve efficiency.

One other important comment from a company stakeholder related to the level of service possible from local versus international suppliers. When dealing with local resellers they are generally only able to sell “off the shelf” goods that meet a certain specification required by the company. However, there are times when a company is facing a challenge and they look to suppliers to not only sell a product, but also to help develop a solution, which may require some customization, modification or custom made items.

Other challenges faced by mining companies are:

- Ability of local resellers to provide warranties or other value added service that can be received only from the manufacturer or official representatives, such as maintenance

- Dependence on one mine means if orders drop then the supplier faces financial difficulties, and sometimes pressure has been used by suppliers to continue purchases even without a need on the part of the mine

- Requirements for (often large) pre-payments that local suppliers may require to buy raw materials

- Community activists may use local procurement as a way to pressure mining companies, one the one hand the represent youth or community groups, on the other they represent business interests, and so a conflict of interest arises

- Dependence on the mine also creates issues during closure if the supplier has no other customers or markets

- Potential suppliers working in the gray economy without registration

d. Development funds

Development funds have been set up under the sub-soil legislation that are intended to bring developmental benefits to mining-affected communities. These funds operate independently of the mining company but could bring additional benefits if the activities of the funds were aligned to support development that is needed by the mining companies in order to increase local content, which would help to support the longer term development goals of the region itself.

Current challenges with the development fund system includes:

- Lack of long term development strategies for regions and local councils mean that the funds tend to focus on highly visible projects that do not necessarily bring development benefits, for example roof repairs, construction of sports

halls, schools or community centres, road repairs etc. Whilst these items are undoubtedly needed, the long term benefits these items bring could be questionable. Items that are not visible, or take longer time to bring benefits, such as expansion of irrigation systems, tend to not be considered.

Funds are controlled locally by local town or regional officials, which means that regional or oblast level investments may not be considered. Larger enterprises that could bring higher socioeconomic benefits generally require long term substantial investments that such a local approach cannot support.

Funds receive a budget estimate for the following year, at which time they plan for this annual spend. As the funding is based on revenue, factors such as lower production or reduced commodity prices could have a negative impact and thus the funds will fall short of revenues. In such cases, the following year's contributions go to cover debts from the previous year. As spending also must be based on an annual cycle, it is challenging to consider multi-year projects that would be larger, and thus potentially bring larger investments.

There is no possibility to fund "projects" that comprise capacity building or training, that would potentially add value when considering development of industry or agriculture. As the challenges facing increased local content as discussed in this report will require significant investments, it could be unreasonable for mining companies to do more than the minimum without additional benefits. Investment will be needed to support skills development and equipment purchases (for example) and the development funds are ideally placed to support in this area.

e. Anti-corruption

Scoring 123 out of 168 countries in the 2015 Transparency International Corruption Perception Index, corruption is a risk if proper controls are not in place to safeguard the mining company.

Apart from Kyrgyz anti-corruption legislation a wide range of foreign legislation relating to bribery of public officials applies to mining companies operating in Kyrgyzstan, including the US Foreign Corrupt Practices Act (FCPA) and the Corruption of Foreign Public Officials Act (CFPOA) from Canada. UK legislation, the UK Bribery Act, also forbids the bribing of private individuals in addition to public officials, and therefore any companies accepting or taking bribes as part of local purchasing would be at risk of infractions if this law applies to them.

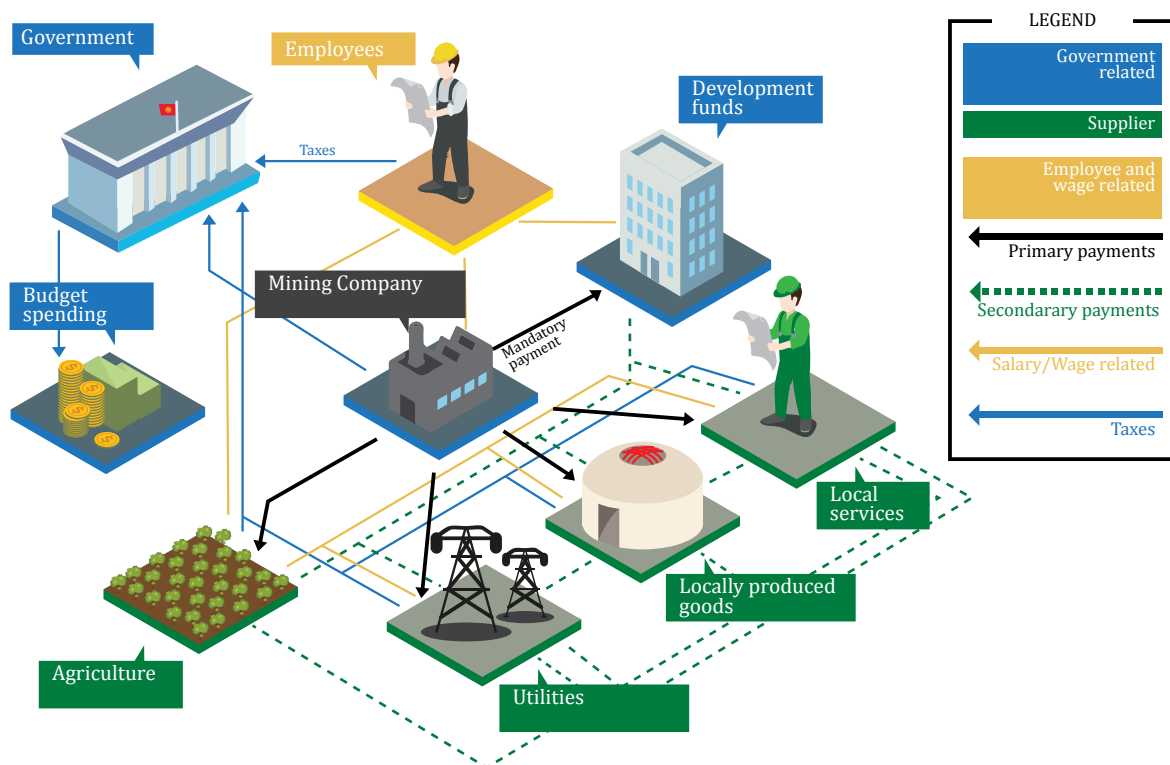
While many international companies have in place a code of conduct or equivalent policy, shifting a greater proportion of purchasing to local suppliers requires a level of supplier due diligence and screening that will require additional resources and procedures to manage. The potential risk corruption could be great, if companies do not spend the time and resources to properly screen ownership of these companies, and they are feeling pressured to meet certain local spend targets.

A recent report from the OECD (OECD, 2016) lists several mechanisms by which corrupt activities can occur through both procurement and social spending and provides examples of controls that can be used to reduce corruption risks.

8. Linkages to Other Sectors of the Kyrgyz Economy

Given the linkages that flow between the various elements of the economy, there is much socioeconomic benefit that can be gained across the economy through local procurement and local content.

One study in Ghana found that 105 local jobs were supported for every US\$1 million increase in local procurement (International Council on Mining and Metals (ICMM), 2015). So whilst the number of opportunities for direct employment may be limited at a mine itself, a company such as Kumtor Gold Company that, in 2014 spent US\$79.8 locally, (Kumtor Gold Company, 2016) could be supporting over 8,000 jobs in Kyrgyzstan just through their local procurement across a number of sectors. This is 3.4 times the number of local employees working directly for the company (www.kumtor.kg). Of course it is not possible to extrapolate directly, as the situation between Ghana and Kyrgyzstan differs, but clearly the benefits and opportunities to other sectors of the economy in Kyrgyzstan are potentially significant



a. Agriculture

The agricultural sector in Kyrgyzstan comprised 17.5% of GDP in 2012 (National Statistical Committee of the Kyrgyz Republic, 2013), but its share in the overall GDP has shrunk from 39.0% in 1992 to 17.7% in 2013, due to the growth of the services sector (Asian Development Bank, 2014). Agriculture employs a large number of the population, especially in rural areas, where 46% of the workforce are employed in agriculture.

This sector in Kyrgyzstan provides the best opportunities to develop local content in a more strategic manner, that would benefit not only mining companies but the economy as a whole. Agriculture is an activity that covers the entire country, provides large number of employment opportunities in rural areas where mines are most often found, and could benefit greatly through increased investment allowing for greater diversity of products and value added processing. The agricultural sector as a whole likely will not become dependant on a single mine, especially after such investment. Indeed, after such investments the reliance on the local mine should rapidly decrease as goods are exported to other markets.

CHEESE PLEASE

JUICE PRODUCED FROM LOCAL

FRUITS IS A CLEAR WINNER FOR MINING COMPANIES, EMPLOYEES AND LOCAL COMMUNITIES. LOCAL JUICE PLANTS HOWEVER, ARE SMALL SCALE AND CANNOT MEET ALL THE NEEDS OF THE MINES, OR DEVELOP A SUPPLY CHAIN THAT ALLOWS FOR YEAR-ROUND PRODUCTION.

INVESTMENT INTO STORAGE CONTAINERS COULD ALLOW FARMERS TO EITHER PRODUCE JUICE LONGER, IN LARGER QUANTITIES OR SELL THEIR PRODUCTS OUT OF SEASON, THUS INCREASING THE VALUE OF THEIR CROPS

Agriculture has seen a rise in employment since 1991 when 622,700 people were employed in the sector to 2012, with 727,300 employed in agriculture, fishing

and hunting related activities (National Statistical Committee of the Kyrgyz Republic, 2016). However, capacity is available as many people working in the agricultural sector in rural areas are working less than 25 hours per week (Asian Development Bank, 2014).

One challenge that is difficult to quantify through data is the impact on Kyrgyzstan joining the Eurasian Economic Union (EEU) in 2015. Anecdotal evidence shows, and certainly the perception of people is, that imported agricultural products have become much cheaper since Kyrgyzstan's accession into the trade pact. This is having an effect of reduced demand for locally produced agricultural products and increasing the pressure on mining companies to take up some of this demand.

Another challenge for the sector remains the seasonality of many products, meaning that they cannot be relied on for year round purchase for mining companies.

b. Industry

In Kyrgyzstan industrial capacity and output has dropped since independence. In 2014, 160,000 people were employed in manufacturing, down from 286,100 in 1991 (National Statistical Committee of the Kyrgyz Republic, 2016). It is currently dominated by five subsectors: metallurgy, food processing, textiles, light manufacturing and energy (World Bank, 2014). These subsectors account for 90% of the industrial production, half of this is from mining alone. It is important also to consider that Kumtor is the main contributor to the mining contributions.

In the Kemins region, industry accounted for 33% of the economy of the region (vs. 67% for agriculture) (Urdolotova, 2016). The Kemins has a strong tradition of mining, with Altynken as an operating gold mine, and the Kutessay rare earths mine recently receiving a new owner. However, despite this, most of the industrial enterprises are either not operating or operating far below capacity, and are seeking investment. The region itself receives approximately 70% of its funding from the central government and only 1 local council is self sufficient, in addition to the cities of Orlovka and Kemins. In considering a strategic location to centralise larger enterprises that would serve the sector as a whole, Kemins could be a wise choice. Kemins, or another similar region, would make an ideal base that would be accessible to transportation links to the rest of the country and could supply many of the mines in both the north and south of the country as a cluster, as well as being close to Kazakhstan for export possibilities. In considering a strategy, it would need to be decided to go with a region that already has other economic benefits (such as those afforded from road traffic of vacationers to and from Lake Issyk-Kul) or to select a region with less alternatives and therefore in greater need of investment.

c. Services

The services sector is one of the main components of the Kyrgyz economy. In 2012 it contributed 46.6% to the GDP (Asian Development Bank, 2014) with trade making up the vast majority of this amount. Due to the EEU, many of these trade related opportunities were expected to disappear, especially the re-export of goods from China to other countries in Central Asia and Russia.

The service economy is one where there are limited opportunities for growth related to local content and mining. Companies already deal on the local market for telecommunications, transport and the hospitality subsectors, which make up a large portion of this sector. The IT sector also is quite strong in Kyrgyzstan and provides a broad range of services required by mining companies. The financial services sub-sector is part of the service industry and could benefit from a more robust economy with a vibrant SME landscape, either through providing credit, processing payments or holding deposits.

9. International Practice

Local procurement and content is an issue that is very important to the mining industry globally, in developed and developing economies. Mining companies understand the importance from a social license to operate perspective but, more importantly, they see the financial benefits such a program brings.

Because of this, there is a wealth of experience globally to draw upon. While it may seem tempting to simply copy the experience from another country or region, it is important to develop a system that fits the specific Kyrgyz situation, economically and socially, in order to bring the most benefits.

a. Guidelines and toolkits

A list of guidelines and toolkits is provided in the references section. These provide a wealth of information that will avoid having to “reinvent the wheel” when it comes to local content development. And whilst it can be beneficial to have such a diverse set of reference material, it is also important, through a multi-stakeholder consensus approach, decide a system for Kyrgyzstan that will be transparent and avoid confusion.

Many of the guidelines use the terms “local procurement” and “local content” almost interchangeably, and do not consider the regional specifics as we have in

Kyrgyzstan, instead focusing more on a national definition for “local”.

Three tool kits which provide excellent guidance and tools for both companies and governments are from the International Finance Corporation (IFC) (International Finance Corporation, 2011), IPIECA (IPIECA, 2016) and the International Council on Mining and Metals (ICMM) (International Council on Mining and Metals, 2012).

For communities it is also important to have a systematic approach. This aids in negotiations and for the mining company to understand community expectations. Generally, communities come to negotiations from a position of weakness as this is their first encounter with an investor and do not understand the approach to take. This causes complications when demands change or different groups within the community attempt to gain benefits that may be more personal, as opposed to community focused. As part of building a professional partnership with the company, communities must gain skills in a wide range of socio-economic topics, and here training can also play an important role.

A set of guidance that has been developed for First Nations in Canada, but has generally applicability here in Kyrgyzstan, is the Impact Benefit Agreement Community Toolkit (Gibson & O’Faircheallaigh, 2015).

b. Measurement and reporting

GIZ, in partnership with Engineers Without borders (EWB) through Mining Shared Value (MSV), an NGO, are creating a measurement and reporting standard for local procurement in the mining industry (Mining Shared Value, 2016). This project is sponsored by the German Federal Ministry for Economic Cooperation and Development (BMZ).

For the past two years, since 2014, MSV has been producing a report that examines the how mining companies report on their local procurement. Through engagement, MSV is also developing a standard that will be ready in summer of 2016 in draft form that will allow mining companies to accurately report on their local procurement, and the impacts from this.

Although other reporting guidelines or standards exist, this guideline is the only one that is focused solely on the mining industry, and is designed to work with other existing standards such as the Global Reporting Initiative (GRI).

For Kyrgyzstan understanding the current level of local procurement will be critical as part of the strategy development and implementation for local content, for without knowing the current level of local procurement and locally produced goods it will be impossible to set targets and goals for future increases.

Reporting will also allow companies to receive reputational benefits from their efforts, as well as allow them to track progress over time and understand what has been effective and what has not worked to increase local production. Using a Return on Investment (ROI) approach can allow an even more objective assessment of programs.

c. Legislation versus incentives

Some countries have taken a legislative approach to local content, both for mining and for oil & gas, which share many of the same challenges and opportunities.

As a member of the World Trade Organization, Kyrgyzstan must follow guidelines under the National Treatment principals which state that imported and locally produced goods should be treated equally, at least after they have entered the local market (World Trade Organization, 2016).

The World Bank, in a recent study (World Bank, 2014) completed a review of the various trends that governments are implementing to legislate or encourage local procurement / production:

1. Requirements for minimum domestic procurement targets: Indonesia, Russia, South Africa and Zimbabwe all have legislation that regulate some elements of domestic procurement for goods or services relating to mining
2. Requirements for companies to produce domestic procurement plans: additional components required in South

Africa, Indonesia and Philippines require not only domestic procurement plans, but also describe the socioeconomic impacts and benefits for local communities

3. Requirements that give preference to locals without specifying targets: this approach, driven mainly by World Trade Agreement requirements, does not prescribe a certain level of local spend, but encourages consideration by companies.
4. Requirements to build local enterprise: This may be done on a project by project basis that will be part of the mine's licensing agreement. It may include skills development in addition to setting up actual businesses.
5. Government-led initiatives with voluntary industry participation: This can be done on a regional or national level that will support infrastructure such as web sites that acts as a bridge between companies and local businesses.
6. Concessions on import tariffs and duties: Normally for large scale or strategic projects, such clauses act to deter local purchases but may target one or more classes of goods or equipment that are not produced locally. They may be phased out as the country develops capacity to produce such goods locally.

Kazakhstan had strict legislated local purchasing requirements and the National Agency for Local Content Regulation (NADLoc) until very recently. The 2010 Subsoil Law has strict requirements for local purchasing, and local purchasing is monitored and enforced by the Ministry of Oil and Gas. A state procurement register is maintained by another government Ministry, the Ministry of Industry and New Technologies. Fines have been levied against companies that do not meet the requirements.

In 2015, Kazakhstan became a member of the WTO and as such, strict laws on minimum local content requirements are no longer permitted. In 2016 a new sub soil law was adopted which removed such requirements, and NADLoc was disbanded.

d. Traditionally disadvantaged groups

Often times, local procurement or local content programs target groups that have been deemed “traditionally disadvantaged” such as aboriginals, first nations or women, and use such programs to provide opportunities that they may not otherwise receive.

This is a more common approach in developed economies that have a strong manufacturing base that can provide most goods and services required by a mining company. In such countries, “local content” is “business as usual” and so the focus shifts to groups that may not have access to companies and have previously been disadvantaged in this regard.

This approach may have some benefits in Kyrgyzstan however, focusing potentially on women and youth, who face barriers to starting businesses and, in the cases of single parent households, have limited opportunities for employment elsewhere.

10. Recommendations to Increase Local Procurement and content in Kyrgyzstan

This study has shown that companies have taken differing approaches to local content in Kyrgyzstan within the mining sector, as well as a wide range of expectations by various stakeholder groups. These activities are generally not formalized, and are more reactive, as opposed to proactive or based on any strategy. As companies are looking at local content within their limited geographical territory, there is little cooperation or sharing of knowledge or experience. Communities and local businesses face a large number of challenges in supplying mines and generally cannot provide what is needed in the required quantities at the required quality. The result is that expectations of communities are not being met, and companies see local content / local procurement more as a community relations exercise, as opposed to within the context of procurement.

At the same time, despite these challenges, there is great potential to increase local content beyond the current level. The current approach is based on a range of actors working voluntarily and independently. This means that any benefits are highly localized, can vary under differing economic situations and are generally not sustainable, nor will they bring lasting benefits beyond the life of mine.

a. Stakeholder inclusion

In order to increase local content and local procurement in Kyrgyzstan, it would be advisable to take an inclusive and staged approach that is based on a clearly communicated strategy and involves all stakeholders including mining companies, government, communities and businesses. Given the number of challenges and current lack of incentives, all stakeholders must be aligned in their understanding of local content, what is possible to be achieved, and over what time frame.

An initial round table is proposed where stakeholders can discuss these issues openly and form a consensus as to the way forward. Maintaining the status quo is likely not in anybody's interest, but in lacking a consensus, this is the situation that would result. Developing an industry wide strategy that includes all stakeholders will take some time and would have to consider external economic factors, the size and scale of operations, the proximity of communities and other larger populated areas, access to alternative markets, and the current structure and level of economic development, to name a few factors.

Beyond an initial sounding, it will be important to broaden the stakeholder group to include those working in ancillary areas, such as education, organizations supporting SME development, and other government departments such as agriculture.

Funding will be an issue and must be kept in mind, as any broad based program will require funding, either new sources or diversion from existing programs, unless synergies can be made between existing initiatives. The burden cannot fall solely on the back of mining companies, especially when this can be considered a voluntary program, so shared costs and shared benefits should be a guiding principal.

The following recommendations have been developed that include an overview of opportunities, risks and associated challenges. The lead stakeholder for each is included along with associated stakeholders that would need to either be actively involved or engaged with.

b. Key recommendations

There are three key recommendations from this study which, in the opinion of the authors, would provide a strong foundation for development of local content in the mining sector in Kyrgyzstan. These recommendations will significantly affect the outcome of any local content development as they provide a foundation upon which a program can be built.

Strategy

1. Develop and approve a strategy for local content development in Kyrgyzstan for the mining sector. Consider the current level of local procurement, potential for growth and proceed with a multi-stakeholder approach in order to develop a shared vision.

As stated, companies are already approaching local content in one form or another to varying degrees of success. This activity however, not coordinated, is often reactive in its approach and focused on quick wins or optics, while at the same time expectations are very high, especially in the local communities. The burden currently rests mainly on the backs of mining companies, and each have developed approaches that allows for some level of local purchasing, albeit not always in a strategic or systematic manner. As each company currently is left to its own accord and is the main customer for local businesses, the end result is small scale enterprises based on agriculture or sewing shops for coveralls and jackets, that do not have as much potential as value added enterprises, but that require larger investments and a larger customer base.

In order to develop a robust strategy that is focused on the longer term as opposed to quick fixes, an assessment of current capacity and a road map to develop to a set targets, goals and assign responsibilities also needs to be conducted. All parties must be engaged with and aligned to ensure that stakeholders are working towards a common goal and can support each other in achieving this goal. A strategic approach will help in the short term by having something to communicate, especially to local communities, who are looking for short term results. In the end, having a strategic approach may mean full benefits are not achieved straight away, but when they do come they will have greater impact, be more sustainable, and last beyond the life of a single mine. Goals should be strengthening SMEs, economic diversification, reducing dependency on one dominant sector and overall, using mining as a catalyst for positive economic development.

Agency for local content development

2. We recommend the formation of an agency that would be under the appropriate government structure (for example Ministry of the Economy) that would administer the local content program and provide a number of services to various stakeholders.

The ability to take a national strategic view would remove much of the burden from individual companies, and in fact would work closely with other government departments and ministries to coordinate activity, including Ministry of the Economy, Ministry of Agriculture, State Geological Agency, Ministry of Education and Ministry of Finance.

Funding for the agency could come from government or international organizations however, in order to be sustainable a self-funding model needs to be developed long term. Given the financial and other benefits expected from a strategic approach to local content development, this should be seen as an investment, rather than a cost.

The activities of the agency could include:

Develop and implement a strategic approach to local content development in the context of the Kyrgyz mining sector and alignment with the national mining strategy.

Coordinate with government branches on matters related to local content development in order to ensure coordinated activities and to support the development of legislation that would encourage or ease local content development.

Conduct community baseline assessments that includes business mapping, workforce availability / capacity and potentially identify opportunities for early cooperation. The baseline assessment will also show where gaps are and allow for the development of a development plan. This should normally be done by a company, but support or methodology could be provided by the agency.

Act as a point of contact for all stakeholders and engage regularly to ensure the agency and program are meeting the needs of these stakeholders.

Develop a training programs to be delivered either through current activities of the Ministry of Education, new programs or through private training agencies or international organizations.

Develop and provide training programs for local communities to assist in negotiating and working with mining companies.

Develop a supplier screening and accreditation program that would act as a database for mining companies to seek local content. Provide support for SMEs in terms of quality, environmental, health and safety, food and other management systems.

Conduct regular capacity mapping and needs assessments through studies or through coordination with the Ministry of Economy.

Coordinate with the Investment Promotion Agency to fill gaps and work with strategic investors to promote the mining supply chain.

Work with local communities to demonstrate the benefits from local content to encourage further investment and acceptance of mining in Kyrgyzstan.

Reform and restructure Regional Development Funds

3. We recommend restructuring and amending legislation relating to Regional Development Funds to allow for funding of national, regional and local activities, such as those covered under recommendation #2, to allow the mining industry to fund the development of local content in a sustainable and strategic manner.

Under the sub-soil legislation, all mining activities require 2% of revenues to be paid into a regional development fund (with the exception of Kumtor which pays 1% to the Issyk-Kul Development Fund).

Considerations for development funds include:

- a. Consider using a portion of the development fund income to fund a centralised agency (as per recommendation #2) that would support the strategic development of local content country-wide.
- b. Base a portion of the funding on long term development strategies aligned to the needs of the mining sector and development of local content, as opposed to annual plans.
- c. Consider long-term funding through an annuity that would preserve some of the fund until after the mine closes to bring longer term development support beyond the life of mine.
- d. Apply local content guidelines to the fund. It will bring more impact if the fund itself spends its money locally where possible.
- e. Fund development programs that build capacity and result in longer term, sustainable benefits.
- f. Focus on income generating and livelihood projects, such as irrigation repairs, that will allow the community to earn incomes and thus increase the tax base.

- g. Improve reporting and transparency of the funds so that the community understands the strategy and the longer term benefits such an approach brings. Report year on year and adjust as needed to maximise benefits.

c. Key steps by government (recommendations)

1. Continue the reform of mining sector legislation and link with the Ministry of Economy's industrial development strategy and the strategy for agricultural development.
2. Include a detailed section on strategy for development of local content into the long term mining strategy for Kyrgyzstan.
3. Develop and support reforms to development funds to support SME growth on the local level to bring greater long-term benefits to mining affected communities.
4. Consider a change in terminology to align with global practices from "Social Package" to "Impact Benefit Agreement" that will stress positive impacts as opposed to a social development role.
5. Ensure alignment with all government stakeholders to support the strategy.
6. Define "local content" and "local procurement" in a Kyrgyz context that will be realistic and support the economic development agenda.
7. Develop a strategy and national plan on local procurement that is linked to industrial development, the education system and capacity building.
8. Form an agency at a suitably visible place in the government structure to support all stakeholders (as per recommendation #2).
9. Consider incentives that would encourage local content development and local procurement that avoid just setting up resale agents to meet local purchase targets but with little benefit.
10. Consider amendments to the State procurement laws which would allow state owned companies and JVs which include state owned company participation to also participate in local procurement.
11. Consider reporting needs and standardized approach for companies in order to track and monitor local procurement, as well as allow for setting robust targets.
12. The next iteration of the "National Strategy for Sustainable Development of the Kyrgyz Republic" 2017- should have expressed mention of local content development and the chosen strategy.
13. Consider the inclusion into the Sector Council for mining sector occupations a work-stream on semi-skilled and skilled exploration positions.
14. Although the focus in Kyrgyzstan is often on gold, the steps taken should reflect the needs of all types of mining, including other commodities and small-scale mining as well.
15. Ensure the investment climate is positive in Kyrgyzstan to allow for increased foreign investment into Kyrgyzstan, supporting the growth of the mining sector overall.

d. Key steps by companies

1. Develop a local procurement strategy and communicate this to stakeholders.
2. Devote adequate resources and build internal capacity to support a local procurement and content program based on the strategy.
3. Understand what is available for purchase in the local marketplace through a community baseline study.
4. Conduct an internal assessment as to what goods and services are required by the mine and map this against the baseline study.
5. Develop a platform for dialog with local communities that will allow for transparent and commercially viable local content.

6. Form partnership for developing suppliers and producers locally with NGOs and organizations that have the skills and experience to implement such programs, and that could then be linked into wider development initiatives.
7. Consider Public-Private Partnerships (PPP) in funding local businesses that would be supplying content to mining companies.
8. Measure, account for and report on local purchases and linkages to the business value (i.e. social license to operate) in order to understand the full benefits and costs.
9. Consider opportunities right from the exploration stage that can involve local communities to begin developing long-term partnerships.

e. Key steps by communities and potential suppliers

1. Participate in initiatives that build capacity and provide access to mining companies.
2. Understand the needs of mining companies through open and structured dialog and seek to form long term strategic partnerships. Understand the quality, sustainability and pricing factors, deliver good service and not depend on geography or threats to be your sales pitch.
3. Keep expectations realistic, and focus on the mid to long term opportunities as opposed to quick wins (that often bring less benefits).
4. Be open and transparent. If you are facing issues that will affect a delivery, then tell the mining company as early as possible. This is preferable to trying to hide the issue until too late. When they know about it early on, companies can make adjustments and other arrangements. This happens to all companies, big and small, and by being open with challenges and working together to solve them you will be seen as a more reliable business partner.
5. Also participate in programs and include local purchases or local labor for your own business needs.
6. Do not become complacent or lazy. A mine is a commercial operation that will always be receiving new offers or even actively seeking them out. A complacent attitude could result in losing your contract.
7. Develop your business while you can. A mine has a finite life-span, after which time it will close. Use the time you work with the mining company to develop new markets, develop your people and company, so you do not become dependent. Ten years can go fast if you do not think strategically!

f. Key steps by GIZ and other organizations

8. Support a detailed study on the Kyrgyz economy which will detail potential for current purchases and, working with the Ministry of the Economy, look to align the growth strategy with the needs of the mining industry.
9. Support a detailed survey of companies using the EWB reporting guidelines to understand current status.
3. Align activities to support the growth of local procurement whether it be training entertainers or small businessmen, capacity building within government institutions, legislative reform support, etc. Consider supporting a coordinating body such as a SWAp or forum.
4. Engage with other local and international organizations and governments to support a broad based, cross-sector approach to the development of local content in Kyrgyzstan. For organizations with similar programs and aims, this would allow for alignment of programs, and for those with programs or aims that are working in parallel, such as in education, it would ensure that external programs can be aligned as much as possible.

11. Appendix 1: Benefits table

Stakeholder	Benefit	Description	Challenges to consider
Government	Increased tax revenue	A more diverse economy with more businesses will supply greater tax revenues to the government at all levels.	Investing back into support business growth Supplier dependence on one mine can cause negative impact at closure
	Reduced unemployment	Providing employment opportunities reduces unemployment but also help to reduce outward migration and reduce associated costs	Alignment with the education system
	Increased investor attractiveness	Reduced conflict and a formal system of community development that aligns with major mining companies today would increase the potential for companies to invest into Kyrgyzstan	Alignment of all government agencies and department Communication with potential investors
	Reduction of the grey economy	Many businesses in Kyrgyzstan operate without proper registration and without paying taxes. Integration of these businesses into the formal economy by incentivising participation in local procurement programs would increase the tax base.	Reduction of red tape and bureaucracy for small businesses

Stakeholder	Benefit	Description	Challenges to consider
Mining companies	Business continuity	Ability to work directly with suppliers increases responsiveness and reduces delivery lead time	Where can international suppliers be replaced with local ones Potential requirement for capacity building to increase capabilities of local suppliers Understanding the supplier supply chain and potential for risks
	Quality and cost control	Being close to suppliers means greater oversight and reduced delivery costs	Capacity building for efficiency at the supplier (optimization)
	Social license to operate	Delivering tangible benefits to the local community build support, and allows the company to contribute positively to their development	Dependence on the mine (post-closure issues) Different stages of the project life cycle require different goods and services

Stakeholder	Benefit	Description	Challenges to consider
Communities	Increased opportunities from mining projects	Apart from direct employment opportunities, which generally are relatively few, acting as a supplier to mining companies would increase employment opportunities in the host community	Alignment of regional development strategy Availability of products and qualified people Access to financing
	Increased dialog with mining companies	Open dialog and cooperation leads to reduces conflict and a partnership type relationship	Taking a strategic approach to development and community needs assessment Understanding the mining life cycle and opportunities that present themselves Ensuring opportunities reach all of the community and not limited to a select few
Предприятия	New opportunities for growth and sales	Companies working with mining companies will have opportunities to expand business, either through increased business or participation in development / training programs	New vs. existing businesses Managing dependence issues
	Introduction of new techniques technologies	When working in a strategic way with mining companies, local suppliers and producers may gain access to new techniques or technologies that will allow them to compete also on national or international markets	Investment costs Ensuring it is not perceived as a “present” to one supplier, causing conflict

12. Appendix 2: SWOT Analysis

Strengths

Robust agricultural sector highly localised could bring short term quick wins for government, companies and communities
Available capacity in the labour market for both skilled and unskilled workers
Strong donor footprint working in relevant areas of development of SME and local economies that can be aligned to mining sector opportunities

Weaknesses

Requires great commitment of company and extra resources to implement
If not done strategically could result in negative reputational damage
Without incentives or regulations not all companies likely to participate in such initiatives
Conflict between development and procurement and the business needs from procurement
Lack of experience or understanding of the benefits of local content in many companies
Lack of flexibility on the part of development funds
Without proper strategic development planning, local enterprises can become too dependant on the mine causing issues in the future

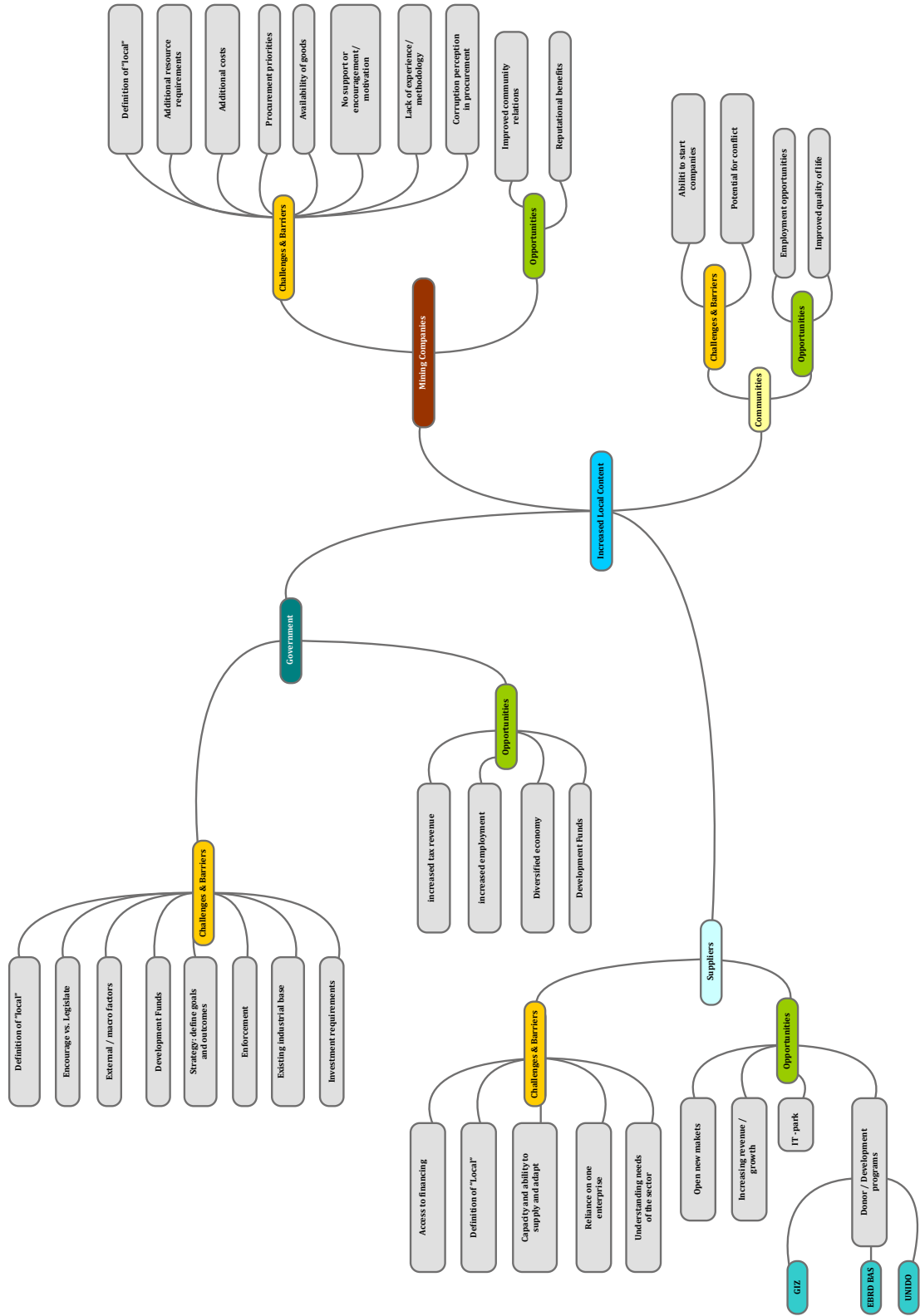
Opportunities

Strategic approach with financial incentives from government
could improve investment attractiveness of Kyrgyzstan
Cluster approach for more specialised goods and services
Development funds linked to mining projects which could provide funding to support SME growth
Reforms or programs targeting mining sector supply chain would have benefits for SMEs across all sectors

Threats

Challenges facing SME growth in general
Export market limited due to strong manufacturing sector in neighboring countries
Low commodity prices means less investment in new mines in the short term
Exchange rate valuation impacts export competitiveness
Dependence of Kumtor on the economy in the sector with no replacement forthcoming limits opportunities for larger industrial suppliers

13. Appendix 3: Map of Opportunities and Challenges



14. Appendix 4: Interviews

No	Name	Representing	Position	Stakeholder
1	Kuban Jusupov	«Altyn Kumushtak Mining» LLC	Representative of the region	Mining Sector
2	Duishonbek Ulanov	Kyrgyzkumyr	Procurement Director	Mining Sector
3	Aichorok Kanatbekova	Talas Copper Gold	Public Relations and Local Community Specialist	Mining Sector
4	Aralbek Obaskanov	ZAO “Shabon”	Procurement director	Mining sector
5	Yaroslava Mekynk	ZAO “Kumtor Gold Company”	Procurement Director	Mining Sector
6	Ilyaz Chelokenov	ZAO “Kumtor Gold Company”	Regional Buyer Supervisor	Mining Sector
7	Daniyar Jasoolov	Association of Legal Entities “Nursery Association”	Director	Supplier
8	Nazira Sheraly	“Green Business” LLC	Deputy Director	Supplier
9	Bakyt Degenbaev	PF “Support for domestic production and export”	Director	Organization
10	Jeff Geipel	Engineers Without Borders	Venture Leader “Mining Shared Value”	Organization
11	Emily Nickerson	Engineers Without Borders	Reporting work stream: Mining Shared Value	Organization
12	John Kielty	Engineers Without Borders	Reporting work stream: Mining Shared Value	Organization
13	Charles Buxton	Interak	Regional Advisor	Organization
14	Bernward Causmann	FAKT	Program Manager	Organization
15	Maksat Abdukparov	Helvetas	Deputy Country Director	Organization
16	Dinara Musabekova	Eurasia Foundation	Director	Organization
17	Nazgul Aksarieva	Eurasian Foundation	Project manager	Organization

18	Bakai Zhunusiv	European Bank for Reconstruction and Development	Director, Advice for Small Businesses	Organization
19	Jumagul Urdolotova	Kemin Region	Economic and industry	Regional government
20	RuslanEshmenbekov	Barskoon Village	Aiyl Okmotu	Local government
21	Adilet Bakytov	Issyk-Kul Development Fund	Head of planning department	Development Fund

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