Executive summary

As part of the ongoing National Policy Dialogue (NPD) on water policy conducted in co-operation with the EU Water Initiative (EUWI), Kyrgyzstan has committed to enhance the use of economic instruments for water resources management to improve the management of surface and groundwater resources, including the quality of the resource. The reform would be very timely as by strengthening incentives for improving water use efficiency economic instruments could help to better balance growing demand for water (not least due to demand from export-led agriculture and tourism as key drivers of economic growth in Kyrgyzstan) with the available fresh water resources (the annual run-off will likely drop after 2050 due to negative impact of climate change) thus ensuring greater levels of security of water supply (presently, many farmers experience water shortages over the vegetation period). Also the reform could help to make the water sector more financially autonomous and less dependent on state support.

This report builds upon, and complements, the previous work on this topic in Kyrgyzstan (OECD, 2013); it presents recommendations on introducing or reforming the following economic instruments for water resources management identified as priorities with stakeholders through the NPD:

- surface water abstraction charges (including non-consumptive uses)
- environmental pollution fees
- tariffs for irrigation water
- specific land-tax rates for the Issyk-Kul Biosphere reserve
- tariffs for urban water supply and sanitation
- product tax (including import duty) on selected products that contribute significantly to diffuse water pollution in Kyrgyzstan.

For each instrument, various reform scenarios and implementation options are identified and assessed following the *Impact Assessment Guidelines* (European Commission, 2009). Specifically, for each economic instrument in question, the potential impacts of each reform option (scenario) were assessed in terms of **environmental, economic and fiscal, and social impact** (see section 2 on methodology for detail). Where data needed for the assessment were lacking, the authors sought **experts**.

The methodology contrasts the potential revenue and cost recovery prospects of each economic instrument, compared to the budget required to meet Kyrgyzstan's water management objectives; the financial, socio-economic and environmental implications of reform are analysed for each option. Actions corresponding to the recommended reform scenarios are presented in the form of a draft Action plan (**AP**).

Main findings

1. The implementation of recommendations will *(i)* help mobilise substantial additional financial resources for water resource management, through fiscal revenue and tariffs, *(ii)* contribute to a greater degree of financial sustainability for Kyrgyz water utilities (Vodokanals*)* and *(iii)* reduce the state irrigation system's dependence on public subsidies for the operation and maintenance (O&M) of water networks.

2. The introduction of **surface water abstraction charges** for both consumptive and non-consumptive uses (initially for big industries and hydropower stations only) will not only help generate significant additional public revenues annually (from KGS 390 million to KGS 2.5 billion per annum), but also create incentives for improving water use efficiency.

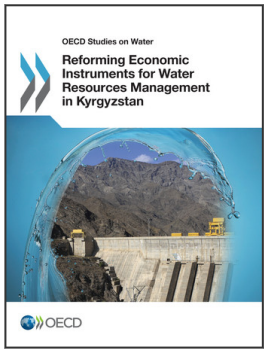
3. The proposed **reform of environmental pollution fees** will help reduce water pollution from point sources. Pollutants that most contribute to diffuse (non-point source) pollution of water resources in Kyrgyzstan include pesticides, mineral fertilisers and machinery lubricants with mineral oil. Introduction of a product tax and equivalent custom duty levied on selected products – particularly on agricultural chemicals (such as pesticides) with rates dependent on toxicity class and on lubricants – will help significantly reduce diffuse water pollution in Kyrgyzstan. Additional public revenues generated by this instrument (estimated at KGS 50-85 million per annum) could strengthen more cost-effective forms of state support to agriculture and the water sector (e.g. more efficient irrigation techniques and better rural infrastructure, including rural water supply and sanitation [WSS]).

4. The introduction of **new land-tax rates** in the Lake Issyk-Kul area – increased and better differentiated – would help capture a proportion of the rent related to the high environmental and recreational value of land in the Issyk-Kul Biosphere reserve. Eventually, increased land tax revenues (estimated at KGS 164 million per annum) could be used to improve water resource management and for other local environmental and social priorities.

5. The financial sustainability of water services – irrigation as well as water supply and sanitation services – is addressed primarily through the restructuring of water tariffs (the introduction of two-part tariffs with fixed and variable volumetric components), as well as an increase in tariff rates.

These ambitious water management objectives can be progressively developed and implemented through **appropriate sequencing** of reforms outlined by the AP for each economic instrument. A well-thought **staged approach** to reforms will also help mitigate or reduce eventual political resistance to the proposed options.

The proposed reforms will generally not have any significant negative impact on the economy (e.g. on businesses, consumers and households, innovation and research and specific regions and sectors). At the same time, **a gradual and well-sequenced implementation** will bring positive environmental, fiscal and social benefits. Overall, the reforms will help align water management policy to the broader development objectives of Kyrgyzstan such as the development of tourism and export-led agriculture in determining water demand. In addition, reduced reliance on public subsidies for O&M of water services will free up significant public funds; these can then be used for capital investment in rehabilitation and extension of water infrastructure and for strengthening the existing social support system through targeting vulnerable socio-economic groups.



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