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CONFORMED COPY

LOAN NUMBER 7145 LV

Loan Agreement

(Second Programmatic Structural Adjustment Loan)

between

REPUBLIC OF LATVIA

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated September 30, 2002

LOAN NUMBER 7145 LV

LOAN AGREEMENT

AGREEMENT, dated September 30, 2002, between REPUBLIC OF LATVIA (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Bank has received from the Borrower a letter, dated February 16, 2000, describing a program of actions, objectives and policies designed to achieve structural adjustment of the Borrower's economy (hereinafter called the Program), declaring the Borrower's commitment to the execution of the Program, and requesting assistance from the Bank in support of the Program during the execution thereof;

(B) by a Loan Agreement entered into between the Borrower and the Bank, dated March 17, 2000, the Bank made a loan to the Borrower of an amount equal to \$40,410,000 in support of the first phase of the Program (the First Phase of the Program);

(C) the Bank has received from the Borrower a letter dated August 6, 2002, describing actions taken and progress made under the First Phase of the Program and declaring the Borrower's continued commitment to the execution of the Program;

(D) the Borrower has carried out the measures and taken the actions described in Schedule 2 to this Agreement (the Second Phase of the Program) to the satisfaction of the Bank and has maintained a macroeconomic policy framework satisfactory to the Bank;

(E) the Borrower may elect to withdraw the proceeds of the Loan provided for in Article II of this Agreement at any time within three years from the date of this Agreement (or any longer period that the Bank may establish as provided in Section 2.03 of this Agreement) when a financing need arises, subject to the provision of Section 2.02 (c) of this Agreement;

(F) on the basis, inter alia, of the foregoing, the Bank has decided in support of the Second Phase of the Program to provide such assistance to the Borrower by making the Loan in one tranche as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Loan and Guarantee Agreements for Fixed Spread Loans” of the Bank, dated September 1, 1999, with the modifications thereto set forth below (the General Conditions) constitute an integral part of this Agreement:

- (a) Section 2.01, paragraph 41, is modified to read:

“‘Project’ means the second part of the program, referred to in the Preamble to the Loan Agreement, in support of which the Loan is made”;

- (b) Section 3.08 is modified to read:

“Each withdrawal of an amount from the Loan Account shall be made in the Loan Currency of such amount. The Bank, at the request and acting as an agent of the Borrower, shall purchase with the Loan Currency withdrawn from the Loan Account the currency or currencies of the deposit account specified in Section 2.02 of the Loan Agreement.”

- (c) Section 5.01 is modified to read:

“The Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in accordance with the provisions of the Loan Agreement and of these General Conditions”;

- (d) The last sentence of Section 5.03 is deleted;

- (e) Section 9.07 (c) shall be modified to read:

“(c) Not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the second part of the program referred to in the Preamble to the Loan Agreement, the performance by the Borrower and the Bank of their respective obligations under the Loan Agreement and the accomplishment of the purposes of the Loan.”; and

- (f) Section 9.05 is deleted and Sections 9.06, 9.07 (as modified above), 9.08 and 9.09 are renumbered, respectively, Sections 9.05, 9.06, 9.07 and 9.08.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

- (a) "Cabinet of Ministers" means the Cabinet of Ministers of the Borrower;
- (b) "CPB" means the Corruption Prevention Bureau established by the Borrower under the Law on Corruption Prevention Bureau;
- (c) "CPC" means the Corruption Prevention Council established by the Borrower and led by the Minister of Justice and any successor thereto;
- (d) "Coordinating Council" means the council established by the Cabinet of Ministers to monitor the implementation of the Medium Term Public Sector Reform Program (hereinafter defined);
- (e) "Corruption Prevention Plan" means the action plan approved by the Borrower's on May 15, 2001, for prevention of corruption;
- (f) "Deposit Account" means the account referred to in Section 2.02 (b) of this Agreement;
- (g) "LASCO" means Joint Stock Company A/S "Latvijas Kugnieciba" (Latvia Shipping Company), registered in the Register of Enterprises of the Republic of Latvia on September 13, 1991, Registration number 000302110, and any successor thereto;
- (h) "Latvenergo" means State Joint Stock Company VAS "Latvenergo" registered in the Register of Enterprises of Republic of Latvia on October 8, 1991, Registration number 000303294, and any successor thereto;
- (i) "Latvijas Gas" means Public Joint Stock Company A/S "Latvijas Gaze" registered in the Register of Enterprises of Republic of Latvia on March 22, 1991, Registration number 000300064, and any successor thereto;

(j) “Maturity Fixing Date” means, for each Disbursed Amount, the date on which the amortization schedule for said Disbursed Amount is established, such date being the first day of the Interest Period next following the Interest Period in which said Disbursed Amount is withdrawn;

(k) “Medium Term Public Sector Reform Program” means the programme approved by the Borrower’s on July 20, 2001, for medium term public sector reform;

(l) “Public Utilities Commission” means the institution established by the Borrower under Law on Public Services Regulators, and any successor thereto;

(m) “Saeima” means the Borrower’s parliament, and any successor thereto;
and

(n) “Ventspils Nafta” means Public Joint Stock Company A/S “Ventspils Nafta” registered in the Register of Enterprises of Republic of Latvia on May 9, 1991, Registration number 000300309, and any successor thereto.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, an amount equal to twenty million, two-hundred ten thousand dollars (\$20,210,000) as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.09 of this Agreement.

Section 2.02. (a) Subject to the provisions of paragraphs (b), (c) and (d) of this Section, the Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in support of the Second Part of the Program.

(b) The Borrower shall open, prior to furnishing to the Bank the first request for withdrawal from the Loan Account, and thereafter maintain in the Bank of Latvia, a deposit account in dollars on terms and conditions satisfactory to the Bank. All withdrawals from the Loan Account shall be deposited by the Bank into the Deposit Account. Withdrawals from the Loan Account, except those for the payment of the front-end fee set forth in Section 2.04 of this Agreement, shall be deposited by the Bank into the Deposit Account.

(c) The Borrower shall be entitled to withdraw any amount from the Loan Account for deposit in the Deposit Account only after the Bank shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement, that: (i) the macroeconomic policy framework of the Borrower continues to be consistent with the objectives of the Program; and (ii) the Borrower continues to adhere to the Program and its actions and policies remain consistent with the objectives of the Program.

(d) The Borrower undertakes that the proceeds of the Loan shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Bank shall have determined at any time that any proceeds of the Loan shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Bank, (i) deposit into the Deposit Account an amount equal to the amount of said payment, or (ii) if the Bank shall so request, refund such amount to the Bank. Amounts refunded to the Bank upon such request shall be credited to the Loan Account for cancellation.

Section 2.03. The Closing Date shall be September 30, 2005, or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a fee in an amount equal to one percent (1%) of any amount withdrawn from the Loan Account for deposit in the Deposit Account. On the date of such withdrawal, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of said fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge at the rate of one percent (1%) per annum on the unwithdrawn principal amount.

Section 2.06. The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, in respect of each Interest Period at the Variable Rate; provided, that upon a Conversion of all or any portion of the principal amount of the Loan, the Borrower shall, during the Conversion Period, pay interest on such amount in accordance with the relevant provisions of Article IV of the General Conditions.

Section 2.07. Interest and other charges shall be payable semiannually in arrears on February 15 and August 15 in each year.

Section 2.08. (a) Subject to the provisions of paragraph (b) of this Section, the Borrower shall repay each Disbursed Amount in semiannual installments payable on each February 15 and August 15, the first such installment to be payable on the 13th Interest Payment Date following the Maturity Fixing Date and the last such installment to be payable on the 26th Interest Payment Date following the Maturity Fixing Date. Each

installment except for the last one shall be equal to 7.14% of said Disbursed Amount. The last installment shall be equal to the remaining outstanding amount of said Disbursed Amount.

(b) Notwithstanding the provisions of paragraph (a) of this Section, if any one or more installments of principal of any Disbursed Amount would, pursuant to the provisions of such paragraph (a), be payable after February 15, 2017, or such later date that the Bank may establish by notice to the Borrower, in case of a postponement of the Closing Date, the Borrower shall also pay on such date the aggregate amount of all such installments.

(c) The Bank shall notify the Borrower of the amortization schedule for the Disbursed Amount promptly after the Maturity Fixing Date.

(d) Notwithstanding the provisions of paragraphs (a) through (c) of this Section, in the event of a Currency Conversion of all or any portion of a Disbursed Amount to an Approved Currency, the amount so converted in said Approved Currency that shall be repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to said Conversion by either: (i) the exchange rate that reflects the amounts of principal in said Approved Currency payable by the Bank under the Currency Hedge Transaction relating to said Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.

Section 2.09. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management:

- (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency;
- (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan from a Variable Rate to a Fixed Rate, or vice versa; and
- (iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Variable Rate.

(b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a "Conversion", as defined in Section 2.01(7) of the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

Section 2.10. The Minister of Finance, or any person he or she shall designate in writing, are hereby designated to take any action required or permitted to be taken on behalf of the Borrower for the purposes of Section 2.02 of this Agreement and Article V of the General Conditions.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower undertakes to implement the Program with due diligence to ensure that actions and policies adopted under the Program are put into effect.

(b) The Borrower and the Bank shall from time to time, at the request of either party, exchange views on the consistency of the Borrower's macroeconomic framework with the objectives of the Program, and the continued adherence of the Borrower to the Program.

(c) The Borrower and the Bank shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program.

(d) Prior to each such exchange of views, the Borrower shall furnish to the Bank for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Bank shall reasonably request.

(e) Without limitation upon the provisions of paragraph (b) of this Section, the Borrower shall exchange views with the Bank on any proposed action to be taken after the disbursement of the Loan which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program, including any action specified in Schedule 2 to this Agreement.

Section 3.02. Upon the Bank's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(b) furnish to the Bank as soon as available, but in any case not later than four (4) months after the date of the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(c) furnish to the Bank such other information concerning the Deposit Account and the audit thereof as the Bank shall have reasonably requested.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Termination

Section 5.01. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
1 Smilsu Street
Riga, LV-1919
Republic of Latvia

Facsimile:

371 7095 503

For the Bank:

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

Telex:

Facsimile:

INTBAFRAD
Washington, D.C.

248423 (MCI) or
64145 (MCI)

(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

REPUBLIC OF LATVIA

By /s/ Gundars Berzins

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Roger W. Grawe

Authorized Representative

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Loan shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;
5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term “environmentally hazardous goods” means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party);
6. expenditures (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and
7. expenditures under a contract in respect of which the Bank determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation.

SCHEDULE 2

Actions Referred to in Recital (D) of the Preamble to this Agreement

1. The Borrower has maintained an appropriate macro-economic policy framework, consistent with the objective of the Program, as determined on the basis of indicators agreed to by the Borrower and the Bank.

2. The Saeima has adopted amendments to the Law on State Pensions, removing all prohibitions to working and taking a pension, improving the equity of the pension system, curbing early retirement, and regulating future indexation.

3. The Saeima has adopted the Law on the Corruption Prevention Bureau, - with the authority to: (a) detect and resolve *ex ante* cases of conflict of interest; (b) detect and evaluate possible cases of illicit enrichment; (c) monitor corruption and corruption prevention in public sector bodies; (d) advise the Cabinet of Ministers, individual ministers, and other heads of public sector bodies, on methods to strengthen corruption prevention; (e) prepare and evaluate legislation related to corruption prevention; and (f) educate officials and the public about corruption prevention.

4. The CPC Secretariat has published changes to and progress in the implementation of the Corruption Prevention Plan.

5. The Saeima has adopted the *Law On the Framework of Public Administration*.

6. The Saeima has adopted the *Law on Public Sector Agencies*.

7. The Borrower, through its Cabinet of Ministers, has adopted a regulation identifying: (a) criteria for the role and responsibilities of each public agency; (b) the mechanism through which a public agency can be created; and (c) criteria on which to decide which agencies to divest.

8. The Borrower, through its Ministry of Justice, has assigned the task to provide guidance and coordinate the implementation of the Petitions Act and the *Law on Openness of Information* to the data inspection unit of the Ministry of Justice.

9. The Borrower, through its Ministry of Justice has adopted a time-bound action plan for the implementation of the Administrative Procedure Law and identified

one staff member within each ministry which has been assigned the responsibility to secure the implementation of this law in its ministry.

10. The Borrower, through its Cabinet of Ministers, has adopted a time-bound action plan for the implementation of the Medium Term Public Sector Reform Program in all line ministries.

11. The Borrower through its Secretariat of Minister for Special Assignment on Public Administration Reforms has designed and piloted a methodology for conducting fundamental reviews which are to be used to support the 2003 budget preparation in selected ministries and shall, *inter alia*, include: (i) a methodology to review and identify priority policies and programs; and (ii) a memorandum of understanding between the central agencies and the line ministries regarding what will be done with the results of the review.

12. The Borrower, through its Secretariat of Minister for Special Assignment on Public Administration Reform, has allocated resources to support the fundamental reviews referred to in paragraph 11 of this Schedule, and to train at least three government staff in the fundamental review methodology.

13. The Borrower, through its Ministry of Finance (MoF), has prepared a draft regulation on pay reform, and estimates of the cost of its implementation, and the Cabinet of Ministers (COM) has: (a) reviewed the draft and cost estimates; (b) accepted the draft in principle; and (c) adopted a schedule requiring the MoF to provide the CoM by October 8, 2002, detailed options for the phasing in of the pay reform.

14. The Borrower, through its Cabinet of Ministers, has issued its first annual budget priority statement, including: (a) an overall fiscal strategy; (b) budget priorities; and (c) criteria for annual budget priority setting to be used starting with the budget for the year 2003.

15. The Saeima has completed its first reading of the new Law on social services and social assistance, which provides for the nationwide implementation of national means tested social assistance benefit and improves the organization and administration of the social assistance system.

16. Subsidiary legislation, needed for the Public Utilities Commission to operate, has been approved by the Cabinet of Ministers.

17. The Borrower, through the Public Utilities Commission Board, has adopted the strategy for the Public Utilities Commission ("Strategy and Basic

Principles”) and published it in the official newspaper Latvijas Vestnesis and the website, <http://www.sprk.gov.lv/>.

18. The Borrower has in the case of the privatization of LASCO: (i) made a public offering of 32 percent of the shares for privatization vouchers; (ii) sold 51 percent of the shares to strategic and financial investors for cash through the Riga Stock Exchange at a price approved by the Board of the Latvian Privatization Agency; and (iii) agreed that the balance of the shares will go to employees and the State Pension Fund by December 31, 2002.

19. The Borrower has submitted the first regular report and evaluation by the international investment bank for Ventspils Nafta to the Bank for review.

20. The Borrower, through its Cabinet of Ministers, has approved a detailed restructuring program for Latvenego which meets the unbundling and market opening requirements of the European Union Directive No. 96/92/EC concerning common rules for the internal market in electricity.

21. The Borrower, through its Ministry of Economy, has prepared an electricity market model which meets EU Directives on market liberalization for its consideration.

22. The Borrower, through its Cabinet of Ministers, has established the transmission system operator as a separate legal entity with its own management, staff and separate accounts.

23. The Borrower, through its Cabinet of Ministers, has approved a concept with a time bound action plan of gas market liberalization in line with European Union Gas Directive No. 98/30, dealing, in particular, with third party access, and elaborating on gas pricing methodologies that deal with separation of storage, transmission, distribution and sales costs and tariffs.

24. The Borrower, through its Cabinet of Ministers, has approved a methodology for legal and regulatory impact analysis.