

CONFORMED COPY

LOAN NUMBER 4287 HU

Loan Agreement

(Higher Education Reform Project)

between

REPUBLIC OF HUNGARY

and

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Dated March 4, 1998

LOAN NUMBER 4287 HU

LOAN AGREEMENT

AGREEMENT, dated March 4, 1998, between REPUBLIC OF HUNGARY (the Borrower) and the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Bank to assist in the financing of the Project;

(B) the Bank has received a letter dated February 2, 1998, from the Borrower describing a program of actions, objectives and policies designed to reform the Borrower's system of higher education (the Reform Program) and declaring the Borrower's commitment to the execution of the Reform Program; and

WHEREAS the Bank has agreed, on the basis, inter alia, of the foregoing, to extend the Loan to the Borrower upon the terms and conditions set forth in this Agreement;

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 Single Currency Loans" of the Bank, dated May 30, 1995, with the

modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

Section 6.03 is modified to read:

"Section 6.03. Cancellation by the Bank. If (a) the right of the Borrower to make withdrawals from the Loan Account shall have been suspended with respect to any amount of the Loan for a continuous period of thirty days, or (b) at any time, the Bank determines, after consultation with the Borrower, that an amount of the Loan will not be required to finance the Project's costs to be financed out of the proceeds of the Loan, or (c) at any time, the Bank determines, with respect to any contract to be financed out of the proceeds of the Loan, that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or the execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation, and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Loan, or (d) at any time, the Bank determines that the procurement of any contract to be financed out of the proceeds of the Loan is inconsistent with the procedures set forth or referred to in the Loan Agreement and establishes the amount of expenditures in respect of such contract which would otherwise have been eligible for financing out of the proceeds of the Loan, or (e) after the Closing Date, an amount of the Loan shall remain unwithdrawn from the Loan Account, the Bank may, by notice to the Borrower, terminate the right of the Borrower to make withdrawals with respect to such amount. Upon the giving of such notice, such amount of the Loan shall be canceled."

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

(a) "Act" means the Borrower's Higher Education Act (Act LXXX of 1993), as amended by Act LXI of 1996.

(b) "CIP" means a capital investment plan specified in paragraph 2(a) or 2(b), as the case may be, of Part A of Schedule 5 to this Agreement.

(c) "Deutsche Mark" and "DEM" each means the lawful currency of the Federal Republic of Germany.

(d) "FEFA" means the Higher Education Development Fund, an agency of the Borrower, established pursuant to the Decree of the Minister of MCE, 11/96 (X.9) MKM, and includes any successor or successors thereto.

(e) "HAC" means the Hungarian Accreditation Committee, established by the Borrower pursuant to Section 80 of the Act and includes any successor or successors thereto.

(f) "HEA" and "HEAs" mean singularly the Higher Education Association (as described in Sections 12 and 12/A of the Act) and collectively the Higher Education Associations selected for participation under Part B of the Project pursuant to and in accordance with paragraph 2 (a) of Schedule 5 to this Agreement.

(g) "HEI" and "HEIs" mean singularly the Higher Education Institution (as described in Section 2 of the Act) and collectively the Higher Education Institutions selected for participation under Part B of the Project pursuant to and in accordance with paragraph 2 (b) of Schedule 5 to this Agreement.

(h) "HERC" means the Higher Education and Research Council, established by the Borrower pursuant to Sections 76-79 of the Act and includes any successor or successors thereto.

(i) "IAP" means the International Advisory Panel referred to in paragraph 4 of Part A of Schedule 5 to this Agreement.

(j) "IDP" means an institutional development plan specified in paragraph 2(a)

or 2(b), as the case may be, of Part A of Schedule 5 to this Agreement.

(k) "Investment Agreement" means an agreement entered into between MCE, on behalf of the Borrower, and a HEA/HEI in respect of an Investment Project, pursuant to and in accordance with paragraphs 3 and 4 of Part C of Schedule 5 to this Agreement, and shall include any amendments made thereto from time to time with the concurrence of the Bank.

(l) "Investment Project" means a capital investment project under Part B of the Project.

(m) "Investment" means a capital investment made or proposed to be made in a selected HEA/HEI by the Borrower for an Investment Project out of the proceeds of the Loan.

(n) "MCE" means the Borrower's Ministry of Culture and Education and includes any successor or successors thereto.

(o) "NCC" means the National Credit Council, established or to be established by the Borrower pursuant to Section 78/A(1) of the Act and includes any successor or successors thereto.

(p) "PMU" means the Project Management Unit, established by MCE pursuant to its Ministerial Resolution No. 2388, dated December 3, 1977.

(q) "Project Preparation Advance" means the project preparation advance granted by the Bank to the Borrower pursuant to an exchange of letters dated July 16, 1997 and October 15, 1997, between the Borrower and the Bank.

(r) "Special Account" means the account referred to in Section 2.02 (b) of this Agreement.

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 two hundred sixty three million six hundred thousand Deutsche Mark (DEM 263,600,000).

Section 2.02. (a) The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement for: (i) amounts paid (or, if the Bank shall so agree, to be paid) by the Borrower on account of withdrawals made by a HEA/HEI under an Investment Agreement to meet the reasonable cost of goods and services required for the Investment Project in respect of which the withdrawal from the Loan Account is requested; and (ii) expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods and services required for Parts A, C, D, E and F of the Project and to be financed out of the proceeds of the Loan and in respect of interest and other charges on the Loan.

(b) The Borrower may, for the purposes of the Project, open and maintain in DEM a special deposit account in the National Bank of Hungary on terms and conditions satisfactory to the Bank. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 6 to this Agreement.

(c) Promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount required to repay the principal amount of the Project Preparation Advance withdrawn and outstanding as of such date and to pay all unpaid charges thereon. The unwithdrawn balance of the authorized amount of the Project Preparation Advance shall thereupon be canceled.

Section 2.03. The Closing Date shall be June 30, 2004, 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 commitment charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the

Loan not withdrawn from time to time.

Section 2.05. The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time in accordance with the provisions of Schedule 3 to this Agreement.

Section 2.06. Interest and other charges shall be payable in arrears on May 15 and November 15 in each year.

Section 2.07. The Borrower shall repay the principal amount of the Loan in accordance with the provisions of Schedule 3 to this Agreement.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project through MCE, all with due diligence and efficiency and in conformity with appropriate administrative, financial, and educational policies and practices and in conformity with the Reform Program, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Bank and the Borrower shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 5 to this Agreement.

Section 3.02. (a) 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 Reform Program and the actions specified in Part B of Schedule 5 to this Agreement.

(b) 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 Reform Program, in such detail as the Bank shall reasonably request.

(c) Without limitation upon the provisions of paragraph (a) 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 Reform Program, or any action taken under the Reform Program, including any action specified in Part B of Schedule 5 to this Agreement.

Section 3.03. Except as the Bank shall otherwise agree, procurement of the goods, works, and consultants' services required for the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 4 to this Agreement.

Section 3.04. For the purposes of Section 9.08 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Bank and furnish to the Bank 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, a plan designed to ensure the continued achievement of the Project's objectives; and

(b) afford the Bank a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall establish and maintain a financial management system, including records and accounts, and prepare financial statements in accordance with sound accounting practices and in a format acceptable to the Bank, adequate to reflect the operations, resources and expenditures for and in connection with the carrying out of the Project.

(b) The Borrower shall:

(i) have the records, accounts and financial statements referred to in paragraph (a) of this Section and the records and accounts for the Special Account for each fiscal year audited, in accordance with auditing standards acceptable to the Bank consistently applied, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six (6) months after the end of each such year, (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year as so audited, and (B) an opinion on such financial statements, records and accounts and a report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested;

(iii) furnish to the Bank such other information concerning such records and accounts and the audit thereof, and concerning said auditors, as the Bank may from time to time reasonably request; and

(iv) (A) have the financial management system for the Project evaluated by an appropriate auditing body by June 30, 1998; (B) furnish to the Bank a report on such evaluation by said auditing body by July 31, 1998; and (C) review with the Bank said report within one month of said report's submission to the Bank, and, thereafter, take all measures necessary to ensure the efficient flow of funds for the Project taking into consideration the Bank's views on the matter.

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of statements of expenditure, the Borrower shall:

(i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and separate accounts reflecting such expenditures;

(ii) retain, until at least one (1) year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;

(iii) enable the Bank's representatives to examine such records; and

(iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during each fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Loan Agreement within the meaning of Section 12.01 (c) of the General Conditions:

(a) the NCC has been established pursuant to Section 78/A of the Act;

(b) the IAP has been established and staffed pursuant to paragraph 4 of Schedule 5 to this Agreement;

(c) the establishment of a task force to oversee the design of the Borrower's student loan guarantee program under terms of reference acceptable to the Bank;

(d) the submission of a proposal with terms of reference for a study on methods and procedures for targeting student subsidies on students in financial need; and

(e) the promulgation of a decree by the Borrower intended to: (i) integrate the maintenance with the teaching allocation category in the Borrower's normative financing system under its budget for 1998 and thereafter; and (ii) reduce the total number of normative recipient categories from 14 to no more than 7.

Section 5.02. The date sixty (60) 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 Deputy President of the National Bank of Hungary 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:

National Bank of Hungary
Department for International Development Institutions
H-1850 Budapest, Szabadsag ter 8-9
Republic of Hungary

Cable address:	Telex:
BANKO Budapest	22-5755

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:
INTBAFRAD Washington, D.C.	248423 (MCI) or 64145 (MCI)

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 HUNGARY

By /s/ Balint Magyar

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Anil Sood

Acting Regional Vice President
Europe and Central Asia

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Loan, the allocation of the amounts of the Loan to each Category and the percentage of expenditures for items so to be financed in each Category:

Category	Amount of the Loan Allocated (Expressed in DEM)	% of Expenditures to be Financed
(1) Civil works for Investments under Part B of the Project	173,400,000	60%
(2) Consultants' services (including auditing services), training and fellowships	50,770,000	100%
(3) Goods	23,010,000	100% of foreign expenditures, 100% of local expendi- tures (ex-factory cost) and 80% of local expenditures for other items procured locally
(4) Incremental Operating Costs	4,220,000	100% up to June 30, 2000, and 75% thereafter
(5) Refunding of Project to Preparation Advance	4,920,000	Amounts due pursuant Section 2.02 (c) of this Agreement
(6) Unallocated	7,280,000	
TOTAL	263,600,000	

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower; and

(b) the term "local expenditures" means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(c) the term "Incremental Operating Costs" means the additional costs incurred by MCE on account of the PMU staff salaries, office facilities, services; staff travel and consumable office supplies as may be agreed by the Bank; and

(d) the term "training" means the training activities (other than consultants' services) to be carried out under the Project, including the travel cost and per diem of the trainees and other expenditures as may be agreed by the Bank.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures: (a) prior to the date of this Agreement; and (b) for an Investment, unless the Investment has been made in accordance with the procedures and on the terms and conditions set forth or referred to in Part C of Schedule 5 to this Agreement.

4. The Bank may require withdrawals from the Loan Account to be made on the basis of statements of expenditure for expenditures for: (a) goods and works under contracts not exceeding \$300,000 equivalent; (b) services under contracts not exceeding \$50,000 in case of individuals and \$100,000 in case of firms; and (c) training and fellowships, under such terms and conditions as the Bank shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to develop a system of higher education that: (a) responds to the Borrower's changed and changing social and economic needs; (b) operates efficiently; (c) mobilizes greater private finance; and (d) distributes the costs of education more equitably.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Bank may agree upon from time to time to achieve such objectives:

Part A: Sector Policy Development

Introduction of key policy and administrative reforms regarding higher education, including: (1) the establishment of an enrollment allocation mechanism based largely on student choice; (2) the further development and implementation of norms-based financing; (3) the development and introduction of a credit and credit transfer system; (4) the reform of curricula to emphasize a broader approach, more independent learning and greater flexibility in requirements, including requirements for general education in earlier years and specialized education in later years; (5) the restructuring and strengthening of FEFA, HAC, HERC, and NCC; (6) the provision of additional financial authority for HEAs/HEIs; (7) the adoption of strategic planning and business procedures and practices within HEAs/HEIs; (8) the introduction of unified procedures and criteria for capital investments; (9) the achievement of higher student-teacher ratios; (10) the adoption of a more equitable system of higher education financing; and (11) the creation of incentives for development of private higher education.

Part B: Capital Investment Projects

Undertaking of capital investment projects, through the execution of CIPs, in selected HEAs/HEIs to support implementation of their respective IDPs, including provision of construction, renovation, furniture and equipment, such as equipment needed for telecommunications, library and lecture halls and large classrooms, and technical assistance specified in their respective CIPs.

Part C: Financial Management Information Systems

Development of new structures, procedures and systems, for such functions as budgeting, accounting and financial control systems, student registration systems, research registry systems and physical facilities control systems through the provision of technical assistance, training, software, and equipment.

Part D: Management Capacity Development

Strengthening of management skills and capacity in the areas of planning (such as institutional development planning and business planning), financial management and information systems, and other areas through the provision of technical assistance and training for the staff of: (1) public and private HEAs/HEIs, and (2) MCE, HERC, HAC, NCC, FEFA and other supervisory bodies in the field of higher education.

Part E: Student Loan Program

Development of a national student loan program through the provision of technical assistance aimed at: (1) establishing an autonomous student loan guarantee agency; (2) designing its policies, systems and operating procedures; (3) elaborating mechanisms for recovering loans; and (4) developing financial products in order to provide borrowers a range of repayment options.

Part F: Project Management

Provision of technical assistance, equipment and operating costs for the management and operation of the PMU.

* * *

The Project is expected to be completed by December 31, 2003.

SCHEDULE 3

Interest and Principal Repayment Provisions

Part A: General Definitions

For purposes of this Schedule, the following terms have the following meanings:

(a) "Disbursed Amount" means, in respect of each Interest Period, the aggregate principal amount of the Loan withdrawn from the Loan Account in such Interest Period.

(b) "Interest Period" means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment date to, but excluding, the next following Interest Payment Date.

(c) "Interest Payment Date" means any date specified in Section 2.06 of this Agreement.

(d) "Rate Fixing Date" means, for each Disbursed Amount, the first day of the Interest Period next following the Interest Period in which such Disbursed Amount is withdrawn.

Part B: Interest

1. The principal amount of the Loan shall be divided into Disbursed Amounts. Interest shall accrue on each Disbursed Amount outstanding from time to time at a rate based on a floating rate index prior to its Rate Fixing Date and at a fixed rate from its Rate Fixing Date, as described in paragraph 2 of this Part B.

2. (a) From the date of withdrawal of each amount of each Disbursed Amount withdrawn and outstanding, to but not including the Rate Fixing Date for such Disbursed Amount, interest on each such amount shall accrue, at a rate equal to the applicable:

(i) LIBOR Base Rate; plus

(ii) LIBOR Total Spread.

(b) From the Rate Fixing Date for each Disbursed Amount until final repayment thereof, interest on such Disbursed Amount shall accrue, at a rate equal to the applicable:

(i) Fixed Base Rate; plus

(ii) Fixed Total Spread.

3. For purposes of paragraph 2 of this Part B, the following terms have the following meanings:

(a) "LIBOR Base Rate" means, for the Interest Period in which a Disbursed Amount is withdrawn, the London interbank offered rate for six-month deposits in single currency for value the first day of such Interest Period (or, in the case of the initial Interest Period, for value the day occurring on the Interest Payment Date preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.

(b) "LIBOR Total Spread" means, for the Interest Period in which each Disbursed Amount is withdrawn:

(i) one half of one percent (1/2 of 1%);

(ii) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank's outstanding borrowings or portions thereof allocated by the Bank to fund single currency loans or portions thereof made by it that include such Disbursed Amount for such Interest Period;

as reasonably determined by the Bank and expressed as a percentage per annum.

(c) "Fixed Base Rate" means, for each Disbursed Amount, the equivalent of the London interbank offered rate for six-month deposits in single currency for value on the Rate Fixing Date for such Disbursed Amount, expressed as a single fixed interest rate based on the fixed interest rates corresponding to the repayment installments of such Disbursed Amount, as reasonably determined by the Bank and expressed as a percentage per annum.

(d) "Fixed Total Spread" means, for each Disbursed Amount:

(i) one-half of one percent (1/2 of 1%);

(ii) minus (or plus) the cost margin, applicable on the Rate Fixing Date for such Disbursed Amount, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank's outstanding borrowings or portions thereof allocated to fund single currency loans or portions thereof made by it that include such Disbursed Amount; plus

(iii) the Bank's risk spread applicable on the Rate Fixing Date for such Disbursed Amount;

as reasonably determined by the Bank and expressed as a percentage per annum.

4. The Bank shall notify the Borrower of LIBOR Base Rate, LIBOR Total Spread, Fixed Base Rate and Fixed Total Spread applicable to each Disbursed Amount, promptly upon the determination thereof.

5. Whenever, in light of changes in market practice affecting the determination of the interest rates referred to in this Schedule, the Bank determines that it is in the interest of its borrowers as a whole and of the Bank to apply a basis for determining the interest rates applicable to the Loan other than as provided in this Schedule, the Bank may modify the basis for determining the interest rates applicable to amounts of the Loan not yet withdrawn upon not less than six (6) months' notice to the Borrower of the new basis. The new basis shall become effective on the expiry of the notice period unless the Borrower notifies the Bank during said period of its objection thereto, in which case said modification shall not apply to the Loan.

Part C: Repayment

1. Subject to the provisions of paragraph 2 of this Part C, the Borrower shall repay each Disbursed Amount of the Loan in semiannual installments payable on each May 15 and November 15, the first such installment to be payable on the seventh (7th) Interest Payment Date following the Rate Fixing Date for such Disbursed Amount and the last such installment to be payable on the twelfth (12th) Interest Payment Date

following the Rate Fixing Date for such Disbursed Amount. Each installment shall be one-sixth (1/6) of such Disbursed Amount.

2. Notwithstanding the provisions of paragraph 1 of this Part C, if any installment of principal of each Disbursed Amount would, pursuant to the provisions of said paragraph 1, be payable after May, 15, 2013, the Borrower shall also pay on said date the aggregate amount of all such installments.

3. After each Disbursed Amount shall have been withdrawn, the Bank shall promptly notify the Borrower of the amortization schedule for such Disbursed Amount.

SCHEDULE 4

Procurement

Section I. Procurement of Goods and Works

Part A: General

Goods and works shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996 (the Guidelines) and the following provisions of this Section.

Part B: International Competitive Bidding

Except as otherwise provided in Part C of this Section, goods and works shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$5,000,000 equivalent per contract, up to an aggregate amount not to exceed \$65,000,000 equivalent, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. International Shopping

Except as otherwise provided in paragraph 3 hereof, goods estimated to cost less than \$500,000 equivalent per contract, up to an aggregate amount not to exceed \$4,100,000 equivalent, may be procured under contracts awarded on the basis of international shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

3. National Shopping

Goods estimated to cost less than \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$2,200,000 equivalent, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to prequalify for bidding or to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for goods, estimated to cost the equivalent

of \$300,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

(b) With respect to the first two contracts for civil works under Part C.1 hereof and each contract therefor thereafter, estimated to cost the equivalent of \$1,000,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of the Introduction and Section IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 (the Consultant Guidelines) and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, paragraph 3 of Appendix 1 thereto, Appendix 2 thereto, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provisions shall apply to consultants services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph. The short list of consultants for services for architectural design, construction, management and supervision under Part B of the Project, estimated to cost less than \$200,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Fixed budget services for university twinning partnerships under Part D of the Project may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

2. Services for sector policy development, auditing, and the PMU may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Bank of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultant Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for employment of consulting firms estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 1, 2 (other than the third subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for employment of consulting firms estimated to cost less than the equivalent of \$100,000, the procedures set forth in

paragraph 1, and the first and third subparagraphs of paragraph 2(a) of Appendix 1 to the Consultant Guidelines shall apply.

(c) With respect to each contract for the employment of individual consultants, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Bank for its prior review and approval. The contract shall be awarded only after the said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 5

Implementation Program

Part A: General Covenants

1. The Borrower shall carry out the Project through MCE with the assistance of HERC, FEFA, PMU and such of its other departments and agencies as may be expedient for the purpose.

2. (a) The Borrower shall, in consultation with the Bank, select, for participation under Part B of the Project, HEAs which shall have: (i) initiated the process of obtaining approval from the Borrower pursuant to Section 4/A or Section 12/A of the Act and the relevant rules, regulations and decrees thereunder; (ii) prepared a comprehensive institutional development plan setting out goals, mission, plans for integration, efficiency targets and means of achievement; (iii) prepared a detailed capital investment plan based on an analysis of occupancy rates and use factors of existing premises and projected schedules of accommodation; and (iv) obtained approval of their respective IDP/CIP from their respective governing bodies (institution councils/senates).

(b) The Borrower may, in agreement with the Bank, select, for participation under Part B of the Project, HEIs, on the basis of competition for purposes of academic rationalization and consolidation and subject to an aggregate limit of thirty million Dollars and ten million Dollars for any single HEI, which shall have: (i) prepared a comprehensive institutional development plan setting out goals, mission, plans for administrative and academic rationalization and consolidation, efficiency targets and means of achievement; (ii) prepared a detailed capital investment plan based on an analysis of occupancy rates and use factors of existing premises and projected schedules of accommodation; and (iii) obtained approval of their respective IDPs/CIPs from their respective governing bodies (institution councils).

3. The Borrower shall approve or cause each IDP and CIP to be approved and make Investment in each HEA/HEI, in consultation with the Bank, in accordance with criteria and procedures, acceptable to the Bank, and on the terms and conditions set forth in Part C of this Schedule.

4. The Borrower shall establish and, during execution of the Project, maintain the IAP for the purpose of evaluating, commenting and advising on the implementation of the Reform Program under terms of reference acceptable to the Bank. The IAP shall comprise a panel of experts, whose experience, qualifications and terms and conditions of employment shall be acceptable to the Bank.

5. The Borrower shall maintain or cause the HERC, FEFA and PMU to be maintained with funds, facilities, functions, powers, and qualified staff in adequate numbers necessary to assist MCE in carrying out the Project as deemed satisfactory by the Bank.

6. The Borrower shall, until completion of the Project, maintain (a) an Executive Director of FEFA in consultation with the Bank; (b) the Deputy State Secretary of Higher Education as Project Director who shall be overall in charge of the Project; and (c) the position of the Director of PMU and keep appointed a person to the said

position as deemed satisfactory by the Bank.

7. The Borrower shall, by June 30, 1998, adopt a policy requiring MCE to apply criteria and procedures for approval of all capital investments in higher education financed from State budget resources, including future phases of current investment projects consistent with the criteria and procedures for Investments under this Project.

8. The Borrower shall maintain its policy, requiring HEAs/HEIs to operate from a balanced budget, specified in the Borrower's Act XXXVIII of 1992 on State Budgetary Procedure, as amended by Act CV of 1995.

9. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators acceptable to the Bank, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about June 30, 1999 and June 30, 2001, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(c) review with the Bank, by September 30, 1999 and September 30, 2001, or such later date as the Bank shall request, the report referred to in subparagraph (b) of this paragraph, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

Part B: Criteria for Approval of Investments

1. No Investment shall be approved by the Bank after June 30, 1999, unless the Bank is satisfied, after an exchange of views as described in Section 3.02 of this Agreement based on evidence satisfactory to the Bank: (a) with the progress achieved by the Borrower in the carrying out of the Reform Program; and (b) that the actions described in paragraph 4 below have been taken.

2. No additional Investment shall be approved by the Bank after June 30, 2001, unless the Bank is satisfied, after an exchange of views as described in Section 3.02 of this Agreement based on evidence satisfactory to the Bank: (a) with the progress achieved by the Borrower in the carrying out of the Reform Program; and (b) that the actions described in paragraph 5 below have been taken.

3. If, after the exchange of views specified in paragraphs 1 and 2 above, the Bank shall have given notice to the Borrower that the progress achieved and actions taken are not satisfactory and, within 90 days after such notice, the Borrower shall not have achieved progress and taken actions satisfactory to the Bank, then the Bank may, by notice to the Borrower, cancel the unwithdrawn amount of the Loan or any part thereof.

4. The Borrower shall have:

(a) as part of its agreed mechanism of restructuring the allocation of enrollments and financial support to HEAs/HEIs, undertaken the reform of the methodology of student allocation to HEAs/HEIs in accordance with a proposal satisfactory to the Bank, including: (i) completion of a detailed design of the system of allocating state funds to students based on results of a national examination; (ii) initiation of the modification of the Act, if necessary, and issuance of regulations necessary to apply the said new system; (iii) development of a national examination for use in determining grant allocations for students entering the system in school year 2000; and (iv) completion of a study on the equity implications of the introduction of the said national examination under (iii) hereof and adoption of compensatory measures.

(b) as part of its agreed mechanism for improving and implementing a norms-based system for allocating central funds to HEAs/HEIs: (i) increased the full time equivalent student-staff ratio basis of normative financing from 8.7:1 to 10.5:1; (ii) eliminated all college/university disparities for same degrees; and (iii) completed a study on the rationalization of teacher training, medical and agricultural higher education, including non-teaching activities such as clinics and practice farms, and adopted key policy recommendations arising therefrom in consultation with the Bank.

(c) as part of its agreed mechanism to install a credit system and rationalize curricula, issued decrees regarding: (i) the establishment of a credit system pursuant to Section 124/D(b) of the Act; and (ii) the guidelines for the process and framework for defining qualifications requirements so as to ensure broadening of study fields and deferral of specialization.

(d) as part of its agreed mechanism to provide financial authority for HEAs/HEIs, and on the basis of positive experience gained, granted greater financial authority to additionally selected HEAs/HEIs.

(e) as part of its agreed mechanism to increase private resource mobilization in public HEIs, increased revenue from tuition charges and instructional fees to at least 15% of direct instructional costs at public HEIs.

(f) as part of its agreed mechanism to target student support subsidies on the most needy students: (i) completed evaluation of alternative procedures, in consultation with the Bank, for identifying financial need; and (ii) begun to allocate no less than 50% of the student support subsidy on the basis of financial need under rules based upon (i) hereof and acceptable to the Bank.

(g) as part of its agreed mechanism to establish a student loan program: (i) completed the design of the student loan program referred to in Section 5.01(c) of this Agreement; and (ii) based on such design, (A) completed the detailed review of existing legislation affecting recovery of loans; (B) established an autonomous student loan guarantee agency; (C) developed systems and procedures for loan origination and servicing by the said agency under (ii)(B) hereof acceptable to the Bank; and (D) offered guaranteed loans to students in their fourth and fifth years of study in at least two of the integrating HEAs.

5. The Borrower shall have:

(a) as part of its agreed mechanism of restructuring the allocation of enrollments and financial support to HEAs/HEIs, put into effect the application of a national examination for determining grant allocations for students developed pursuant to Section 4(a) above;

(b) as part of its agreed mechanism for improving and implementing a norms-based system for allocating central funds to HEAs/HEIs: (i) reduced the number of normative financing categories to 5; and (ii) increased the full time equivalent student-staff ratio basis of normative financing from 10.5:1 to 12:1;

(c) as part of its agreed mechanism to install a credit system and rationalize curricula, caused MCE to implement the credit system established pursuant to paragraph 4(c) above nation-wide;

(d) as part of its agreed mechanism to provide financial authority for HEAs/HEIs, and on the basis of positive experience gained pursuant to Section 4(d) above, granted greater financial authority to all HEAs/HEIs whose IDPs have been approved under the Act;

(e) as part of its agreed mechanism to increase private resource mobilization in public HEIs, increased revenue from tuition charges and instructional fees to at least 20% of direct instructional costs at public HEIs;

(f) as part of its agreed mechanism to target student support subsidies on most needy students, allocated no less than 75% of the student support subsidy on the basis of financial need; and

(g) as part of its agreed mechanism to establish a student loan program, and on the basis of experience gained: (i) reviewed initial experiences with the loan program; (ii) refined the procedures in light of the said experiences; and (iii) on the basis of positive experience gained pursuant to paragraph 4(g)(ii)(D) hereof, made the student loan program accessible to all students making satisfactory progress on an accredited program of study in a HEI.

6. No Investment shall be made in a HEA unless it has received the final approval from the Borrower pursuant to Section 4/A or Section 12/A of the Act.

Part C: Procedures for and Terms and Conditions of Approval of Investments and Investment Projects

1. No expenditures for goods or services required for an Investment Project shall be eligible for financing out of the proceeds of the Loan unless the Investment for such Investment Project shall have been approved by the Bank and such expenditures shall have been made not earlier than ninety (90) days prior to the date on which the Bank shall have received the application and information required under paragraph 2 of this Part in respect of such Investment.

2. (a) When presenting an Investment to the Bank for approval, the Borrower shall furnish to the Bank an application, in form satisfactory to the Bank, together with: (i) a description of the IDP and CIP and an appraisal of the Investment Project, including a description of the expenditures proposed to be financed out of the proceeds of the Loan; (ii) the proposed terms and conditions of the Investment; and (iii) such other information as the Bank shall reasonably request.

(b) Applications and requests made pursuant to the provisions of subparagraph (a) of this paragraph shall be presented to the Bank on or before December 31, 2002.

3. Investments shall be made on terms whereby the Borrower shall, through MCE, obtain, by written contract with the HEA/HEI or by other appropriate legal means, rights adequate to protect the interests of the Bank and the Borrower, including to the extent that it shall be appropriate, the right to:

(a) require the HEA/HEI to carry out and operate the Investment Project with due diligence and efficiency and in accordance with sound financial, managerial, and educational standards and practices, and to maintain adequate records;

(b) require that: (i) the goods, works and consultants' services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 to this Agreement; and (ii) such goods and services shall be used exclusively in the carrying out of the Investment Project;

(c) inspect, by itself or jointly with representatives of the Bank if the Bank shall so request, such goods and the sites, works, and construction included in the Investment Project, the operation thereof, and any relevant records and documents;

(d) require that: (i) the HEA/HEI shall take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice; and (ii) without any limitation upon the foregoing, such insurance shall cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Loan to the place of use or installation, any indemnity thereunder to be made payable in a currency freely usable by the HEA/HEI to replace or repair such goods;

(e) obtain all such information as the Bank or the Borrower shall reasonably request relating to the foregoing and to the administration, operations and financial condition of the HEA/HEI and to the benefits to be derived from the Investment Project; and

(f) suspend or terminate the right of the HEA/HEI to the use of the proceeds of the Loan upon failure by such HEA/HEI to perform its obligations under its contract with the Borrower.

4. The Investment Agreement shall include the purpose, objectives, means and specific targets for: (a) administrative reform and consolidation, if applicable,

including consolidation of joint services to achieve scale economies and adoption of modern business planning practices; (b) academic reform and consolidation, if applicable, including broader degree programs and less academic specialization, implementation of a credit system, definition of full-time equivalent students, modularization of curricula, consolidation of core courses across departments and faculties, allowance of cross registration of students between faculties and institutions, and increasing the proportion of elective courses in total study programs; and (c) more effective and efficient teaching processes, including greater reliance on independent study by students outside of class with corresponding reductions of time in class, increased average number of students per teacher through such means as reduced weekly compulsory hours of class room instruction for students, increased average number of students per class and/or increased weekly teaching loads for staff. The Investment Agreement shall also specify the data to be collected in monitoring achievement of these targets and objectives.

5. The Borrower shall exercise its rights in relation to each Investment Agreement in such manner as to: (i) protect the interests of the Bank and the Borrower; (ii) comply with its obligations under this Agreement; and (iii) achieve the purposes of the Project.

SCHEDULE 6

Special Account

1. For the purposes of this Schedule:

(a) the term "eligible Categories" means Categories 1, 2, 3, and 4 set forth in the table in paragraph 1 of Schedule 1 to this Agreement; for the avoidance of doubt, it is clarified that the term eligible Categories will be deemed to include the categories specified above only if and to the extent the conditions of disbursements, if any, in respect thereof provided in paragraph 3 of Schedule 1 to this Agreement have been fulfilled;

(b) the term "eligible expenditures" means expenditures in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Loan allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and

(c) the term "Authorized Allocation" means an amount equivalent to DEM 7,000,000 to be withdrawn from the Loan Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Schedule, provided, however, that unless the Bank shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to DEM 3,500,000 until the aggregate amount of withdrawals from the Loan Account plus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of DEM 21,100,000.

2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.

3. After the Bank has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Bank a request or requests for deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account such amount or amounts as the Borrower shall have requested.

(b) (i) For replenishment of the Special Account, the Borrower shall furnish to the Bank requests for deposits into the Special Account at such intervals as the Bank shall specify.

(ii) Prior to or at the time of each such request, the Borrower shall furnish to the Bank the documents and other evidence

required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for eligible expenditures. All such deposits shall be withdrawn by the Bank from the Loan Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Bank shall reasonably request, furnish to the Bank such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Bank shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Bank shall have determined that all further withdrawals should be made by the Borrower directly from the Loan Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

(b) if the Borrower shall have failed to furnish to the Bank, within the period of time specified in Section 4.01(b)(ii) of this Agreement, any of the audit reports required to be furnished to the Bank pursuant to said Section in respect of the audit of the records and accounts for the Special Account;

(c) if, at any time, the Bank shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Loan Account pursuant to the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Loan allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Loan Account of the remaining unwithdrawn amount of the Loan allocated to the eligible Categories shall follow such procedures as the Bank shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Bank shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Bank shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Bank, the Borrower shall, promptly upon notice from the Bank: (A) provide such additional evidence as the Bank may request; or (B) deposit into the Special Account (or, if the Bank shall so request, refund to the Bank) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Bank shall otherwise agree, no further deposit by the Bank into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Bank shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Bank, refund to the Bank such outstanding amount.

(c) The Borrower may, upon notice to the Bank, refund to the Bank all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Bank made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Loan Account for subsequent withdrawal or for

cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.

