

January 18, 2001

His Excellency
Roberts Zile
Minister of Special Assignments
or Cooperation with International Financial Agencies
Ministry of Finance
1 Smilsu Street, LV-1919, Riga
Republic of Latvia

Re: Japanese Grant for Second Programmatic Structural Adjustment Loan
Grant No. TF026556

Excellency:

I am writing on behalf of the International Bank for Reconstruction and Development (the Bank) to indicate the Bank's agreement, as administrator of grant funds provided by Japan, to make a grant in an amount not exceeding five hundred and four thousand, three hundred and fifteen United States dollars (\$504,315) (the Grant) to Republic of Latvia (the Recipient).

The Grant is made in response to the Recipient's request for financial assistance and for the purposes and on the terms and conditions set forth in the Annex to this Letter Agreement. The Recipient represents, by confirming its agreement below, that it is authorized to contract and withdraw the Grant for the said purposes and on the said terms and conditions.

Please confirm your agreement with the foregoing, on behalf of the Recipient, by signing, dating, and returning to us the enclosed copy of this Letter Agreement. Upon receipt by the Bank of the copy of this Letter Agreement countersigned by you, this Letter Agreement will become effective as of the date of the countersignature.

Very truly yours,

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Basil G. Kavalsky
Director
Estonia, Latvia, Lithuania and Poland Country Unit
Europe and Central Asia Region

AGREED:

REPUBLIC OF LATVIA

By /s/ Roberts Zile
Minister for Special Assignment for Cooperation
with International Financial Agencies

Date: February 5, 2001

ANNEX

Purposes, Terms, and Conditions of the Grant

1. Purposes and Activities

The purposes of the Grant is to assist in the preparation of the Second Programmatic Structural Adjustment Loan (the Project), which has as main objectives to support the continuation of the Recipient's Government (the Government) ongoing economic reform program backed by the Bank's first Programmatic Structural Adjustment Loan (PSAL I) (the Project). The activities (the Activities) for which the Grant is

given are as follows:

(A) Social Sectors and Resource Use:

(i) provision of technical assistance to enhance reforms in the area of pensions and delivery of social assistance with the objective of advising the Government how to further rationalize resource use in the social sector. The technical assistance will focus on how the social assistance system may be reformed to a system which: (a) places gatekeeping and referral decisions and financing responsibilities for social care and social assistance with one level of the Government; (b) assists the Government evaluating the impact of its public expenditure policies, especially on households and poverty reduction; (c) assists the Government evaluating the impact of its pension reforms; and (d) assists the Government completing the reform agenda in this area, which is estimated to cost US\$110,970, equivalent; and

(ii) provision of technical assistance to enhance reforms in the public sector through identifying measures to improve resource use in the public sector showing the Government how to performance oriented budgets. The technical assistance will focus on the development of an action plan for the Government to strengthen the function of the Ministry of Finance, and other related ministries, by developing strategic expenditure plans which focus on: (a) explicit objectives for the medium-term; (b) explicit programs for reaching development objectives; (c) explicit output and outcome indicators; (d) identification of expenditure priority programs along functional lines; (e) fully funded programs and with the developments of a manual for costing out activities and policies; and (f) the improvement of the participation of civil society in the process of policy formulation and expenditure evaluation, which is estimated to cost US\$150,209, equivalent.

(B) Functioning of Public Sector:

(i) provision of technical assistance to enhance the reform of the public sector by demonstrating to the Government how: (i) to further improve the effectiveness of the anticorruption campaign of the Corruption Prevention Council and the anti corruption unit in the State Revenue Service; (ii) to establish capacity in public sector bodies to respond to public request for information and how to enforce public access to information; and (iii) how to design administrative procedures that meet the requirements of a modern democratic state, which is estimated to cost US\$30,642, equivalent;

(ii) provision of technical assistance to enhance the reform of the public sector by: (a) demonstrating to the Government how to improve the transparency and accountability of public sector agencies; (b) participate in developing an action plan for the Government on how to amend the Government's public expenditure management and administrative structures in order to bring all public sector agencies in conformity with the laws on institutional frameworks for public administration and the law on public sector agencies, which is estimated to cost US\$30,642, equivalent;

(iii) provision of technical assistance to enhance reform of the public sector by demonstrating to the Government how to design and sequence the horizontal and vertical functional reviews so that the outcome will guarantee a minimum of disruption of the current functions of the public sector and takes advantage of the existing synergy between the two delicate processes both with the objective to streamline the structure of the public sector and to increase its efficiency, which is estimated to cost US\$30,642, equivalent; and

(iv) provision of technical assistance to enhance reform of the public sector by demonstrating to the Government how to implement the pay reform concept so its implementation will not disrupt the financial viability of the Government budget and will lead to a comprehensive pay system for the

public sector that will provide a fair, transparent and equitable reward for the ensuring retention of high skilled personnel as well as giving the government the ability to monitor and evaluate the impact of the pay system on performance of its employees, which is estimated to cost US\$60,284, equivalent.

(C) Regulatory framework that rationalizes the relationship between public and private sector:

(i) provision of technical assistance to enhance regulatory reform by demonstrating to the Government how to develop a regulatory agenda in the area of utilities so that the Recipient establishes an effective, well-focused, and flexible post privatization governance that serves the public interests, mimics the market to a maximum extend possible and stipulates a preference for market-like policy solutions and determinations, which is estimated to cost US\$30,642, equivalent; and

(ii) provision of technical assistance to enhance judicial reform by demonstrating to the Government how to develop a medium term strategic action plan for the reform of the judicial system that incorporates actions to increase its efficiency, strengthen its incentive structure, guarantee its independence, enhance its transparency and openness, and collects feedback from the public as well as establishes a system to monitor and report on the performance of the judicial sector, which is estimated to cost US\$60,284, equivalent.

2. Implementation Generally

2.1. The Recipient shall: (a) carry out the Activities with due diligence and efficiency; (b) promptly provide the funds, facilities, services and other resources required for that purpose; (c) furnish all information covering the Activities and the use of the proceeds of the Grant as the Bank shall reasonably request; (d) from time to time exchange views with the Bank's representatives on the progress and results of the Activities; and (e) take all necessary measures required to enable the Bank to visit the territory of Republic of Latvia for purposes related to the Grant. Without limitation on the foregoing, the Recipient shall, if the Bank shall so request, prepare and furnish to the Bank promptly upon completion of the Activities a report, in form and substance satisfactory to the Bank, on the results and impact of the Activities.

3. Procurement

3.1. Except as the Bank shall otherwise agree, procurement of the consultants' services required for the carrying out of the Activities and to be financed out of the proceeds of the Grant shall be governed by the provisions of Attachment I to this Annex.

4. Withdrawal of Grant Proceeds

4.1. The amount of the Grant shall be credited to an account opened by the Bank on its books in the name of the Recipient (the Grant Account), and may be withdrawn therefrom by the Recipient in accordance with the provisions of this Section 4, for expenditures in respect of the reasonable cost of services required for the Activities and to be financed out of the proceeds of the Grant.

4.2. The expenditures for the following items may be financed out of the proceeds of the Grant and shall be used exclusively in the carrying out of the Activities:

Items Financed	Amount of the Grant Allocated (in U.S. Dollars)	% of Expenditures to be
(1) Consultants' services	504,315	100%
TOTAL	504,315	

4.3. Notwithstanding the provisions of paragraph 4.2 above:

(a) No withdrawals shall be made from the Grant Account: (i) for payments made for expenditures prior to the date of signature of this Letter Agreement by the Bank; (ii) on account of payments for any taxes levied by or in the territory of the Recipient; (iii) on account of expenditures in the territories of any country which is not a member of the Bank or for services supplied from such territories; or (iv) for the purpose of any payment to persons or entities if such payment, to the Bank's knowledge, is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations;

(b) No withdrawals shall be made from the Grant Account after July 31, 2001, or such later date that the Bank shall establish by notice to the Recipient (the Closing Date), provided that, except in special circumstances, the Closing Date shall not be extended beyond the expected date of Bank approval of financing for the Project. However, withdrawals may be made after the Closing Date for expenditures incurred prior to the Closing Date if the corresponding withdrawal application is received by the Bank within four months after the Closing Date, after which time any amount of the Grant remaining unwithdrawn from the Grant Account shall be canceled; and

(c) If, in the Bank's opinion, an amount of the Grant allocated to any of the items in the table in paragraph 4.2 above will be insufficient to finance the expenditures for such item, the Bank may, by written notice to the Recipient, reallocate to such item an amount of the Grant then allocated to another item which, in the Bank's opinion, will not be necessary to meet other expenditures.

4.4. When the Recipient shall desire to withdraw any amount from the Grant Account, it shall deliver to the Bank a written application for withdrawal of such amount in the form specified by the Bank. Withdrawal applications shall be: (a) signed on behalf of the Recipient by the Minister of Finance or such other person as he or she shall have authorized in writing; and (b) accompanied by such evidence in support of the application as the Bank shall reasonably request. Authenticated specimen signatures of the person authorized to sign withdrawal applications shall be provided with the first application bearing his or her signature. Each withdrawal application for an amount of the Grant and its supporting evidence must be sufficient in form and substance to satisfy the Bank that the Recipient is entitled to withdraw such amount from the Grant Account and that such amount is to be used in the carrying out of the Activities. The Bank shall pay the amounts withdrawn by the Recipient from the Grant Account only to or on the order of the Recipient.

4.5. The Bank may require withdrawals from the Grant Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) services of consulting firms costing less than US\$100,000 equivalent; and (b) services of individual consultants costing less than US\$50,000 equivalent, all under such terms and conditions as the Bank shall specify by notice to the Recipient.

4.6. Withdrawals of the proceeds of the Grant shall be made in the currency of the Grant. The Bank, at the Recipient's request and acting as an agent of the Recipient, shall purchase with the currency of the Grant withdrawn from the Grant Account such currencies as shall be required to pay for expenditures to be financed out of the proceeds of the Grant. Whenever it shall be necessary, for the purposes of this Letter Agreement, to determine the value of one currency in terms of another, such value shall be as reasonably determined by the Bank.

4.7. To facilitate the carrying out of the Activities, the Recipient may open and maintain in US dollars a special deposit account (the Special Account) in a commercial bank on terms and conditions satisfactory to the Bank, including appropriate protection against set-off, seizure or attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Attachment II to this Annex.

5. Accounts and Audits

5.1. (a) The Recipient shall maintain or cause to be maintained a financial management system, including records and accounts, and prepare financial statements in

a format acceptable to the Bank, adequate to reflect in accordance with sound accounting practices the operations, resources and expenditures related to the Activities.

(b) The Recipient shall: (i) have the records, accounts and financial statements referred to in subparagraph (a) above 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 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 statements, records and accounts and report of such audit, by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and (iii) furnish to the Bank such other information concerning said records and accounts and the audit thereof, and concerning said auditors, as the Bank shall from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Grant Account were made on the basis of statements of expenditure, the Recipient shall: (i) maintain or cause to be maintained, in accordance with subparagraph (a) above, records and accounts reflecting such expenditures; (ii) retain, until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Grant 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 subparagraph (b) above and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

6. Suspension and Cancellation

6.1. The Bank may at any time, by notice to the Recipient, suspend the right of the Recipient to make further withdrawals from the Grant Account if any of the following events has occurred and is continuing: (a) the Recipient has failed to comply with any of its obligations herein specified; or (b) the right of the Recipient, or any other entity to which the Bank has made a loan with the guarantee of the Republic of Latvia, to make withdrawals under any loan agreement with the Bank or any development credit agreement with the International Development Association shall have been suspended.

6.2. The Bank may, by written notice to the Recipient, terminate the right of the Recipient to make further withdrawals from the Grant Account: (a) at any time after the right of the Recipient to make withdrawals from the Grant Account shall have been suspended pursuant to the provisions of paragraph 6.1 above; or (b) if the Recipient shall have failed to take action, satisfactory to the Bank, within six months after the effective date hereof, to carry out the Activities; or (c) if the Bank has decided, at any time after consultation with the Recipient, to withdraw its support to the Project; or (d) if the Recipient has withdrawn its request for the Bank's assistance in financing the Project.

Attachment I

Procurement

Section I. Consultants' Services

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 and revised in September 1997 and January 1999 (the Consultant Guidelines), and the following provisions of this Section I.

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.

Part C: Other Procedures for the Selection of Consultants

1. Selection Based on Consultants' Qualifications

Services for activities described under paragraph 1.1 (B)(iv) of the Annex may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.7 of the Consultant Guidelines.

2. Individual Consultants

Services for activities described under paragraph 1.1 (A), 1.1 (B)(i),(ii) and (iii) and 1.1 (C)(i) and (ii) of the Annex shall 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 Activities 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 the employment of consulting firms estimated to cost the equivalent of US\$200,000 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 the employment of consulting firms estimated to cost the equivalent of US\$100,000 or more, but less than the equivalent of \$200,000, the procedures set forth in paragraphs 1, 2 (other than the second subparagraph of paragraph 2 (a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(c) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of US\$50,000 or more, 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 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.

Attachment II

Special Account

1. For the purposes of this Attachment:

(a) the term "eligible item(s)" means the item(s) set forth in the table in paragraph 4.2 of the Annex to this Letter Agreement;

(b) the term "eligible expenditures" means expenditures in respect of the

reasonable cost of services required for the Activities and to be financed out of the proceeds of the Grant; and

(c) the term "Authorized Allocation" means an amount equivalent to US\$35,000 to be withdrawn from the Grant Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Attachment.

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

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) The Recipient shall furnish to the Bank a request or requests for a 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 Recipient, withdraw from the Grant Account and deposit into the Special Account such amount or amounts as the Recipient shall have requested.

(b) (i) For replenishment of the Special Account, the Recipient 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 Recipient shall furnish to the Bank the documents and other evidence required pursuant to paragraph 4 of this Attachment 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 Recipient, withdraw from the Grant Account and deposit into the Special Account such amount as the Recipient 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 Grant Account under the eligible item(s), and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Recipient out of the Special Account, the Recipient 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 Attachment, 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 Recipient directly from the Grant Account;

(b) if the Recipient shall have failed to furnish to the Bank, within the period of time specified in paragraph 5.1 (b) (ii) of the Annex to this Letter Agreement, any of the audit reports required to be furnished to the Bank pursuant to said paragraph 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 Recipient of its intention to suspend in whole or in part the right of the Recipient to make withdrawals from the Grant Account pursuant to the provisions of paragraph 6.1 of the Annex to this Letter Agreement; or

(d) once the total unwithdrawn amount of the Grant shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawals from the Grant Account of the remaining unwithdrawn amount of the Grant shall follow such procedures as the Bank shall specify by notice to the Recipient. 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 Attachment; or (ii) was not justified by the evidence furnished to the Bank, the Recipient 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 Recipient 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 Recipient shall, promptly upon notice from the Bank, refund to the Bank such outstanding amount.

