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**Report No. P-5854-KG**

**REPORT AND RECOMMENDATION  
OF THE  
PRESIDENT OF THE  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
TO THE  
EXECUTIVE DIRECTORS  
ON A  
PROPOSED REHABILITATION CREDIT  
IN AN AMOUNT EQUIVALENT TO SDR 43.3 MILLION  
TO  
THE REPUBLIC OF KYRGYZSTAN**

**APRIL 22, 1993**

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**REPUBLIC OF KYRGYZSTAN**

**REHABILITATION CREDIT**

**CURRENCY EQUIVALENTS**

Currency Unit = ruble  
1 ruble = 100 kopecks

1 SDR = US\$ 1.385  
US\$ 1 = SDR 0.722

**Rubles per US Dollar**

	<b><u>Official Exchange Rate</u></b> (average)	<b><u>Auction/MIFCE Rate</u></b> (average)
1987	0.6238	n.a.
1988	0.6080	n.a.
1989	0.6274	8.9
1990	0.5856	18.8
1991	0.5819	59.0
1992		222.1
.....	.....	.....
	(End of Period)	(End of Period)
December 1991	0.5771	169.2
January 1992	n.a.	230.0
February 1992	n.a.	139.0
March 1992	n.a.	160.3
April 1992	n.a.	143.6
May 1992	n.a.	113.0
June 1992	n.a.	144.0
July 1992	n.a.	161.2
August 1992	n.a.	205.0
September 1992	n.a.	254.0
October 1992	n.a.	398.0
November 1992	n.a.	447.0
December 1992	n.a.	414.5
January 1993	n.a.	572.0
February 1993	n.a.	593.0
March 2, 1993	n.a.	649.0

**FISCAL YEAR**

January 1 - December 31

**WEIGHTS AND MEASURES**

Metric System

**ABBREVIATIONS AND ACRONYMS**

AMC	Antimonopoly Committee
CEM	Country Economic Memorandum
CG	Consultative Group
CIF	Cost, Insurance and Freight
CIS	Commonwealth of Independent States
EAMU	External Assistance Management Unit
EC	European Community
ESW	Economic and Sector Work
FSU	Former Soviet Union
FXC	Foreign Exchange Component
GDP	Gross Domestic Product
GNP	Gross National Product
GOSKOMINVEST	State Commission for Foreign Investments and Economic Assistance
ICB	International Competitive Bidding
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
IS	International Shopping
LC	Letter of Credit
LIB	Limited International Bidding
MIS	Management Information System
MOH	Ministry of Health
NBK	National Bank of Kyrgyzstan
NMP	Net Material Product
OECD	Organization for Economic Cooperation and Development
PCR	Project Completion Report
PIC	Pre-identified Imports Component
PIU	Project Implementation Unit
PPF	Project Preparation Facility
PPR	Project Preparation Report
SAL	Structural Adjustment Loan
SECAL	Sector Adjustment Loan
SDR	Special Drawing Rights
SE	State Owned Enterprises
SOE	Statement of Expenditures
SPF	State Property Fund
TA	Technical Assistance
TAC	Technical Assistance Component
TCA	Technical Cooperation Agreement
TEP	Trade Expansion Program
TOR	Terms of Reference
UNDP	United Nations Development Program
UNICEF	United Nations Children's Fund
VAT	Value-Added Tax

**REPUBLIC OF KYRGYZSTAN  
REHABILITATION CREDIT  
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## **REPUBLIC OF KYRGYZSTAN**

### **REHABILITATION CREDIT**

#### **Credit and Project Summary**

- BORROWER:** Republic of Kyrgyzstan
- BENEFICIARY:** The Government of Kyrgyzstan
- AMOUNT:** SDR 43.3 million (US\$ 60 million equivalent)
- TERMS:** Standard IDA terms, with 40 years maturity.
- OBJECTIVES:** The objectives of the Credit are: (i) to support the Government's Reform Program, outlined in the Memorandum from the Government to the Association; (ii) to establish a policy dialogue between the Government and the Association; (iii) to finance critical imports of inputs, raw materials and spare parts in key sectors, thus easing the shortage of foreign exchange and minimizing further contraction of economic activity; (iv) to stimulate foreign exchange markets and enhance private sector access to foreign exchange; and (v) to provide priority technical assistance in the key structural reform areas, which will facilitate implementation of the program and build up overall implementation capacity in the country.
- DESCRIPTION:** The proceeds of the Credit would finance (i) pre-identified imports for priority sectors (PIC); (ii) other priority imports by the private and public sectors through the provision of foreign exchange (FXC); and (iii) technical assistance (TAC). The import component of US\$ 53 million will comprise PIC of US\$ 33 million and FXC of US\$ 20 million. In addition, TAC will amount to US\$ 7 million. In the case of the FXC, the items not eligible for financing under the Credit have been developed into a standard "negative list." Foreign exchange will be provided for imports under the Credit at the market exchange rate, without any exchange rate subsidies. Any compensatory subsidies subsequent to importation will have to be through the budget within the constraints imposed by the stabilization program, targeted where possible.
- BENEFITS:** The proposed Credit would allow increased production and capacity utilization through the provision of resources to finance critical imports of inputs, raw materials, spare parts and services. These imports would help limit further output decline and sustain employment and the balance of payments. The foreign exchange financing provided by the Credit would help to develop an inter-bank market in convertible currency and also would enhance private sector access to foreign exchange. Technical assistance (TA) under the Credit would contribute to the development of capability in economic, financial and technical management and would reinforce the implementation of the Government's Economic Reform Program. TA would also contribute to the restructuring of the Government to

meet the needs of a market economy. The Credit has also had the catalytic effect of mobilizing other sources of financing, particularly through the Consultative Group meeting in December 1992. Cofinancing of US\$ 70 million is expected to be provided by the Governments of Japan, Netherlands and Switzerland.

**RISKS:**

The main risks include the following: (i) substantial institution building is required to underpin the key elements of the Reform Program: while this is being advanced with TA to be provided under the Credit as well as by other donors, slippage in financing and organizing the TA activities might result in delays in the implementation of the Reform Program; (ii) underfinancing of the external requirements might slow down the implementation of the Economic Reform Program of the Government and increase the resistance by conservative elements, jeopardizing the Program; and (iii) lack of familiarity and experience in working with IDA procurement, accounting and disbursement procedures might cause implementation delays. The risks under (i) and (iii) are being addressed with a core TA program which is already under way with resources from the Trust Fund established under the Technical Cooperation Agreement (TCA), and the Project Preparation Facility. In addition to those provided under the Credit, additional resources to finance TA, particularly grant funds, are being provided by other donors. Finally, the Association took the lead in organizing the Consultative Group meeting to help mobilize resources to counter the risks under (ii).

		—US\$ million equivalent—		
		Local	Foreign	Total
<b>FINANCING PLAN:</b>	IDA	-	60.00	60.00
	Government	<u>0.25</u>	<u>-</u>	<u>0.25</u>
	Total	0.25	60.00	60.25

**SCHEDULE OF DISBURSEMENTS  
OF THE IDA CREDIT:**

FY93	10.00
FY94	45.00
FY95	3.00
FY96	2.00

**MAP:**

IBRD 24301

**REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE  
INTERNATIONAL DEVELOPMENT ASSOCIATION  
TO THE EXECUTIVE DIRECTORS ON A  
PROPOSED REHABILITATION CREDIT  
TO THE REPUBLIC OF KYRGYZSTAN**

**I. INTRODUCTION**

1. I submit for your approval the following report and recommendation on a proposed Rehabilitation Credit to the Republic of Kyrgyzstan for SDR 43.3 million (US\$ 60 million equivalent) to finance essential imports and technical assistance associated with the Government's Economic Reform Program. The Credit would be at the standard IDA terms, with a maturity of 40 years. Cofinancing of US\$ 70 million on a parallel basis is expected to be provided by the Governments of Japan, the Netherlands and Switzerland.

2. The Republic of Kyrgyzstan joined the IMF on May 8, 1992; the IBRD on September 18, 1992; the IDA on September 24, 1992; and IFC on February 11, 1993. Economic missions from the Association visited Kyrgyzstan in February, April and October, 1992 and January - February 1993. A draft Country Economic Memorandum (CEM) was distributed to the Board in December 1992 and a red cover CEM is being published. A note on Kyrgyzstan's IDA eligibility is being distributed to the Executive Directors.

**II. COUNTRY POLICIES AND IDA ASSISTANCE STRATEGY**

**A. Recent Political and Economic Developments**

3. **Background.** Kyrgyzstan is one of the smallest and poorest of the newly emerging countries of the FSU, lacking the abundant natural resource endowment of most of its neighbors.<sup>1</sup> In some respects it faces issues similar to those facing other low income developing countries. It has a population of 4.4 million, of which 62 percent live in the rural areas.<sup>2</sup>

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<sup>1</sup> Per capita estimates are subject to major uncertainties. A Bank-wide working group is currently revising estimates for all FSU countries. Preliminary indications are that Kyrgyzstan is likely to be at or below IDA operation cut-off level in 1992.

<sup>2</sup> Over half of the population is Kyrgyz. Other nationality groups, in percentages, are Russian (21), Uzbek (13), and Ukrainian and German (2.5 each). About half the population is in the active age group, and the demographic composition has been fairly stable during the last decade. Population growth averaged 1.8 percent in 1985-90 and declined to 1.2 percent in 1991 following net emigration,

Agriculture, which accounts for about 32 percent of GDP and 36 percent of employment, is geared mainly towards livestock and crop farming. The industrial sector comprises about 30 percent of GDP and 20 percent of employment. The most important industries include mechanical and electrical engineering (vehicle assembly, washing machines), light industry (mainly textiles), and food processing. During the Soviet period, the central government chose to exploit very little of the country's minerals (gold, uranium, and antimony). Although its economy is highly dependent on other sources of imported energy, Kyrgyzstan has considerable hydroelectric potential and is an exporter of peak electric power.

4. Kyrgyzstan displays some important differences from other developing countries of similar income level. Its population is relatively well educated, and until recently the country enjoyed generous social services in education, health, pensions, and income support. The Soviet system also developed an industrial base in Kyrgyzstan designed to support the Union-wide industrialization strategy which fostered strong interdependence among the republics. Finally, although Kyrgyzstan's physical infrastructure was mainly designed for FSU trade, it is relatively developed and reaches a significant portion of the country and population.

5. The aftermath of the Soviet Union's collapse has been particularly difficult for Kyrgyzstan. Until 1991 the economy depended on large transfers from the Union Government to finance trade and fiscal deficits. On average, the Republic's budget was financed by explicit transfers of 10 to 12 percent of GDP. Industrial and agricultural production relied heavily on inputs and spare parts from other republics, which were often subsidized. Kyrgyzstan also received large implicit subsidies on wheat, oil, and gas imports from Russia and other Central Asian republics. A large portion of output was exported to meet centrally managed demand in other parts of the FSU. Almost all of Kyrgyzstan's trade was conducted through FSU-wide trade and payments organizations.

6. Now deprived of Union transfers, subsidized imports, and a centrally managed trade network, Kyrgyzstan is facing a dire economic situation. Output and trade have plummeted, real incomes have fallen drastically, and annual inflation has surged to four digit levels. As in other FSU countries, many production units are on the verge of collapse with limited prospects for future viability since they lack either inputs or markets for output. Unemployment is not yet pervasive, but is imminent, as enterprises exhaust all means to keep labor employed.

7. Despite expectations of heavy short-run economic costs, Kyrgyzstan's political decision to break with the Union was very clear. In 1989 emerging nationalist sentiments were manifested in the passing of a law making Kyrgyz the official language. In 1990, major ethnic violence broke out near the border with Uzbekistan over what was regarded as an unfair distribution of land between Kyrgyz and Uzbek populations living on Kyrgyzstan's territory. Widespread demonstrations became the focus of a broader anti-regime campaign by all

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mainly of Russians.



opposition forces. This eventually forced Parliament to hold new Presidential elections. In October 1990, Mr. Askar Akaev, who has led the pro-reform and pro-democracy movement in Kyrgyzstan, was elected President by popular vote. During the failed coup of August 1991 in Moscow, a parallel attempt was aimed at President Akaev. The defeat of the hard liners led to a formal declaration of independence. Kyrgyzstan joined the Commonwealth of Independent States (CIS) in December 1991.

8. **Recent Performance.** The Government demonstrated its commitment to achieve a market-oriented economy by introducing reforms often ahead of other FSU countries. These reforms include a more rapid reduction of the role of the state, the introduction of a new tax system, measures to strengthen the autonomy of the central bank, quicker price decontrol, and the targeting of family allowances.

9. Kyrgyzstan is expected to be the first country in the CIS to have an upper tranche standby agreement with the IMF. It was the head start on reforms in 1992 and the resulting hardships of transition, that made the administration aware of the need for macroeconomic stability. The country's reform-minded leadership believes that its only chance for success lies in implementing a radical reform program and stabilizing the economy as soon as possible.

10. Efforts to achieve macroeconomic stability in 1992 were undermined by events elsewhere in the ruble zone and a relaxed domestic credit policy in Kyrgyzstan in the second half of the year. Inflation and steep exchange rate depreciations were mainly imported from Russia. After the one-step price liberalization in early 1992, an inflationary process was fueled by credit expansion. Although Kyrgyzstan tightly controlled its fiscal deficit during the first half of 1992, in the last quarter expenditures increased to compensate for large declines in real incomes. The relaxation in fiscal control of the second half of the year gave way to a budget deficit of about 15 percent of GDP. By the end of 1992, inflation had reached almost 2,000 percent for the year.

11. In spite of the delineating macroeconomic situation, important structural reforms were approved in 1992. First, the Government started privatization quickly, but lacked the enabling legal framework to carry out the whole program. A legislative framework and a new program were designed thereafter to allow for the acceleration of privatization: a privatization law was approved in July 1992, and was subsequently further developed in a Concept Note adopted by Parliament in December 1992. By January 1993, about 2300 enterprises accounting for about 12 percent of total fixed assets, were privatized. The majority of these, about 2000, were small-scale enterprises in the trade and services sectors. Second, most legal and institutional barriers to private sector participation in trade and distribution, including state orders, were eliminated by the end of 1992, except for some exportable goods (wool, tobacco, cotton, and grains). These state orders remain as emergency measures in order to obtain, through bilateral arrangements, oil and gas from the FSU for 1993. State orders and purchases will be eliminated by December 1993 (see para 38).

12. Third, the tax system was thoroughly reformed in order to respond to the new emerging economic system and to prepare for the anticipated collapse of the revenue base. This

effort began with the introduction of VAT, personal and corporate income tax, and excises. By December 1992, most of the previously granted tax privileges and exemptions had been eliminated. Further fiscal measures have been approved by Parliament and are included in the IMF standby program. Fourth, multiple exchange rates and foreign exchange surrender requirements on exports were abolished in September 1992, and a 10 percent export tax was introduced. Fifth, new central bank and commercial banking laws have been adopted, establishing a two-tier banking system with the National Bank of Kyrgyzstan (NBK) as the central bank with increased supervisory authority. This legal framework, supported with prudential regulations, constitutes a basis for transforming specialized state-owned banks and recently established commercial banks, largely owned by enterprises, into modern market-oriented banks. Sixth, discussion of a draft new constitution which includes provisions for property rights and private ownership of land is at an advanced stage.

13. The declines in output and living standards in Kyrgyzstan are among the most severe in the FSU republics not involved in a civil war or internal strife. Output in 1993 is expected to be 40 percent below the level in 1990 (Table 1). Real wages fell by 37 percent between the last quarter of 1991 and the last quarter of 1992. Pensions and minimum wages have dropped to only a few dollars a month. While this level reflects in part the undervaluation of the ruble at the market exchange rate, there is no doubt that the purchasing power of pensions and minimum wages has declined sharply in real terms. Although there are no firm data on the incidence of poverty, it is very likely that at least one-third of the population was below the poverty line in 1992. As economic hardships deepened, social pressures also mounted.

Table 1.  
Kyrgyzstan: Key Macroeconomic Indicators

	1991	1992 est.	1993	Projections	
				1994	1995-1998
<b>Gross domestic product</b>					
Annual real growth (%)	-5.0	-24.0	-16.0	-1 to 1	3 to 5
Billion rubles (current prices)	15.6	180.5	890.5	-	-
<b>Inflation (end-year, %)</b>					
Retail prices	147	1,660	380	50 to 30	-
Wholesale prices	288	1,900	380	-	-
<b>Fiscal balance (% of GDP)</b>					
Revenues and grants	4.8	-14.7	-6.9	-7 to -5	-5 to -4
Expenditure	35.2	13.9	16.6	-	-
<b>Current account balance</b>					
US\$ million	966	-155	-423	-380 to -360	-300 to -150
% of GDP	10.8	-5.8	-20.1	-18 to -17	-13 to -5

Source: Official Statistics and staff estimates.

14. Under the Soviet system, the state spent about 30 percent of GDP on social services in Kyrgyzstan. In 1990, the state provided social services in health (4 percent of GDP) and education (8 percent) as well as financial support through family allowances (4 percent), pensions and food subsidies (7 percent each). Such extensive social coverage cannot be sustained. Indeed, social expenditures fell sharply in 1992 to about 17 percent of GDP in response to the tightening fiscal position. Moreover, the system of job guarantees combined with soft budget constraints led to overstaffing of state enterprises (SEs), also unsustainable under a market economy. In addition to jobs, SEs have provided social services such as basic health and housing.

15. Social pressures are now becoming apparent. Privileged groups from the past system are recruiting support from state farm and enterprise managers, and from vulnerable groups who have suffered the severe effects of the first year of transition. These groups have recently become more outspoken, and are being heard in Parliament.

16. Mobilizing political endorsement of the reforms is extremely difficult in an environment in which policy changes are seen as leading to a continuing deterioration in living standards: while some transition costs have already taken effect, the benefits will take some time to materialize. Maintaining support for reforms will require providing the public a stake in the economy's transformation through vigorous promotion of private sector activities, continued privatization, provision of basic public services, and effective protection of the most vulnerable groups in the transition.

## **B. Country Development Objectives and Policies**

17. The policies for accomplishing the Government's objectives are articulated in the Economic Reform Program which was presented to Parliament by President Akaev and approved after extensive deliberation in July 1992. The program details are outlined in the *Memorandum of Economic Reform Policies* (Annex III). Kyrgyzstan's reform program has two primary objectives. First, to achieve a macroeconomic framework that reduces inflation and includes the necessary financing to prevent further declines in critical imports. This framework also contains the ingredients for gradually making the economy less dependent on foreign savings. Second, to generate an early supply response through structural and sectoral reforms. Key elements of the structural reforms include:

- o Enterprise reform, including privatization and better governance of SEs expected to remain in state ownership
- o Creation of an incentive framework to foster private sector development, including promotion of foreign direct investment and dismantlement of monopolistic markets

- o Reform of the financial sector to support both enterprise restructuring and development of the private sector and,
- o Establishment of a strong social safety net in which spending is targeted to the most vulnerable groups and is consistent with the budget constraints imposed by stabilization needs.

Sectoral reforms designed to promote a rapid supply response in key sectors of the economy are initially to be focused on the agriculture, mining, and service sectors.

### Macroeconomic Stabilization

18. Negotiations with the IMF have been concluded and an upper-tranche standby arrangement covering an 11-month period is expected to start in May 1993. In order to be able to implement a stabilization program, Kyrgyzstan has decided to leave the ruble zone and introduce its own currency, the Som. At the same time, the Government intends to pursue restrictive monetary and fiscal policies to ensure the successful introduction of its new currency.

19. Successful stabilization requires the containment of budget deficits to around 5% of GDP over the nineties. For 1993, the program aims to achieve a drastic reduction in both the budget deficit (from 15 to 7 percent of GDP) and the growth of broad money and domestic credit. Measures to increase revenue are essential. Parliament recently approved measures to enlarge the tax base and increases in tax rates for alcohol and petroleum. Expenditures are also under pressure. For 1993, the program includes subsidy reductions, better targeting of transfers, and a conservative wage policy.

20. Non-inflationary domestic financing is virtually non-existent and the stabilization program envisages no central bank financing of the fiscal deficit for the remainder of 1993. Therefore, the fiscal deficit needs to be funded by external resources. The role of the donors is essential in the financing of Kyrgyzstan's budget deficit over the coming years. Otherwise, critical social expenditures will not materialize under such stringent budgetary conditions. Currently less than one-third of foreign savings can be used by the Central Government: most of the remaining foreign savings are tied to financing inter-enterprise trade with FSU countries, mainly oil and gas imports, which will ease the adjustment to higher imported energy prices.

### Structural Reforms

21. The success of the stabilization program and reform in general depends to a large extent on whether the state enterprises (SEs) can be transformed into economic entities which respond to market signals. A successful transition will require simultaneous progress on three fronts: privatization, enterprise reform, and assistance to the development of new business.

22. Wide-ranging decrees on privatization and the creation of joint ventures were approved by Parliament in 1991 and 1992. The State Property Fund's (SPF's) authority to

exercise the State's rights on property has been backed by a law approved by Parliament in July 1992. In December 1992, the Parliament adopted a Concept Note on Privatization which envisages: (i) rapid sale of small-scale-enterprises such as shops and restaurants; (ii) mass privatization of medium- to large-scale-enterprises through a voucher system; and (iii) the privatization of large enterprises on a case-by-case basis. By late 1993, 35 percent of the fixed assets of SEs are to be transferred to new forms of ownership; a further 35 percent are to be transferred by end-1996.

23. There are three steps to enterprise reform: (i) reducing subsidies and state financial transfers to SEs; (ii) restructuring SEs; and (iii) improving corporate governance of SEs. Given the lack of resources, the Government has started enterprise reform by contracting credit to SEs in real terms, reducing subsidies and switching them to the budget, and linking financial support to enterprise-level adjustment or liquidation.

24. Restructuring of small to medium sized enterprises is expected to be undertaken by new private owners. Given the lack of resources for large investments in restructuring, large enterprises will be passively restructured over time. These SEs, however, will need to engage - with foreign technical assistance - in some reorganization, segmentation, downsizing, and management changes. With no substantial private and foreign capital available, a more active adjustment program for these enterprises will require provision of lines of credit for restructuring, and increased technical assistance from the international community. This is taken into account in the projected external requirements (see Table 1), where the non-Government sector continues to absorb an important share of foreign savings.

25. In conjunction with tightening financial discipline, the governance of state enterprises is to be improved through their conversion to joint stock companies with boards of directors, the establishment of proper statutes, and increased clarification of assets and liabilities. Moreover, a system to monitor and assess the financial performance of enterprises is to be established. Branch ministries are to transfer the state's remaining ownership rights to the SPF, except for a few enterprises in need of continued regulation. The SPF has set up a temporary holding company for those remaining SEs that require complex restructuring and partial liquidation.

26. **Private Sector Development.** Privatization is a necessary but not a sufficient condition for the emergence of a strong private sector. The Government is developing a program of measures designed to encourage the emergence of new private enterprises. Legislative measures to be presented to Parliament include: (i) measures to expand ownership and property rights; (ii) enacting commercial legislation on contracts, bankruptcy, and liquidation procedures, secured transactions, and the registration of ownership in real and intellectual property; and (iii) measures to identify and eliminate obstacles to the formation of new enterprises and eradicate the abuse of monopoly power through regulation or the breaking up of amalgams into competing enterprises.

27. The Government expects foreign direct investment to play an important role in the development of the productive base of the private sector. It intends to promote foreign investment through a stable macroeconomic environment and the simplification of foreign investment procedures. A one-stop system for foreign investment processing and licensing is planned for 1993. Direct foreign investment and joint ventures are needed as a source of capital flows and as a way of gaining access to world markets. Investment potential exists in mining, tourism, electronics, and some light manufacturing production.

28. **Financial Sector.** During the initial stages of the transition the financial sector will be exposed to increasing bankruptcies and enterprise closures. The role of the financial sector is likely to be constrained in Kyrgyzstan in the early stages of reform, since there are only 15 commercial banks mostly owned by SEs, and 3 large state owned banks which dominate the system. Moreover, the stringent monetary policy and restricted access to credit which will accompany the introduction of a new currency will put SEs under additional financial strain.

29. A large fiscal contingent liability is expected to arise from the deterioration in loan portfolios as SEs restructure and the existing banking system comes under stress. A Restructuring Agency is envisaged, to handle non-performing assets in the banking system as soon as a new currency is adopted. The restructuring agency would relieve the commercial banks of liabilities of at least the 20 to 25 largest loss-making enterprises, and would force the restructuring or liquidation of these firms. The removal of subsidies should also help because the largest uncollectible bank loans are from bakeries and oil trading firms which have carried the burden of price controls.

30. As institutions develop and the economy recovers, the financial market is expected to play the main role in allocating scarce resources. Although the response to new incentives and prudential standards will take time, extensive institution building in the sector is required now to build up expertise, to further improve banking standards, and to tighten prudential requirements. Over time prudential standards for the banking system should increase the competition for funds and make possible the continuation of tight budget constraints on SEs through indirect monetary policy.

31. The National Bank has recently been given more autonomy, and central bank refinancing is now being auctioned. By September 1993, all banks will have to comply with the recently adjusted capital requirements and exposure limits to individual shareholders and borrowers. Future measures to strengthen the financial sector include the restructuring of long-term and agricultural lending (now provided by state banks) and the mobilization of household deposits by commercial banks. The Savings Bank, which held a virtual monopoly, will be downscaled and restructured. Similarly, all interest rate subsidies will be removed parallel with the introduction of the new currency. Implicit subsidies, through interest rates which are lower than NBK rediscounting or are different for specific sectors, will also be eliminated.

32. **Social Safety Net.** Protection of the poor and maintenance of the political mandate to continue with the thrust of the reform program is one of the most difficult tasks confronting

the Government. Moreover, the Soviet system of social protection is not sustainable under a market economy, because of its large burden on the budget and on SEs. Restructuring social expenditures is, therefore, part of the reform program. Among others things, it will involve shifting SEs services to the central or local governments, which will assume responsibility for primary services.

33. The Government's immediate concern is the growing number of poor in the country. The immediate objective is to protect vulnerable groups from falling into poverty by preventing a dramatic deterioration of their personal income, and ensuring that they have access to an adequate social safety net. Vulnerable groups will be identified and policies implemented to effectively protect them by establishing a realistic poverty line. A baseline survey on the poor, as well as institutionalizing a monitoring system based on restructured family budget surveys, will also be carried out. Technical assistance will be needed in the monitoring of poverty, in the development of a minimum consumption basket and a poverty line (no later than the end of 1993), and in the monitoring of the social impact of the reform process.

34. The Government intends to separate social protection needs into social insurance and social assistance. Social insurance will cover pensions, unemployment compensation and sickness/disability benefits. Increasingly, these benefits would be funded on a contributory basis, managed through an amalgamated fund. The Government is expected to propose legislation by June 1993 to reform the funding and expense obligations of the Pension Fund. To ensure that vulnerable groups are protected immediately, the value of minimum pensions would be protected from inflation, but pensions above the minimum would be allowed to fall in real terms. The Government would be fully responsible for social assistance, implying additional budgetary costs, which will be covered temporarily by the external financing package embodied in the macroeconomic program.

35. In addition to falling output levels, the readjustment in the domestic terms of trade in favor of agricultural prices will have major short run implications for social safety net costs and real incomes. Along with the need for income compensation measures to mitigate the social impact of falling real incomes, labor mobility needs to be facilitated. For this purpose, the Government will submit to Parliament draft legislation on amending laws to eliminate the *propiska*, i.e., the residence requirement for both employment and the provision of social services that also serves security purposes. To increase the efficiency of the labor market, job guarantees will be eliminated by June 1993. Activities for retraining and for providing employment services will also be implemented.

### Sectoral Reforms

36. The most rapid supply response is expected to come from the agricultural sector. Under the old system, prices of farm products were kept artificially low to provide cheap food for the population. State controls over allocation, distribution, and marketing (of inputs, services, and products) compounded the disincentive to produce. The positive domestic terms of trade effect which follows complete price liberalization of agricultural products should stimulate

farmers to increase production. Moreover, yields in agriculture production could increase significantly if the production, distribution, and marketing networks were liberalized and/or privatized. The agricultural sector should grow by an average 4 percent per year over the nineties, with higher growth rates in the early years.

37. Small-scale farmers are expected to respond positively to the revised incentive structure. In the next few years, the expansion in agricultural production may substitute for food products currently imported from elsewhere within the FSU and China. Legal and institutional barriers to private sector competition with state operations have been removed to facilitate the expansion of agricultural activity. The reduction of state control over the input and distribution networks should, if coupled with strong promotion of the private sector, stimulate higher yields in 1993. State purchases with prices determined by the Government continue for a few products covered by trade agreements (grains, wool, tobacco, and cotton), but will be eliminated by December 1993. During this year's transition, private and public sector use of the state trading agencies will be allowed on a commercial and voluntary basis. Government control over land, inputs, and distribution networks will be eliminated in tandem with restructuring efforts.

38. The mining sector may also have significant long term potential. Compared with its relatively well-endowed neighbors, Kyrgyzstan's mineral potential was only partially explored by the Soviet planners, and an early assessment of its actual potential will need to be undertaken in conjunction with the development of an overall sector strategy. The Government is already moving to establish an appropriate legal, institutional and taxation framework in the sector conducive toward new investment and ensuring an appropriate management of these natural resources. The Government hopes that the development of this sector will strengthen the economy's export base and, over time, improve its debt servicing capacity.

### Medium Term Prospects

39. The experience of centrally planned countries that started the transition to a market economy ahead of the FSU shows that output recovery takes time to materialize. Output in 1993 is expected to be 40 percent below the level in 1990 and could decline further in 1994 before renewed growth emerges in the middle of the decade (Table 1). Provided that macroeconomic stabilization and structural and sectoral reform begin to take hold, GDP growth of 3 to 5 percent could be achieved in the second half of the 1990s. In addition to agriculture and mining, other sources of growth in the short term are likely to come from services and light manufacturing production. If structural reforms proceed at the envisaged pace, and external financial support is forthcoming, inflation should drop significantly in 1994.

40. The service sectors have been underdeveloped under centrally planned economies. There is a large gap between the level of business and consumer services in the FSU countries and those in both OECD and developing countries. Preliminary studies of Eastern Europe show that services have been rapidly expanding in terms of employment and number of establishments. Indeed, some growth in services is already evident in Kyrgyzstan. The establishment of commodity exchanges dealing with a wide range of products, particularly agricultural produce,



is an example. Although services are starting from a small base and are mostly developing as an informal sector, future growth is likely to bring about a major expansion of trade and business services. Some of these services will be associated with transition needs, such as privatization. The expansion of consumer services, however, is likely to lag behind because of the general decline in real incomes.

41. Domestic resource mobilization is expected to fall short of Kyrgyzstan's needs for many years to come. Given the drastic erosion in real incomes and the expected gradual recovery, financial savings will be minimal. Corporate savings are also expected to be limited during the transition period when enterprises adjust to new relative prices. Kyrgyzstan, therefore, needs to rely on large external savings in the foreseeable future.

42. Kyrgyzstan's exports, which are starting from a very low base, are expected to grow to about US\$1.1 billion in 1998, while imports increase from about US\$1 billion to US\$1.3 billion. Almost half of the trade deficit may still be on account of imports from FSU countries, since market diversification may take some time. Although non-ruble exports of leather, mining, and agricultural products could grow strongly, they are starting from a low base. Over the medium term, increased earnings from electricity exports are expected to reduce the trade imbalance. Moreover, Kyrgyzstan's comparative advantage could lie in the production of high value/low weight exports. Low unit labor cost levels, coupled with a well educated work force with some specialized skills - in electronics for example - suggest that an internationally competitive light manufacturing sector could be developed. The Government hopes foreign direct investment, in infrastructure and tourism for example, may provide the initial stimulus to this development.

43. As infrastructure is developed and the private sector expands, trade with non-FSU markets, will probably become an important source of growth. A recently established railroad connection through Kazakhstan to Western China in Xinjiang, China's province bordering Kyrgyzstan, should facilitate an expansion in trade in a relatively short time. This could open possibilities for trade with other East Asian economies. In 1992, as inter-state arrangements were not working, trade with the Xinjiang province expanded significantly.

Table 2: Kyrgyzstan: External Financing Requirements (US\$ million)

	1993	1994		1996		1998	
		Low	High	Low	High	Low	High
<b>Financing Requirements</b>							
Non-interest current account	420	350	370	180	200	80	150
Debt service	3	11	11	36	37	90	91
Amortization	0	2	2	10	10	49	49
Interest	3	9	9	26	27	41	42
Change in gross reserves	<u>18</u>	<u>20</u>	<u>20</u>	<u>30</u>	<u>30</u>	<u>40</u>	<u>40</u>
Total	441	381	401	246	267	210	281
<b>Sources</b>							
Direct foreign investment	2	2	2	10	10	30	30
Multilateral	104	130	140	100	115	95	115
Bilateral loans <sup>a</sup>	295	225	235	116	122	65	116
Export credits	<u>40</u>	<u>24</u>	<u>24</u>	<u>20</u>	<u>20</u>	<u>20</u>	<u>20</u>
Total	441	381	401	246	267	210	281

a/ Concessional.

Source: Staff estimates.

44. Kyrgyzstan's external financing requirements will peak at around US\$400 to US\$450 million in 1993 and will gradually decrease to about US\$250 million during the second half of the nineties (Table 2). The current account deficit of the balance of payments is projected to reach 20 percent of GDP in 1993, which is in part an artifact of the exchange rate. When foreign resources are converted to rubles at such an undervalued exchange rate, the ratio of foreign financing to output is overstated. These financing requirements are evenly split between FSU and non-FSU liabilities. Following the Consultative Group meeting in December 1992, a pledging session held in April provided US\$200 million of grant and concessional financing for balance of payments support and US\$114 million of export credits from non-FSU sources, together with US\$44 million from the IMF and a 131 billion ruble credit tranche from the Russian Federation. Kazakhstan, Uzbekistan, and Azerbaijan have also agreed to provide Kyrgyzstan with 73 billion rubles of trade credits. For the outer years, closing of the external financing gap would require financial support of about US\$100 to US\$120 million from the multilateral sources, and of about the same amount from bilateral donors, including the FSU.

45. Having agreed with Russia on the zero debt option, by transferring Kyrgyzstan's share of the assets and liabilities of the FSU to Russia, Kyrgyzstan's initial debt position is minimal. While debt obligations will probably remain low in the short term, the existing export earnings and the lag between policy changes and productive responses suggest that Kyrgyzstan would continue to require access to external financing on highly concessional terms in the near term. In order to keep the debt service ratios within manageable limits in the late nineties,

Kyrgyzstan would need to mobilize about three quarters of its external financing on concessional terms.

### **C. External Environment and Major Uncertainties**

46. Kyrgyzstan confronts a difficult external environment. The economy benefited from large explicit and implicit transfers under the old system and thus ran a large, hidden structural balance of payments deficit which was financed from the center. Because of its weak domestic production base, the economy is heavily dependent on imports from Russia and the rest of the FSU (representing over 90 percent of all imports). As relative prices adjust in the FSU toward world levels, especially for oil, the burden of adjustment will intensify. The country's weak export base does not provide much of a cushion for the difficult transition to a market-oriented economy that will compete in international markets.

47. Although Kyrgyzstan already suffered negative terms of trade shock in 1992, additional losses are expected for the future. The economy is totally dependent on imported oil and gas, and its main suppliers are moving to world market prices. The distribution of the remaining shock over time will be determined by the pace at which these prices move to international levels. Nevertheless, in the next few years the total value of Kyrgyzstan's exports is likely to fall short of the country's energy import requirements.

48. Given the heavy dependence of Kyrgyzstan's economy on the FSU markets, delays in stabilization and recovery in other FSU economies would significantly constrain prospects for Kyrgyzstan. Since establishing new export markets outside FSU and substituting for imports from the FSU would require time, the pace of output recovery would critically depend on restoration of trade relations among the FSU states. Introduction of national currencies by increasing number of FSU states would pose further challenges for establishing well functioning, market based, and mutually beneficial trade, payments, and trade financing arrangements. Delays in establishing these arrangements would seriously hamper the supply response in Kyrgyzstan, and could potentially prolong the transition.

49. In addition to the potential constraints posed by the external environment and availability of external financing, Kyrgyzstan's reform program is faced with two additional areas of uncertainty: (i) the possibility that the commitment to reform will weaken and lead to policy slippages; and (ii) limited implementation capacity.

50. Commitment to Reform. Although the authorities in Kyrgyzstan have demonstrated their commitment to reform under exceedingly difficult circumstances, the simultaneous implementation of stabilization and structural reforms will be a difficult challenge. The success of the stabilization program will depend to a large extent on the transformation of SEs into economic entities which will respond to market signals. At the same time, implementation of structural reforms might themselves result in transitory macroeconomic instability. For example, as implicit subsidies are made explicit and directed through the budget,

the fiscal deficit will increase, thus putting further pressure on the stabilization efforts. Similarly, as state enterprises face losses, profit-based fiscal revenues will decrease, making the budgetary situation even more difficult.

51. Domestic political pressures posed by the dual challenge of stabilization and structural reform could be further aggravated by continuing large economic decline and the uncertain prospects for future growth. The likely increase in unemployment and continued restraint on real wages constitute additional social costs. These pressures may force the Government to ease up on the implementation of the comprehensive reform program. Sustained strong support from the donor community will be important to counter these domestic pressures.

52. Implementation Capacity. While policy design is critical, the formulation of an appropriate reform program is not sufficient; the program must be implemented. As the range of decisions broadens and the complexity of issues increases, decentralization of authority will be necessary if the pace of reforms is to be sustained. Timely and effective implementation of the structural and sectoral reform program will require a substantial strengthening of institutional capacities -- both at the center to establish priorities in the reform agenda and allocate resources to support these priorities, and in the line ministries and specialized institutions to undertake these programs. The extent of the new processes to be installed and skills to be acquired cannot be overstated. The conduct of economic activities consistent with market principles will require, for example, creating a capacity within the Government to procure goods and services under conditions of competitive bidding and putting in place a system of financial control and audit to ensure proper use of funds.

53. The transformation of institutions into structures that are suitable for democratic processes and supportive of market-oriented activities will require fundamental adjustments in the existing institutional framework. Technical assistance from abroad can assist the transformation process -- this report identifies several areas of priority -- but it is clear that the process will be lengthy and made more difficult by the current economic decline. Training to improve the capacity to implement economic policy should therefore be of high priority. At the same time, the formulation of reform objectives should attempt to incorporate identified deficiencies in implementation capacity, to improve the realism of the reform package and the prospect that it can be fully realized.

#### **D. IBRD/IDA Country Assistance Strategy**

54. **Main Objectives and Future Program of Assistance.** The design of an assistance program for Kyrgyzstan poses an unprecedented challenge. All sectors are being simultaneously reformed while old structures collapse. Not only a new economy but also a newly independent country is being built. As the situation evolves and greater understanding of the country is gained, the most important task for the program is to remain open to new ideas and to have the flexibility to adapt to changing conditions. IDA's assistance program to Kyrgyzstan has been

designed to provide early and strong support to the Government's program through policy advice, ESW and lending in the following areas:

- o Macroeconomic stabilization through balance of payments support
- o Structural reforms through enterprise restructuring, privatization, and financial sector reforms
- o An effective social safety net
- o Sectoral reforms through operations in agriculture, infrastructure, mining and environment
- o Institution building and reinforcement of the Government's implementation capacity, including the establishment of an agency to manage external assistance.

55. **Assistance in 1992.** Beginning with the preparation of the first economic report, the Bank's assistance since February 1992 has consisted of: (i) policy advice and institution building under the Technical Cooperation Agreement (TCA); (ii) aid coordination through the recently established Consultative Group; and (iii) preparation of investment and policy-based operations. Bank assistance to Kyrgyzstan began through the TCA signed on November 5, 1991. In addition to policy advice and institutional support, the work funded by the TCA provided an initial understanding of the overall structure of Kyrgyzstan's economy through the first Country Economic Memorandum (CEM) and the initial preparation of the proposed Rehabilitation Credit.

56. Other areas of assistance provided under the TCA include: (i) advice on the legal and institutional infrastructure necessary in a market economy; (ii) assistance in the development of an overall strategy for privatization and private sector development; (iii) a review of the financial sector that provided initial policy advice in this area; and (iv) a review of the Government's social sector policies, soon to be distributed in Gray Cover. The work in these areas has helped to define the Government's reform program and the Association's lending priorities. It is being continued under the Association's ESW and project preparation work.

57. The *policy dialogue* between Kyrgyzstan and the Association has been extremely open and has been instrumental in the Government's design of its structural reform program. Committed to a fast-track reform program toward a market economy, the authorities have been highly receptive to outside support and advice. The Government has also established a productive policy dialogue with the IMF, culminating in an agreement on the standby arrangement.

58. **Future Assistance.** In order to manage the risks described in section C, while maintaining the required flexibility, the IDA assistance program will adapt to alternative scenarios that may develop during the next three years. Three alternative scenarios are presented below, which differ with respect to lending totals and instruments used.

59. The policy actions that underlie the strong reform scenario are contained in the *Memorandum of Economic Reform Policies* (Annex III) supporting this proposed Rehabilitation Credit. They are also described in Section C of this report. Macroeconomic policies to sustain the successful introduction of a new currency are a key element of this scenario. Moreover, the stabilization program is being supported by structural measures that enable the achievement of the macroeconomic targets in the program and are consistent with long run growth and equity requirements. This strong reform scenario supports privatization and improved governance of SEs remaining in the public sector; rationalization of social expenditures and social assistance targeting; and cost recovery in infrastructure. In particular, this scenario depends on successful implementation of the Government's privatization program, described in paras 21 to 27. Another trigger, which is key for materialization of the supply response, is the reduction in the role of the state in distribution and marketing, especially in agriculture.

60. The main risk to the strong reform scenario is that large external shocks and social costs could lead to politically induced slippage in the implementation of reforms. Policy slippage on privatization, on reducing the role of the state, or on macroeconomic management, will trigger a move towards an intermediate case lending program. The working assumption in this scenario would be that macroeconomic stabilization is expected over a longer period but that policy measures are still in the right direction. Delays in privatization relative to the existing goals (although with a minimum progress required on medium and small-scale privatization) as well as slow expansion of private activity in agriculture production, trade and distribution would also trigger a move to the intermediate program.

61. There are two triggers that would move IDA's assistance program to a low case. First, if key elements of reforms already taken were reversed. This would involve reversals of actions in the area of privatization, legislation and regulation, financial sector and social safety net. It would also involve actions that reimpose barriers to entry or state orders. Second, if macroeconomic management deteriorated.

62. **Strong Reform Scenario.** As seen today, it is the Association's judgement that the strong reform scenario is the most likely for Kyrgyzstan. The reform program has strong support from the highest administration officials. Moreover it has been approved by Parliament (para 17). At the same time, negotiations for an upper-tranche standby arrangement with the IMF have been concluded. In addition to the proposed Rehabilitation Credit, the lending program under the strong reform scenario would include policy-based loans over the FY94 to FY96 period covering enterprise and financial sector reforms, human resources, and cross sector reforms in the outer years. It would also include investment operations and technical assistance as described below. Total lending for the period would be around US\$ 240 million.

63. **Adjustment Lending in Support of Structural Reforms.** The first proposed operation, *the Rehabilitation Credit*, has been designed in response to Kyrgyzstan's immediate needs: (i) to help stabilize the economy by financing critical imports, and thereby halting the decline in output and trade; (ii) to help the Government launch the structural reform program with technical assistance in core areas; and (iii) to initiate sectoral reforms, by providing

technical assistance in key sectors. The proposed Credit would be the first quick disbursing operation for the CIS, excluding Russia.

64. Given the authorities' lack of familiarity with IDA requirements and practices, several actions have been initiated at an early stage of preparation of the proposed Credit to minimize potential implementation problems. Implementation arrangements for the Credit are discussed in Section III and Annex VI. These arrangements include the establishment of a local project implementation unit, significant staff resources for IDA supervision activities to ensure fast disbursement and full utilization of the proposed Credit, and training on procurement and disbursement procedures. Finally, the Regional Mission in Tashkent is expected to play an important role in supervision and implementation support.

65. Support for *privatization, private sector development, and financial sector reforms* would form the core of the Association's policy-based assistance for structural reforms. A proposed Financial and Enterprise Sectors Credit, amounting to about US\$50 million, would support reforms of commercial banking and the establishment of a payments system, privatization and enterprise restructuring. The Credit would also finance the strengthening of institutions through training, technical assistance, and related equipment and software.

66. Considering the speed and scope of the privatization effort in Kyrgyzstan, addressing the potential unemployment to be generated during the adjustment process will be IDA's first priority in the area of *human resources*. The Association plans to prepare a FY95 operation of about US\$40 million to help ensure the provision of an effective and adequate social safety net. This project would aim to strengthen the capacities of the Ministry of Labor and Social Protection, the Employment Service, and the State Committee for Training to pay unemployment compensation, to design and carry out proactive labor market policies, including job search and placement activities, and to implement retraining programs.

67. The proposed operation would also provide technical assistance, training, and equipment to support the Government's effort to improve the efficiency of the various existing social insurance measures by integrating the Pension Fund, the Employment Fund, and the Social Insurance Fund, by improving the collection system and financial management of the three insurance funds, and by computerizing the system and enhancing financial controls. It would also increase the capacity of the Ministry of Social Protection and the State Statistical Committee to devise mechanisms for targeting social assistance to vulnerable groups. Finally, given the tension between fiscal tightening and rising social safety net expenditure needs, additional assistance from donors, in the form of cofinancing or parallel financing, to support health and education programs, may also be warranted.

68. Investment Lending in Support of Sectoral Reforms. In addition to adjustment lending, the Association plans to develop investment operations in sectors with potential for a quick supply response. This assistance would begin in agriculture and would extend later, possibly into hydropower. In addition, support is needed in key areas of infrastructure to increase the competitiveness and quality of domestic production and promote sectors with export-

earning potential. The Association will provide some assistance in the telecommunications sector and will continue to seek cofinancing for these activities and to encourage other donors to invest in Kyrgyzstan's infrastructure.

69. Given the dominance of *agriculture* in Kyrgyzstan's economy, operations in this sector are a critical part of the Association's assistance program. In order to ensure that the sector generates a positive supply response, it will be essential to support continuing sectoral reforms, particularly in the structure of agricultural incentives and institutions. An investment operation in agriculture would address the most significant constraints in the crops and livestock sub-sectors, with emphasis on physical infrastructure, storage and distribution, research and extension, and availability and quality of inputs. The proposed operation would amount to about US\$65 million. The policy content of this operation will depend on the outcome of the agricultural sector review planned for FY94.

70. Because Kyrgyzstan is landlocked, investment in potentially productive sectors is necessary but is not sufficient for the country's access to world markets. The *infrastructure* needed to facilitate communication and transportation to the outside world will be particularly critical in linking both export and import markets to the productive sectors, and thus facilitating their growth. In this context, the Association, together with other donors, plans an investment project in *telecommunications* for FY95, with the Association's contribution amounting to about US\$10 million. This operation, consisting of a small component of TA and a large component of specific investments, would aim at: (i) rehabilitating and expanding the basic (international, national, and local) telecommunications network to provide priority subscribers with quick, economic access to quality telecommunication services; (ii) establishing a market-oriented policy, regulatory, and institutional framework to facilitate private and public investment in basic and non-basic services and improve sector efficiency; and (iii) commercializing and corporatizing the basic telecommunication operator. Over time, although the Association may become involved in other infrastructure activities emphasizing the maintenance of existing capital assets, it will continue to encourage other donors to support infrastructure investments in Kyrgyzstan.

71. Based both on the vulnerability resulting from Kyrgyzstan's dependence on imported energy and the country's potential for growth in the *hydropower* sector, the Association would consider investing in this sector in the medium term. Identification of investment projects will depend on the outcome of an overall strategy for the sector and the assessment of potential markets in the region. Hydropower studies, expected to be financed by USAID and EBRD, could be instrumental in defining IDA's future interventions in the sector. At present, an operation of about US\$30 million, is proposed for FY97. Based on the Association's current knowledge of the sector, activities in hydropower could focus on the need for rehabilitation and reconstruction of existing plants, improvement in the transmission and distribution systems, improved efficiency of energy use, and technical assistance for the marketing system in hydropower.

72. **Intermediate Case.** Quick-disbursing lending would be postponed but investment lending, training, and technical assistance would be maintained. The privatization project



(para 66) would be limited to support reforms of the payment system since the lack of a stabilization program would affect the success of the privatization of four large state-owned commercial banks, which is currently envisaged. Investment projects would focus on supporting reforms and sectors which are less dependent on macroeconomic stability. In agriculture, for example, investment projects would support the liberalization of distribution and marketing in the sector and, thus, foster private sector participation and supply response. Similarly, investment in telecommunications and social sectors could advance the reform program. Under the intermediate case the lending program would range between US\$ 120 and US\$ 180 for the FY94 to FY96 period.

73. Under the low case the Association would like to maintain presence in all sectors, focussing on TA to maintain institutional reform and the policy dialogue. The lending program would comprise technical assistance and institution-building operations and a small amount of investment lending in key infrastructure sectors. These investment projects would be aimed at rehabilitating facilities and basic service levels, to avoid the collapse of key infrastructure where postponement of rehabilitation would increase its cost in the future. Overall lending would be within the range of US\$ 50 to US\$ 80 million for the FY94 to FY96 period.

74. **Lending Summary.** Six projects are planned for Kyrgyzstan during the FY93-FY96 period. The total lending amount for these years could be in the range of US\$240 million. Given the country's low income, large drops in output and real incomes for 1992 and those expected in 1993 and beyond, its weak creditworthiness, and fast-track reform program, the Bank has decided to consider Kyrgyzstan eligible for financing on IDA terms. Over time, as the Association is better able to assess the country's creditworthiness, lending may shift to a blend of IDA and IBRD financing. The extension of IDA to Kyrgyzstan is already having a catalytic effect in the mobilization of concessional financing from other donors.

75. The Association's strategy emphasizes the role of quick-disbursing, adjustment lending in support of a strong program of structural reforms. The forms of assistance could comprise as much as 50 percent of total lending in the next four years, after which its share would decline sharply. Such a high proportion is justified on balance of payments grounds to meet the country's external financing requirements. Quick-disbursing, policy-based operations will help finance imports, preventing further collapse in the economy and thereby contributing also to the political sustainability of the reform program. Without IDA's policy-based support for structural reform, Kyrgyzstan would have difficulty accessing other sources of external finance.

76. **Economic and Sector Work.** The Association's ESW on Kyrgyzstan is the basis for advising the Government on policy design and implementation. Economic work should be less sensitive, than the lending program, to the scenarios described above. The first comprehensive economic assessment of the country's macroeconomic framework and its structural and sectoral characteristics was carried out under the first Country Economic Memorandum (CEM). The report also contains the Association's initial policy recommendations on the transition to a market economy.

77. Given their importance in these initial years and the need for annual Consultative Group meetings, annual CEMs are planned for the next three years. The new CEMs will take stock of economic developments and the progress of the reform program and then focus on a series of cross-sectoral issues. The next CEM, envisaged for FY94, will include a first review of the public investment program, to provide advice on the efficient allocation of public resources and on preventing the crowding out of private investment as well as the on development of an appropriate institutional framework.

78. Sectoral reviews will also provide the analytical basis for designing the various sectoral lending operations. The first of these, the human resources review and the enterprise reform, privatization and financial sector review, are already underway. A comprehensive agriculture review is also planned for FY94.

79. The Government has requested participation in the Trade Expansion Program (TEP). This program, financed by UNDP and executed by the Association, has been extremely successful in other countries. If the financing is forthcoming, the program would help provide the blueprint for future trade reform. The advantage of the TEP is that its terms of reference are developed by the main agencies involved in the reform program. The resulting agenda for trade reform programs is thereby owned by the local agencies concerned. This would provide the basis for the Association and other donors to support the implementation of trade reform through lending operations.

80. As in the other FSU republics, the past system of state planning in Kyrgyzstan did not factor in the value of the environmental resources that were lost as a result of economic plans and policies. The incentive framework led to overconsumption of resources, such as energy and water for irrigated agriculture. A Bank staff report "Aral Sea Crisis: Proposed Framework of Activities" was published in March 1993. An international conference will be held on April 26, 1993 to discuss the proposals contained in the report.<sup>3</sup> An Environmental Action Plan will be developed in FY94 to address these issues and to help the Government improve environmental policies and regulations as they develop their economic structure. This work will be supported by other sector work on agriculture and by the regional work carried out by the Bank on the Aral Sea.

81. **Portfolio Management.** IDA's strategy will be based on the lessons learned from the implementation experience of other FSU countries and Eastern Europe with the objective of minimizing potential implementation problems. At the project design stage, the Association will ensure that adequate emphasis is given to building up the institutional capacities to manage and implement projects. Training needs of local staff in procurement, disbursement, and financial management will be given particular attention. As the portfolio develops, through the Mid-Term Review process and Country Implementation Reviews (CIRs), implementation issues will be closely examined with a view to facilitating the design of future operations.

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<sup>3</sup> The conference has been organized by the Bank in collaboration with UNEP and UNDP.

82. **Other Bank Group Activities.** Kyrgyzstan became a member of the International Finance Corporation (IFC) on February 11, 1993 and is expected to become a member shortly of the Multilateral Investment Guarantee Association (MIGA). IFC has already conducted a preliminary assessment of potential work in the country. As a result, two initial projects, for the establishment of both a model private commercial bank and a leasing company for small and medium-size enterprises, are currently planned. At a later stage, IFC envisages playing a role with IDA on the privatization program as well as in the mobilization of private foreign investment in the tourism, mining, and electronics sectors. IFC is already investigating a possible investment project in gold mining.

83. **Coordination of External Assistance.** A major part of the Association's work in Kyrgyzstan is devoted to mobilizing and coordinating donor resources. Through chairing Consultative Group meetings and through ensuring a continued exchange of information, the Association aims to maintain close cooperation with multilateral and bilateral agencies. The Association organized and chaired the first Consultative Group meeting for Kyrgyzstan on December 15, 1992 and, as a follow up, a pledging session was held on April 8, 1993 to firm up donor commitments for external financing. Given the success of both meetings, the Association, as Chairman of the CG, will continue its resource mobilization and coordination efforts with the international community, including with FSU countries. Throughout the process of aid coordination and mobilization, the Association and the IMF will continue to work closely in developing complementary programs of assistance.

84. In cooperation with the EC and UNDP, the Association is helping to establish the External Assistance Management Unit (EAMU). This unit will be the channel through which Kyrgyzstan will receive and coordinate the aid from various donors. In this effort, the Bank has provided a grant of approximately US\$300,000 under the Institutional Development Fund. The local Consultative Group meeting, expected to be held in Bishkek in May 1993, will: (i) take stock of technical assistance flows to date and remaining requirements, (ii) discuss procedures for implementation of the EAMU, and (iii) discuss specific technical assistance needs in the social sectors.

## Summary Assessment

85. Kyrgyzstan faces issues pertaining both to an economy in transition, and to a low-income developing country. Since Kyrgyzstan is small and has a political leadership committed to reform, the external community has the opportunity to play an important role in facilitating the transition to a more resilient economy.

86. Kyrgyzstan faces many uncertainties in its transition to a market economy. These include developments in the external environment, the sustainability of political support for reform, and the capacity of the Government to implement across-the-board reforms. Such uncertainties are complicated by the fact that this is a new country with no track record of past performance. Also, political developments in Russia could have implications in Kyrgyzstan. The adoption of a new currency in such a fluid and uncertain situation has inherent risks.

87. The international community, including the Association, should support the current Government's determined effort to proceed with reform. Assistance is needed to slow down output decline through the financing of critical imports, selective investments to minimize further decline in basic services, pivotal technical assistance to support reforms in key sectors, and measures to support enterprise restructuring and strengthen social safety net arrangements. Training and the implementation of an adequate institutional framework are also required for the Government to be able to effectively use this financing.

88. Given the uncertainty and newness of the Kyrgyzstan economy, the Association faces a threefold challenge: (i) to be able to adapt to rapidly changing conditions; (ii) to prioritize interventions so as to maximize the effectiveness of IDA and other donor resources; and (iii) to invest relatively large proportions of IDA resources in designing policies and projects, that can become a platform for other assistance, including cofinancing.

89. The Association's assistance strategy described earlier is based on three scenarios that are triggered by alternative Government policy performance. It is also based on the most likely financial needs and realistic financing availability as seen today. However, it is important to recognize that there are significant uncertainties surrounding the magnitude of external financing needs and sources. If these uncertainties were to materialize, the Association would have to reconsider stepped-up assistance -- at least temporarily -- provided that it is complemented by the mobilization of additional financing from the donor community and, additional domestic policy measures. Achieving a proper balance between these elements would represent a complex challenge for the Association in the future.

### III. THE REHABILITATION CREDIT

#### A. Background

90. The proposed Rehabilitation Credit would be the Bank Group's first lending operation in the country. It would provide concrete support for the Government's reform efforts by providing foreign exchange for imports critical to production and for technical assistance critical to the implementation of the systemic reform measures. The Association intends to continue to support the reform process through its lending program, portfolio management and ESW. Supervision of the proposed Credit, which is expected to be very staff-intensive, will also provide the basis for carrying out a policy dialogue in the areas of systemic reform that the Credit supports.

91. Rationale for IDA Involvement. As has been discussed earlier in this report, the economic situation in Kyrgyzstan has been deteriorating in the last few years, in line with the developments in the FSU. Output has declined owing to severe disruptions in interstate trade. The economy is suffering a severe terms of trade deterioration because of the recent and prospective increases in energy prices. The fall in demand, as a consequence, is expected to heighten the need for adjustments in the goods and labor markets.

92. Although the country's economic management capability is weak, it has a reform-minded Government. The Government's Economic Reform Program is consistent with the recommendations of the Association and the IMF. It represents a courageous and ambitious attempt to remove the vestiges of a command economy and move to a market economy with predominantly private sector activities. Substantial adjustment will be involved: a massive restructuring of agricultural, industrial and commercial activities will take place as producers adjust to realigned relative prices; the financial sector will undergo reforms involving the development of a strong central bank, a commercial banking sector, and a stronger regulatory environment; privatization will be implemented; a targeted social safety net, that will make effective use of its budgetary resources, will be developed; and the state will reduce its role in production, distribution and resource allocation. The basic constraint the Government now faces is the financing of the Economic Reform Program so that the adverse effects of the adjustment are minimized.

93. IDA supports the Government's Economic Reform Program. The Government's Memorandum on the Economic Reform Program will form the basis of the future policy dialogue between the Government and the Association. The Government's Program will focus on limiting economic decline in the short-term and establishing the basis for systemic reform in the medium and long-term. (The Government's Memorandum is provided in Annex III.)

94. In the short-term, the reform process will entail significant problems of unemployment, austerity, inflation and political confrontation. Obstacles in the development of markets (limited market and price information, limited private sector traders and intermediaries,

inadequate communication facilities, regulatory environment, etc.) will slow down the adjustment of relative prices. Trade, already significantly disrupted among the FSU republics, will not be easy to develop with the rest of the world. Industry and agriculture will suffer setbacks as profound restructuring takes place. However, Kyrgyzstan has good longer term potential for development. While its mineral wealth (with potential for exploitation on an expanded scale in gold, antimony, mercury, uranium and rare earth metals) has yet to be exploited, agriculture (with potential for intensive high value production), hydroelectric potential, tourism, and well-educated human resources are major assets which could form the basis for sustained growth.

## **B. Project Objectives and Description**

95. The objectives of the Credit are: (i) to support the Government's reform program, outlined in the Memorandum from the Government to the Association; (ii) to establish a policy dialogue between the Government and the Association; (iii) to finance critical imports of inputs, raw materials and spare parts in key sectors, thus easing the shortage of foreign exchange and minimizing further contraction of economic activity; (iv) to stimulate foreign exchange markets and enhance private sector access to foreign exchange; and (v) to provide priority TA in the key structural reform areas, which will facilitate implementation of the program and build up overall implementation capacity in the country.

96. Project Description. The proceeds of the Credit would finance (i) pre-identified imports for priority sectors (PIC) of SDR 23.8 million; (ii) imports by the private and public sectors through the provision of foreign exchange (FXC) of SDR 14.4 million; and (iii) technical assistance (TAC) of SDR 5.1 million. In the case of the FXC, the items not eligible for financing under the Credit have been developed into a standard "negative list." Foreign exchange will be provided for imports under the Credit (both FXC and PIC) at the market exchange rate, without any foreign exchange rate subsidies. Any compensatory subsidies subsequent to importation will have to be through the budget, targeted where possible and within the constraints imposed by the stabilization program.

97. PIC. For the PIC, priority sectors will be limited to a few pre-identified imports which will be financed for only a limited number of large orders. The emphasis will be on maintaining production and services in critical areas and reducing production and employment declines. Such imports include: telecommunications replacement equipment and spare parts, pharmaceuticals, agricultural chemicals, veterinary medicines, spare parts in the public transportation sector, petroleum products, replacement power transmission lines and motors, replacement irrigation pumps and equipment and spare parts, and equipment for environmental monitoring laboratories. A summary of items to be financed under the PIC is provided in Annex IV and the procedures for implementation are discussed in Annex VI.

98. FXC. The foreign exchange market in Kyrgyzstan has been limited, owing to the legacy of Government controls under the FSU. However, now several commercial banks and exchanges are authorized to deal in foreign exchange. With the introduction of the national

currency, the exchange rate will be determined by periodic auctions in the independent inter-bank foreign exchange market. The government is committed to refrain from intervening in the market with the purpose of influencing the exchange rate. There is apparent demand for foreign exchange by the private and public sector enterprises but the volume of transactions is constrained by the limited export earnings and foreign capital inflow. Commercial banks have limited experience in foreign exchange transactions but are interested in expanding their activities in this area; they are establishing correspondent bank relations, and TA will be provided in the Credit for training in foreign exchange operations. Through the FXC, private and public entities will have access to foreign exchange. Disbursement under this component will be made as reimbursement to the government for imports by the private and public sector already made. Individual documentation for imports costing less than US\$10,000 equivalent or exceeding US\$500,000 equivalent would not be eligible for reimbursement under the FXC.

99. The FXC of US\$ 20 million will serve three broad purposes. First, it will provide foreign exchange to finance imports by the private and public sectors at the exchange rate freely established in the inter-bank foreign exchange market. Second, the local currency received by the Government from the sale of this foreign exchange will provide non-inflationary deficit financing for the budget. Third, the FXC will also provide some assistance to the authorities in the establishment of the new inter-bank foreign exchange market and help underpin the new currency during the initial critical period after its introduction. The volume of transactions that will initially flow through the market is uncertain. However, the formal auction market will tend to set the rate for transactions outside the market (since sellers will have no reason to sell for less than and buyers have no reason to pay more than the auction market prices). By adding to the potential supply of foreign exchange available for sale, the FXC will help get the new market established. The rate and periodicity of sales by NBK of foreign exchange at the inter-bank foreign exchange market will be agreed upon between the authorities and the Association.

100. The linkages between the foreign exchange auctions and the financial sector need to be noted. The auctions of rediscount credit initiated by the NBK in February, 1993, will ensure that public and private enterprises shall have access to commercial bank credits under the same terms and conditions. Meanwhile, prudential regulations have been introduced to prevent concentration of lending by commercial banks to their public enterprise shareholders. In December, 1992, loans to individual shareholders were reduced to 20 percent of a bank's capital while exposure limits on individual borrowers were set at 40 percent of capital and reserves. Furthermore, loans to all shareholders, who own more than 5 percent of shares individually, will be reduced to a total of less than 25 percent of the outstanding loans by the end of 1994, with intermediate targets to be agreed upon between the Government and the Association. The stabilization program also contains global credit ceilings which will limit the public sector's access to credit. In addition, by the end of January 1993, privatization has been extended to over 2000 enterprises, which amounts to a transfer of more than 10 percent of the total fixed assets of the state enterprise sector to the private sector. The Government intends to accelerate the privatization of state enterprises and by the end of 1993 aims for a target of 35 percent of state enterprise fixed assets. Implementation of these measures facilitates the creation of a conducive

environment for the private enterprises to have access to the foreign exchange provided through the FXC and limits the possibility of the private sector being crowded out by the public sector.

101. A protocol would be required between the Government and the NBK indicating the predetermined amounts and periodicity of the foreign exchange transfers to the NBK for sale at the inter-bank foreign exchange market. NBK will submit to the PIU, with copy to the Association, monthly reports indicating the portion of foreign exchange auctions during the month that has been financed through the resources from reimbursements by the Association for imports under the FXC.

102. **TAC.** The TAC will provide financing for technical assistance in the key structural reform areas of the Government's Economic Reform Program. The key areas of the reform program include, enterprise reform, privatization and private sector development, the financial sector, social safety net, policy and legislation development in agriculture, mining, procurement, development of private and public sector capacities in technical and economic analysis, including project preparation, evaluation and implementation. Technical assistance will be provided to the State Property Fund (SPF) and the Antimonopoly Committee (AMC) in the areas of privatization, enterprise governance, enterprise restructuring/liquidation and competition policy. In the financial sector, TA will be provided to (i) develop an approach and procedures that are suitable for auditing commercial banks during the transition of the economy and the financial systems, and (ii) to carry out, as a pilot exercise, audits of two large commercial banks. For the mining sector, the TA is designed to aid the Government to establish a legal framework and an enabling environment to promote efficient production operations under market economy conditions which will be conducive to new investment. Technical assistance in the area of social safety net will focus on key aspects of the health sector, emphasizing the critical areas of pharmaceutical policy and health facility restructuring. Development and implementation of policy change, and privatization of production and production factors, particularly land privatization, in the agriculture sector would be supported by detailed studies to be carried out under the TA program.

103. TA related to procurement is being expedited through the use of part of an advance from the Project Preparation Facility (PPF) resources of US\$ 0.5 million. The TAC will also facilitate continuity with the TA activities already started by other donors, mainly the European Community (EC), and with resources from the Trust Funds established under the Technical Cooperation Agreement (TCA) between the Government and the Bank. The TA needs are much larger than can be supported by the proposed Credit and major multilateral donors such as the EC. A Consultative Group meeting was convened under the chairmanship of the Bank to mobilize additional multilateral and bilateral support for Kyrgyzstan's core TA requirements. A summary of the TAC is provided in Annex V and the TAC procurement and implementation schedules are provided in Annex VI, Tables A-VI.2 and A-VI.3.

104. The TA program has been developed in close consultation with the Government as it is closely linked to the development and implementation of the Reform Program. The terms of reference (TOR) for individual TA activities have been substantially developed by the



Borrower and are being reviewed by the Association. Bids have been launched using resources from the PPF for the Procurement Agent.

### **C. Environmental Aspects**

105. The project would be consistent with IDA policy and would follow acceptable IDA procedures. In conformity with IDA policies for adjustment operations, no environmental rating has been assigned. Nevertheless, in developing procurement procedures for financing imports under the Credit, specific provisions will be made to ensure that the inclusion of any toxic or hazardous substances would be under conditions acceptable to the Association. Furthermore, in the privatization program, environmental audits will be conducted where pertinent and a legal framework will begin to be developed in order to incorporate assignment of environmental liability for past and current environmental damage into the privatization process.

### **D. Project Implementation**

106. The State Commission for Foreign Investments and Economic Assistance (GOSKOMINVEST) is the high level Government organization responsible for coordinating and implementing the proposed project. GOSKOMINVEST, chaired by the Prime Minister, coordinates foreign assistance to the Republic. It was created by decree on July 27, 1992, as a state entity outside the regular structure of the Government. Its functions cover external assistance management, aid management, foreign investment facilitation, and procurement and audit service. It will serve as a focal point for relations with investors and donors, and as the official counterpart of all donor agencies operating in Kyrgyzstan, as far as their economic, financial and technical activities are concerned.

107. The Project Implementation Unit (PIU) will be under the direction and responsibility of GOSKOMINVEST. The organization of the PIU is described in detail in Annex VI. The PIU will be responsible for the overall implementation, procurement and disbursement of the Rehabilitation Credit and the related reporting and accounting activities of PIC, FXC and TAC. In these activities, PIU will benefit from the services of the Procurement Agent and the TAC management consultants (organization and finance). Given the wide scope and importance of its assigned functions, the PIU has been given the authority and stature to deal directly and effectively with Government ministries and offices, as well as the NBK, and commercial and correspondent banks and project beneficiaries. The Government has agreed to provide the PIU with adequate staff, and office space, transport and office furniture for the staff. Equipment for photocopying, telecommunications (telephone, telex and facsimile) and information systems (computers and software) will be provided under TAC. The PIU will be required to provide extensive support to commercial banks participating in the FXC and TAC, and to provide guidance in procurement procedures new to the country and other aspects of project implementation. As a result, it is important that the PIU be exclusively concerned with the

Credit during the implementation period and that it not be given additional duties and responsibilities unrelated to the Credit. The main responsibilities of the PIU and details of implementation arrangements are described in Annex VI.

## **E. Procurement**

108. As imports and procurement in the FSU were coordinated through Moscow, there has been practically no procurement capacity in Kyrgyzstan. An international procurement agency acceptable to IDA will be contracted to assist the Government in the management of procurement and pre-shipment inspections, and training of the PIU staff will also be provided in procurement (resources have been mobilized through the PPF to choose this procurement agency through a tender). The Borrower and the procurement agency will ensure that procurement complies with IDA guidelines. Contracts estimated to cost above US\$ 300,000 equivalent will be awarded through modified International Competitive Bidding (ICB), using IDA's standard bidding documents modified to suit the requirements of individual packages. Contracts costing less than US\$ 300,000 equivalent will be procured through international shopping, based on at least three quotations from two different countries. Limited international bidding will be used for goods for which there are a limited number of suppliers. Direct contracting will be allowed for proprietary goods and items required for standardization. Subject to the Association's prior approval, commonly traded commodities will be procured through organized international commodity markets or through other channels of competitive procurement acceptable to the Association in the event that the pre-identified import list is amended. The necessary prior clearances will be obtained from the Association for procurement of hazardous materials such as agricultural chemicals (herbicides, pesticides, etc.).

109. To ensure compliance with IDA guidelines, the first two contracts for the procurement of goods through the PIC (including bidding documents) in each sub-sector, all contract packages awarded under Direct Contracting procedures and all contracts (including bidding documents) over US\$ 0.5 million equivalent will be subject to prior review by IDA. All other contracts will be subject to ex-post review. Pre-shipment inspection will be carried out as necessary for contracts costing over US\$ 300,000 equivalent. Consultants will be selected in accordance with the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency" and the evaluation will be based on technical criteria only. Details of the functions of the PIU, procurement processes under the Credit and a draft Terms of Reference for the consultant Procurement Agent are provided in Annex VI.

110. The proposed procurement arrangements for goods and the hiring of consultants are presented in Annex VI, Tables A-VI.1 and A-VI.2. These procurement plans represent best estimates; precise amounts under each procurement category will be determined when the Procurement Agent identifies bidding packages according to equipment needs and at the time when the bidding document for each package are prepared. The bidding packages will require the prior approval of IDA. The estimated aggregate amounts to be procured under procedures

other than ICB are as follows: LIB: US\$ 12 million; International Shopping (IS): US\$ 14.5 million; Direct Contracting US\$ 0.5 million and TA (consultants' services): US\$ 7.0 million.

#### **F. Disbursement**

111. The proceeds of the Credit will finance 99.6 percent of the project costs or 100 percent of the expenditures on imported items. The Credit will also refinance the advance made under the Project Preparation Facility (PPF) No. P193-0 KG. The proceeds of the Credit are expected to be fully disbursed for the PIC and the FXC within six months from the time of effectiveness. For the TAC, disbursement will extend over 36 months. The Closing Date for the Rehabilitation Credit is June 30, 1996. Contracts costing less than US\$ 10,000 under the FXC and less than US\$ 50,000 under the PIC will not be eligible for financing under the Credit. To facilitate the disbursement of PIC and TAC, a Special account (SA) of US\$ 5.0 million will be opened in a foreign commercial bank acceptable to IDA. The SA will not be used for FXC, which will be disbursed on a reimbursement basis. Details of the disbursement processes under the Credit are provided in Annex VI.

#### **G. Retroactive Financing**

112. The proposed Credit will provide retroactive financing for up to 20 percent of the sum of the PIC and FXC for imports of goods and services that meet the procurement guidelines of IDA and which have been imported on or after February 1, 1993.

#### **H. Reporting, Accounting and Auditing<sup>4</sup>**

113. The PIU will establish and maintain a Management Information System (MIS) covering all procurement financed by the Credit, as follows: (i) under the PIC and the TAC, the records will include information received on all procurement transactions, including the identity of the user, the kind of goods and services purchased, the contract value, identification of the bidders and the winning supplier, the key dates for the bidding process, and the subsequent fulfillment of the contract; (ii) for the FXC, the records will include details of the purpose of the foreign exchange purchased, as per information submitted by the participating commercial banks and importers. The PIU will use this information to prepare progress reports and the Project Completion Report required after the Credit has been disbursed and closed.

114. The PIU will establish an appropriate accounting system according to generally accepted standards, in order to provide information on receipt and use of funds, in line with the terms of the Credit Agreement. The Borrower will prepare annual statements of all receipts and

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<sup>4</sup> Details of Accounting, Auditing and Reporting are provided in Annex VI.

payments under the Credit showing the amounts relating to each component and category as detailed in the Credit Agreement.

115. Project Accounts (including the Special Accounts) will be audited in accordance with the March 1992 "Bank Guidelines for Financial Reporting and Auditing of Projects financed by the World Bank." The Borrower will arrange for the auditing of all the above financial statements, in accordance with generally accepted accounting standards, by independent auditors acceptable to IDA. The Association will be provided by the Borrower the audited statements and audit report of such scope and detail as the Association may reasonably request, within six months after the end of each fiscal year of the Borrower. The auditor's report will specifically refer to the eligible use of IDA's funds in accordance with the Credit Agreement and with IDA's guidelines.

#### **I. Agreements Reached**

116. Conditions. The Government's Economic Reform Program has been officially communicated to IDA in the form of a Memorandum of Economic Reform Policies, referred to in the Credit Agreement and included as Annex III to this report.

117. In addition, at negotiations the following specific agreements were reached with the Borrower:

- a. GOSKOMINVEST will represent the Government as the Borrower for the Rehabilitation Credit;
- b. the Government has established the PIU under GOSKOMINVEST; staffed and provided adequate facilities and budgetary resources for the PIU and the implementation of the project; and has agreed that the PIU be exclusively in charge of the Rehabilitation Credit, and not be encumbered with other duties and responsibilities;
- c. the Borrower will hire and authorize a procurement agent to conduct procurement on behalf of the Borrower;
- d. the Borrower will hire consultants to aid in the management of the TAC and the consultant's TOR will be reviewed and approved by IDA;
- e. the Borrower has agreed to provide IDA with audited statements and audit reports of the Project of such scope and detail as IDA may reasonably request, within six months after the end of each fiscal year of the Borrower;

- f. The Borrower has agreed to sign with the NBK a Protocol satisfactory to the Association indicating the predetermined amount and periodicity of the foreign exchange transfers to NBK for sale at the interbank foreign exchange market;
- g. The Borrower has agreed to establish intermediate targets satisfactory to the Association for reducing the share of outstanding loans to shareholders, who own more than 5 percent of shares individually, to 25 percent by end of 1994;
- h. The Borrower agreed that PIU will enter into implementation agreements with respective ministers, agencies and the NBK, clearly delineating responsibilities, identifying counterparts, and indicating actions to be taken.

## **J. Benefits**

118. The proposed Credit would allow increased production and capacity utilization through the provision of resources to finance critical imports of inputs, raw materials, spare parts and services. The PIC to be financed by the Credit would help limit further output decline in priority sectors and also would reduce adverse developments in employment and balance of payments. The FXC would help to develop an inter-bank market in convertible currency and also would allow the private sector access to foreign exchange. Technical assistance financed under the Credit would contribute to the development of capability in economic, financial and technical management and would reinforce the implementation of the Government's Economic Reform Program. TA would also contribute to the restructuring of the Government to meet the needs of a market economy. The Credit has also had the catalytic effect of mobilizing other sources of financing, particularly through the Consultative Group meeting in December 1992. Cofinancing on a parallel basis of about US\$ 70 million equivalent is expected to be provided by the Governments of Japan, Netherlands and Switzerland.

## **K. Risks**

119. The main risks include the following: (i) substantial institution building is required to underpin the key elements of the Reform Program: while this is being advanced with TA to be provided under the Credit as well as by other donors, slippage in financing and organizing the TA activities might result in delays in the implementation of the Reform Program; (ii) underfinancing of the external requirements might slow down the implementation of the Economic Reform Program of the Government and increase the resistance by conservative elements, jeopardizing the Program; and (iii) lack of familiarity and experience in working with IDA procurement, accounting and disbursement procedures might cause difficulties. The risks under (i) and (iii) are being addressed with a core TA program which is already under way with resources from the Trust Funds established under the TCA, and the Project Preparation Facility. In addition to these provided under the Credit, additional resources to finance TA, particularly grant funds, are being provided by other donors. Finally, the Bank took the lead in organizing

the Consultative Group meeting and a subsequent pledging session to help mobilize resources to counter the risks under (ii).

#### **IV. RECOMMENDATION**

120. I am satisfied that the proposed credit would comply with the Articles of Agreement of the International Development Association and recommend that the Executive Directors approve it.

**Lewis T. Preston**  
**President**

**Attachments**

**Washington, D.C.**  
**April 22, 1993**

**REPUBLIC OF KYRGYZSTAN  
REHABILITATION CREDIT**

Annex I  
page 1 of 2

**ANNEX I: MAIN ECONOMIC INDICATORS**

Mid-1991 Population (mls.) 4.4

	<u>A. Shares of Gross Domestic Product</u> (from current price data)						<u>B. Growth Rates (% per annum)</u> (from constant price data)					
	1965	1973	1980	1989	1990	1991	1965-73	1973-80	1980-91	1990	1991	1992
Gross Domestic Product m.p.	100.0	100.0	100.0	100.0	100.0	100.0	..	..	..	3.2	-3.6	-24.0
Net Indirect Taxes	..	..	..	..	..	..	..	..	..	..	..	..
Agriculture	..	..	..	32.9	33.7	28.4	..	..	..	5.5	-8.0	..
Industry	..	..	..	29.5	28.2	37.8	..	..	..	-0.4	-1.3	..
Services	..	..	..	37.5	38.1	33.8	..	..	..	6.6	-2.7	..
Resource Balance	..	..	-9.3	-22.1	-16.9	-0.5	..	..	..	-55.3	-96.1	..
Total Expenditures	..	..	109.3	122.1	116.9	100.5	..	..	..	-8.2	-12.4	..
Total Consumption	..	..	76.8	82.5	83.4	66.2	..	..	..	-2.2	-16.1	-12.1
Private Consumption	..	..	56.1	66.1	67.0	50.3	..	..	..	-4.3	-19.7	..
General Government	..	..	20.7	16.4	16.5	15.8	..	..	..	6.3	-3.2	..
Gross Domestic Investment	..	..	32.5	39.6	33.5	34.4	..	..	..	-21.4	-2.2	-52.5
Fixed Investment	..	..	24.9	31.4	28.1	27.5	..	..	..	-7.7	-13.0	..
Changes in Stocks	..	..	7.6	8.2	5.4	6.9	..	..	..	-67.2	99.5	..
Gross Domestic Saving	..	..	23.2	17.5	16.6	33.8	..	..	..	..	..	..
Net Current Transfers	..	..	..	7.1	10.9	12.2	..	..	..	..	..	..
Gross National Saving	..	..	..	24.6	27.5	46.0	..	..	..	..	..	..

	<u>(1990 = 100)</u>						<u>Inflation Rates (% p.a.)</u>						
	1980	1986	1988	1989	1990	1991	1992	1965-73	1973-80	1980-91	1990	1991	1992
C. Price Indices													
Wholesale Prices (IFS 63)	..	..	..	..	100.0	259.6	4578.8	..	..	..	..	159.6	1663.8
Implicit GDP Deflator (1983=100)	..	100.9	101.0	106.8	113.0	223.3	3510.3	..	..	..	5.8	97.6	1472.0

D. Other Indicators	1965-73	1973-80	1980-91			
Growth Rates(% p.a.):						
Population	..	..	1.9			
Share of Total Labor Force in:	1965	1973	1980	1990	1991	
Agriculture	..	..	32.0	32.8	35.5	
Industry	..	..	27.9	27.8	26.5	
Services	..	..	40.1	39.4	38.0	
Total	100.0	100.0	100.0	100.0	100.0	

	<u>Volume Index</u>						<u>Value at Current Prices (millions Rubles)</u>					
	1987	1988	1989	1990	1991	1992	1987	1988	1989	1990	1991	1992
<b>E. Merchandise Exports</b>												
Total Exports FOB	..	..	..	..	..	..	2324	2595	2600	2499	6509	54889
<b>F. Merchandise Imports</b>												
Total Imports CIF	..	..	..	..	..	..	3490	3745	4281	3906	6746	73785
<b>Memorandum Items:</b>												
Official X-Rate (LCU/US\$)	0.63	0.61	0.63	0.59	1.75	161						
	<u>Share of GDP (%)</u>						<u>Nominal Growth Rates</u>					
<b>G. Government Finance</b>	1987	1988	1989	1990	1991	1992	1980-88	1988	1989	1990	1991	1992
Current Receipts	37.9	37.5	37.9	38.6	32.1	14.1	..	9.2	11.2	11.1	69.2	369.8
Current Expenditures	30.6	30.4	30.7	32.6	26.8	21.0	..	9.9	10.9	15.8	67.2	738.0
Current Budget Balance	7.3	7.1	7.2	6.0	5.3	-6.9	..	..	..	..	..	..
Capital Receipts 1/	..	..	..	..	..	-6.7	..	..	..	..	..	..
Capital Expenditures	4.9	5.6	5.1	5.8	1.1	1.3	..	25.8	0.0	23.1	-60.4	1100.0
Overall Surplus/Deficit (-)	2.4	1.4	2.1	0.2	4.2	-14.9	..	..	..	..	..	..

1/ In 1992, net lending from the budget to the enterprise and private sectors.

Note: All 1991 data are preliminary. 1992 data are estimates.



**REPUBLIC OF KYRGYZSTAN  
REHABILITATION CREDIT**

Annex II  
page 1 of 1

**ANNEX II: TIMETABLE OF KEY PROCESSING EVENTS**

- |     |                                |   |
|-----|--------------------------------|---|
| 1.  | Time taken to prepare:         | Nine months   |
| 2.  | Project prepared by:           | The Government, with the assistance of IDA staff and consultants <sup>5</sup> |
| 3.  | Identification mission:        | April 3 - 18, 1992  |
| 4.  | Pre-appraisal mission:         | June 21 - July 7, 1992  |
| 5.  | Appraisal mission:             | October 16 - 23, 1992   |
| 6.  | Negotiations:                  | April 22, 1993  |
| 7.  | Board Presentation:            | May 13, 1993  |
| 8.  | Planned date of effectiveness: | June 15, 1993   |
| 9.  | Expected project completion:   | June 30, 1996   |
| 10. | Relevant PCRs and PPRs:        | None  |

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<sup>5</sup> The World Bank missions which visited Kyrgyzstan in April 1992, June/July 1992 and October 1992, assisted the Government in the identification and preparation of the project and concurrently appraised it. Mission members, some of whom also contributed to the CEM mission in April 1992, included: Mr. Kutlu Somel (task manager, economist, agriculture), Ms. Isabel Guerrero (principal economist, IMF coordination), Mr. Sanjay Dhar (economist, CEM task manager), Mr. Keith Lloyd (country economist), Mr. Tevfik Yaprak (country economist), Mr. Reza Ghasimi (economist), Ms. Christina Leijonhufvud (country officer), Ms. Barbara Ossowicka (macroeconomics, statistics), Mr. Joseph Saba (lawyer, private sector development), Mr. Dan Mozes (financial sector); Mr. Juergen Voegele (agriculture), Mr. Dhananjaya Kumar (industry, privatization), Ms. Ann Ishee (telecommunications), Mr. Donald Keesing (social safety net, trade policy), Mr. Milan Vodopivec (labor markets), Mr. Howard Barnum (health); Ms. Jacqueline Renkewitz (disbursements), Mr. Ismail Ibrahim (debt reporting), Mr. Bernard Drum (private sector development), Mr. Hans Juergen Gruss (lawyer), and Ms. Sabine Engelhard (procurement). Mr. Kadir T. Yurukoglu and Mr. Russell Cheetham are the managing Division Chief and Departmental Director, respectively, for this operation.

**REPUBLIC OF KYRGYZSTAN**

**REHABILITATION CREDIT**

**MEMORANDUM OF ECONOMIC REFORM POLICIES**



37

БИШКЕК ш., ӨКМӨТ ҮҮҮ

г. БИШКЕК, ДОМ ПРАВИТЕЛЬСТВА

199 ж. г.

№ \_\_\_\_\_

REPUBLIC OF KYRGYZSTAN

Mr. Lewis T. Preston  
INTERNATIONAL BANK FOR  
RECONSTRUCTION and Development  
1818 H Street N.W.  
Washington, D. C. 20433

April 10, 1993

Dear Mr. Preston,

The attached Memorandum of Economic Reform Policies outlines the Program of macroeconomic stabilization and systematic reforms of the Republic of Kyrgyzstan. We request the World Bank to support this program with a Rehabilitation Credit in the amount of US\$ 60 million equivalent.

It is intention to implement the program described in the attached Memorandum in order to achieve a rapid resumption of economic growth within a sustainable macroeconomic framework. Given the complexity of the transition to a market economy, it is inevitable that there will be some uncertainty associated with the implementation of this program. Some adjustments and corrective actions are likely to be required. We will, where appropriate, review the necessary adjustments with the World Bank.

Yours sincerely,

Tursunbek Chyngyshev  
Prime Minister

Attachment

Жооп кайтарыула баздан № жана дата көрсөтүлсүн.  
При ответе обязательно ссылаться на наш № и дату

**REPUBLIC OF KYRGYZSTAN****MEMORANDUM OF ECONOMIC REFORM POLICIES**

Kyrgyzstan has embarked on a comprehensive reform program to transform its centrally planned economy to a market economy. The key objectives of the reform program are: (i) to stabilize the economy, which has been severely affected by the disintegration of the Soviet Union; and (ii) to undertake extensive structural reform to create the conditions for long-term growth in an economy increasingly integrated with the world economy.

The transition to a market based economy will not be easy, even in the best of circumstances. Output has already declined substantially since 1990 and will continue to do so as the economy of Kyrgyzstan adjusts to new conditions. Inflation was 85 percent in 1991 and consumer prices have already increased by 855 percent in 1992. These transitional costs are specially difficult to bear at a time when our society is establishing a democratic Government with new political and administrative structures.

The year 1992 was an extremely difficult one for Kyrgyzstan. Industrial production, which accounted for 45 percent of Net Material Product (NMP) in 1991, declined by about 27 percent in 1992. This decline is expected to continue as inter-republican trade is constrained by access to credit in Russia and oil prices continue to increase, affecting the terms of trade adversely. Public investment has fallen sharply as a consequence of the tight fiscal situation and to date, there is only limited expansion in the private sector. Agricultural output growth was flat in 1992; grain production increased owing to favorable weather conditions while the performance of other crops was variable owing to downward adjustments in area and output. Overall output in 1992 fell by 24 percent compared with a decline of 3.9 percent in 1991.

While the severe cash shortage experienced in the first half of 1992 has now been alleviated, the restriction on credit with Russia has resulted in most trade now being undertaken through barter arrangements. This has put additional pressure on the economy which is heavily integrated with Russia. The instability of the Ruble has similarly resulted in nearly all trade outside the Ruble area occurring through barter. The falling output, increased reliance on barter trade, and acceleration in inflation have caused shortfalls in fiscal revenues. The budget problem is exacerbated by the ending of grants from the Union and the uncertainty of financing sources. The lack of foreign exchange to finance critical imports aggravates the output implications of this financial plight.

In spite of these difficult circumstances, the Government of Kyrgyzstan is committed to implementing the necessary measures to successfully support the transition to a market economy. At the beginning of 1992 the Government took several measures to initiate this transition. These were wide ranging and covered: (i) price liberalization; (ii) revenue and expenditure measures to decrease the fiscal imbalance; (iii) adoption of a new legislative framework, more appropriate for promoting private sector development; and (iv) initiation of privatization in most sectors of the economy. In late 1992 the Government took several additional measures. These include: (i) parliamentary approval of the Concept Note on Privatization and the Banking Law; (ii) liberalization of rents on privatized housing; (iii) removal of all barriers to private entry into competition with state operations in agriculture; (iv) elimination of input subsidies in agriculture; and (v) approval of the first draft of Constitution, which stipulates private ownership including land ownership. The nascent private sector activities in production and trade and the establishment of commodity exchanges are visible positive signs of the Government's reform policies.

The economic program outlined in this *Memorandum of Economic Reform Policies* has been designed to support the implementation of this reform program. First, the *Memorandum* briefly reviews the program aimed at the financial stabilization of the economy. As was mentioned above, this is one of the key objectives of the reform that the Government of Kyrgyzstan has embarked upon. A fuller discussion of our program in these areas can be found in the Memorandum that we have submitted to the International Monetary Fund. This *Memorandum* focuses on the second key objective: building the conditions and institutions for long-term growth in an economy increasingly integrated with the world economy.

Five areas of systemic change or structural adjustment are covered. The first is **enterprise reform**, including privatization and corporatization, and dismantling the system of state intervention. Second, the steps that need to be taken to create a **more competitive environment** where the private sector can develop, in agricultural, industrial and commercial activities. Third, given the sector's importance to the economy, issues of **agricultural sector reform** are discussed. Fourth, the main areas for **financial sector reform** and the requirements for the commercial banking sector are discussed. The Memorandum concludes with a discussion of **social protection**: what the Government has already undertaken and the future needs, consistent with sound fiscal management, to strengthen the **social safety net** during the transition period in which substantial increases in unemployment seem inevitable.

### **Prices, Macroeconomic Management and External Economic Relations**

In January 1992, a wide ranging price reform was introduced in tandem with the liberalization measures implemented in the FSU. Most of the consumer and producer prices were liberalized, and those remaining under Government control were raised by factors ranging between 3 and 11. All limits on profit margins were abolished, but monopolistic enterprises were

required to consult with the Pricing and Antimonopoly Committee on pricing decisions to prevent abuse of monopolistic power. The Government's policy is to further limit the number of goods and services subject to price controls and reduce subsidies. At the producer level, price controls, without entailing any subsidization, will stay limited to energy and oil products, precious metals and strategic minerals, to prevent the abuse of monopolistic power. Utilities, public transport, housing rents and communications services will also remain subject to regulated prices and partial, but declining, subsidies. On the retail level, price controls will be limited to only low quality bread, and well targeted subsidies will remain only on milk for children and lactating mothers, and on coal distributed to low income groups during winter.

The Government fully recognizes the importance of stabilizing the macroeconomic situation in containing the decline in output and eventually embarking on a sustainable growth path. The experience in 1992 has proven that, as a small state in the Ruble area, Kyrgyzstan would not be able to pursue an independent macroeconomic policy, and thus isolate its economy from the instability in the rest of the Ruble area, unless it introduces a separate currency and then maintains the credibility and the value of the national currency through prudent fiscal, monetary and incomes policies. Therefore, the Government has decided to introduce the national currency, Som, in early 1993. It has worked out, in collaboration with the International Monetary Fund, measures to reduce the budget deficit from 17 percent of GDP in 1992 to 7 percent in 1993, to eliminate money financing of the budget deficit, and to limit domestic credit expansion after the introduction of the national currency. It has decided to eliminate all targeted and subsidized credits from the financial system, including the National Bank of Kyrgyzstan, and to channel any such financial support through the budget. The Government is also committed to adopt a restrictive wage policy for the public sector in line with the projected decline in real national income and the scarcity of fiscal resources, and to reduce budgetary transfers to the enterprise sector as well as the household sector. A detailed discussion of our macroeconomic policies is provided in the Memorandum we have submitted to the International Monetary Fund.

The Government recognizes the positive role of an open external trade and liberal foreign exchange regimes in fostering a more efficient resource allocation, eliminating supply shortages, and introducing a rational relative price structure. Given the dominance of economic relations with the FSU states, the Government's intention is to take all possible measures to establish mutually beneficial economic relations with other FSU states based on multilateral trade and payment arrangements, to eliminate trade disruptions, and to promote direct trade relations between enterprises. However, given the current difficulties in achieving these objectives, the Government has signed bilateral trade and credit agreements with its major trading partners, such as Russia, Belarus, Kazakhstan, and Uzbekistan, so as to prevent further declines in inter-republican trade. Regarding relations with non-FSU countries, given the currently limited export potential, Kyrgyzstan's imports in the coming years will be determined by the amount of external financing expected to be provided by the international donor community through the Consultative Group mechanism. The Government also recognizes the importance of a liberal foreign exchange regime in promoting exports to and increasing imports from the non-FSU area.

It is committed to eliminate all restrictions on current account transactions, and keep such restriction to a minimum on capital account transactions. It has drafted a liberal foreign exchange law which is expected to be passed by Parliament before the introduction of the national currency.

### **Enterprise Reform**

The reform of public enterprises constitutes a fundamental element of systemic change. The Government intends to undertake enterprise reforms in three main areas. First, there will be quick privatization of small enterprises at the local level and the implementation of a program for the privatization of medium and large enterprises. Second, improved corporate governance will be implemented for those medium and large state owned enterprises (SE) which are expected to remain in the public sector in the medium or long-term. Financial support to enterprises will be conditional on their restructuring efforts and measures will be taken to bring all SE under strict financial discipline. Finally, state intervention in the commercial decisions of enterprises will be stopped. This will be achieved primarily by the elimination of the State Order system and the controls over the input, service and output distribution system. In the State Order system, the state required deliveries of specified quantities of products at prices determined by the state. In an interim period, the requirements of the State will be managed through the State Purchases system, where prices are negotiated between the suppliers and the state agency in charge. (See below on State Purchases and State Orders.)

### **Privatization Program**

In early 1991, the Government designed a program for corporatization and privatization. The first phase of the program focuses on establishing the principles of ownership of all state property, an administrative framework for the delegation of ownership rights, and the privatization of small-scale industrial and agricultural enterprises and most small shops, trade and service establishments. The second phase is intended to focus on the privatization of medium and large enterprises. In December 1992, the Parliament adopted a resolution on new Concept Note on Privatization which envisages rapid privatization of small enterprises mainly through auctions, and three principal methods of privatizing medium-size and large enterprises, with varying roles played by voucher holders, employees, the National Entrepreneurs Fund and other investors. It also envisages special forms of privatization for specific sectors. Contract management and the formation of holding companies under the State Property Fund (SPF) are among the measures provided to improve the governance of the still non-privatized firms.

Wide-ranging decrees on privatization and the creation of joint ventures were approved by Parliament in 1991 and 1992. The allocation of legal authority to the SPF to exercise ownership rights in all the properties of the Republic has been implemented in order

to clarify ownership and management responsibility. The authority of the SPF in exercising the state's rights on property was further strengthened by a law approved by the Parliament in July 1992. The SPF will retain a significant degree of independence from the branch ministries that exercised the State's ownership role in the past but should now regulate their sectors independent of the State's ownership. Moreover, the SPF will have an adequate financial allocation from the national budget to exercise its functions.

As of the end of January 1993, privatization has been extended to 2,299 enterprises of which 1,984 were in the service and trade sectors. This amounts to the transfer to the private sector of around 10.2 percent of the total fixed assets formerly in the state enterprise sector. It is the Government's intention to accelerate the privatization of the SE which will not remain in state hands. By the end of 1993, the aim is to privatize 35 percent of SE fixed assets, valued at 11.2 billion rubles in 1991 prices, and to privatize a further 35 percent by the end of 1996. In each year, sale or transfer of the majority shares to the employees of medium and large scale enterprises in the non-agricultural sectors shall not account for more than 20 percent of fixed assets in these sectors. Privatization will not only pursue these quantitative goals but will also be oriented toward creating ownership structure that enhance effective governance, ensuring competition between potential investors and not giving preferential treatment to employee collectives for their acquisition of a controlling or higher share of an enterprise.

Privatization of many large industrial enterprises will be preceded by their reorganization and segmentation into smaller components. Detailed procedures and legislation for the further refinement and implementation of the Concept Note on Privatization together with a timetable for the implementation of the new privatization strategy are being elaborated. The privatization program in housing will be initiated by providing citizens with a one time lump sum payment for purchase of homes. All rent controls on privatized housing have been removed. In order to support the success of housing privatization, the Government has agreed to prepare a timetable for increasing public housing rents which includes an increase of a minimum tenfold by mid-1993 in close coordination with the increases in Government wages. The Government has also planned full recovery of operation and maintenance costs of public housing by the end of 1993. The Government will review land privatization, and legal ownership rights to land attached to property being privatized will be clarified (see section on Agriculture below).

### **Improved Corporate Governance of Large Enterprises**

The Government has already established a Working Group to strengthen corporate governance for those SE expected to remain in the public sector. Boards of directors will be appointed, and incentives and accounting systems will be spelled out. An action plan will be completed by June 1993 and its implementation in selected large enterprises will start by July 1993.



### **Elimination of State Orders and State Purchases**

As price controls are eliminated, State Orders and State Purchases for SE in industry will be reduced and will be eliminated by the end of July 1993 (also see section on Agriculture below). Given that Kyrgyzstan is an economy in transition, where information is not as widely available as in market economies, the state trading agencies will continue to offer services on a commercial and voluntary basis. In other words, enterprises will not have to sell to or buy from the Government and the Government will not be forced to provide inputs or buy output from the enterprise. Purchases for Government consumption (military, hospitals, etc.) are now conducted at market prices through competitive procedures, and legislation on rules and regulations for public procurement on all categories of goods is to be developed by June 1993. All legal and institutional barriers to private entry into competition with state operations have been removed.

### **Competition and Private Sector Development**

The Economic Reform Program gives special attention to promoting competition in both production and distribution in order to support private sector development. To this end, numerous laws and decrees have been enacted aimed at the development of a market economy. These measures have recognized rights in private property and business activity, have established the legal basis for the banking system and privatization, have simplified regulation procedures for new enterprises, and have facilitated the growth of commodity exchanges, and they include a foreign investment law and a law on concessions through which the state can lease property, including mineral rights.

The Government will ensure the implementation of judicial reforms in a fair, transparent and consistent manner. Moreover, it intends to pursue other reforms to ensure consistency among laws and to complement actions already taken. The new reforms include: (i) expanding ownership and property rights; (ii) enacting commercial legislation on contracts, bankruptcy and liquidation procedures, secured transactions and the registration of ownership in real and intellectual property; and (iii) identifying and eliminating the obstacles to the formation of new enterprises and eradicating the abuse of monopoly power through regulation or the breaking up of amalgams into competing enterprises. The bulk of these legal reforms and a set of legislation facilitating private sector development are expected to be presented to Parliament before mid-1993. A foreign investment commission was created in September 1992 and a one stop foreign investment processing and licensing system and agency will be established by June 1993.

The Government recognizes the importance of demonopolization to promote competition and efficiency. An Antimonopoly Committee (AMC) has been established, is already working on these issues and will conduct a comprehensive review of the regulatory obstacles to

the entry and exit of firms as well as, more generally, the obstacles to new enterprise formation. An action program will be finalized by June 1993 and concrete progress in its implementation will be achieved by September 1993. Given the urgency of ensuring competition at this stage, the AMC will concentrate its work on breaking up monopolistic firms into competing enterprises, especially in trade and transport, and on regulating monopoly power.

## **Agriculture**

The dissolution of former Soviet trade relations has caused disruptions in agricultural production, input and output marketing and distribution and processing. The Government initiated a liberalization program in agriculture in March 1991, covering increases in farmgate prices for agricultural commodities, and in early 1992, increased prices for farm equipment and inputs. In April 1992, the Government initiated an agricultural program through a Presidential Decree that increased input and output subsidies and reinstated physical controls in the allocation of inputs and output. While the intention was to stimulate the agricultural sector and promote import substitution, these decisions have been reconsidered. In particular, it was felt that the lack of financial resources to support this program may have adverse consequences in raising expectations. This program has been explicitly rescinded following the approval of the Economic Reform Program by the Government and the Parliament. A medium-term agricultural strategy that will induce efficient and profitable agricultural production will be developed. The following are some of the salient features of the initial actions in this context.

State Orders in agriculture have been reduced substantially and State Purchases with negotiated prices have been introduced for some commodities. State Orders and State Purchases on food products except grains have been eliminated and State Orders and State Purchases for grains, wool, tobacco and cotton will be eliminated by December 1993. Until the remaining State Orders and State Purchases on grain, wool, tobacco and cotton are completely phased out by December 1993, private and public sector use of the state trading agencies will be allowed on a commercial and voluntary basis (e.g., charges and commissions to cover operation costs). Subsequently, such agencies will be restricted to state procurement only. All legal and institutional barriers to private entry into competition with state operations in agriculture (input, output and services) have been removed.

A law on private ownership explicitly allowing private sector operations in agricultural input and output marketing (wholesale and retail), transportation and distribution, imports and exports, storage, production and processing has been adopted. All policies and procedures favoring the public sector in the allocation of goods and services and all delivery quotas, physical input allocations and actual sales or purchases by the state or its agents for these purposes have been eliminated with a view to reducing the role of the state in these areas.

The privatization program in agriculture will continue, with due consideration to social conditions. The Government has been reviewing the limited experience with long-term leases with rights of inheritance. Owing to social problems, implementation of the program was slowed down in some areas. The Government intends to accelerate this program and three alternative drafts of legislation have been prepared and submitted to the Parliament allowing transferability, inheritance, sale, rental (for cash or in kind) and collateral use of land lease rights.

The present structure of crop and livestock production and agroprocessing is based on the trade relations of the former Soviet Union. A medium-term program will be developed, based on a study of agricultural policies to be completed by September 1993. The transition will be managed carefully to ensure that the current and future terms of trade shocks do not affect the profitability of operations in a drastically adverse manner so as to cause a collapse of the sector. This program will involve interventions in the sector through policies based on the results of the agricultural policies study. Input subsidies covering chemical inputs, fertilizer, seeds, equipment, energy and water, except for credit, have been eliminated. Credit subsidies will be eliminated when the new currency is introduced. In the future, all subsidies will be financed through the budget, where they will appear as explicit and transparent line items. Furthermore, such interventions will not be through direct purchases or sales but through fiscal interventions (such as compensation payments) based on the agricultural policies study through which the program will be developed.

A medium-term program has been developed for the transformation of the remaining State and Collective Farms into private corporate entities or private farms, no longer depending on the Government for administration, salaries, provision of goods and services, etc.

An inventory of the current and proposed public investment projects in the agricultural sector, including irrigation projects, will be completed by June 1993, indicating the stage of development and remaining works to be undertaken. A study will be conducted and finished by September 1993, assessing the technical and economic feasibility of these projects according to international standards and prices. Subsequently, the public investment program in agriculture will be based on the results of this study and will focus on infrastructural investments and leave investments in productive capacity to the private sector. In particular, investment in social facilities in state and collective farms and rural areas will be suspended.

In irrigation, a system of water charges to cover operation and maintenance costs was introduced on December 15, 1992 and the Government intends to adjust water charges for inflation. Water user associations will be encouraged and a Government resolution has been prepared for their organization.

## **Financial Sector Reforms**

The Government wants to ensure that Kyrgyzstan has a solid and efficient financial system. To this end, institution building and other measures will be implemented in the near future.

A new Banking Law, introducing prudential regulation and a supervision system was approved by the Parliament in December 1992. Modern accounting and auditing standards are necessary for the expansion of financial intermediation and will be introduced by December 1993. Banks are required to increase capital requirements (commercial banks and banks with foreign participation, to 150 million rubles; limited liability banks to 100 million rubles and private banks to 50 million rubles) by April 1, 1993, and these requirements will be reviewed on a regular basis and changed according to developments. In December 1992, loans provided to individual shareholders/founders were reduced to 20 percent of capital. Exposure limits on individual borrowers were reduced from 50 to 40 percent of capital and reserves in December 1992. New banks are required to comply with these rules while existing banks will be required to comply by September 1993. Furthermore, loans to all shareholders/founders owning more than 5 percent of shares individually will be reduced to a total of less than 25 percent of the outstanding loans by the end of 1994, with intermediate targets to be agreed upon between the Government and the Association.

Given the importance of competition for financial intermediation, a draft of a study on the necessary measures to increase competition among banks will be ready by June 1993 and initial measures will be implemented by September 1993. By July 1993, plans for special institutional arrangements and procedures to deal with overdue debts of enterprises will be elaborated in detail, and initial implementation steps will be taken by August 1993. Any relief on enterprises from major overdue debt will be tied to strict requirements of privatization or restructuring subject to the plans elaborated in July 1993.

To facilitate the opening of the economy to international markets, the banking sector is encouraged to increase its foreign exchange operations. Authorized banks are now allowed to establish foreign exchange bureaus and banks are allowed to hold foreign exchange positions.

Finally, in order to facilitate competition and efficiency in capital markets, all credit subsidies, particularly those implemented through differential interest rates or interest rates lower than the NBK rediscount rate, will be removed by when the new currency is introduced. In order to put monetary policy on a sound base and promote savings, positive real interest rates will be achieved and maintained as inflation is brought down to a moderate level.

## **Social Safety Net**

The Government of Kyrgyzstan is aware that social investment and expenditures will need to be reconsidered in these difficult times, and refocused on those families that are more vulnerable to or most affected by output decline, unemployment, and inflation. There are also structural measures which can ease the difficulties in the transition.

A poverty (subsistence) line will be defined as soon as possible, but not later than the end of 1993, in order to have a threshold with which to estimate the minimum income required for subsistence. A methodology will be agreed on to estimate this line as well as to defend it from inflation. The poverty line will be used as a criterion for targeting the social safety net and Government social assistance.

Pensions and family allowances will be revised to reduce them to affordable levels and target them to the poorest families. Pensions above the minimum will not be fully protected from inflation until the budgetary situation permits. The Government will propose legislation by June 1993 to reform the funding and expense obligations of the Pension Fund to make it financially viable.

The anticipated drop in output will aggravate unemployment in the short to medium-term. The Government is ready to take measures on several fronts in order to mitigate the impact of unemployment on vulnerable families. This will be implemented through income compensation and helping labor mobility through eliminating the effect of "*propiska*" on employment. For this purpose, the Government will prepare and submit to the Parliament draft legislation on amending laws to eliminate the "*propiska*" requirement for employment and provision of social services. To increase the efficiency of the labor market, job guarantees will be eliminated and active labor market policies will be implemented to retrain and offer employment services by June 1993.

**REPUBLIC OF KYRGYZSTAN - REHABILITATION CREDIT  
ANNEX IV: GOODS ELIGIBLE FOR IDA FINANCING**

**A. Negative list of goods which would not be financed**

**1. No withdrawal from the Credit account shall be made in respect of:**

- a. Expenditures for goods to be supplied under a contract which a national or international financing institution or any other financing agency shall have financed or agreed to finance.
- b. Expenditures for goods intended for a military or paramilitary purpose or for luxury consumption.
- c. Expenditures for items in the following groups or sub-groups of the United Nations Standard International Trade Classification, Revision 3:

<u>Group</u>	<u>Sub-group</u>	<u>Description</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 semi-precious stones, unworked or worked
718	718.1	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, nonmonetary (excluding gold ores and concentrates).

**B. Pre-identified essential imports**

The Government and the Association have agreed on a list of essential imports in seven sectors: telecommunications, transportation, energy, health, agriculture, irrigation and the environment. The list of critical imports is attached.

The goods on the lists have been selected by mutual agreement between the Government and the Association on the basis of their economic and social priority. However, the lists may be amended from time to time by mutual agreement, provided the following criteria are applied:

- a. To be eligible, goods must be intended for the maintenance of essential services and economic activities in key sectors (for instance, spare parts or pieces of equipment for the maintenance of essential services, raw materials or intermediate goods for the production of essential goods).
- b. To ensure speedy procurement, preference will be given to: (i) goods of a commodity nature, which can be described easily without long or complex technical specifications, and which can be procured from several sources under large contracts; and (ii) goods which are available off-the-shelf without lengthy delivery times.

To be eligible for disbursement under the Credit, all pre-identified critical imports will have to be procured in accordance with agreed IDA procurement procedures. Procurement of agro-chemicals and other hazardous materials in the context of the PIC must conform to IDA guidelines, which require prior review by the Association.

**REPUBLIC OF KYRGYZSTAN**  
**REHABILITATION CREDIT**

**SUMMARY LIST OF THE PRE-IDENTIFIED CRITICAL IMPORTS**

Sector and PIC lists	US\$ million	Subtotals US\$ million
<b>TELECOMMUNICATIONS</b>		
Replacement local cables, outside plant equipment and accessories	1.75	
Spare and replacement units and installations for switching and transmission systems	1.75	
Telex, facsimile, data transmission and terminal equipment	1.25	
Measuring instruments, tools, network construction and operational equipment	0.75	
<b>TRANSPORTATION</b>		5.50
Spare parts for road building machines	1.15	
Spare parts for buses	3.35	
<b>ENERGY</b>		4.50
Cable	5.36	
Replacement transmission lines	1.32	
Materials, including pipes, hoses, electrodes, etc.	0.80	
Communication equipment	0.90	
Replacement pump equipment	0.21	
Steel hardware	0.32	
Replacement electric motors	0.16	
Replacement compressors and boiler equipment	0.43	
<b>MEDICAL</b>		9.50



Critical drugs	1.50	1.50
<b>AGRICULTURE</b>		
Veterinary medicines	2.22	
Replacement equipment for making tablets, packaging medicines and preparations	0.14	
Insecticides and pesticides	2.97	
Herbicides	3.05	
Spare parts for agricultural loaders and harvesters	1.12	
		9.50
<b>IRRIGATION</b>		
Replacement pumps, pumping station equipment, transformers, cables, wires, etc.	0.75	
Replacement concrete mixing machines, cranes, crushing plants, cutting machines, etc.	0.25	
		1.00
<b>ENVIRONMENT</b>		
Equipment and materials for the environmental laboratory	0.25	
Water treatment chemicals and equipment	1.25	
		1.50
<b>TOTAL</b>		<b>33.00</b>

**REPUBLIC OF KYRGYZSTAN  
REHABILITATION CREDIT****ANNEX V: TECHNICAL ASSISTANCE COMPONENT (TAC)****Introduction**

1. In implementing both its Economic Reform Program and the Rehabilitation Credit, the Government of Kyrgyzstan will need to develop strategies, execute studies, devise legislation, implement specific programs and carry out procurement. In these activities, Kyrgyzstan will need technical assistance (TA) in many areas such as economic and financial analyses, agriculture, macroeconomic management, privatization and private sector development. Resources have already been mobilized under the World Bank Trust Fund whereby a program under the Technical Cooperation Agreement (TCA) between the Government of Kyrgyzstan and the Association is currently under advanced implementation. This program covers the areas of the banking sector, privatization and private sector development and the social safety net as well as the preparatory economic work for bank membership. Several reports have been produced, including the CEM, under the TCA and activities have been initiated that will be followed up under TAC. Through the Consultative Group meeting, additional resources have been mobilized from other donors.

2. Technical assistance will be provided to the SPF and the AMC in the areas of privatization, enterprise governance, enterprise restructuring/liquidation and competition policy. In the financial sector, TA will be provided to (i) develop an approach and procedures that are suitable for auditing commercial banks during the transition of the economy and the financial systems, and (ii) to carry out, as a pilot exercise, audits of two large commercial banks. For the mining sector, the TA is designed to aid the Government to establish an enabling environment to promote efficient production operations under market economy conditions which will be conducive to new investment. Technical assistance in the area of social safety net will focus on key aspects of the health sector, emphasizing the critical areas of pharmaceutical policy and health facility restructuring. Development and implementation of policy change, and privatization of production and production factors, particularly land privatization, in the agriculture sector would be supported by detailed studies to be carried out under the TA program.

3. This Annex summarizes the Technical Assistance Component (TAC) of the Rehabilitation Credit and highlights the core TA activities, which are defined as those that are closely linked to the Government's Economic Reform Program and that serve the development of policies, legislation and implementation under the Program. Total resources allocated to the core TA program under the Rehabilitation Credit are US\$ 7 million equivalent (12 percent of the Credit).

## **Enterprise Reform, Privatization and Private Sector Development**

4. Privatization, Enterprise Governance, Enterprise Restructuring/Liquidation and Consolidation Policy. Kyrgyzstan has made a firm commitment to establish a market economy and has focused on systemic reforms to accomplish its goals. To demonstrate its commitment, it has begun a legislative program to create the legal framework for a private sector; a detailed program has been adopted providing for the privatization of 35 percent of enterprise fixed assets by the end of 1993 and another 35 percent by 1996; enterprises not privatized are to be reorganized to operate on a commercial basis; and a program for demonopolization and the encouragement of competition through the development of new enterprises has commenced. Not surprisingly, the capacity to implement many of these reforms is severely limited owing to a lack of experienced personnel, and there are numerous constraints arising from an uncertain property rights regime, the absence of clear commercial laws and resistance from those with vested interests in the *status quo*. The two institutions charged with undertaking many of the reforms, the State Property Fund (SPF) and the Antimonopoly Committee (AMC), have requested TA for their programs and for the improvement of the regulatory and administrative environment for the emerging private sector. There is an immediate need to address these requests to maintain the momentum and enthusiasm for reform and to have the greatest and most efficient impact at a time when much of legislation and reform program design are being drafted.

5. The objective is to provide TA to the SPF and the AMC in the areas of privatization, enterprise governance, enterprise restructuring/liquidation and competition policy. This TA would be provided through help in drafting and reviewing relevant legislation; designing strategies and implementation mechanisms; carrying out pilot transactions; and strengthening institutions and skills. The scope of the TA would involve the provision of assistance (until March 1995) to the SPF and AMC through the placement of four long-term advisers in Bishkek, several short-term interventions through specialist missions, and training of local staff outside Kyrgyzstan, mainly through guided study tours on particular subjects.

6. The long-term advisers would include a senior adviser in charge of team coordination, overall privatization policy, and the privatization of medium and large firms; a mass privatization expert focusing on issues related to vouchers, investment funds, share auctions, etc.; a legal expert providing advice on pertinent legislation, model contracts and statutes, individual privatization documents including contracts, etc.; and a competition policy expert dealing with antimonopoly policy but also with further constraints to private sector development, especially to market entry and exit. One set of specialist missions would concentrate on issues of enterprise governance, including a database and regular reporting system on all state enterprises, revaluation of enterprise assets and capital, corporatization, establishment of diversified holding companies removed from the branch ministries, mechanisms of financial supervision of state enterprises, etc. Another set of short-term missions would deal with problems related to insolvent state enterprises, in particular with the detailed planning of institutional and procedural arrangements for handling such enterprises, the assessment of their viability, their financial and organizational restructuring, and their possible liquidation. A third group of missions would support small-scale privatization; it is here presumed that further assistance in this area will be

provided from other sources. Public information will benefit from short-term assistance as well. Training would include, among other forms, study tours on state enterprise governance (including supervision, corporatization, holding companies), on enterprise restructuring and liquidation, and on privatization. Each study tour would consist of three to five local policy makers and staff and one foreign expert, and would visit two to three countries mainly in Eastern and Western Europe. Equipment would be provided as early as possible, and would include mainly facsimile machines, computers, photocopiers, printers and other office equipment for SPF, AMC, and their territorial branches.

7. Counterparts and Reports. The main counterpart for these TA activities is the State Property Fund. However, the Anti-monopoly Committee will be involved in the competition policy component and the Ministry of Economy and Finance will be involved in the financial arrangements for the State Enterprises under restructuring. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; bi-monthly progress reports; informal reports on a variety of specific issues; draft legislation, statutes, guidelines, etc.; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

8. Privatization in Agriculture. This TA activity is discussed below under Agriculture and entails a budget of US\$ 600,000.

9. Mining Policy and Legislation. This program is intended to help the Kyrgyzstan Government establish an enabling environment which will promote efficient production operations under market economy conditions and which will be conducive to new investment. It is recognized that Kyrgyzstan's mineral endowment can provide the tax revenues and export earnings for sustainable development. To realize this potential the sector should be opened to new capital, technology, and international market expertise offered by private local and foreign investors. The technical assistance program is composed of two interrelated projects: mineral sector development policies and mining legislation, including regulations and model investment agreements.

10. Project 1: Mining Development Policies Statement. The objective of this project is to prepare a "Statement of Principles and Policies" with respect to mining and metallurgical sector activities in Kyrgyzstan. This statement will then serve as the guideline for further work specifically on the mining legislation. The Consultants will assist in the identification of the key sector issues, and inform the Government about how similar issues are addressed in other countries. Some of the relevant issues are:

- a. The nature of the international mining industry: large and small companies, commodities markets, economic and financial evaluation of projects and ore-bodies (gold).

- b. The position and competitiveness of the Kyrgyzstan mining and metallurgical sector with respect to the local economy, inter-republican economy, international economy.
- c. Mining rights: policies, instruments, institutional implications.
- d. The role of the state institutions in promoting, regulating, and monitoring developments in the sector.
- e. The fundamentals of mine project assessment.
- f. National, regional and municipal jurisdiction over natural resources.
- g. Private and foreign ownership of producing facilities and access to mining titles;
- h. Environmental issues associated with mining, including environmental audits and environmental liability.
- i. The layout of legislation and limits to government discretionary authority.
- j. The spin-off effects of mining and metallurgy on other economic sectors, including employment, tax and export reserves.

11. **Project 2. Mineral Development Legislation.** The objective of this project is to assist the Government in preparing mining legislation and regulations, and a model investment agreement which will provide acceptable and attractive investment conditions for prospective investors while adequately protecting the interests of the Government. A law on sub-soil resources is to be considered by Parliament shortly, which elaborates some of the basic principles that are common to mining codes and legislation in other countries with significant mining industries. However, many of the principles and concepts of the law need to be defined, clarified, and/or further specified in order to provide a firm legal basis for investment in the sector. This will entail the preparation of a new law specific to the mining sector that will be of equal standing, but will not conflict with, the proposed law on sub-soil resources.

12. Building upon the "Statement of Principles and Policies," the Consultants will assist Kyrgyzstan authorities to (i) examine the proposed law on sub-soil resources, determine its consistency with international practice and recommend any amendments on clarifications; (ii) prepare clear and concise implementing regulations; (iii) establish procedures for implementing the law and regulations; and (iv) prepare a model mining investment agreement. The work should fully address, among other topics, the following:

- a. Ownership of minerals
- b. Administrative jurisdiction of mineral rights

- c. Exploration rights
- d. Exploitation rights
- e. Small-scale mining
- f. Access to land and resources located thereon
- g. Storage, transport, marketing and export of minerals
- h. Processing of minerals
- i. Environmental protection and liability
- j. Dispute resolution
- k. Offenses and penalties
- l. Administrative provisions

13. **Counterparts and Reports.** The main counterpart for these TA activities is the Mining Agency. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; bi-monthly progress reports; informal reports on a variety of specific issues; draft legislation, statutes, guidelines, etc.; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

14. **Legal Reform Coordination and Institution Building.** Apart from the various specific areas in which TA will be required to develop and implement the legal aspects of the reform activities (privatization, corporate governance, accounting, the financial sector, mining legislation), there is an urgent need to develop an overall legal reform program and to coordinate the legal reform activities in the various sectors of the economy. The transition from a command to a market economy will require substantial changes in the legal and institutional framework governing economic activities in Kyrgyzstan. Sustainable development and, in particular, increased private sector development can only be achieved if an appropriate legal system is put in place -- a system based on comprehensive objective rules, which are actually applied, and on functioning institutions, which ensure the proper application of such rules. The challenge for the Government is to review and analyze the existing legal and institutional framework and to reform and adjust it in parallel to the political and economic reform measures already implemented or planned by the Government. In order to strengthen the Government's capacity to carry out such a comprehensive legal reform program, this TA component would support the establishment and operation of a Central Legal Reform Unit. This unit should (i) be placed within the Central Government with appropriate links to both the Parliament and the economic reform group in the President's Office; (ii) coordinate all legal reform activities within the various sectors of the economy; (iii) make use of the indigenous legal expertise, including that in the private sector; and (iv) serve as liaison vis-à-vis interested donors involved in separate legal TA activities. The Central Legal Reform Unit would be supported by a Resident Legal Adviser and would receive logistical support (computer, office equipment) as well as a basic set of international legal materials and law books. Funds would also be provided for in-country training and overseas study tours for its staff. The total cost of the TA under this heading would be US\$ 950,000, of which US\$ 250,000 would come from the Rehabilitation Credit and the balance from interested donors. Because of the critical importance of the legal reform program

to Kyrgyzstan's transition towards a market economy, the TA for the Legal Reform Coordination and Institution Building is considered core TA.

15. Counterparts and Reports. The main counterpart for these TA activities is the Ministry of Justice. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; bi-monthly progress reports; informal reports on a variety of specific issues; draft legislation, statutes, guidelines, etc.; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

16. Promotion of the Reform Activities. The reform process will entail many positive developments that need to be publicized. Legislative and policy developments have to be communicated to the public and the business community in a clear and expeditious manner. There will also be adverse developments for some in the short to medium-term that will need to be explained and justified, and the measures to buffer these adverse developments will need to be clarified. Traditional communication devices for public announcements, such as the publication of official texts in newspapers or the broadcasting of announcements on radio or television, will not be fully effective in extending the spirit of reform and mobilizing public support. Instead, publicity campaigns, using both established and new channels of communication, will be needed to increase public knowledge regarding the reforms and, thereby, to gain public support for them in due course. A TA budget of US\$ 250,000 is allocated for this purpose, to be used for advisers in public relations, media experts, public opinion polls, etc.

17. Counterparts and Reports. The main counterpart for these TA activities is the State Commission for Foreign Investments and Economic Assistance. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; designs for TV, radio and other media programs; bi-monthly progress reports. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

18. The total cost of the TA under the heading of Enterprise Reform, Privatization and Private Sector Development would be US\$ 3.85 million, of which US\$ 300,000 has already been provided under the TCA with Trust Fund resources, and US\$ 3.55 million from the Rehabilitation Credit. In view of their critical importance to the Government's Economic Reform Program, the TA for Enterprise Reform and Privatization TA activities are considered core TA. The consultants will be provided with (in addition to the resources spelled out under the "Responsibilities of the Borrower," in the President's Report and Annex VI) secretarial assistance, interpreters, office space and equipment as available.

**Financial Sector**

19. **Audits of Commercial Banks.** The rapid improvement of bank supervision is critical to the restructuring and sound development of the commercial banking sector. One important aspect in this regard is the audit of commercial banks. TA will be provided to (i) develop an approach and procedures that are suitable for auditing commercial banks in Kyrgyzstan during the transition of the economy and the financial system, and (ii) carry out, as a pilot exercise, audits of two large commercial banks. It is recommended that the Promstroibank and the Kyrgyzstan Bank be selected for those pilot audits. The TA would start as soon as possible, should take no more than six months to complete, and is estimated to cost US\$ 400,000.

20. **Commercial Banking.** Associated with the financial sector, and specifically the procurement activities, is the critical importance of the commercial banks for the Foreign Exchange Market component (FXC) of the Rehabilitation Credit. The commercial banks of Kyrgyzstan are young banks with practically no experience in commercial banking practices. Most of the trade operations in the past were made on a barter system within the Soviet republics; for imported goods, Moscow handled all the operations and Moscow state banks were the intermediaries with international commercial banks. There are only a few banks in Kyrgyzstan that are licensed to operate in foreign exchange, but most of these foreign accounts are inactive and the volume of transaction is minimal. Without a rapid development of sound commercial banking practices in Kyrgyzstan, trade will not improve and the banks will face major difficulties in entering the international market.

21. TA should be provided to selected commercial banks. The eligibility of banks for training would be carefully evaluated by the consultants, as several banks are non-performing. This training should be provided by large international commercial banks and international institutions and should cover all aspects of commercial banking (documentary credits, payments transfers, international banking rules, SWIFT system and other international communications tools, computer technology, language, etc.).

22. The training would take the following form:

- a. Secondment of staff from foreign commercial banks to Kyrgyzstan banks for the short, medium and long-term;
- b. Training abroad in commercial banks and international institutions; and,
- c. Seminars and fellowships.

23. **Counterparts and Reports.** The main counterpart for these TA activities is the National Bank of Kyrgyzstan, even though the beneficiaries under the Commercial Banking TA will be the commercial banking sector. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; bi-monthly progress reports; informal reports on a



variety of specific issues; draft legislation, statutes and guidelines on bank audits; audit reports; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

24. This training is urgently needed and is considered part of the core TA activities. The bank chosen for the Special Account, if it agrees to, could provide this training as part of its services. Otherwise, grant resources or direct financing from the proposed Credit should be considered. The cost of this program is estimated at around US\$ 350,000.

### **Social Safety Issues**

25. Through the TCA, the Association conducted a review of the social safety net. The identified needs for TA in the social sector cover more areas than can be supported within the frame of the TAC under the Rehabilitation Credit. Some of these areas are being covered by TA resources provided on a grant basis by other donors. The Japanese Government has provided a grant of US\$ 1 million to Kyrgyzstan for TA in the areas of income support design, labor markets and education, with the Association as the executing agency. It is also expected that another bilateral donor will fund technical assistance in the areas of health financing and health personnel planning and training. The TA under the Rehabilitation Credit will therefore focus on other key aspects of the health sector, emphasizing the critical areas of pharmaceutical policy and health facility restructuring.

26. Pharmaceutical Policy. Currently, the drug and equipment supply system is operated in the old command mode, except that senior managers at the "Pharmacy" organization now contract directly with suppliers. There is virtually no national expertise in international procurement or modern management of drugs, vaccines and equipment. The plans for creating a pharmaceutical industry, including herbal medicines, should be subjected to considerable strategic thinking and analysis. Kyrgyzstan's comparative advantage in the production of solutions and essential drugs, in extracting compounds from local herbs and in the production of syringes, needles, sutures and the like should be assessed early. However, any large scale industrial development should be looked at in an international perspective.

27. The objective of the TA would be to transform the drug, vaccine and equipment sector into a modern, effective system. Without a national drug policy, improvements in organization and training in modern procurement systems, much money could be wasted and chronic drug and equipment shortages could become the rule. Investments in pharmaceutical and equipment industries could be both costly and might require long term subsidies or protective trade barriers. TA could contribute to much improved management of drug procurement, distribution and rational use of drugs, vaccines and equipment.

28. TA would be provided to advise and train personnel to: (i) develop a national drug policy; (ii) streamline the organization of "Pharmacy", including the establishment of private retail pharmacies;

(iii) apply international procurement techniques; (iv) improve management of drugs, vaccines and equipment supplies; (v) carry out a comprehensive study of the present and future drug and equipment needs and to determine the feasibility of and cost of national or regional production of drugs, vaccines and equipment.

29. The projected cost of this component would be US\$ 250,000 and it would commence soon after Credit effectiveness and be completed by June 1994. Assistance would be provided to the Ministry of Health (MOH) and the newly established Pharmindustry by specialists in drug policies, procurement (e.g., from UNICEF) and pharmaceutical and equipment industries. The outcome would be (i) a draft national drug policy, (ii) a more effective drug, vaccines and equipment system and, (iii) a comprehensive plan for the future importation, production and pricing of drugs, vaccines and medical equipment.

30. Facility Restructuring. Kyrgyzstan has a total of 1,482 health facilities, including 464 hospitals. There are over 118 inpatient beds per 10,000 population, which is higher than that of any middle income country outside of the FSU. In order to increase the resources available for priority outpatient and primary health care programs, the number of hospital beds needs to be reduced and some underutilised health facilities closed down. Savings could be used to reequip and upgrade remaining hospitals, and to improve referral systems (for example, through extension of the ambulance services). Redundant hospitals could be auctioned off or converted into polyclinics.

31. However, bed reductions and facility rationalization obviously need to be planned carefully and phased in slowly. Hospital closure is a highly sensitive issue, and every effort needs to be made to ensure that the quality of care in remaining facilities is indeed improved. Standards of care need to be specified and monitored, and the average length of inpatient stay needs to be reduced from its current high level of 14.9 days. Cost effective technologies also need to be adopted, especially in the delivery of emergency, trauma and midwifery services. In many instances this will involve the purchase of new medical equipment.

32. The objectives of the technical assistance in this area are: (i) to help develop a comprehensive five year plan to reduce the number of inpatient beds and excess hospitals; (ii) to help develop standards of care and systems for regulating standards in public and private facilities; and (iii) to help develop systems to enable rayon and oblast authorities to "purchase" services, under contract, from public and private health facilities.

33. The different components of this strategy would need to be developed in a phased fashion over a period of up to 24 months. Technical assistance should be packaged under one contract, and the total cost would be about \$250,000. Outputs would include a five year plan for bed- and facility rationalization; the development of standards of care along with systems to monitor and regulate service quality; and the outlining of longer term plans for the development of an internal market for health care. Training would also be provided to develop a cadre of hospital administrators.

34. **Counterparts and Reports.** The main counterpart for these TA activities is the Ministry of Health. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; bi-monthly progress reports; informal reports on a variety of specific issues; draft legislation, statutes, guidelines, etc.; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

### **Agricultural Sector**

35. During the transition from an administrative command system to a market economy, the agricultural sector will undergo fundamental changes. The agricultural structure in Kyrgyzstan reflects the regional specialization developed in the FSU to promote interdependence among the Union republics. This is observed also in agroindustrial production and the production of agricultural inputs, machinery and equipment. The dissolution of these former Soviet relations has caused disruptions in agricultural production, input and output marketing and distribution and processing. The following areas are currently major constraints to agricultural development; they should be thoroughly reviewed and adequate policy changes should be implemented on the basis of detailed studies:

- a. **Agricultural policies.** This would involve the agricultural incentive structure, including the distorted price policy with its system of administered prices for both inputs and outputs, and the opaque and pervasive subsidy structure.
- b. **Privatization of agricultural production and production factors, with special emphasis on land privatization.** The issues would relate to small-scale private sector development, including legal aspects, farm and business management, marketing, sustainable agricultural practices (integrated pest management, small scale machinery, etc.), mass privatization of agroprocessing and input supply industries including transport and storage facilities, and implementation of an adequate legal, financial and institutional framework.
- c. **The changing comparative advantages in agricultural production.** This requires analysis of the current production structure, a thorough review of the irrigation system and its potential and needs for rehabilitation, and an assessment of Kyrgyzstan's potential in diversifying agricultural production under changing terms of trade in the agricultural sector.

36. The objectives of the proposed studies are to understand and describe the current structure of the areas discussed above and to develop proposals for agricultural development based on best financial, economic and environmental practices.

37. **Study 1 - Agricultural Policies.** This study would examine the extent to which controls have distorted the relative price structure and encouraged inefficient use of resources, and have

contributed to the emergence of crop-mixes not in conformity with the comparative advantage of Kyrgyzstan. The study would review the effect of the introduction of international prices on inputs and the general profitability of agriculture including the livestock sector (for example, the issues of the comparative advantage of intensive versus extensive livestock, and the heavy emphasis on fodder production). In reviewing the profitability of agriculture, the study would develop farm budgets for all main agricultural activities showing the current price structure for inputs and outputs, and then a price structure reflecting international prices at different projected exchange rates. The study would also look at the transition relating to the elimination of the system of state orders. In addition, it would assess the status of the rural poor and the effects of the reforms with recommendations as to how any adverse impacts may be mitigated.

38. The emphasis on the subsidy side would be on production subsidies; consumer subsidies would not be considered. It would look into such aspects as the magnitude and nature of subsidies, the distortions they produce, and ways in which they can be simplified for easier and more transparent management as a policy tool. The study would consider subsidy policies in a market economy, with the elimination of input subsidies and a focus on output and compensatory subsidies. It would discuss related issues of the comparative advantages of Kyrgyzstan's agriculture (through the estimation of protection coefficients), and the natural protection arising from distance from major markets. It would seek to identify the framework in which the Government could develop policies, within the bounds of budgetary resources and discipline, for a limited number of major agricultural commodities. Such programs would interfere as little as possible with production decisions and would be in the form of compensation payments (methods would be developed through the study) instead of active purchases by the Government. The study would be managed by a group of expert consultants, comprised of specialists in agricultural economics (two), crop production, livestock, irrigation, agroindustry, agricultural machinery and equipment, and chemical inputs including fertilizers.

39. Study 2 - Privatization. This study would seek to identify the issues that will affect the privatization process in agriculture and those actions necessary to address these issues. Important areas to be covered would include (i) limitations in the legal system, including procedures for registration and licensing, that would affect private ownership and operations including the ability to trade such ownership in part or in whole; (ii) options available to achieve private ownership, such as joint stock companies, cooperatives, sole proprietorships, partnerships, or a mixture of the above; (iii) changes needed in the financial system including rural credit to provide financing, including the issue of collateral; (iv) the effect of privatization on wages of management and labor, including the introduction of incentives and social benefits such as schools and pensions; (v) infrastructure such as roads, transportation and communication, land and buildings for storage and operations; (vi) the availability of expertise and its development, particularly in the areas of accounting and management information systems, auditing, marketing and other commercial activities; and (vii) the general climate and political will toward private ownership and endeavor. In addition, this study would address the issue of land reform and would seek to identify a methodology for allowing the lease rights of land to be transferable through sales and rental and also to be used for collateral. The review would include representative

enterprises eligible for privatization and would draw on the experience of recently privatized enterprises.

40. Aspects of the study related to privatization in marketing, distribution, storage and transport would examine the effects of state dominance in marketing, distribution, storage and transport of agricultural inputs, services and products on the efficiency of the distribution network, farmgate to retail costs and margins. This part of the study would define a program that would gradually eliminate state controls in processing and marketing, to be implemented in the transition to a market economy. It would also look at current restrictions to the development of private marketing channels, the adequacy of infrastructure, and the institutional framework along with its linkage to the transport system.

41. The study would be managed by a group of expert consultants with experience in economies recently moving toward a market system, including macroeconomic and trade policy experts, and marketing, distribution, storage and transport specialists. In addition to expertise in privatization, the team would include expertise in legal and commercial practices. The output of the study would include recommendations as to the future course for the development of the private sector and the privatization of existing entities.

42. The studies would be conducted in Kyrgyzstan over a period of four to six months each. They would be provided with assistance from staff, information and resource contributions from the Ministries of Agriculture, Trade, Finance and Water Resources, and the Institute of Agricultural Sciences, particularly the Faculty of Agricultural Economics, as well as any other organization related to the subjects being studied. The recommendations would take into consideration the Government's Economic Reform Program and the associated Plan of Action.

43. The consultants for the above studies would be provided with suitable accommodations and transportation as indicated in the Project Implementation Section of the President's Report and in Annex VI. They would be given furnished office space, suitably equipped with telephones, telexes and facsimile machines, bilingual secretaries, interpreters and any other reasonable requirement. The above facilities, including equipment and supplies, would be in place before the arrival of the foreign experts and would be free of export and other duties, and imports would be expedited. All data, legal texts, and other pertinent information would be made readily available to the experts. The experts would be allowed to travel unrestricted around the country, including in rural areas, and would be allowed to conduct surveys necessary for their work.

44. Counterparts and Reports. The main counterpart for these TA activities is the Ministry of Agriculture. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; training activities; bi-monthly progress reports; informal reports on a variety of specific issues; draft legislation, statutes, guidelines, etc.; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations. The draft of each Final

Report would be discussed with the Association and the Government at least one month before finalization.

45. These studies are critical to the Government's Economic Reform Program in Agriculture and are considered core TA activity. Each study would begin as soon after Credit effectiveness as possible and the cost of each of the above studies is estimated as follows (Study 2 is considered under Enterprise Reform, Privatization and Private Sector Development):

Study 1 -	six months	\$ 500,000
Study 2 -	six months	\$ 600,000
<b>Total</b>		<b>\$ 1,100,000</b>

46. Study 3: Irrigation and Water Charges. There is concern about the financial sustainability of existing irrigation schemes and the economic justification of future projects under the present cropping pattern, which is largely devoted to grain and feed crop production. More diversified agriculture including higher value crops may be required to justify the modernization program considered by the Ministry of Water Resources and Irrigation. Import substitution in agricultural production, if justified, may require different strategies for irrigation development. TA will be required to assess the irrigation program, including the rehabilitation of existing systems and proposed future investments. This would include the services of experts or consulting firms, familiar with the international technical and economic criteria, to assist in training for the preparation of feasibility reports, particularly on the marketing, economic, social and environmental aspects.

47. This study would review proposed irrigation investments for the rehabilitation of existing systems, their economic and environmental impact and their technical aspects. This review would consider expected changes in water distribution arising from the proposed privatization of large farms into smaller units. It would also develop a water tariff system that would at least cover operation and maintenance costs with automatic adjustment linked to cost changes. The study would be managed by a group of experts in irrigation and water management, economists with water resources management experience and an environmentalist. The output of the study would take into consideration the privatization of land rights, and possible crop diversification based on comparative advantages and existing and potential environmental issues. The tentative costs of this activity are estimated to be around US\$ 300,000. This is considered a core TA activity.

48. Counterparts and Reports. The main counterparts for these TA activities are the Ministry of Water Resources and Irrigation and the Ministry of Agriculture. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; training activities in project evaluation; bi-monthly progress reports; informal reports on a variety of specific issues; draft legislation, statutes, guidelines, etc.; the review and design of water charges; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis

of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

### **Project Implementation**

49. Management of the Technical Assistance Program. The technical assistance program is integrally linked to the development and implementation of the critical aspects of the Government's Economic Reform Program. Timely and effective implementation of the TA program will enhance the likelihood of success of the Economic Reform Program. The coordination of TA between the technical staff in the line ministries, consultants providing the TA and the policy makers will require management and organization skills that are not readily available in Kyrgyzstan. Therefore, two long term consultants will be hired (initially for one year) under the TA to assist the Government in managing and coordinating the TA program. These consultants will focus on the administration and the organization of the TA as well as financial matters related to TAC. The consultants' activities will entail primarily coordination among the technical authorities, the consultants for the different TA activities and policy makers and ensuring that the scheduling of TA allows timely availability of results that can be used in the development and the implementation of the reform processes. The consultants will work with the counterpart agencies, guide TA consultants, monitor the progress of the TA programs and ensure the communication of results to the Government and the Association and also provide on the job training to the TA Coordination Unit staff in GOSKOMINVEST. The consultants will be placed in the PIU. From among the PIU staff already appointed, one staff will be dedicated exclusively to assisting the consultants in the management of the TAC under the Credit. A budget of US\$ 500,000 is allocated for the TA management consultants.

50. Requirements of the Project Implementation Unit. For the efficient operation of the PIU, particularly for the processing and communication needs, office and communication equipment (computers, software, telex, telephone, facsimile, etc.) will be required. A budget of US\$ 200,000 is allocated for this purpose. The resources to be provided for the PIU by the Government are discussed in Annex VI.

51. Counterparts and Reports. The main counterpart for these TA activities is the PIU. The output from the TA activities will include an Inception Report outlining the approaches and the implementation program; training activities in procurement; bi-monthly progress reports; informal reports on a variety of specific issues; and a Final Report at the completion of the work program. These reports and the Final Report will form the basis of discussions between the Association and the Borrower, with the participation of the consultants if necessary, and eventual agreements on implementation of the recommendations.

### **Contingency**

52. Additional resources of US\$ 450,000 are earmarked for contingencies or TA activities which may be identified.

**REPUBLIC OF KYRGYZSTAN - REHABILITATION CREDIT  
SUMMARY OF THE CORE TECHNICAL ASSISTANCE COMPONENT**

Sector and TAC lists	Counterpart Implementing Agencies	Items US\$ '000	Total US\$ '000
<b>ENTERPRISE REFORM, PRIVATIZATION AND PRIVATE SECTOR DEVELOPMENT</b>			
1. Technical Assistance and Training for detailed implementation planning, legislation, capacity building and actual implementation of privatization, enterprise reform and competition policy through full time advisers, short-term missions and equipment	State Property Fund, Anti-monopoly Committee, Ministry of Economy and Finance	2200	
2. Study on Privatization in Agriculture (legal framework and institutional requirements)		600	
3. Mining Legislation (advisers for assistance in draft legislation)	Ministry of Agriculture		
4. Legal Reform Coordination (advisers for assistance in coordination between legal and economic reform)	Mining Agency	250	
5. Promotion of the Reform Activities (advisers for public relations)	Ministry of Justice	250	
	GOSKOMINVEST		3,550
<b>FINANCIAL SECTOR</b>			
6. Assistance to developing audit approaches for commercial banks and pilot audits	National Bank of Kyrgyzstan	400	
7. Commercial Banking (assistance, training and equipment)	National Bank of Kyrgyzstan	350	
			750
<b>SOCIAL SAFETY ISSUES</b>			
8. Health Care and Pharmaceuticals	Ministry of Health	500	
			500
<b>AGRICULTURE</b>			
9. Study on Agricultural Policies (review of price and support policies, policy development and training)	Ministry of Agriculture	500	
10. Irrigation Rehabilitation and Water Charges Study	Ministry of Water Resources	300	
			800
<b>PROJECT IMPLEMENTATION</b>			
11. Procurement Agent, Training	PIU	250	
12. Management of Technical Assistance	PIU	500	
13. Project Implementation Unit (equipment)	PIU	200	
			950
<b>CONTINGENCY</b>			
			450
<b>TOTAL</b>			
			7,000



**REHABILITATION CREDIT****ANNEX VI: PROJECT IMPLEMENTATION****INSTITUTIONAL ARRANGEMENTS**

1. The State Commission for Foreign Investments and Economic Assistance (GOSKOMINVEST), is the high level Government organization responsible for coordinating and implementing the proposed project. GOSKOMINVEST coordinates foreign assistance to the Republic; its Chairman is the Prime Minister. It was created by decree on July 27, 1992, as a state entity outside the regular structure of the Government. Its functions cover aid management, foreign investment facilitation, and procurement and audit service. It will serve as a focal point for relations with investors and donors, and the official counterpart of all donor agencies operating in Kyrgyzstan, as far as their economic, financial, and technical activities are concerned.
2. The Responsibilities of GOSKOMINVEST. GOSKOMINVEST will be the main agency for coordination and communication between IDA and the Government. It will also be responsible for ensuring that the links between the PIU and the various Government Ministries and agencies and the NBK is conducive to effective and efficient implementation by channeling the communication under GOSKOMINVEST's own authority. It will have the authority to sign contracts, open bank accounts under the Credit in Kyrgyzstan and abroad in the name of the Borrower and authorize withdrawals from these accounts under the Credit; some of these functions can be delegated to the PIU. It will ensure that the PIU conducts its business in a timely and efficient manner. It will facilitate and assist Credit supervision and audits. It will ensure that under TAC, the consultants have complete access to information, facilities (office space, furniture, telecommunication and office equipment, etc.) and transportation necessary for the implementation of their duties. It will also ensure that consultants and IDA staff can travel unrestricted to and from and within Kyrgyzstan, be accorded dispensation from taxation, and be allowed to bring and take out of the country freely and without being subject to customs duties, restrictions and taxes the personal effects, equipment and furniture for the execution of their duties.
3. Overall Implementation and the Responsibilities of the PIU. The Project Implementation Unit (PIU) will be under the direction and responsibility of GOSKOMINVEST. The PIU will be responsible for the overall implementation, procurement and disbursement of the Rehabilitation Credit and the related reporting and accounting activities of PIC, FXC, and TAC. In these activities, PIU will benefit from the services of the Procurement Agent and the consultants for the management of TAC. Given the wide scope and importance of its assigned functions, the PIU has been given the authority and stature to deal directly and effectively with

Government ministries and offices, as well as the NBK, and commercial and correspondent banks and project beneficiaries. The Government has agreed to provide the PIU with adequate staff, and office space, transport and office furniture for the staff. Equipment for photocopying, telecommunications (telephone, telex and facsimile) and information systems (computers and software) will be provided under TAC. The PIU will provide support to commercial banks participating in the FXC, and TAC, and will provide guidance in procurement procedures new to the new implementing agencies in the country and other aspects of project implementation. As a result, it is important that the PIU be exclusively concerned with the Credit during the implementation period and that it not be given additional duties and responsibilities unrelated to the Credit. The following is a summary of the main responsibilities of the PIU; which should be read with IDA's Procurement Guidelines, Disbursement Handbook, and Guidelines for Financial Reporting and Auditing, which are the binding documents defining the responsibilities of the PIU, and copies of which have been left with the PIU.

4. The overall project implementation responsibilities of the PIU will include the following:
- a. To follow up and report periodically (monthly) on the progress of the Government's Economic Reform Program, as indicated in "the Memorandum of Economic Reform Policies" in the Credit Documentation.
  - b. To coordinate the activities of concerned ministries, other public entities, trading companies, participating commercial banks, and consultants, in order to ensure a consistent and timely implementation of the Credit.
  - c. To monitor overall project implementation, in particular the procurement and disbursement of the goods and services purchased through the Credit.
  - d. To provide other management and administration services as may be necessary for the successful implementation of the Credit.
  - e. To prepare the Project Completion Report.

5. Organization. The PIU comprises a full-time Project Manager (who has been appointed) who has overall responsibility for the project. He will be assisted by a Financial Manager responsible for project finance and accounting, and a Procurement Manager who will advise and assist on all procurement procedures and monitor their implementation. The managerial group will be assisted by other professional staff as needed to ensure timely decisionmaking and project execution. Support staff should include (some on a part-time or occasional basis) interpreters/translators, Russian-speaking and bilingual (Russian/English) secretaries (at least one full-time Russian/English-speaking bilingual secretary) and drivers. The

Procurement Agent representatives and the long term management consultant for the implementation of the TA program will also be placed in the PIU.

6. The Responsibilities of the Government. The Government will provide the salaries and the benefits of the PIU staff, and, office space and furniture, and access to direct communication facilities (direct domestic and international telecommunications access) to the PIU and all the consultants working under TAC. The Government will provide adequate housing to long term consultants (staying more than one month in Bishkek) at reasonable cost. The necessary repairs to consultant housing will be provided by the Government or obtained in the market and charged to the Project. Short term consultants (less than one month) will be housed in acceptable hotels. The Government will provide transportation (vehicles and fuel) to the TAC consultants on the following basis: (i) for the long term consultants for procurement and TA management and those residing temporarily in Kyrgyzstan for longer than one month, permanent allocation (seven days a week) for the duration of their activities of one vehicle with driver per two consultants, and all the related operating expenses (fuel, maintenance and regular and overtime salaries and benefits of the driver); (ii) for the short term consultants staying in Kyrgyzstan for a period of less than one month, the allocation of one vehicle per three consultants under the same conditions as (i).

7. The Responsibilities of the Ministries and other Government Agencies. The Ministries and other Government Agencies benefiting from PIC, FXC or TAC will provide adequate resources and staff to assist the PIU, the Procurement Agent and the TAC management consultant for the timely development of procurement documents, especially the technical specifications; assist in the evaluation of the bids; and ensure that the imports under FXC and PIC are within their budgets and/or credit ceilings. They will actively assist the PIU and the TAC management consultant in the development of the terms of reference for the TAC, and provide counterpart staff, facilities, assistance (transportation, access to information, etc.) and guidance for the consultants hired under the TAC and in the implementation of the TAC. A draft implementation agreement between the PIU and the respective ministries, agencies and the NBK, clearly delineating responsibilities, identifying counterparts and indicating actions to be taken is expected to be finalized shortly.

8. The Responsibilities of the NBK. The NBK will maintain the accounts of the Government pertaining to the Credit and transfer funds from these accounts in a timely and expedited manner; obtain adequate imports documentation to enable reimbursements under FXC and provide these documents to the PIU; allocate and channel a pre-determined amount (to be decided jointly between the Association and the Borrower) of the FXC to the inter-bank foreign exchange auction market (IFEAM), deposit local currency equivalent of auctioned amounts of the auction exchange rate to the Government's account, and provide monthly progress to the PIU, on the amounts of foreign exchange from the FXC auctioned at the IFEAM.

9. **Supervision.** Owing to the weak institutional structure and implementation capacity in Kyrgyzstan, the high level of TA activities in this Credit and the extensive reform activities that would need to be monitored, supervision requirements will be higher than indicated in the normal supervision coefficients and are estimated to be around 75 SW. The supervision program is given in Annex VI, Table A-VI.4.

## **PROCUREMENT**

10. The PIU's responsibilities for procurement are discussed below under the Pre-identified Component (PIC) and the Technical Assistance Component (TAC). As imports and procurement in the former Soviet Union (FSU) were coordinated through Moscow, there is practically no procurement capacity in Kyrgyzstan, and also because of the lack of experience of the PIU, a Procurement Agent, responsible to the Borrower and acceptable to the IDA, will be hired to carry out public sector procurement under the Credit while simultaneously developing a local procurement capacity or institution to be responsible for public procurement in future. A draft "Terms of Reference for the Procurement Agent" is provided in the Attachment to this Annex. An international procurement agency acceptable to the Association will therefore be contracted to manage procurement activities and provide training in procurement. The Borrower and the procurement agency will ensure that procurement complies with Bank guidelines. Contracts estimated to cost above US\$ 300,000 equivalent will be awarded through ICB, using IDA's sample bidding documents modified to suit the requirements of individual packages. Contracts costing less than US\$ 300,000 equivalent will be procured through international shopping, based on at least three quotations from two different countries. Limited international bidding will be used for goods for which there are a limited number of suppliers. Direct contracting will be allowed for proprietary goods and items required for standardization. To ensure compliance with IDA guidelines, the first two contract packages (including bidding documents) in each subsector procured through ICB and all contracts (including bidding documents) costing more than US\$ 0.5 million equivalent will be subject to prior review by the Association. All other contracts will be subject to ex-post review. Pre-shipment inspection will be carried out as necessary for contracts costing more than US\$ 300,000 equivalent. Consultants will be selected in accordance with the "Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency."

11. The proposed procurement arrangements for goods and the hiring of consultants are presented in Tables A-VI.1 and A-VI.2. These procurement plans represent best estimates; precise amounts under each procurement category will be determined when the Procurement Agent identifies bidding packages according to equipment needs and at the time when the bidding documents for each package are prepared. The bidding packages will require the prior approval of the Association. The estimated aggregate amounts to be procured under procedures other than ICB are as follows: LIB: US\$ 12 million; IS: US\$ 14.5 million; Direct Contracting US\$ 0.5 million and TA (consultants' services): US\$ 7.0 million. IDA financing is 99.6 percent of the cost of the project.

12. **Pre-Identified Component (PIC)**. For procurement to be conducted under the PIC, the PIU will coordinate activities between the Procurement Agent and the end users of imports.

13. In addition, the PIU will review proposals under the PIC for the purchase of imported goods to ensure that they comply with the agreed "pre-identified list," that funds are available in the Credit account to cover their costs and that the local currency equivalents have been deposited by the importers in the Borrower's account in the National Bank of Kyrgyzstan (NBK) (see Som Account - SOA, below under Disbursement).

14. **Foreign Exchange Component (FXC)**. For the FXC, the PIU would undertake the following:

- a. Review import documentation submitted by NBK for reimbursement under the FXC, to ensure that these items are not included on the "negative list," to ensure that these items were imported in accordance with agreed procurement procedures, and that funds are available in the Credit Account to cover their costs.
- b. Establish and maintain records of purchases committed and paid, to ascertain the total amount of this component that remains available, and to record the utilization of this component by main economic activities.
- c. Designate a staff who will be responsible for the disbursement of the component.

15. **Technical Assistance Component (TAC)**. For the TAC, the PIU will undertake the following:

- a. Complete the preparation of terms of reference acceptable to the Association, and, with the assistance of the Procurement Agent and the TA management consultant, review proposals and appoint consultants for the studies agreed to be carried out under this component, ensuring that the procurement procedures and contracts comply with the Credit Agreement and with IDA Guidelines.
- b. Monitor, with the assistance of the TA management consultants, the implementation of the TAC contracts to ensure their timely execution, and also to ensure that the consultants receive the supporting services agreed (housing, transportation, staff, office facilities, etc.), that they travel unrestricted to, from and within Kyrgyzstan and have access to documents and other information necessary, and that they are paid in a timely and professional manner; the PIU will also ensure that an acceptable output is received for each study.

**Table A-VI.1**  
**Summary of Proposed Procurement Arrangements<sup>#</sup>**  
**(US\$ millions)**

Project Element	Procurement Method		Total Cost
	ICB	Other	
<b>Goods</b>			
Telecommunications	4.5	1.0	5.5
Transportation	1.5	3.0	4.5
Energy	6.0	3.5	9.5
Medical	1.5		1.5
Agriculture	7.0	2.5	9.5
Irrigation	0.5	0.5	1.0
Environment		1.5	1.5
Foreign Exchange Component	5.0	15.0	20.0
Technical Assistance		7.0	7.0
<b>TOTAL</b>	<b>26.0</b>	<b>34.0</b>	<b>60.0</b>

<sup>#</sup> These procurement plans represent best estimates; precise amounts under each procurement category will be determined when the Procurement Agent identifies bidding packages according to equipment needs and at the time when the bidding document for each package are prepared. The bidding packages, except those specifically mentioned for expost review, will require the prior approval of the Association. The estimated aggregate amounts to be procured under "Other" are as follows: LIB: US\$ 12 million; IS: US\$ 14.5 million; Direct Contracting US\$ 0.5 million and TA (consultants' services): US\$ 7.0 million. IDA financing is 99.6 percent of the cost of the project.

**Table A-VI.2  
COST ESTIMATES BY MAJOR CONTRACT AND SCHEDULE OF CRITICAL PROCUREMENT STEPS FOR  
TECHNICAL ASSISTANCE**

Component	Contract Type	Base Cost US\$ '000	Procurement Method	Critical Procurement Steps		
				Preparation of Bidding Documents	Issuance of Invitations for Bids	Signing of Contract
Privatization, Enterprise Reform and Competition Policy	Consultants	2,000	Short list of three to six firms with selection based on technical merit	April 30, 1993	May 30, 1993	July 15, 1993
Equipment	Goods	200	International Shopping (IS)	April 30, 1993	May 30, 1993	July 15, 1993
Mining Legislation	Consultants	250	Short list of three to six firms with selection based on technical merit	October 1, 1993	November 1, 1993	January 15, 1994
Privatization in Agriculture	Consultants	600	Short list of three to six firms with selection based on technical merit	April 15, 1993	May 30, 1993	July 15, 1993
Legal Reform Coordination	Consultants	250	Short list of three to six firms with selection based on technical merit	October 1, 1993	November 1, 1993	January 15, 1994
Promotion of Reform Activities	Consultants	250	Short list of three to six firms with selection based on technical merit	November 1, 1993	December 1, 1993	January 30, 1994
Commercial Bank Auditing	Consultants	400	Short list of three to six firms with selection based on technical merit	January 30, 1994	March 1, 1994	May 1, 1994

Commercial Banking	Consultants/ Training	300	Short list of three to six firms with selection based on technical merit	March 1, 1994	April 15, 1994	June 15, 1994
Equipment	Goods	50	IS	April 1, 1994	April 15, 1994	June 15, 1994
Health Services and Pharmaceuticals	Consultants	500	Short list of three to six firms with selection based on technical merit	June 1, 1993	July 15, 1993	October 1, 1993
Agriculture <sup>1</sup> Policies	Consultants	500	Short list of three to six firms with selection based on technical merit	April 30, 1993	May 30, 1993	July 15, 1993
Irrigation	Consultants	300	Short list of three to six firms with selection based on technical merit	April 30, 1993	May 30, 1993	July 15, 1993
Procurement Agent <sup>2</sup>	Consultants/ Training	250	Short list of three to six firms with selection based on technical merit and cost	March 30, 1993	April 6, 1993	May 30, 1993
Management of the Technical Assistance Program	Consultants	500	Short list of three to six firms with selection based on technical merit	April 30, 1993	May 30, 1993	July 15, 1993
PIU - Office and telecommunication Equipment	Goods	200	IS	May 30, 1993	June 30, 1993	August 30, 1993

<sup>2</sup> This pertains to the approximate cost of the training component of the Procurement Agent's functions and not the fees and other costs to be charged for actual procurement activities on behalf of the Borrower. However, the training and the procurement activities are being tendered together.



**DISBURSEMENTS**

16. The PIU will be responsible for the disbursement of funds, the preparation of withdrawal applications and the collection of documents. Disbursement will start once the Credit becomes effective, and funds for the PIC and FXC will be disbursed within 6 months but the TAC may take 36 months to disburse. The Disbursement Handbook, which is binding in disbursement matters for IDA Credits, provides additional information on the procedures and will be utilized in conjunction with this section.

17. Project Preparation Facility (PPF). A PPF of US\$ 500,000 has been provided to finance some activities related to the start-up of project implementation (equipment for the PIU office, procurement, training and technical assistance, etc.). The Credit will refinance the advance made under the Project Preparation Facility (PPF) No. P193-0 KG.

18. Special Account. To facilitate the disbursement of funds for PIC and TAC, a Special Account (SA) will be opened in a foreign commercial bank acceptable to the Association. The currency in which the SA is to be maintained is to be agreed between the Borrower and the Association and is to be specified in the Credit Agreement. The SA will be maintained in a fully convertible and stable currency. The authorized allocation to the SA under the Credit will be US\$ 5 million. The SA will be used for PIC and TAC components.

19. The foreign commercial bank selected to be the depository bank of the SA should be selected as soon as possible. The criteria for the selection of this bank are defined on page 31 of the Disbursement Handbook. The SA will be in the name of the Borrower and will be administered by authorized representatives of the Borrower (preferably staff at the PIU). Two signatures will be required to make any transaction from the account. The SA will be replenished monthly.

20. Pre-Identified Component (PIC). Under the PIC, large contracts, i.e., equivalent of US\$ 50,000 (fifty thousand) minimum of eligible imports from the pre-identified list, will be financed under this component. The contracts will include payment terms and the PIU will have to ascertain, before approving the contracts, that these payment terms are in line with IDA disbursement procedures. The acceptable disbursement procedures for this component will be the following:

- a. Procedure of special commitments for larger LCs (a special commitment is an irrevocable agreement to reimburse commercial banks for payments made, or to be made, under the cover of an LC). The special commitment is issued by the Association at the request of the Borrower and is in favor of the supplier through their banks; the mechanism for this procedure is fully described in the Disbursement Handbook, page 24.

- b. **Payments of the LC through the Special Account:** once the importer's commercial banks have notified the SA depository bank of their readiness to pay the suppliers, the SA depository bank will transfer the necessary funds to the banks of the suppliers and notify the Borrower and the PIU of the transactions. The importer's bank will send all documentation to the SA depository bank. This documentation will support the requests for the replenishment of the SA.
- c. In the case where no LC has been used, direct payments to the suppliers by the Borrower from the SA can also be effected. Payment terms should be reasonable and protect both the buyer and the seller. Advance payment of 100 percent cannot be accepted; acceptable commercial payment terms are, for instance, 10 percent at signing of contract, 80 percent at shipment and 10 percent at delivery, or a reasonable variant of this.
- d. There might be cases when the same contract will include one or more of the acceptable procedures. A combination of these procedures can also be used.

21. The Borrower will submit to the Association monthly (or more frequently, if necessary) requests to replenish the SA; these requests will be made against Statements of Expenditures (SOE) for contracts of less than US\$ 300,000 (three hundred thousand), and by full documentation for those contracts equal to or in excess of US\$ 300,000 (three hundred thousand) (two copies of contracts, copy of LC, invoices, evidence of payment and evidence of shipment, or any other documentation as might be required by the Association). A sample of the SOE format can be found in the Disbursement Handbook, page 34.

22. The Borrower will open an account, called the Som Account (SOA) hereon, in the name of the Borrower, in the NBK or in a commercial bank. Public sector importers using foreign exchange resources under the PIC of the Rehabilitation Credit, will pay (deposit) at the time of the request for imports the equivalent local currency into the SOA in the NBK for the foreign exchange converted at the market exchange rate.

23. Foreign Exchange Component (FXC). The PIU will be responsible for this component. Disbursement under this component will be made as reimbursement to the Government for imports by the private and public sector already made. Individual documentation for imports costing less than US\$ 10,000 equivalent or exceeding US\$ 500,000 equivalent will not be eligible for reimbursement under the FXC. These imports will comply with and not include items in the Association's standard negative list.

24. The FXC is expected to disburse over a six month period from the date of effectiveness of the Credit and would also cover retroactive financing. The Bank will disburse foreign exchange for FXC to the Borrower on a reimbursement basis for eligible imports which have already been made by the public or the private sector. These funds will be disbursed in

foreign exchange in account(s) opened by the Government. The Borrower would be expected to provide an initial set of documentation for imports made since the retroactive financing cutoff date of February 1, 1993, which would be the basis for the initial disbursement on a reimbursement basis. NBK will submit all the necessary documentation (customs certificates where available, LCs, shippers' documents, etc.) to the PIU. If, during the implementation of the Credit, disbursement under the FXC proves to be lower than anticipated or other unforeseen issues appear, resources will be transferred from the FXC to be used under PIC.

25. As soon as the Credit Agreement is signed, PIU, with input from the NBK, will collect documentation on imports either from the customs office (if these documents are available) or from commercial banks. Once the Credit is effective, PIU will send to the Association the first request to reimburse the Government for these imports. The Association will deposit these funds in foreign exchange in the Government's account(s). There might be more than one account as the requests for reimbursement are expected to be expressed in various currencies, depending on how the imports were paid. The funds deposited as reimbursement of FXC by the Association in the Government account(s) will be used to feed the inter-bank foreign exchange market through the NBK.

26. A protocol would be required between the Government and the NBK indicating the predetermined amounts and periodicity of the foreign exchange transfers to the NBK for sale at the inter-bank foreign exchange market. NBK will submit to the PIU, with copy to the Association, monthly reports indicating the portion of foreign exchange auctions during the month that has been financed through the resources from reimbursements by the Association for imports under the FXC.

27. The PIU will submit periodic applications for reimbursement for FXC with the following documentation:

- a. For imports under US\$ 300,000; statement of expenditures (SOE) based on customs certificates (if available) or on information obtained from the commercial banks (copies of LCs issued and paid and other documents such as invoices, evidence of payment, if necessary). The PIU will retain the documentation which will be reviewed by IDA supervision missions and by the external auditors
- b. For imports between US\$ 300,000 and US\$ 500,000 (the latter figure being the upper limit per contract under the FXC), the PIU will send with their requests for reimbursement, copies of all the traditional documents (LCs, contracts, suppliers' invoices, shipment documents, bill of lading, evidence of payment).

28. Technical Assistance Component (TAC). The beneficiaries under the TAC will be paid directly by the Borrower through the SA, according to the payment terms indicated in the technical assistance contracts. The Borrower will send to the Association monthly requests

for replenishment of the SA accompanied by a copy of the invoices. In addition, two copies of each technical assistance contract will be sent to the Association.

29. **Actions to be Taken by the Borrower.** The following list summarizes the actions that would need to be taken by the PIU. The PIU office should keep a copy of the PPF Letter of Agreement in their files. The PIU should follow up with the State Commission for Foreign Investments and Economic Assistance (representing the Borrower) to ensure that a letter signed by the Vice Chairman of the Commission representing the Borrower has been sent to the Association giving authorization to those designated to sign requests for payment under the PPF and the Rehabilitation Credit. The letter should include the following:

- a. The authorization of those designated to sign the requests to the Association for payments and special commitments. The Government might want to have joint signatures or sole signature. At least two persons should be authorized for signing, in case one person is away.
- b. The authorization of the persons designated to make transactions of any kind from the SA. Two signatures will be requested for each transaction. More than two persons should thus receive this authorization.
- c. Legalized specimen signatures. These should be attached to the above letter, and the letter should be addressed to the Association, to the attention of Division Chief, Country Operations, Central Asia, Azerbaijan and Kazakhstan, Europe and Central Asia Region, Department III, with a copy to Disbursement Officer, EMENA and LAC Disbursement Division (LOAEL), Loan Department

30. The selection of the depositary bank of the SA should be made as soon as possible. Once the account has been opened, the PIU should advise the Disbursement Division of the Association (LOAEL) by facsimile, giving full information on the account number, the name and full address of the bank, including all the codes, and the name in which the account is to be held.

31. The Borrower should inform the SA Bank of the purpose of the Special Account and obtain the following:

- a. Letter of intention, whereby it would not seize or set-off any balances in the account (if such letter has not yet been received by the IDA); a model of this letter is shown in page 92 of the Disbursement Handbook.
- b. Confirmation that monthly bank statements will be sent to the Association to reflect each transaction in the depositary account with a copy to the PIU.

- c. An agreement to provide technical assistance to the PIU.

32. Once the Credit becomes effective, the advance of US\$ 5 million (five million) should also be requested through Form 1903. All requests for payments should be prepared on Form 1903 and duly signed by the authorized signatories.

### **REPORTING, ACCOUNTING AND AUDITING**

33. The PIU will establish and maintain a Management Information System (MIS) covering all procurement financed by the Credit, as follows:

- a. Under the PIC and TAC, the records will include information received on all procurement transactions, including the identity of the user, the kind of goods purchased, the contract value, identification of the bidders and the winning supplier, the key dates for the bidding process, and the subsequent fulfillment of the contract.
- b. For the FXC, the records will include details of the purpose of the foreign exchange purchased, as per information submitted by the NBK.

34. The above information and monthly reports provided by the NBK on the amount of foreign exchange auctioned under the FXC, will allow the PIU to monitor Credit implementation and will also provide the basis for the PIU to prepare progress reports and the Project Completion Report required after the Credit has been disbursed and closed.

35. The PIU will establish an appropriate accounting system according to generally accepted standards, in order to provide information on receipt and use of funds, in line with the terms of the Credit Agreement. The system will ensure timely and accurate accounting of all transactions under the Credit, and clear presentation of the financial information. It should enable identification of the use of all funds by components and categories of goods imported. The accounting should reflect the movements of the receipts and payments through the Special Account, with balances agreed with monthly financial statements from the holding commercial bank and with periodic statements from the Association. Also, it will reflect the transactions through the Som Account with monthly agreement with the National Bank. The accounting will be supported by appropriate documentation which will be retained in well-organized files and made available for review by IDA staff and the auditors.

36. The Borrower will prepare annual statements of all receipts and payments under the Credit showing the amounts relating to each component and category as detailed in the Credit Agreement. The statements will include a summary of all Withdrawal Applications submitted to the Association, showing individual dates, and amounts in U.S. Dollars and domestic currency

equivalent. In addition, there will be an annual statement summarizing receipts and payments in the Special Account.

37. Project Accounts (including the Special Accounts) will be audited in accordance with the March 1992 "Bank Guidelines for Financial Reporting and Auditing of Projects financed by the World Bank." The Borrower will arrange for the auditing of all the above financial statements, in accordance with generally accepted accounting standards, by independent auditors acceptable to the Association. The Association will be provided by the Borrower the audited statements and audit report of such scope and detail as the Association may reasonably request, within six months after the end of each fiscal year of the Borrower.

**TABLE A-VI.3**  
**SUMMARY OF PROJECT IMPLEMENTATION SCHEDULE FOR THE TECHNICAL ASSISTANCE COMPONENT**

<b>TA Activity</b>	<b>Preparation of Final Report or Project</b>	<b>Discussion with the Government</b>	<b>Completion of Studies or Projects</b>
<b>Privatization, Enterprise Reform and Competition Policy</b>	September 15, 1994	November 15, 1994	March 20, 1995
<b>Mining Legislation</b>	February 20, 1995	April 15, 1995	June 20, 1995
<b>Privatization in Agriculture</b>	July 15, 1994	November 15, 1994	March 20, 1995
<b>Legal Reform Coordination</b>	August 20, 1994	October 15, 1994	December 10, 1994
<b>Promotion of Reform Activities</b>	February 15, 1995	March 21, 1995	September 30, 1995
<b>Commercial Bank Auditing</b>	July 20, 1995	August 10, 1995	September 30, 1995
<b>Commercial Banking</b>	July 15, 1995	August 5, 1995	September 30, 1995
<b>Health Systems and Pharmaceuticals</b>	December 1, 1994	February 15, 1995	March 15, 1995
<b>Agricultural Policies</b>	August 15, 1994	October 15, 1994	January 15, 1995
<b>Irrigation</b>	August 15, 1994	October 15, 1994	January 15, 1995
<b>Procurement Agent</b>	August 30, 1995	n.a.	September 30, 1995
<b>Management of the Technical Assistance Program</b>	July 30, 1995	n.a.	September 30, 1995
<b>PIU - Office and telecommunication Equipment</b>	December 30, 1993	n.a.	December 30, 1993

**Table A-VI.4  
IDA SUPERVISION INTO KEY ACTIVITIES**

<u>Approx. Dates</u>	<u>Expected Mission Activity</u>	<u>Staff Composition</u>	<u>Staff Weeks</u>
5-6/1993	Project Launch Workshop	TM, Procurement Officer, Accounting Specialist, Disbursement Officer, Component Specialists	8
7-8/1993	Procurement Review <sup>1</sup>	Procurement Officer	13
9-10/1993- 4/1996	Supervision Missions <sup>2</sup>	TM, Procurement Officer, Component Specialists	36
9-10/1994	Mid-Term Review <sup>3</sup>	TM, Procurement Officer, Component Specialists, Disbursement Officer, Country Officer, Country Economist	10
5-6/1996	Project Completion Mission	TM, Procurement Officer, Component Specialists, Country Officer	8
<b>Total Supervision (SPN) Resources</b>			<b>75</b>
<b>Resources by FY:</b>			
	FY94		30
	FY95		25
	FY96		<u>20</u>
			75
<p>1. One mission every two months during FY94; One mission every 3 months during FY95; and 3 missions during FY96. Total missions - 13 (1 sw per mission), of which 8 missions will be combined with SPN Missions.</p> <p>2. Three missions each during FY94 and FY95; Two missions in FY96. Total SPN missions - 8.</p> <p>3. In lieu of Supervision Mission. Total Resources required for SPN missions adjusted accordingly.</p>			



**Attachment****PROCUREMENT OF KYRGYZSTAN  
REHABILITATION CREDIT****DRAFT TERMS OF REFERENCE FOR THE PROCUREMENT AGENT**

1. **Procurement.** According to IDA policy, procurement is the responsibility of the borrower. However, due to the fact that before the independence of Kyrgyzstan, all public sector procurement was carried out centrally from Moscow through long established and experienced trading companies, no procurement expertise was created in the Republic of Kyrgyzstan, nor does any exist today. Appropriate international procurement practices need to be developed to use scarce foreign exchange resources efficiently.

2. Consequently, the Government of Kyrgyzstan and the Association agree that either through obtaining grant funds and/or through the proceeds of the Project Preparation Facility (PPF) and the proposed Rehabilitation Credit, a Procurement Agent be hired to initially carry out procurement under the Rehabilitation Credit while simultaneously training a local procurement capacity or institution to do so in the future. This training effort would require an adequate organization of the procurement capacity or institution, which should be staffed with at least some staff who speak English because it is commonly used in international commerce. It is important that the Procurement Agent base the services required in the designated Government offices in Bishkek, Republic of Kyrgyzstan, to be able to conduct the procurement and training functions adequately for the Government.

3. The services of the Procurement Agent will be financed through: (i) using the proceeds of the Project Preparation Facility and the Rehabilitation Credit; and/or (ii) obtaining grant funds.

4. **Profile of the Procurement Agent.** The Procurement Agent will be responsible for carrying out procurement functions on behalf of the Borrower in accordance with the procedures outlined in IDA Guidelines and specified in the Credit Agreement with the Borrower. The term Procurement Agent is used to mean expert staff from an organization, which has wide knowledge of and experience with the international commercial practices and the Procurement Guidelines and the Guidelines for the Use of Consultants of the Association. The Procurement Agent must also have an established organization capable of providing the various back-up services expected under procurement activities.

5. **Responsibilities of the Procurement Agent.** For procurement conducted according to International Competitive Bidding (ICB) procedures, the Procurement Agent will:

- a. Arrange advertising and provide information to interested suppliers;

- b. Prepare bidding documents in all respects, including review of technical specifications, using the Sample Bidding Documents for the procurement of goods issued by the Association with appropriate adjustments to suit individual procurement packages; seek approval of documents from the Association which would involve discussions and meetings;
  - c. prepare documents for the selection of consultants complying with Bank requirements;
  - d. Distribute/sell bidding documents to prospective bidders at a nominal cost, crediting the funds received to the Borrower's account;
  - e. Invite bids;
  - f. Provide clarifications in response to potential bidders' questions;
  - g. Conduct the bid opening process and prepare the minutes of bid opening;
  - h. Evaluate bids (and Consultants' offers) and submit a bid evaluation report to the Borrower with award recommendation. Provide any clarification or analysis required by the financing agency;
  - i. When designated to do so, sign and finalize the contract, follow-up and monitor the delivery schedule and status of goods which could include visits to suppliers;
  - j. When required, arrange and witness pre-shipment inspections (PSI); and,
  - k. Receive goods at entry, clear customs, and ensure delivery to final destination.
6. For non-ICB procurement, the Procurement Agent would follow the appropriate procedures specified in the Credit Agreement, including:
- a. Soliciting written quotations from a list of potential suppliers broad enough to secure competitive prices and informing the Borrower of the results in writing; evaluating the quotations and negotiating the resulting contracts;
  - b. Soliciting quotation on sole-source basis, after required approvals, and negotiating with supplier for spare parts or other proprietary items at reasonable cost; and,
  - c. Placing purchase orders and contracts with selected suppliers, including follow-up for delivery of goods according to schedule.

7. In the area of contract administration services, the Procurement Agent will:
  - a. Collect documentation, such as inspection certificates, certificates of origin/manufacturer, manufacturers'/suppliers' guarantees, bills of lading, beneficiary insurance certificates, and manufacturers' invoices;
  - b. Forward documentation to the forwarding agent;
  - c. Maintain, in coordination with the PIU, accounting and financial management and handle warranty and insurance claims; and,
  - d. Assist in the preparation of withdrawal applications with the required supporting documentation and arrange payments to suppliers through the PIU.
  
8. The Procurement Agent will also undertake the following two tasks;
  - a. Training the Borrower's staff in international commercial practices and IDA Procurement Procedures, including familiarization with IDA's sample bidding documents so that the Borrower's staff can eventually handle the procurement work in the future. (This part may be financed by grant funds and be handled independently by the Procurement Agent). The cost for training should be provided separately in your financial proposal; and,
  - b. Assisting in collecting and translating into English local procurement laws, regulations and commercial practices with the purpose of enabling the preparation of a Country Procurement Assessment Report for Kyrgyzstan (CPAR) and recommending improvements to the existing regulations and practices, within the framework of international procedures and trading practices using the model developed by UNCITRAL as a basis.
  
9. **Reports.** The Procurement Agent will submit periodic reports to the Government of Kyrgyzstan as follows:
  - a. An Inception Report, within one month of work in Bishkek, describing the proposed program of work for assistance in the procurement and training;
  - b. Subsequent reports every two months thereafter and a Final report on the conclusion of the work including a draft CPAR based on the IDA's outline; and,
  - c. Five copies of each report will be submitted in English and in Russian to the Government of Kyrgyzstan and one copy of the English version will be submitted to the Association.

