PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: AB1092

Project Name	KYRGYZ AGRIBUSINESS AND MARKETING PROJEC
Region	EUROPE AND CENTRAL ASIA
Sector	Agricultural marketing and trade (85%);Agro-industry (15%)
Project ID	P049724
Borrower(s)	KYRGYZ REPUBLIC
Implementing Agency	
	Government of the Kyrgyz Republic Kyrgyz Republic
Environment Category	[ ] A [X] B [ ] C [ ] FI [ ] TBD (to be determined)
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1. Country and Sector Background

In the initial years after independence, the economy of the Kyrgyz Republic underwent a major contraction, as output fell by 50% between 1991 and 1995, resulting in a significant increase in poverty. The fiscal consequences were disastrous: the output collapse triggered a loss of tax revenues of 7.5% of GDP, direct budgetary support from Moscow on the order of 13% of GDP was discontinued, and implicit energy subsidies came to an end abruptly. As a result, inflation soared to triple digits.

Recent Macro-economic performance

Since the mid-1990's, economic performance has been impressive, with annual GDP growth averaging about 5 percent. In 2002, real GDP growth fell to zero due to problems in the gold and power sectors of the economy. In 2003, real GDP growth rebounded to 6 percent. The overall percentage of the population living below the poverty line declined from about 55 percent in 1999 to 48 percent in 2001 and to an estimated 41 percent in 2003. The majority of the poor in Kyrgyzstan are in the rural areas. Rural poverty rates have also shown a down trend, declining from 60 percent in 1999 to 47 percent in 2002.

In recent years inflation has been running below 5 percent and the som/dollar exchange rate has been stable, with some appreciation of the som against the dollar in 2002 and 2003. Both the budget and current account deficits have also improved since 2000.

Fundamental macro-economic problems remain nevertheless, with major implications for the sustainability of future growth and Kyrgyzstan's capacity to reduce poverty. These problems are rooted in high levels of public expenditure and public debt, slow progress with important elements of the economic reform program (privatization and strengthening of the banking sector), poor governance and high levels of corruption. Tax revenue is low at 18%-19% of GDP, although it is commensurate with other small, low-income countries at this stage of economic transition. The limited capacity of this meager resource base is further reduced by chronic corruption, over-employment and inefficiency in government. The ability to fund effective public programs, without incurring large budget deficits (and/or inflation), thus relies heavily on a donor-funded public investment program (PIP), and donor budget support. In 2003 the total PIP amounted to 4.7% of GDP, and 25% of all public expenditure.

Under a debt-reduction program developed with the IMF, the PIP is to be reduced to 3% of GDP by 2006. There is also widespread agreement that these changes will have limited impact unless accompanied by measures to increase the incentives for private investment, as the long-term basis for sustainable growth. More rapid progress with privatization and banking sector reform, and a more favorable environment for foreign direct investment, are critical to continued economic growth.

Concomitant with this aim to reduce external debt and improve the sustainability of public expenditure programs, government has also adopted a National Strategy for Poverty Reduction for 2003-2006. Targets for the NSPR include 5% annual GDP growth, and a cumulative reduction of one million people in poverty, without increasing income inequality. It will not be easy to reconcile these objectives with the need for higher taxes and lower levels of donor funded, public expenditure. GDP growth and increased tax revenues will allow a modest expansion of public expenditure programs. But much greater attention must be given to the type of program funded, the need for continued public support, the type of donor funding (loans or grants), and the capacity to meet recurrent costs. Future public investment programs should also place more emphasis on measures to encourage and facilitate private sector activity and investment.

To maintain economic growth rates at the targeted level of 5%, there will need to be improvements in the business and investment climate, and expansion of exports of goods and services. These issues have been a focus of the Government's National Poverty Reduction Strategy (NPRS) and the Bank's current Country Assistance Strategy (CAS).

Agricultural and food sector performance

Agriculture accounts for roughly 35% of GDP. When adding in associated processing, service and trade industries, the share of the agro-food sector is over 40% of GDP. The economic rebound since the mid-1990's was supported by strong agricultural growth. But this growth has relied heavily on expansion of subsistence agriculture and the inflow of labor to agriculture that came as a result of shrinkage of other sectors of the economy. Simply sticking with this strategy in the coming years runs the real risk of declining growth rates in the sector, which will threaten the ability of the country to meet aggregate economic growth targets essential for dealing with debt-payment and poverty reduction targets. Agricultural growth rates, after increasing at over 10 percent per year in 1996 and 1997, and at approximately 5 percent per year during 1998 to 2001, fell to 3.3 percent in 2002 and 3.9 percent in 2003. At present, there is very little value added downstream of the farmgate. Supply chain linkages are weak and unreliable. It is estimated that less than 15 percent of agricultural produce by value goes to manufacturing sub-sectors. There is limited aggregation of product in marketing.

The quality of enterprise management remains weak. While the land reform has been successful in converting the large farming collectives into household-based private farms, there is limited trust among private farmers to associate with one another for the purposes of marketing, input supply or provision of services. Traders and wholesalers are not yet playing a sufficiently strong linking role. Part of the problem lies in the disincentives that exist for the aggregation of economic activity, due to a higher profile with respect to both taxation and harassment from regulatory bodies.

Kyrgyzstan is facing increasingly tough competitive challenges for agricultural and food commodities. In traditional export markets in the CIS countries, particularly in Russia, new agricultural and food import links are being built with China, Europe, and others. Consumer expectations in these traditional markets have risen significantly since the 1980's.

Because of its land-locked status, Kyrgyzstan faces challenging logistical issues in reaching outside markets. This is exacerbated by restrictive commercial transit policies, particularly for trucks, in the neighboring country of Kazakhstan. These factors, combined with continued inefficient commodity supply chains, have resulted in a decline in Kyrgyz agricultural and food exports since the mid-1990's. In 1995, the value of agricultural and food and beverage exports was $120 million. By 2001 it had fallen to half that level. The bulk of the decline came in food and beverage exports. The domestic market, with a population of 5 million and per capita GDP of slightly over $300, is small, particularly for value-added products, but has been growing in recent years. In the emerging commercial market for value-added product that exists (primarily centered around Bishkek), competition with foreign suppliers is evident and the longer-term ability of Kyrgyz suppliers to compete is threatened.

At the same time, Kyrgyzstan continues to enjoy competitive advantages with respect to markets to its north (primarily Siberia) due to its climate. This is reflected in export market analysis carried out recently by other donors (USAID and SECO). The obstacles to increased penetration of these markets by Kyrgyz suppliers include inability to meet requirements for lot size, consistency of quality, and periodicity of delivery. Favorable movements in the exchange rate between the som and both the ruble and the tenge are likely in coming years, due to continued strong energy exports from Russia and Kazakhstan. Lastly, Kyrgyzstan is a member of the WTO. Admission of Russia and Kazakhstan to the WTO, which is anticipated within the next 2-4 years, could open up additional trade advantages for Kyrgyzstan. There is growing indication of interest among Kazakh buyers for Kyrgyz agricultural commodities.

Addressing the set of challenges outlined above will require a comprehensive approach focused on competitiveness. Capacity building at the enterprise level and bringing together agents in commodity supply chains will be essential. This will have to be combined with effective feedback from, and linkage to, markets. Improved competitiveness will entail investment in real resources. Currently, the financial market in Kyrgyzstan is weak and inefficient, there is almost a complete lack of medium to long-term capital, and there are perceived risks in lending to agriculture and the rural economy.

Banking Sector

The banking sector (21 commercial banks) is small, the total loan portfolio of commercial banks as of end-2003 amounted to about US$ 65.8 million (about 3.5% of GDP), which nevertheless was a 50% increase from the US$ 43.7 million portfolio at the end of 2002. Kyrgyzstan's banking sector significantly developed and became more robust during 2003, mainly due to consolidation of the sector - new investments, especially by foreign investors (Kazakhstan banks have bought three banks in Kyrgyzstan), failures of weaker banks (5 in 2002 and 2 in the first 9 months of 2003), and strengthening through change of ownership. Both deposit and loan markets, although registered strong growth during the last couple of years, suffer from dollarization of the economy, with the majority of deposits (almost 65% of total deposits as of end-2003), and loans (over 60%) being in foreign currency. Both loans and deposits are also characterized with short maturities, since only about 20% of deposits and about 10% of loans have maturity over one year.

*Lending to agriculture***.** Despite the importance of the agro-food sector in the economy, only about 5% of total lending by commercial banks goes for agriculture, agro-processing and storage activities. An exception here is the Kyrgyz Agricultural Finance Corporation (KAFC), a non-bank financial institution with an outstanding loan portfolio of US$ 28.8 million (end-2003), mostly in loans to primary agricultural producers (91% of the total portfolio). The average loan size is relatively small, about US$ 1,450 equivalent. Eight percent of KAFC's portfolio is in agro-processing, and has been increasing only gradually.

Major Challenges in Lending to Agriculture

The key reasons for very limited lending to agriculture and rural sectors are mostly systemic, i.e., they exist in the whole banking sector. The Project, through its technical assistance component and new financial instruments, will offer relevant training and advice to the financial intermediaries to help address these issues.

Inadequate skills of commercial banks to appraise long-term agricultural loans. While the banks are fairly experienced in providing working capital loans, they face lack of skills when it comes to appraisal of long-term investment projects. The inadequate skills are a major contributor to the lack of investment lending in agriculture, i.e., as of end-2003, there were no loans for either production or processing with maturity of over one year in the loan portfolios of commercial banks.

Lack of acceptable collateral in rural areas. Most commercial banks prefer real estate in larger urban areas, which most of the borrowers in agriculture-related businesses may not have. KAFC is an exception, as they work with a wide range of assets in rural areas, and this experience will be shared with the commercial banks. The project, therefore, will offer new financial products, such as loans using warehousing and contractual farming arrangements.

Agricultural lending risks. Lending to agriculture in general is perceived as very risky. Besides production risk, which is a major concern, the commercial banks mentioned poor readiness of the borrowers to take loans, especially poor management capacity, and lack of business planning, marketing, sales, etc. skills in the potential client companies.

2. Objectives

The direct project development objectives will be to expand the level of activity of processing, marketing, and trade enterprises downstream of the farmgate, to increase the number and economic importance of producer organizations, and to improve the functioning of markets and trade linkages between producers, and primary and secondary level trade organizations. The Project will work directly with private enterprises and producer and other commercial organizations to improve the competitiveness of Kyrgyz products. It is important that the Project be responsive to the needs of the private sector in achieving this goal. Best practice from around the world shows that there needs to be an integrated effort along the supply chains in question if real results are to be achieved. If project interventions are not targeted in this manner, the chances of achieving the ultimate objective of increased sales will decline.

The ultimate objective of these efforts will be to increase the amount of value added to Kyrgyz agro-food commodities, to increase sales of those commodities both domestically and abroad, and to improve the operation of domestic agricultural markets.

Key outcome indicators for the Project will be:

- Increased share of agricultural production being processed
- Increased role of producer organizations in agricultural marketing
- The repayment performance of loans extended (repayment rate, etc)
- Increased institutional lending to agro-industry clients

Key output indicators for the Project will be:

- Increase in sales of enterprises and organizations supported by the Project
- Increase in profits of enterprises and organizations supported by the Project
- The number and volume of loans to agricultural producers, agro-processors and agri-business
- The number of PFIs participating in the Project

The Country Assistance Strategy, approved on May 15, 2003, focuses on three key priorities, each corresponding to a priority focus of the National Poverty Reduction Strategy (NPRS). The Project will directly address the number one priority identified in the CAS, namely promoting private sector-led growth. The CAS identifies three key drivers of economic growth for Kyrgyzstan -- agriculture and agro-processing, industry and energy, and small and micro enterprises. The Project will be a key element in addressing these. At the time of the CAS presentation, the Project was included with a new irrigation project under the title "Agriculture Modernization and Marketing Project". Subsequently, the Country Unit took the decision to split the project in two, allowing the processing of the Agribusiness and Marketing Project to move ahead separately and to simplify project design and implementation arrangements.

3. Rationale for Bank Involvement

The Agribusiness and Marketing Project (ABMP) will support the Government's efforts to build more reliable and efficient marketing chains between the farmgate and the final consumer, and will contribute to increased value added in the agro-food sector and increased commodity sales both domestically and abroad.

Government recognizes the need to shift its growth strategy for the agriculture and food sectors in the direction of increased value added and competitiveness and fully supports the Bank's involvement in this area..

Efforts have been underway by other donors and earlier Bank projects to improve agricultural services, to support the development of producers' organizations and small and medium size enterprises, and to promote the export of Kyrgyz agricultural and food commodities. Other donors that have taken an important role in these efforts include the Swiss Cooperation Office, USAID, the ADB and GTZ. The Bank is in a unique position to support the ongoing donor efforts by supporting expansion of tested and proven pilot work, by strengthening links among these efforts, and by adding focus on needed regulatory and policy changes.

4. Description

The Project will work with commodities for which viable marketing opportunities have been identified. This information will be generated through direct interaction with enterprises and organizations involved in those supply chains. The approach of the Project will be to work with those business opportunities that are relatively closer to achieving higher sales of commodities or improved market functioning, rather than to take on higher-risk areas where a greater number of issues would need to be addressed. Working directly with private sector organizations involved in commodity supply chains will ensure that interventions included in the Project are targeted to real business needs rather than to assumptions of what those business needs might be.

Component 1: Market Development Component ($6.65 million of which PHRD Cofinancing Grant $4.05 million and IDA Credit $2.6 million)

The Market Development Component is designed to address constraints to improved functioning of commodity supply chains through interventions in both the private and public sectors. The focus of this component will be on building business capacity of the parties involved in marketing chains of agricultural commodities and providing them the foundation to work together more effectively.

The sub-components are: (i) Supply Chain Management ($4.5 million of which PHRD Cofinancing Grant $3.95 million and IDA Credit $0.55 million); (ii) Export Promotion ($1.05 million, all IDA Credit); (iii) Public Sector Investment Program ($1.0 million, all IDA Credit);

and (iv) Public Sector Capacity Building ($0.10 million, of which PHRD Cofinancing Grant $0.10 million).

Supply Chain Management Sub-Component

The goal of this sub-component is to directly support institutional and overall capacity building among private sector actors involved in the marketing of Kyrgyz agricultural and food commodities. An Agribusiness Competitiveness Center (ABCC) – with strong business and language skills – will be established by the Project to manage the work under the Market Development Component. This will be modeled on the basis of similar private sector development organizations set up in Georgia, Moldova, and Slovenia. The ABCC will engage directly with the following types of private sector clients: producer organizations, processing enterprises and traders. The ABCC will serve as both a channel for providing technical assistance to these clients and for collecting feedback from the private sector concerning limitations on competitiveness and efficiency that would entail changes in the policy and regulatory environment and/or investment in public sector infrastructure.

The ABCC will need to be a fair and objective player in dealing with marketing chain issues, have top level business and professional skills, and be free from political interference in its work. *Agreement on criteria for selection of staff of the ABCC will be reached during appraisal. Issuing of a Government resolution legally establishing the ABCC will be a condition of negotiations.* Legal analysis of the appropriate form for the ABCC has been carried out. The ABCC will be established as an entity (uchrezhdenie) with the Government as its founder. A Supervisory Board consisting of the MAWRPI, the Ministry of Economy, Industry, and Trade, and the Ministry of Finance, and representatives of the private sector and donors will be established to oversee the work of the ABCC.

The ABCC will provide business and technical advice to private sector clients through contracting with international business consulting firms and teaming these with local consultants to be hired on a per-contract basis. The business and technical services will be provided on a matching grant basis, with the clients obligated to contribute toward partial covering of these costs. Based on experience in comparable interventions elsewhere in the region, the client co-financing shares are expected to be 20 percent or less. *Agreement on the minimum cofinancing shares for clients will be reached during appraisal.* Because of the relatively high share of grant financing, the lessons learned through the work with the private sector clients will be available to others as a public good.

Within the ABCC capability needs to be established to handle market development and trade promotion in the Kyrgyz Republic in a pro-active and results oriented approach. The approach taken heretofore in the Kyrgyz Republic has been primarily reactive in that markets have to be found for what has been produced, without sufficient feedback from the markets themselves about the appropriate product profile. It has been identified that both agro-processors and primary producers are currently suffering from a severe lack of market information and have also not been successful in developing trade contacts and trading links with consumers of their goods. For these reasons, a **Market Development Service** (MDS) will be established within the ABCC.

The strategy behind establishing the ABCC is to create skills and capacity within Kyrgyzstan to collaborate effectively with foreign TA providers and to take over leadership of technical assistance functions in the area of business development by the end of the Project. To support this objective, a program of capacity building for the ABCC will be undertaken with focus in the first two years of Project implementation. This will consist of a program of foreign training at relevant models both within the CIS and in the West. There will be a program of training and assistance internally for ABCC staff carried out by consultants from other countries in the CIS that have developed skills under related enterprise development projects, as well as by closely-focused international TA.

Once the ABCC is well-established, a program of technical assistance for processing and trading enterprises, as well as for producer organizations and marketing cooperatives, will be provided. The scope and depth of the interventions will differ depending on the nature and needs of the clients. After an initial review of prospective clients, TA packages will be defined and bid competitively. There will need to be flexibility in the number and type of clients in each package, and the phasing of the packages. The Project will be working actively with other donors and relying on analysis done during preparation of the Project by the team from AFC to identify potential clients for participation. For producers organizations and marketing cooperatives, the ABMP will rely on the work of other donors active in this area, most notably the GTZ, and on the Village Investment Project to identify potential clients of this type. The first package will be critical for establishing the credibility of the ABCC and the Project and will be given particular attention. (A description of the phasing of this work is provided in Annex 6). It will be important that the first package includes a representative cross-sample of private sector clients and that there is diversity in the commodity composition. On the basis of the experience from the first package, subsequent packages will be put together and tendered.

The ABCC will have the role not only of working with individual private sector clients, but of serving as mediator and forum for bringing together agents in the marketing chains of agricultural and food commodities to address overriding efficiency and competitiveness issues, to communicate more effectively, and to identify opportunities for ‘win-win’ business collaboration. The ABCC will work to identify opportunities for supply chain integration for specific commodities and to structure subsequent TA packages to incorporate this. Through its work with the private sector, the ABCC will be responsible for identifying marketing inefficiencies that can and should be addressed either through policy and regulatory reform or through investment in public or mixed public-private infrastructure.

For this sub-component, the PHRD Cofinancing Grant will finance the costs of consultant services. The IDA Credit will finance the operating and equipment costs of the ABCC, as well as a program of foreign training for local consultants and ABCC staff.

Export Promotion Sub-Component

The export link is sufficiently critical for the Project that targeted interventions in this area, in addition to the efforts of the ABCC, may be required. For this reason the Project would hire a trade linkage contractor (TLC) with the purpose of reinforcing the efforts of the ABCC to link domestic sellers of Kyrgyz agricultural and food commodities with foreign buyers. The TLC will have demonstrated success in the promotion of agricultural and food commodity exports, preferably in the ECA region, and will have incentives built into their contract to link their payments to actual increases in exports.

The TLC will be responsible for identification of specific barriers to increased sales of Kyrgyz commodities at specific markets, in particular inconsistencies in grades and standards, packaging and presentation, volume and quality consistency. The TLC will provide this information to the ABCC. One option is to target Russian firms for this assignment, given that: (i) this will be the most important export market; (ii) the Russian food processing industry is developing strongly with growing trade expertise; and (iii) there are advantages to interaction without a language barrier and having a shared socio-cultural link through their shared status as ex-Soviet republics.

All costs under this sub-component are to be financed by the IDA Credit.

Public Sector Investment Program

Significant infrastructure and technology weaknesses are likely to be encountered in the supply chain work under this Component. For private sector investment requirements, the Access to Credit Component (see below) will be available to address those needs. For public sector investment requirements, funds will need to be set aside. These may include market information systems, grading and standards, and municipally-owned marketing infrastructure. There may be cases of mixed public-private infrastructure, where a push from the public sector is necessary to overcome existing hurdles to development. The Project will be able to address these constraints as well on the condition that control arrangements for these infrastructural elements adequately reflect their private sector content. Any proposals for public sector or mixed public-private infrastructure investment will have to be generated from the work with private sector clients and be tied to real business needs as demonstrated in the supply chain work. This is consistent with the demand-driven orientation of the Project and the need for well-targeted interventions.

All costs under this sub-component are to be financed by the IDA Credit.

Public Sector Capacity Building

The Supervisory Board of the ABCC will serve as the vehicle for bringing together stakeholders in the Project. The Board, in addition to its members – the MAWRPI, the Ministry of Finance, the Ministry of Economy, Trade and Industry, the Chamber of Commerce and two other privated sector representatives – will allow for participation of non-member representatives in its meetings and an ‘open house’ framework for airing views and issues of concern to the Project. The Supervisory Board will play an important role in addressing a number of public sector issues under the Market Development Component. These are: (a) strengthening of the public sector’s ability to carry out functions appropriate for a market system, and to build appropriate public-private linkages in the agro-food sector of the economy; and, (b) raising for consideration by Government identified policy and regulatory constraints to improved competitiveness of Kyrgyz commodities that are identified by the ABCC and by other Board representatives. Under point (a) the following activities are foreseen: (i) workshops and short training sessions for Government staff on the strategy of the Project and status of its implementation; (ii) appropriate models for public-private partnerships; and (iii) other topics relevant to efficient market operation, such as roles for the private sector in price risk management. Activities foreseen under point (b) include: (i) reconciliation of existing grades and standards to international standards for identified export markets; (ii) legal facilitation of commodity-based financing mechanisms; (iii) improvement in VAT administration and practices; and (iv) improvement in customs procedures, and others.

The costs of this sub-component are to be financed by the PHRD Cofinancing Grant.

Component 2: Access to Credit Component ($5.9 million, of which PHRD Cofinancing Grant $0.6 million and IDA Credit $5.3 million)

The objectives of the Access to Credit Component are to: (a) address key constraints associated with access to capital by enterprises in the agricultural and food sector of the economy, and (b) expand lending to agricultural and food processing sector by the formal banking sector through introduction of risk mitigating tools for commercial banks.

The Component will be implemented through eligible commercial banks and other financial institutions. The Participating Financial Institutions (PFIs), selected on the basis of specific eligibility criteria, will sign a Subsidiary Loan Agreement (SLA) with the MOF. After the initial training and technical assistance provided by the project, the PFIs will be responsible for identifying prospective sub-borrowers, and have full autonomy in sub-project approval. Detailed eligibility criteria for sub-borrowers, and terms and conditions for borrowing the proceeds of the Credit Facilities and on-lending to the final beneficiaries are specified in the Lending Guidelines.

The Component is designed as a combination of capacity building in the participating financial institutions, and a credit line for investment and working capital loans, to help the commercial banks to mitigate the risks involved in lending to agriculture. The component will encourage the banks to expand their rural lending activities, as, except for some of the larger food processors in Kyrgyzstan, enterprises in the agricultural sector are currently not able to access credit from financial institutions.

The Component will be composed of the following parts: (i) Technical Assistance to the commercial banking sector, including PFIs (US$ 0.66 million, of which PHRD Cofinancing Grant US$ 0.5 million); (ii) Investment Credit Facility (US$4.0 million, all financed from the IDA Credit); (iii) Structured Finance Facility (US$1.0 million, all financed from the IDA Credit); and (iv) Credit Line Management Unit (US$0.265 million, of which $0.105 million financed from the PHRD Cofinancing Grant).

Technical Assistance to the Commercial Banking Sector, including Participating Financial Institutions (US$ 0.66 million, of which US$0.5 million financed from the PHRD Co-financing Grant and US$0.16 million financed from the IDA Credit)

The project will undertake capacity building of the PFIs, to help them deal with entering the relatively new markets of lending to agricultural and rural sectors. After participation in the training, qualified participating financial institutions will have access to a credit facility, for lending for viable business activities. The training will be provided on two subjects:

- *Investment lending*. The training will be designed to address the limited knowledge and skills in the banking sector as to appraisal and risk management of long-term investment lending, especially with respect to agriculture. The training will include specifics of agricultural lending (such as seasonality of agricultural production, impact of external factors, introduction to agricultural technologies, etc); appraisal of financial and operational sustainability of long-term investment proposals, including commercialization opportunities; identification and mitigation of risks in investment lending; and loan pricing methodologies.

- *Risk mitigation tools for lending to agricultural production and processing.* The training will focus on teaching loan officers in the participating financial institutions to identify risks involved in lending to agricultural production and processing, and introduction of selected risk mitigation tools, such as:
    - (i) the use of price risk mechanisms, such as contractual farming arrangements, and warehouse-backed working capital financing (marketing efficiency improvements) by those involved in agro-food supply chains and the role of banks in the operation of those mechanisms; and
    - (ii) the use of transaction finance, such as warehouse receipts and other commodity-based financing mechanisms as a means of risk reduction and expanding the collateral base.

Investment Credit Facility (US$4.0 million, all financed from the IDA Credit)

This sub-component will provide access to investment capital for the emerging producer organizations and private businesses in any legal form, involved in processing and marketing of agricultural commodities, which will also allow the PFIs to apply the improved knowledge in appraisal of such investment proposals.

Eligible investments will include a wide range of agriculture-related activities, such as investments in development of storage, grading, packing and marketing of agricultural produce, investments in processing facilities and domestic marketing and export of agricultural products. Proceeds of the IDA funds will be on-lent through Participating Financial Institutions (PFIs) - commercial banks and KAFC, which be selected on the basis of specific eligibility criteria, and will be responsible for identifying prospective sub-borrowers.

Structured Finance Facility (US$1.0 million, all financed from the IDA Credit)

This sub-component will be the “learning” part of the credit line, and will test innovative financing schemes for Kyrgyzstan, through: (a) facilitating establishment of contractual arrangements throughout agricultural value chains, in particular, between producer organizations, agro-processing companies and marketing companies, and (b) introducing banks to transaction finance, such as warehouse-backed risk mitigation tools.

The structured finance sub-component will have two main products. The first product will be transaction finance working capital loans to agro-processing companies, involving *managed warehouses and insurance of goods* as risk management tools for the participating financial institutions. An option of using warehouses as price risk management tool to finance working capital loans for improvement of marketing efficiency, both for agro-processors and producer organizations, will also be considered.

In principle, such transaction financing is very relevant for commodity companies without track records, as it allows the lenders to reduce the risk profile of the transaction they are financing, as well as allows to expand the borrower's collateral base. The credit enhancement provided by structured finance lies in the fact that banks have greater control over the commodity and financing flows. The traditional balance-sheet lending requires knowing the real value of the balance sheet, while in structured finance deals much less emphasis is placed on the value of the balance sheet, enabling banks to isolate the financing of sound transactions from the overall accounts of the company. It is expected that the training and piloting of deals with the PFIs will work as a catalyst for future development of structured finance in Kyrgyzstan.

The second product will provide seasonal working capital loans to allow pre-financing agricultural production in contractual farming schemes, financing of marketing contracts, and other similar types of contractual arrangements with agro-producers. A precondition for beneficiaries under this sub-component will be a signed / preliminary agreed forward contract. The maximum loan amount will be US$ 200,000 equivalent (aggregate of sub-loans A and B).

Credit Line Management Unit (US$0.265 million, of which $0.105 million financed from the PHRD Cofinancing Grant and US$0.16 million financed from the IDA Credit)

A separate management unit - Credit Line Management Unit (CLMU) - will be used for implementation of this component. The Component will use the PMU of the Second Rural Finance Project (RFP II), as during its operation, the PMU has developed the necessary capacity and specific skills to administer implementation of all aspects of credit lines. The PMU has been staffed and supplied with the necessary equipment and software, and fully equipped to assume management of the credit line component, liaising with the commercial banking sector, financial management, disbursement, and other day-to-day administrative tasks. (For more details on the implementation arrangements please see Annex 4.)

Component 3 : Project Monitoring and Advisory Office ($0.15 million, of which $0.11 million financed from the PHRD Cofinancing Grant and $0.04 million from the IDA Credit)

A Project Monitoring and Advisory Office (PMAO) will be established in the MAWRPI on the basis of the existing Project Preparation Unit. Its functions will include overall monitoring of the Project and management of the public-sector capacity building activities included in the Project. As part of its monitoring functions, the PMAO will carry out environmental monitoring for the Project as specified in the ABMP Environmental Impact Assessment. The PMAO would be responsible for identifying issues related to implementation of the Project that might require attention and possible follow up action by Government and/or IDA. The PMAO will also be responsible for summary reporting on the Project, based on reports provided by the ABCC and the CLMU, and other sources. The PMAO would have a staff of three, with a Director, Project Monitoring Officer, and Office Assistant.

5. Financing

Source:		($m.)
BORROWER/RECIPIENT		.22
INTERNATIONAL DEVELOPMENT ASSOCIATION		8.5
FOREIGN MULTILATERAL INSTITUTIONS (UNIDENTIFIED)		4.75
	Total	13.47

6. Implementation

Financing of the Project is being shared with the Government of Japan, which is providing a US$4.75 million PHRD Cofinancing Grant. The PHRD Cofinancing Grant will play a critical role in financing the consultant services included in the Project. It will be used to finance the following activities by sub-component:

(1) the Market Development Sub-Component – the staff costs of the ABCC and the MDS (local consultants), consultant services for capacity building of the ABCC which will take place during the first two years of project implementation, and the costs of the TA packages for clients of the ABCC;
(2) the Public Sector Capacity Building Sub-Component – consultant service and training costs;
(3) the Technical Assistance to the Commercial Banking Sector Sub-Component – the major share of the of the TA for the participating financial institutions;
(4) the Credit Line Management Sub-Component – costs of the CLMU specialists (local consultants); and
(5) the Project Monitoring and Advisory Component – costs of the PMAO specialists (local consultants).

The IDA Credit will finance the Investment Credit Sub-Component, the Revolving Working Capital Fund Sub-Component, the cost of all goods and works (net of taxes), operating costs of the ABCC, the PMAO, and the CLMU, and the program of foreign training for the ABCC staff. The IDA Credit will also finance the export promotion sub-component (consultant services) and a portion of the TA for participating financial institutions. The Government will finance the cost of taxes associated with the Project.

The Supervisory Board of the ABCC will be established to allow for broader stakeholder involvement in the Project. One of the key functions of the Board will be to coordinate with the activities of other donors working in areas such as agribusiness development, marketing, support to producer organizations, and export promotion. Implementation of project interventions, particularly for the supply chain management and export promotion, will need to be sufficiently flexible to fit with ongoing and planned activities by the other donors. *During appraisal the* *other donors will be contacted with respect to coordination between their ongoing and planned efforts and the work foreseen under the ABMP.*

The Project will adhere to the principle of objective, business-oriented control of resource allocation decisions. As described above, an independent agency – the ABCC – will be established for the Market Development Component, and the existing PMU for the Second Rural Finance Project will be used for the Access to Credit Component. Monitoring and reporting tasks for the Project as a whole will be carried out by a small Project Monitoring and Advisory Unit, which will be based in the Ministry of Agriculture, Water Resources, and Processing Industry.

<u>Agribusiness Competitiveness Council</u>: The establishment of the ABCC has the following objectives:

- Efficient implementation and monitoring of the technical assistance delivered to Kyrgyz enterprises;
- Building the consulting capabilities and development of the Kyrgyz consulting market;
- Reporting on component activity to the PMAO and the Consultative Council;

In order to achieve those objectives the ABCC should have very capable and honest management reflecting the following characteristics:

- Independent (to the extent possible) from political and anti-competitive business interests
- Staff who speak fluent English;
- Staff with good writing skills in English, Kyrgyz, and Russian;
- Staff preferably with Western business education, i.e., American or European MBA; or, as an alternative, staff with solid experience in consulting in the Kyrgyz context (or teaching experience at a business school) in addition to Western experience;
- Leadership efficient in communicating with Government officials regarding the Market Development Component's objectives, methods and expected results; able to ensure positive relationships with all stakeholders;
- An open-minded Director with excellent analytical, learning and communication skills, and preferably managerial skills.

The key success factor of the Market Development Component lies in the ability of ABCC Director to build within the first year of implementation a management team with high integrity and capabilities:

1. To evaluate consulting proposals and assess the work of individual local and foreign consultants as well as the work of international consulting firms involved in the Project;
2. Based on these evaluations, to make optimal decisions in managing the Project;
3. To inspire and motivate local consulting teams to develop professionally and to ensure their efficient work in enterprises;
4. To effectively communicate results to the Government of Kyrgyzstan.

The objective criteria for selection of the Director will be set at Appraisal [and be reflected in the set of negotiated documents (finalized PAD, Credit Agreement, and Minutes of

Negotiations)]. The short list of candidates will be subject to IDA's prior review and 'no objection'. A simple English written test (including substantive content on finance and marketing) will be used to screen shortlisted candidates.

Since the ABCC will be accountable for the effectiveness of the Market Development Component, it is critical to have procurement in-house and under the direct supervision of the ABCC Director. Management of the ABCC will play the critical role in evaluating implementation of consultant TORs and in processing of consultant contracts.

<u>Project Management of the Access to Credit Component:</u> The Access to Credit Component will be coordinated by the PMU of the Second Rural Finance Project (closing date June 30, 2005). The PMU, which under the ABMP will be renamed the Credit Line Management Unit (CLMU), has experience in implementing credit lines, communicating with the banking sector, and performing financial management, disbursement, and other day-to-day administrative functions. The main responsibilities of the CLMU will include: (a) monitoring compliance by the PFIs with terms and conditions of subsidiary loan agreements and the credit guidelines; (b) ensuring that intended beneficiaries are receiving support; (c) performing the financial management, including disbursement, functions for the Project Activities; (d) monitoring the implementation of the technical assistance to the PFIs and providing feedback to the consultants; and (e) providing reporting and ensuring feedback to the PIU, the Consultative Council, and IDA on this Component.

The Ministry of Finance (MOF) will sign Subsidiary Loan Agreements (SLA) with the (PFIs), and the CLMU will ensure enforcement of the of the applicable guidelines for on-lending facilities and transfer the Credit Line funds to the PFIs on behalf of the MOA and MOF. The MOF will also be responsible for (i) calculating the interest rate due on the subsidiary loan agreement, and notifying the PFIs on the amount due; (ii) devising the repayment schedule for the principal amount of the subsidiary loan; and (iii) ensuring compliance of the PFIs with the respective subsidiary loan repayment schedule.

<u>Project Monitoring and Advisory Unit:</u> To assure high quality of the monitoring and evaluation of the Project, an overall PMAO will be established within the MAWRPI. The PMAO will be in charge of monitoring the performance of both components, including monitoring of environmental issues, and providing consolidated reporting on implementation of the Project as a whole. The PMAO will report to the MAWRPI, the Consultative Council and IDA. The unit will be composed of 3 staff (Director, Project Monitor, and Assistant).

7. Sustainability

Sustainability of Project interventions will be enhanced by their market and demand-driven approach, carried out primarily in the domain of the private sector. The Project focuses on capacity building and through the supply chains that will be addressed, will provide a model for improved performance more broadly through the economy. The skills that will be developed, including those within the ABCC, will remain available to the country following the close of the

Project. The Project will contribute to a stronger group of business interests to push a pro-market agenda further in Kyrgyzstan.

The World Bank's own past experience with credit line operations in the Kyrgyz Republic, the Rural Finance II Project being the most recent one, indicates that the private sector has the technical and managerial ability to successfully tap market opportunities, provided they have access to appropriate financing (e.g., in terms of pricing and maturity), and the PFIs are qualified to make lending decisions and are free from political influence. Both of these conditions will be met in the ABMP. The Project will also encourage PFIs to broaden their lending base beyond that which they currently serve.

8. Lessons Learned from Past Operations in the Country/Sector

The ABMP task team has carefully reviewed the experience of other donors in Kyrgyzstan and is working actively with these organizations. The task team has also carefully reviewed the Bank's own experience in SME development, export promotion, and projects that addressed development of farm producer organizations in ECA and other regions. The major lessons are that for projects of this type there needs to be an appropriate delineation between public and private sector roles and a cooperation between the two, a comprehensive and professionally competent oversight of efforts to strengthen supply chains and build trade linkages, a careful combination of international and local skills so as to build needed domestic skills and capacities, and a critical mass of interventions to be able to deal with the issues in a comprehensive manner.

Some of the projects that were reviewed in detail were found to be very valuable for the design of the ABMP: The Georgia Enterprise Rehabilitation Project and the Moldova First Private Sector Development Project have a number of attractive elements, including the effective combination of international and domestic expertise and an effective delineation of private vs. public sector roles. The ABMP team is using experience and staff from the Georgian Project for the MDC. Export promotion projects that were reviewed included the Senegal Agricultural Export Promotion Project and the Bangladesh Agricultural Services Innovation and Reform Project. Important lessons from these projects were the need for comprehensive and competent private sector management of supply chains, with careful control of non-business oriented influences.

The task team has also reviewed carefully the work of other donors in Kyrgyzstan working in the area of agri-business and marketing . Efforts very closely linked with the ABMP have been underway by the Swiss Cooperation Office, carried out by Helvetas, in the development of the fruit and vegetable processing industry, and by USAID, carried out by Pragma, in SME development, increased competitiveness, and export promotion. Other donor interventions also touch upon issues to be handled by the ABMP (see Annex 2). Those interventions have clearly demonstrated the challenging competitive environment facing Kyrgyz suppliers of agro-food commodities. They have made progress in working with Kyrgyz counterparts in this area and are generating a great deal of information. The primary lesson learned for the ABMP is confirmation of the need to bring a comprehensive set of interventions to bear on the problems, and to do this in a way that builds upon the ongoing and planned interventions of other donors.

9. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment (OP/BP/GP 4.01)	[X]	[ ]
Natural Habitats (OP/BP 4.04)	[ ]	[X]
Pest Management (OP 4.09)	[ ]	[X]
Cultural Property (OPN 11.03, being revised as OP 4.11)	[ ]	[X]
Involuntary Resettlement (OP/BP 4.12)	[ ]	[X]
Indigenous Peoples (OD 4.20, being revised as OP 4.10)	[ ]	[X]
Forests (OP/BP 4.36)	[ ]	[X]
Safety of Dams (OP/BP 4.37)	[ ]	[X]
Projects in Disputed Areas (OP/BP/GP 7.60)*	[ ]	[X]
Projects on International Waterways (OP/BP/GP 7.50)	[ ]	[X]

10. List of Factual Technical Documents

11. Contact point
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* *By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas*