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Report No: 30703

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED CREDIT

IN THE AMOUNT OF SDR 5.5 MILLION
(US$ 8.1 MILLION EQUIVALENT)

TO THE

KYRGYZ REPUBLIC

FOR AN

AGRIBUSINESS AND MARKETING PROJECT

November 16, 2004

Environmentally and Socially Sustainable Sector Unit
Central Asia Country Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of November 10, 2004)

Currency Unit	=	Kyrgyz Som (KGS)
KGS 41.6532	=	US$1
US$ 0.02401	=	KGS 1

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

ABCC	Agribusiness Competitiveness Center
ABMP	Agribusiness and Marketing Project
ACC	Access to Credit Component
ADB	Asian Development Bank
ASSP	Agriculture Support Services Project
CAS	Country Assistant Strategy
CIS	Commonwealth of Independent States
CLMU	Credit Line Management Unit
DCA	Development Credit Agreement
DFID	Department for International Development (UK)
EA	Environmental Assessment
EBRD	European Bank for Reconstruction and Development
EIA	Environmental Impact Assessment
EMP	Environmental Management Plan
FMR	Financial Monitoring Report
FMS	Financial Management Specialist
GDP	Gross Domestic Product
GOK	Government of Kyrgyzstan
GTZ	Gesellschaft fur Technische Zusammenarbeit
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
ICB	International Competitive Bidding
IFDC	International Fertilizer Development Corporation
IFIs	International Financial Institutions
IMF	International Monetary Fund
IPM	Integrated Pest Management
ISDS	Integrated Safeguards Data Sheet
JICA	Japan International Cooperation Agency
KAFC	Kyrgyz Agricultural Finance Corporation
KAMIS	Kyrgyz Agricultural Market Information Service
KGS	Kyrgyz Som
KICB	Kyrgyz Investment Credit Bank
MAWRPI	Ministry of Agriculture, Water Resources, and Processing Industry
MDC	Marketing Development Component
MDS	Marketing Development Service
MEDP	Mozambique Enterprise Development Project

MEES	Ministry of Ecology and Emergency Situations
MOE	Ministry of Economy, Industry and Trade
MOF	Ministry of Finance
MOH	Ministry of Health
NBKR	National Bank of Kyrgyz Republic
NGO	Non-Governmental Organization
NPRS	National Poverty Reduction Strategy
NPV	Net Present Value
PCN	Project Concept Note
PFI	Participating Financial Institutions
PHRD	Policy and Human Resources Development
PIC	Project Information Center
PID	Project Information Document
PIP	Public Investment Program
PIU	Project Implementation Unit
PMAO	Project Monitoring and Advisory Office
PPU	Project Preparation Unit
RAS	Rural Advisory Services
RFP II	Second Rural Finance Project
RFP	Request for Proposals
RIC	Rural of Investment Constraints
RTP	Regional Trade Promotion
SA	Social Assessment
SECO	Swiss Cooperation Office
SLA	Subsidiary Loan Agreement
SME	Small and Medium Enterprise
TA	Technical Assistance
TIP	Trade and Investment Project
TLC	Trade Linkage Contractor
TOR	Terms of Reference
USAID	United States Agency for International Development
VAT	Value Added Taxes
VIP	Village Investment Project
WTO	World Trade Organization
WUA	Water User Association

Vice President:	Shigeo Katsu
Country Manager/Director:	Dennis de Tray
Sector Manager:	Joseph Goldberg
Task Team Leader:	Edward C. Cook

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KYRGYZ AGRIBUSINESS AND MARKETING PROJECT

PROJECT APPRAISAL DOCUMENT

EUROPE AND CENTRAL ASIA

ECSSD

Date: November 11, 2004 Country Director: Dennis N. de Tray Sector Manager/Director: Joseph R. Goldberg	Team Leader: Edward C. Cook Sectors: Agricultural marketing and trade (85%);Agro-industry (15%) Themes: Rural markets (P);Rural policies and institutions (P);Rural non-farm income generation (P);Rural services and infrastructure (P)
Project ID: P049724	Environmental screening category: Partial Assessment
Lending Instrument: Specific Investment Loan	Safeguard screening category:

Project Financing Data

[ ] Loan [X] Credit [ ] Grant [ ] Guarantee [ ] Other:

For Loans/Credits/Others:
Total Bank financing (US$m.): 8.10
Proposed terms:

Financing Plan (US$m)

Source	Local	Foreign	Total
BORROWER	0.13	0.00	0.13
INTERNATIONAL DEVELOPMENT ASSOCIATION	0.00	8.10	8.10
GOVERNMENT OF JAPAN	0.00	4.75	4.75
Total:	0.13	12.85	12.98

Borrower:

Kyrgyz Republic

Responsible Agency:
Ministry of Finance, Ministry of Economic Development, Industry and Trade, and Ministry of Agriculture, Water Resources and Processing Industry

Estimated disbursements (Bank FY/US$m)

FY	2005	2006	2007	2008	2009	2010	2011
Annual	0.11	1.22	1	1.6	1	1.2	0
Cumulative	0.11	1.33	3	4.6	6	7.5	8

Project implementation period: Start March 14, 2005 End: June 30, 2010
Expected effectiveness date: March 14, 2005
Expected closing date: December 31, 2010

Does the project depart from the CAS in content or other significant respects? ***Ref. PAD A.3***	[ ]Yes [X] No
Does the project require any exceptions from Bank policies? ***Ref. PAD D.7*** Have these been approved by Bank management? Is approval for any policy exception sought from the Board?	 [X]Yes [ ] No [X]Yes [ ] No [ ]Yes [X] No
Does the project include any critical risks rated "substantial" or "high"? ***Ref. PAD C.5***	[ ]Yes [X] No
Does the project meet the Regional criteria for readiness for implementation? ***Ref. PAD D.7***	[X]Yes [ ] No

Project development objective ***Ref. PAD B.2, Technical Annex 3***

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 build trade linkages between producers, and primary and secondary level trade organizations. The Project will work directly with private enterprises and 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 agricultural markets

Project description *[one-sentence summary of each component]* ***Ref. PAD B.3.a, Technical Annex 4***

The ABMP will have two components, the Market Development Component and the Access to Credit Component. 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 critical factors here will be capacity building and establishing a framework for effective interaction among economic agents. The Access to Credit Component is designed to address key constraints associated with access to capital by enterprises in the agricultural and food sector of the economy. Except for some of the larger food processors, enterprises in this sector of the economy are not currently able to access credit from financial institutions

Which safeguard policies are triggered, if any? ***Ref. PAD D.6, Technical Annex 10***

The only safeguard policy triggered is the Environmental Assessment. An environmental chapter of the Operations Manual (OM) will be prepared describing the procedures and arrangements to assure subprojects compliance with the national environmental regulations and Bank policy on Environmental Assessment.

Significant, non-standard conditions, **if any**, for:
Ref. PAD C.7
Board presentation:
N/A

Loan/credit effectiveness:
Establishment of the Agribusiness Competitiveness Center.

Covenants applicable to project implementation:
The Borrower shall ensure:

(a) that within six months after the effectiveness of the DCA, the ABCC has been staffed and is fully operational, with structure, functions necessary to carry out the implementation of the Market Development Component of the Project;

(b) that not later than March 31, 2006, the ABCC's financial management system has become operational and is acceptable to the Association; and

(c) that CLMU's financial manager carries out the accounting requirements for the ABCC until the financial management system of ABCC has been found acceptable by the Association

A. STRATEGIC CONTEXT AND RATIONALE
1. Country and sector issues

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 also 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, and 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 they 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 by 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 lack 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. 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 (see Annex 2). 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.

3. Higher level objectives to which the project contributes

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.

B. PROJECT DESCRIPTION

1. Lending instrument

The lending instrument for the ABMP will be an IDA Credit in combination with a PHRD Cofinancing Grant from the Government of Japan. For the IDA Credit, the Government of the Kyrgyz Republic would borrow at standard IDA terms, with 40 year maturity and a 10 year grace period.

2. Project development objective and key indicators

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
- Number of loan officers trained.

3. Project components

The Project will work with commodities for which viable import substitution, export development opportunities, or inefficient functioning of domestic markets has 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. Cost tables for the Project, including information by financing source, are provided in Annex 5.

Component 1: Market Development Component ($6.74 million, of which PHRD Cofinancing Grant $3.97 million, IDA Credit $2.64 million, and Government $0.12 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 ($4.39 million of which PHRD Cofinancing Grant $3.87 million and IDA Credit $0.52 million); (ii) Export Promotion ($1.25 million, of which IDA

Credit $1.13 million and Government $0.12 million); (iii) Public Sector Investment Program ($1.00 million, all IDA Credit); and (iv) Public Sector Capacity Building ($0.10 million, all PHRD Cofinancing Grant).

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. During the appraisal mission, agreement was reached on the draft legal documents for establishment of the ABCC. Agreement was also reached on the process of selection of the Director of the ABCC. The Ministry of Finance will take responsibility for overseeing a tender for this position, including the publication of the request for expressions of interest, composition of the evaluation committee, and submission to IDA of the evaluation report for review. Agreement was reached during the mission of key eligibility criteria for this position to be included in the expression of interest. *Issuing of a Government resolution legally establishing the ABCC is a condition of effectiveness.*

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, chaired by the Ministry of Economy, Industry and Trade, and consisting of the MAWRPI, 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 will be set in the range of 3-20 percent. 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 functions and structure of the MDS are described in Annex 4.

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, except for 10 percent of the costs of the international TA.

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 by the ABCC 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. The ABCC will approve proposals for use of funds allocated for the public sector investment program, which will then be cleared by Government and sent to IDA for appraisal and no-objection. The appraisal of sub-projects under this sub-component will be undertaken as part of supervision of the Project.

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 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 private sector beneficiaries. 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 ($7.87 million, of which PHRD Cofinancing Grant $0.70 million, IDA Credit $5.27 million, PFIs $0.65 million, and beneficiaries $1.25 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 (US$ 0.69 million, of which PHRD Cofinancing Grant US$ 0.53 million and US$ 0.16 million from the IDA Credit); (ii) Investment Credit Facility (US$ 5.52 million, of which US$4.0 million financed from the IDA Credit, US$0.52 million from the PFIs, and US$1.00 million from beneficiaries); (iii) Structured Finance Facility (US$1.38 million, of which IDA US$1.00 million, PFIs US$0.13 million, and beneficiaries US$0.25 million); and (iv) Credit Line Management Unit (US$0.28 million, of which US$0.17 million financed from the PHRD Cofinancing Grant and US$0.11 million from the IDA Credit).

Technical Assistance to the Commercial Banking Sector

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

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 their 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

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 a 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 both facilities).

Credit Line Management Unit

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 ($0.10 million, of which $0.08 million financed from the PHRD Cofinancing Grant and $0.02 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, consisting of three staff: Director, Liaison Officer, and Assistant. Its functions will include: (a) acting as the liaison between the MAWRPI and the MOEIT with respect to the Project's activities; (b) having responsibility for implementation of the Public Sector Capacity Building sub-component, on the basis of decisions of the Supervisory Board of the ABCC; (c) acting as liaison for the flow of information between the MAWRPI and the ABCC; and (d) acting as the liaison between the MAWRPI and the CLMU in respect of the Project monitoring data reflected in the Financial Monitoring Reports (FMR).

4. Lessons learned and reflected in the project design

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.

5. Alternatives considered and reasons for rejection

Public-sector orientation – Early in preparation the Task Team considered building the Project around a more traditional set of public sector interventions. It soon became apparent that this approach would not have sufficient impact on the set of challenges being faced to be able to deliver the intended outcomes and results.

Traditional PIU – Most projects in Kyrgyzstan financed by multilateral financial institutions utilize project implementation units within a Government implementation agency. The experience on this approach has been mixed. Given the need to shift orientation away from traditional public-sector interventions for the ABMP, the rationale for a traditionally organized project implementation unit did not make sense. This is supported by the experience of similar projects in implementation elsewhere in the ECA region.

Expatriate contractor control – The Task Team reviewed a number of SME development and export promotion projects (in particular the Mozambique Enterprise Development Project) that were based on contracting out key management functions to international consulting firms, and were successful in delivering anticipated results. This model could not be applied to Kyrgyzstan without modification due to its relatively high costs and to the priority expressed by Government for development of local consulting capacity.

Greater a priori determination of Project design – The Task Team had wanted to push for greater specificity with respect to the commodities to be handled by the Project and to the public sector constraints that were impacting on competitiveness of Kyrgyz suppliers. Deeper analysis showed, however, that these questions could be adequately answered only on the basis of fairly intensive interaction with private sector actors, and in any case should be kept flexible to allow for new information and changing economic circumstances.

C. IMPLEMENTATION

1. Partnership arrangements (if applicable)

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).

A full breakout of the Project costs financed by the PHRD Grant are provided in Annex 5.

The IDA Credit will finance the Investment Credit Sub-Component, the Structured Finance Facility Sub-Component, the cost of all goods and works, 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 ABCC and its Supervisory Board will be established to allow for broader stakeholder involvement in the Project. One of the key functions of the ABCC and its 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.

2. Institutional and implementation arrangements

The Project will adhere to the principle of objective, business-oriented control of resource allocation decisions by providing bottom-up input from the private sector.

Agribusiness Competitiveness Center: 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 Supervisory Board of the ABCC.

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 with good verbal and writing skills in English, Kyrgyz, and Russian;
- Staff preferably with Western business education, 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 the 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 criteria for selection of the Director is reflected in the Minutes of Negotiations. The results of the evaluation committee's work will be subject to IDA's prior review and 'no objection'.

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.

Project Management of the Access to Credit Component: 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, including the environmental aspects; (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 on the Access to Credit Component, as well as consolidating the progress reports for the whole project for presentation to the Government, IDA and other relevant parties..

The 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 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.

Project Monitoring and Advisory Office: The PMAO will be established in the MAWRPI. It will oversee the Public Sector Capacity Building sub-component and act as liaison between the MAWRPI and other organizations involved in Project implementation, including the MOETI, the CLMU, and the ABCC.

3. Monitoring and evaluation of outcomes/results

Key results indicators for the Project will be:

- Increase in sales of enterprises supported by the Project
- Increase in profits of enterprises supported by the Project
- The number and volume of loans to project beneficiaries
- The repayment performance of loans extended (recovery rate, arrears, etc.)
- Number of PFIs participating in the Project
- Number of loan officers trained

These data will be available from the participating enterprises and marketing organizations, and from the participating financial institutions. The ABCC will be responsible for gathering relevant data from participating enterprises and organizations on a regular basis using a participant enterprises feedback survey method. The CLMU will be responsible for monitoring the lending progress in the PFIs, and collecting the relevant information from them. The CLMU will summarize and analyze the collected information, and provide reports to MAWRPI, MOF, IDA and other project stakeholders.

Key outcome indicators for the Project will be:

- Increased share of agricultural production being processed
- Increased institutional lending to agro-industrial clients.

These data will come from available national statistics, progress reports of the PFIs, and reports of the NBKR.

4. 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.

5. Critical risks and possible controversial aspects

Weak institutional capacity – Both the private and public sectors in Kyrgyzstan are characterized by weak institutional capacity. The Project will directly address this issue by building up domestic business and consulting service skills, and by providing training and technical assistance to public sector organizations and to participating financial institutions. For success of the Project, it will be very important to locate the required caliber of leadership for the ABCC along with highly qualified staff. This in turn will likely require Government agreement to permit pay scales above those common for other IDA financed projects,

Business environment – While the Project will be working with specific commodities and enterprises, the Project will not have the weight to address macro-level issues that influence the business environment. The strategy of the Project will be to identify regulatory and policy constraints for the commodities included in the supply chain work. The ABCC and its Supervisory Board will serve as the forum for vetting identified business constraints at a high level in Government. At the same time, the Project will need to be supported by continued donor-Government dialogue on systemic business environment issues.

Commercial risk – Commercial risk will be addressed by using a demand-driven approach, which will only support commodities that have clear market demand and where the needed interventions for success are clearly defined and lower-risk. Risk will be addressed by support to complete supply chains, and will also be spread by addressing a number of different commodities. As described above, there is a large market in Russia for products that Kyrgyzstan can supply if Kyrgyz suppliers can improve their ability to meet buyers' requirements.

Political risk – It is critical that decisions about allocation of resources for the private sector be made by the private sector. The Project draws on demonstrated best practice by putting responsibility for management of issues associated with supply chains on a professional and objective basis, based on commercial expertise rather than political considerations. The Supervisory Board of the ABCC will serve as a vehicle for raising issues associated with political influence over private sector decisions. TA and training will be provided to relevant Government agencies to support development of market-oriented public-private relationships.

Borrowing for TA – By the nature of the Project, technical assistance will be crucial. Government has been reluctant to borrow for technical assistance. Provision by the Government of Japan of the Cofinancing Grant of US$ 4.75 million will go a long way to covering the consultant service requirements for the Project. At the same time, the strategy of the Project will be to build local capacity as quickly as possible. This will require careful design of the terms of reference for the international consultants that focuses their work on transferring skills to Kyrgyz specialists. Appropriate incentives and performance indicators, careful monitoring of consultant performance, and adequate redress in case of under-performance will be needed.

Private sector and picking winners – Concern has been raised about the extent of the private sector interventions planned under the Project. The Task Team's position is that interventions in the public sector, while important for achieving the goals of the Project, will not allow for achievement of the Project objectives. There are significant constraints in the private sector that will have to be addressed. Experience on this has been gained from numerous Bank projects in ECA and in other regions. The Project design also includes an open, business oriented process for selection of commodities that will be handled under the Market Development Component.

Project complexity – The Project has just two components, but each of them will be demanding in their own right in implementation. This will require careful and intensive supervision, particularly in the first two years of implementation. The Access to Credit Component in many respects follows on the implementation practice of the Rural Finance II Project, and expertise from the RF II has been incorporated into the ABMP team. Similarly, it is planned to draw on accumulated expertise in the Georgia and Moldova projects for assistance in guiding implementation of the Market Development Component.

6. Loan/credit conditions and covenants

Prior to Effectiveness:

Government shall establish the ABCC in an adequate legal form satisfactory to IDA.

Dated Covenants:

The Borrower shall ensure:

(a) that within six months after the effectiveness of the DCA, the ABCC has been staffed and is fully operational, with structure, functions necessary to carry out the implementation of the Market Development Component of the Project;
(b) that not later than March 31, 2006, the ABCC's financial management system has become operational and is acceptable to the Association; and
(c) that CLMUs' financial manager carries out the accounting requirements for the ABCC until the financial management system of ABCC has been found acceptable by the Association.

Management:

Throughout the implementation of the project, the CLMU, the ABCC and the PMAO will be maintained with a sufficient number of staff, adequate resources and terms of reference satisfactory to the Association.

Project Implementation:

Standard financial covenants applicable to investment projects, including accounting system, audit, and financial monitoring reports (FMR);

Monitoring, Review and Reporting:

Government will maintain policies and procedures adequate to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association, the carrying out of the project and the achievement of the project's objectives; and

Quarterly progress reports will be submitted to government and IDA not later than 45 days after the end of each quarter.

D. APPRAISAL SUMMARY

1. Economic and financial analyses

The economic benefits of the Project will accrue through two channels: (i) direct interaction with clients of the ABCC; and (ii) assistance to other private sector actors, improvement in the functioning of markets, and enhanced public sector capacity. The second channel of benefits will be realized through the public sector work of the Project on infrastructure and capacity enhancement, introduction of necessary regulatory and policy changes, work of the MDS which is provided to organizations that are not included in the programs of TA run by the ABCC, provision of credit under the two credit lines, and capacity building of participating financial institutions.

The Access to Credit Component will provide two-fold benefits:

(a) ***increase capacity and willingness of commercial lenders*** to lend for, currently underserved, agricultural and agri-business clients, by improving the relevant loan appraisal skills in the banks, and providing them with a set of tools allowing for improved risk management in agricultural lending. The technical assistance activities are designed to trigger increased lending to the agricultural and agro-processing sectors, as banks will be able to apply the new skills, and are thus expected to complement the project funds with other available funding.

(b) ***increase the overall investment* in the agricultural and agro-processing sector.** Based on the lending activities for agro-processing in KAFC and the commercial banking sector, it is projected that during the project period, in addition to the US$ 5 million made available under the project, the commercial banks and KAFC will make additional loans to agro-processing and marketing companies in the amount of US$ 5 million equivalent from their own funds or other available credit lines.

Because of the diverse nature of these benefit streams, an overall economic and financial analysis for the Project has not been undertaken. However, analysis of the specific benefits to the budget has been carried out for the first channel listed above – direct interaction with clients of the ABCC and is described in Annex 9. The Access to Credit Component, will provide two demand driven credit lines and it is not possible to foresee the specific activities that will be financed. However, according to the lending guidelines for participating financial institutions, each sub-loan approved will be required to have rates of return above on-lending rates of interest and to demonstrate the repayment capacity of the borrower. An estimation of the financial benefits of the use of the structured finance mechanism is provided in Annex 9.

2. Technical

Not applicable.

3. Fiduciary

Procurement Issues

The Bank finalized the country procurement assessment for the Kyrgyz Republic in December 2002. As a result of the findings of this assessment, the Kyrgyz Republic has been ranked as a high-risk category country from the public procurement point of view. Training programs to train public officials in procurement according to the law are not well developed and implemented. The process of procurement in the country is not totally transparent, tenders are not advertised properly, and frequently the procurement conducted by tender committees is not consistent with the provisions of the law. There have been instances of public officials' interference in the procurement process. As a result, the general economic environment in the Kyrgyz Republic is not yet fully conducive to transparent, economic, and efficient procurement. Improvements are expected from 2005 onwards, as Parliament is currently discussing new procurement provisions.

A procurement officer will be hired to work full time for the ABCC. The major share of procurement under the Project will be for consultant services (QCBS, Consultants Qualifications, and Individual Consultants), most of which for the Market Development Component. It is important that the tendering process be managed by the ABCC, as they will be the ones intimately aware of the professional requirements, term, and scope of the assignments, and will generate experience and insight for modification of the TORs for this work over the life of the Project. Consultant services for the Access to Credit Component can also be handled through the ABCC procurement officer. The terms of reference for these assignments will be prepared jointly by the CLMU, PFIs, and Government, with advisory input from IDA.

There will be limited procurement of goods and equipment under the Project. The larger contracts for goods, which will come under the Public Infrastructure Sub-Component, cannot be identified at this stage, as they will depend on input from private sector clients during the course of implementation. Under the Public Infrastructure Sub-Component there is a possibility of procurement of works associated with improvement of physical marketing infrastructure. But these requirements, likewise, cannot be specified prior to input from those involved in marketing chains that will come during implementation.

Terms of reference for the procurement officer were agreed at appraisal and the position will be tendered following appointment of the Director of the ABCC. It is anticipated that individuals with experience in IDA procurement procedures will be interested in applying. Following selection of the procurement officer, a program of training will be identified and offered as appropriate through the Bishkek Resident Mission. To cover the period up to selection and training of the procurement officer in the ABCC, it was agreed at appraisal that the procurement officer to be moved to the PMU of the Rural Finance II Project to handle procurement for the GTAC Project would also handle procurement functions for the ABMP. Following their appointment, the Director and Deputy Director of the ABCC will also receive basic training in IDA procurement procedures to ensure that they have adequate background to oversee this work.

During the first two years of implementation, there will be a program of capacity building for the ABCC that will provide training for all staff on substantive and administrative issues (see Annex 6). The consultants providing this program will also take an active role in preparing the terms of reference for the early round of procurement of TA packages for the Supply Chain Management Sub-Component.

The ABCC will open a file for each contract package and all procurement correspondence and other relevant documents such as draft and final bidding documents, minutes of bid opening, evaluation reports, minutes of contract negotiations, draft RFPs, and draft and final contracts will be filed. This will not only make the implementation work more efficient but also allow IDA staff and independent auditors to conduct their functions of supervision and audit more efficiently.

Financial Management

Financial management, including disbursements, special account operations and preparation of FMRs for both IDA-financed and PHRD-financed parts of the Project, will be undertaken by the CLMU, which will be the new name of the PMU of the RFP II.

The World Bank Financial Management Specialist conducted a financial management capacity assessment of the PMU of the Rural Finance II Project in the Fall of 2003, and reached the conclusion that the Unit's capacity is adequate for carrying out all tasks related to the Project's financial management, disbursement, and overall credit line implementation. This was reconfirmed during the appraisal mission for the ABMP. Upon a thorough review of the RFII PMU, including topics such as staffing arrangements, staff experience, including implementing donor-funded projects, accounting procedures, accounting systems, financial reporting, internal controls, and physical infrastructure (hardware and software), and concluded that the PMU's financial management capacity and arrangements are acceptable to IDA.

The Unit is currently using accounting software 1C Enterprise System, which will be modified to embrace both project implementation progress and financial management aspects. The Unit staff have been trained in the application of the software. The changes necessary to allow for initial ABMP-related tasks to run in parallel to the tasks of the Second Rural Finance Project will be introduced to the system by effectiveness.

The Financial Management Manual will be finalized by the Board date. The Manual sets out the relations, tasks and responsibilities of the parties involved in the financial management tasks, internal control procedures, disbursement, as well as specify the flow of documents. The Unit has a FM Manual acceptable to IDA for the purposes of implementation of RFP II. Draft of a similar manual for the ABMP has been developed, and comments from the FMS have already been obtained. After the required changes will be made, the CLMU staff will send the final version to the FMS for clearance.

Financial Management capacity of the Agribusiness Competitiveness Center (ABCC). The ABCC will be set up as an independently-operated Government-owned legal entity. In view of the substantial financing the ABCC will receive under the Project, it requires full financial management capacity. During Negotiations, it was agreed that the ABCC's financial management system will be fully implemented and operational no later than March 31, 2006. Upon completion of the setting-up of the financial management system, the ABCC will undergo the financial management assessment by the IDA's financial management specialist. In the meantime, to permit take-off and operation of the ABCC, the CLMU financial manager will temporarily handle the accounting requirements for the newly established entity.

4. Social

The ISDS Review Meeting concluded that no social safeguards are triggered by the Project. It is expected that no land will be expropriated in any of the physical investments for which funds may be borrowed by enterprises under the Credit component. Land transactions, if any, will be private, on a willing-seller/willing-buyer basis. Under the Market Development Component for Public Infrastructure there will be no new construction requiring acquisition of land through eminent domain, and will be limited to rehabilitating existing structures.

A Social Assessment (SA) was carried out assessing the views of private sector stakeholders, including producers, processors, marketers, warehousers, and transporters. The SA is available in the project files. The major finding of the SA was the lack of trust among marketing chain participants, highlighting areas of mutual interaction that are of particular concern. The Project, by its nature, will bring together participants with differing and conflicting sets of interest. The clearest example of this is the fact that producers of agricultural commodities are seeking to sell high, while processors and marketers, who are purchasing agricultural commodities are seeking to buy low. This situation needs to be handled by a impartial and professional mediator within the Project. This function is to be carried out by the ABCC. The SA also confirmed that producers are in a generally weak position vis a vis other parties in the marketing chains. Attention will need to be given during implementation of the Project to supporting the interests of producer organizations and to ensure that their interests are fully represented.

The Task Team has met with the key public sector stakeholders in the Project. The major potential conflict here is over the extent to which the public sector should directly control implementation of the Project. As excessive public sector control of private sector activities has led to a string of failures in Kyrgyzstan in improving the situation in the agribusiness and marketing sectors of the economy, the Task Team has stood by the position of a clear delineation of roles by sector, and designed the Project accordingly. This issue will also need to be tracked carefully during implementation.

The forum for discussing potentially conflicting issues associated with the Project will be the Supervisory Board of the ABCC .

5. Environment

Environmental safeguard issues are foreseen with regard to the Access to Credit Component, which will provide credit lines to existing agro-processing enterprises, and with regard to rehabilitation of public infrastructure under the Public Infrastructure Sub-Component of the Market Development Component. The project is not likely to raise any significant pest management issues. The purchase of pesticides is not intended under the project, although the use of pesticides by the sub-borrowers cannot otherwise be precluded.

The safeguard consultation meeting agreed that the environmental category B is appropriate. The ABMP itself is environmentally benign. The overall effect of the sub-projects will be positive. An Environmental Assessment (EA) for the Project has been prepared, translated into Russian and disclosed in Kyrgyzstan, and feedback incorporated. The EA noted possible environmental impacts through financing of agro-processing industries and the potentially stimulating effect of the Project on the use of agricultural inputs.

Mitigation of any environmental effects will be the responsibility of the sub-project proponent. However, it will also be the responsibility of the lending agency, the Ministry of Ecology and Emergency Situations (MEES), concerned public and the CLMU to ensure that mitigation is carried out successfully.

The CLMU will be responsible for monitoring the environmental aspects of the Credit Line implementation. This Unit should have a staff member or a consultant with an environmental background (through training) to ensure that projects being supported are not ones that would unduly affect the environment. The individual would be responsible for screening the sub-project (although the PFI would also provide screening recommendations) that would result in designating the sub-project a World Bank category (A, B or C). Guidelines for screening sub-projects are provided in the Agri-Credit Guidelines. The individual should also be in close collaboration with relevant MEES staff and concerned NGOs.

An important accompanying document to the EA is a set of easy to follow environmental guidelines to be used by those stakeholders (PFIs, MEES, and borrowers) who will have responsibilities for environmental management. The guidelines cover IDA requirements, environmental impact assessment formatting, monitoring instructions and checklists.

The full EA, including the Guidelines for Identification, Assessment and Mitigation of Environmental Impacts of Sub-projects, is available in the Project Files and through the Infoshop. The review of the environmental aspects of the project, including the Environmental Management Plan from the EA, are provided in Annex 10.

6. Safeguard policies

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]

7. Policy Exceptions and Readiness

It was agreed at appraisal, and cleared with the PAS, that procurement functions for the Project will initially be handled by the procurement specialist for the GTAC Project pending effectiveness of the Development Credit Agreement and Letter Agreement for the PHRD Cofinancing Grant, at which time the procurement specialist in the ABCC will be hired, trained and certified.

It was agreed at Negotiations that the Agribusiness Competitiveness Center's financial management system will be fully implemented and operational no later than March 31, 2006, as certified by IDA's financial management specialist (FMS). Prior to this time, the CLMU financial manager will handle the accounting requirements for the newly established entity.

The Project complies with all other Bank policies and is ready for implementation.

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

Annex 1: Country and Sector or Program Background
KYRGYZ REPUBLIC:

AGRIBUSINESS AND MARKETING PROJECT (ABMP)

Macroeconomic Environment

The steady economic growth obtained since 1995 is a response to improved monetary and fiscal management, adherence to IMF guidance, and a willingness to reform and liberalize key economic sectors and policies. GDP has grown at 5.0%-5.5% annually since 2000, and inflation has fallen from 18.7% in 2000 to 3.9% in 2003. Both the budget and current account deficits have also improved since 2000. The budget deficit fell from -9.2% to -4.9% (on a cash basis) of GDP, and the current account deficit fell from -6.6% to -3.4%. Increased tax revenue and improved fiscal management led to the lower budget deficit, and increased exports were the main determinant of the lower current account deficit. External debt fell from 111.1% of GDP to 98.8% of GDP during the same period, and the debt-service to export ratio from 21.7% to 12.3%. The exchange rate has also been stable since 2000. Current IMF projections for 2004-2006 indicate that these trends will continue, with GDP growth forecast at 5.0% annually, and inflation of 3.5% and a budget deficit of 3.0% by 2006.

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. Such high levels of donor funding increase external public debt, with the attendant risks of debt servicing and default. It also creates a high dependence on donor budget support for the provision of even basic public services. To address these problems, the IMF has introduced a debt reduction strategy; based on lower public borrowing, higher tax revenues, and debt rescheduling. Under this program, 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 NPRS for 2003-2006. Targets for the NPRS 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. The impact of higher taxation on private sector activity should be considered carefully in this context.

Continued agriculture growth is central to meeting and reconciling the objectives of the government's NPRS and the IMF. While further public investment is essential for continued sector growth in the short to medium-term; private investment will need to increase significantly if this growth is to be sustainable. Given the small size of Kyrgyzstan's domestic market, increased exports will also be essential for sustained sector growth. At the same time, agricultural producers will be expected to assume a more equitable share of the tax base, and contribute more to the recurrent costs of public service programs such as irrigation and extension. Hence, economy-wide policies affecting private sector activity and investment, foreign direct investment, taxation and trade will all have a bearing on future agriculture sector growth.

Characteristics of Agriculture Sector Growth

Observed agriculture growth is a response to sweeping structural reforms, including a land reform that transferred most arable land to small, private (peasant) farms; the termination of state procurement and government price setting; and the liberalization of agricultural input and output markets. These reforms changed not only the resource base of peasant farmers, but also their incentives to produce. A concomitant increase in producer prices further enhanced producer incentives. Profound shifts in the level and composition of output have occurred as a result. Major investments have also been made in irrigation, to rehabilitate physical infrastructure and establish Water User Associations (WUAs). The full impact of this investment in irrigation has yet to be felt, however, as most farmer beneficiaries are not yet in a position to take full advantage of their improved access to water.

Preliminary analysis (drawn from on-going World Bank analysis) indicates that agriculture sector growth for the period 1995-2002 is characterized by the following factors:

- Most of the increase in value added was generated by peasant farms, which now account for the majority of total agricultural output.
- Increased crop production, in response to higher yields, accounted for a much higher proportion of the increase in value added than increased livestock production. Crop production now accounts for more than 50% of total output.
- Fertilizer use increased dramatically in the first two years of recovery (from a very low base), but has stabilized since then. Crop yields increased and then stabilized in a similar pattern, but they remain at very low levels relative to western agriculture.
- Livestock numbers and productivity have increased less, although recent growth has been strong for cows and poultry.
- Subsistence agriculture has expanded more than commercial agriculture. Most of the increase in crop production has been in food crops for household consumption, as reflected in increased caloric consumption by rural households and a higher protein intake. The marketed surplus of traditional food crops (wheat, potatoes, and vegetables) produced by peasant farmers also increased as a consequence.
- Increased producer prices and increased yields were the main determinants of the increase in value added (in almost equal measure), with a small impact due to substitution to higher value crops.
- Land productivity has increased as a result of increased crop production (higher yields) from a declining area under cultivation
- Labor productivity has not changed significantly, as increased output has been offset by a net inflow of labor into agriculture.
- Sector growth was rapid from 1995-1998, but it has slowed markedly since then. It is not clear whether this shift in the rate of growth is the result of short-term factors associated with the Russian crisis in 1998, or whether it reflects the impact of deeper, structural constraints to growth that are now becoming more apparent.

Opportunities and Constraints for Future Agricultural Growth

These characteristics suggest that agriculture growth thus far has been driven more by the desire of rural households to increase food security, than as a response to market incentives. It is also evident that there is considerable scope to increase production and productivity further. Higher crop and livestock yields can be achieved in response to irrigation, higher input use, improved crop varieties, better livestock feeding and breeding, and more efficient management systems. But farmers are unlikely to significantly expand output beyond subsistence levels, unless their surplus production can be sold profitably. Hence, measures to sustain sector growth will need to emphasize not only technology transfer to increase production and productivity, but also measures that improve the incentives to increase marketed surplus and to engage more actively in agricultural markets.

This commercialization of agriculture will be a major challenge, due to the small size of the domestic market, the difficulties of exporting, the weakness of physical and market infrastructure, and poor understanding by farmers of how markets work. The urban, domestic market comprises no more than 2 million people, most of whom still produce a large part of their own food. It is thus easily saturated, especially given the ease of importing agricultural products, and thus highly volatile. Recent increases in the marketed surplus of onions, potatoes and beans all resulted in heavy losses to the farmers involved. Mountainous terrain, limited physical infrastructure (roads, communications) and weak marketing systems raise transactions costs and so the ability to compete with imports. Constant border disputes with neighboring Uzbekistan and Kazakhstan inhibit trade, not only with these countries but also by blocking trade routes with traditional trading partners in the CIS.

Farmers are reluctant to actively engage in agricultural markets because they lack understanding of how markets work. They need to learn how to minimize the risks associated with increased market participation, how to raise product quality and get better prices for their products, and how to strengthen their negotiating position relative to other market agents. Better access to post-harvest storage and working capital, new forms of contractual relationship, and the advantages of group activity (farmer co-operatives and associations) are all pre-conditions for increased market activity. These constraints apply to both input and output markets. Slow growth within the agri-business and agro-processing sectors has further inhibited market development. Raw materials are lacking and business management is weak.

Not all rural households will benefit from public support programs that respond to these imperatives. The potential for agriculture sector growth varies widely according to region and farm type. Crop producers in the more fertile river valleys, with good access to irrigation and local input and output markets, will benefit substantially and respond more quickly. Their proximity to domestic and international markets, better roads, and better market infrastructure will allow greater reduction in transactions costs, better access to information and higher returns. Livestock producers with good access to markets will benefit for similar reasons, but those in more isolated mountain areas will benefit less. Farmers who rely on crop production in marginal, mountain areas will also derive limited benefits. Agricultural potential is low in these areas and marketing costs are prohibitive. Measures to increase subsistence production will generate some improvements in household welfare, but ultimately these households may derive greater benefit from measures to increase non-farm income, and to improve health and education for young people as the basis for finding employment elsewhere.

These observations suggest that future public support should be oriented toward measures to: increase on-farm production and productivity through technology transfer, improve market access and reduce market transaction costs, and strengthen and diversify the rural non-farm economy. More emphasis should be placed on the development of product markets, compared to the emphasis on factor markets and public infrastructure and institutions (land reform, credit, irrigation, public institutions) that has characterized public expenditure programs to date. This shift in emphasis is also consistent with the need to strengthen private sector activity and investment.

Banking Sector

Kyrgyzstan has a two-tier banking system, which includes the National Bank of Kyrgyzstan and 21 commercial banks. The banking sector 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. Overall, although still small, 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, failures of weaker banks (5 in 2002 and 2 in the first 9 months of 2003), strengthening through change of ownership, etc. Three commercial banks, Ineximbank, Energobank, and Kazkommertz Kyrgyzstan were purchased in 2003 by Kazakh banks: TemirBank, ATF Bank, and KazkommertzBank, respectively. In addition, a notable development was registration of the Kyrgyz Investment and Credit Bank (KICB) in 2001, whose shareholders include Aga Khan Foundation, EBRD, DEG, IFC, and the GOK.

The growth in deposits during 2002 and 2003 is quite significant, 40% and 38% respectively, which reflects increase trust of population in the banking sector. However, reflecting the dollarization of the economy, the majority of deposits are in foreign currency (almost 65% of total deposits as of end-2003), and a small share of the deposits, only about 20%, have maturity over one year. Although the volume of long-term deposits is increasing, the problem with predominantly foreign currency deposits continues to exist. The deposit market situation, paired with the fact that so far all donor credit lines through the banking sector have been denominated in foreign currency, result in over 60% of lending is in foreign currency. Such funds restrict the lending efforts, as a large portion of demand for loans in the country is for longer-term national currency loans without a foreign exchange exposure. As a result, only about 10% of loans have maturity over 1 year.

Lending to agriculture. Agricultural production, processing, transportation and marketing is about 45% of total GDP, including agricultural production is about 34%. At the same time, 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. 8% of KAFC's portfolio is in agro-processing, and will be increases 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, as only 5% of total lending is for agriculture-related businesses (production, processing and storage), and investment lending is extremely small. Besides production risk, which is a major concern (the Project will not be addressing directly), 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. These issues will be addressed through the technical assistance component of the Project, which will first work with the potential borrowers to improve their operation.

Annex 2: Major Related Projects Financed by the Bank and/or other Agencies

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

Market Development Component

IDA

- Agriculture Support Services Project (IP-S; DO-S); Market information, farmer advisory services
- Village Investment Project (IP-S; DO-S); Agricultural marketing, producer organizations
- On-Farm Irrigation Project (IP-S; DO-S); Producer associations (water users' associations)

USAID

- Trade and Investment Project - (TIP - Pragma) supports the removal of unduly restrictive administrative and procedural barriers to trade and investment. The effort supports the development of more competitive small and medium business in the Kyrgyz Republic.

- Removal of Investment Constraints (Pragma) - The RIC component is designed to assist the governments of the Republic of Kazakhstan and the Kyrgyz Republic in streamlining administrative procedures related to the business environment and investment, and in carrying out regulatory reform on both the national and local levels.

- Regional Trade Promotion – RTP, available to Small and Medium Enterprises in all Central Asian Republics, provides an Internet-based marketplace at www.smetradecenter.net linking buyers and sellers in Central Asia with each other and with the Global Market.

- Small and Medium Enterprise Development Project - USAID is promoting small and medium enterprises (SME) development through business advisory services, accounting training, and business and economic education, support to customs modernization.

EU- TACIS

- Kyrgyzstan SME Development Program
- EU Food Security Program

  The main goal of the project is to assist the Government in macroeconomic stabilization through the budgetary support, reforming the agriculture sector and improving the food security of the country.

GTZ

- Agromarketing Center was established with the Support from GTZ and EuropeAid, EU.
- Trade and Service Cooperative Development Project

  The main goal of the project is to assist in the creation and functioning of agricultural cooperatives in the areas of trade and service provision.

SWISS ASSOCIATION OF INTERNATIONAL COOPERATION

- Support to Private Initiative (Project)
  The main goal of the project is the development of private small and medium - sized enterprises involved in food and forestry product processing. Activities are implemented through Business Consultancy Companies, offering different types of services to processing enterprises located in rural areas all over the country.
- Rural Advisory Services (RAS)
  Jointly with IDA's ASSP, provides advisory services to farmers
- Legal Assistance to Rural Citizens
  Provides legal advisory services to farmers and others in the rural economy
- Agricultural Vocational Education Project
- Business Promotion Project
  The project worked extensively with fruit and vegetable processors and producers, including the establishment of a fruit and vegetable association and export promotion activities

ADB

- Capacity Building in the Ministry of Agriculture, Water Resources and Processing Industry (completed in 2002)
  The project objective was to strengthen capacity of the Ministry in developing the PIP in the agriculture sector through training.
- Agriculture Area Development Project (in Chui oblast).
  The project aim is to increase incomes of farm enterprises in the Chui area. It is implemented through the following components:
  1. Farm development;
  2. Irrigation and Drainage Rehabilitation systems;
  3. Marketing and Input supply;
  4. Project management. .

JICA

- Delivery of agricultural equipment. The project provided the country with 43 combines and tractors in the amount of US $ 5 mln.

- Agribusiness and marketing project. The project will support the development of agribusiness and marketing of the agriculture and processing industry. [Need more here]

<u>Access to Credit Component</u>

IDA

- Rural Finance II Project (IP-S; DO-S)

EBRD credit line of EUR 15.0 million (about US$ 17.6 million) for SME development in Kyrgyzstan, predominantly to lend to micro and small businesses. The facility has been operating since end of April, 2002. The maximum loan size is up to US$ 100,000 with the maturity of up to 3 years. The facility finances a wide range of projects, including agro-processing, which currently amount to about 6% of total disbursements, majority of loans have been provided to borrowers in urban areas. Of all disbursements, 70% of the loans volume (90% of the number of loans) have been provided for trade, 10% for processing, and 24% for services.

IFC leasing finance facility for Central Asia in the amount of US$ 40.0 million, of which between US$ 5.0 and 8.0 million have been allocated for Kyrgyzstan. The project is expected to start in late 2004, and continue for 2 years. The leases have no pre-set minimum or maximum limit, provision of micro-leases is envisaged. The leases are to finance a range of economic activities, including equipment for agro-processing.

KFW credit line of EUR 4.5 million (US$ 5.5 million), for manufacturing businesses, including agro-processing, and services. Loans are up to US$ 500,000, and are granted in foreign currency. The ratio between investment and working capital loans is 50%:50%. The funds will be given to the banks for 15 years, and loans to the borrowers will be for up to 7 years. Each loan is reviewed by KfW in Germany.

Annex 3: Results Framework and Monitoring

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

Results Framework

PDO	Outcome Indicators	Use of Outcome Information
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	Increased share of agricultural production being processed Value of sales of producer organizations increased. Minimum repayment rate to PFIs of 95 percent. Increased institutional lending to agro-industry clients	Verify achievement of project development objectives.
Intermediate Results One per Component	**Results Indicators for Each Component**	**Use of Results Monitoring**
Component One: Program of technical assistance to client enterprises and organizations carried out	**Component One:** Increase in sales of enterprises and organizations supported by the Project Increase in profits of enterprises and organizations supported by the Project	**Component One:** Assure that technical assistance to client enterprises is effective and introduce changes to the program as necessary.
Component Two: Credit lines disbursed by diverse set of PFIs Increased capacity in the banking sector	**Component Two :** The number and volume of loans to Project beneficiaries Number of PFIs participating in the Project Number of loan officers trained	**Component Two:** Assess potential adjustments in the credit line programs and the list of participating PFIs.
Component Three: Public sector capacity building program implemented	**Component Three:** Number of public service staff trained	**Component Three:** Assure the effectiveness of the training programs and introduce the necessary adjustments.

Arrangements for results monitoring

		Target Values					Data Collection and Reporting		
Outcome Indicators	**Baseline**	**YR1**	**YR2**	**YR3**	**YR4**	**YR5**	**Frequency and Reports**	**Data Collection Instruments**	**Responsibility for Data Collection**
Increased share of agricultural production being processed	12%	12%	12%	13%	15%	17%	Annual	National statistics	Government
Minimum repayment rate by borrowers to PFIs of 95 percent	KAFC = 95%	95%	95%	95%	95%	95%	Quarterly	Portfolio reports by PFIs	CLMU
Increased institutional lending to agro-industry clients	CY 2004 NBKR data	+0%	+4%	+8%	+12%	+15%	Annual	Portfolio reports by PFIs; NBRK reports	CLMU
Results Indicators for Each Component									
Component One :									
Increase in sales of enterprises and organizations supported by the Project	Enterprise data	+0%	+10%	+15%	+20%	+25%	Annual	Enterprise data	ABCC
Increase in profits of enterprises and organizations supported by the Project	Enterprise data	+0%	+5%	+10%	+15%	+20%	Annual	Enterprise data	ABCC
Component Two :									
Number of loans to Project beneficiaries	0	5	15	25	35	50	Quarterly	Portfolio reports by PFIs	CLMU
Number of PFIs participating in the Project	2	2	2	3	3	3	Annual	Progress reports	CLMU
Number of loan officers trained	0	50	75	100	125	150	Quarterly	Progress report	CLMU

Annex 4: Detailed Project Description

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

Market Development Component

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 key element of this component will be the Agribusiness Competitiveness Center, which will directly manage the Supply Chain Management Sub-Component, and be the channel for needed private sector input into the Public Sector Investment Sub-Component and the Public Sector Capacity Building Sub-Component.

Staffing and Functions of the Agribusiness Competitiveness Center

The ABCC will be composed of the following staff: Director, Deputy Director, Consultant Manager, Procurement Officer, Office Manager, Accountant, Assistant to the Director. In addition, consultants will be contracted for IT administration, legal issues, and public relations. The ABCC will hire on a contract basis local consultants for interaction with client enterprises and organizations. The pool of local consultants to the ABCC will be built up during the initial stage of implementation through a program of recruitment and training (see Annex 6). Local consultants will be teamed with the program of international TA, assigned to work full time with specific ABCC clients in conjunction with the international consultants. The work of the local consultants will be rated on the basis of feedback from the clients and from the international TA. The local consultants will be assessed on the basis of their performance in terms of their professional skills, accumulation of new expertise, and ability to work with the client to get results. Their continued employment in the Project will be dependent on satisfactory performance in these areas.

The Project will allow for channeling of local consultants into specific areas of expertise and will allow for promotion in pay scales and level of responsibility based on performance. The program of developing and managing the pool of local consultants will be overseen directly by the Consultant Manager, with ultimate responsibility with the Director.

The ABCC will tender packages for international TA for specific groups of identified clients. For each of the identified clients, a preliminary diagnostic will have been carried out indicating the nature and scope of business and technical intervention necessary. Proposals from international firms will be received on the basis of this information and evaluations conducted. The winning firm will have the right to select the local consultants with whom it will work from the ABCC pool of local consultants. It will also have the right to change local consultants in case of demonstrated poor performance.

Client enterprises and organizations will need to agree to make available basic business information to the international TA. In cases where the client does not agree, or fails to follow through on provision of needed information, the client will be barred from further participation in the Project.

The types of clients to be served by the Project will include processing enterprises, producer organizations, and trading and marketing enterprises. The specific types of business and technical advice and support to be provided to each client will be determined on the basis of the initial diagnostic carried out prior to tendering, which will be further elaborated in the contract negotiation between the client and the TA provider.

The services provided by the Project will be on a matching grant basis, with the share of client financing dependent on the type of client. Because public financing will cover the bulk of these services, the lessons learned from the interventions with the clients will be treated as public goods and made available to the Kyrgyz economy as a whole. These would include technical and organizational improvements, basic management practices, and improved marketing linkages. The public relations consultant to the ABCC will be directly responsible for the dissemination of best practices and lessons learned through the Project.

Firms competing for the TA tenders will need to demonstrate prior success in achieving improvement in business performance for clients in market economies and to provide personnel who have carried out that work. They will also need to be prepared to sub-contract out elements of work, in particular technical expertise, as necessary to meet the needs of the clients. The firm's eligibility to take part in subsequent tenders under the Project will be dependent on satisfactory performance in its initial assignment, as determined by the ABCC.

While the Project will begin work with individual client organizations, the intention will be to build supply chain linkages for specific commodities and to get more integrated interaction among supply chain agents. At the least this will be in the form of the ABCC as mediator and forum for bringing parties together to discuss business issues. In the more ambitious variant, this will include integration of clients in a TA package where 'win-win' opportunities have been identified.

For this role as objective mediator, it is critical that the staff of the ABCC, and in particular the Director and Deputy Director, be free of vested interests in the process and as immune as possible from political influence.

Public-Private Sector Interactions

Through its work with private sector clients, the ABCC will be responsible for identifying constraints to improved competitiveness of Kyrgyz agri-food suppliers that will require investment in public or mixed public/private infrastructure. An additional source of information on this will be the Supervisory Board of the ABCC , which will have input from private sector participants and key public sector entities. For any proposals put forward for potential inclusion under the Public Infrastructure Component, a full cost-benefit analysis (as understood in market economics) will need to be provided demonstrating the quantified positive returns of the proposed investment. These proposals will be approved by the ABCC, cleared by the Government, and then appraised by IDA prior to final approval. Appraisal of these sub-projects will be conducted as part of overall supervision of the Project.

In cases where the proposed infrastructure is not purely public in nature, but represents a mix of public and private aspects, a plan for utilizing management control with appropriate private sector content will need to be provided prior to appraisal.

The ABCC and its Supervisory Board will also be responsible for identifying policy and regulatory constraints to increased competitiveness of Kyrgyz agri-food suppliers and to the improved functioning of agri-food markets within Kyrgyzstan. The ABCC will take the lead in submitting specific proposals for changes in the legal-regulatory environment, but members of the Supervisory Board will be welcome to undertake such initiatives, as well.

The Supervisory Board will serve as the primary forum for the exchange of views between private and public sector interests, and it will be a function of the ABCC to put forward the views and interests of its clients in this regard. The ABCC, in consultation with the Supervisory Board, will be responsible for defining the program of Public Sector Capacity Building, as described in the main text.

Functions of the Market Development Service

This unit will work directly within the ABCC, reporting to the Director. Product dissemination from the MDS will be executed by the ABCC to project clients and to other, fee paying clients. Effectively the unit will have 6 main terms of reference:

a) Data gathering and analysis
b) Trade advisory services
c) Re-active sales services
d) Pro-active marketing services
e) Sales and marketing training services
f) Sourcing.

Description of services

Data gathering and analysis

The Kyrgyz market is currently serviced by KAMIS (Kyrgyz Agricultural Market Information Service), which is a private company set up with the help of donor funds. KAMIS produce a weekly publication, which contains information on traded prices for various agri-products at both wholesale and retail market levels. This information is provided for markets in the main regional centers. The publication also contains such items as classified advertisements and articles on agricultural issues. This publication is provided on a subscription basis to fee paying clients. It is proposed that the MDS should contract with KAMIS for the supply of targeted market information and analysis. This information should also include such data as traded volumes and other regional market information (Central Asia, Russia). MDS will be required to carry out regular qualitative analysis of the information provided by KAMIS.

It will be the responsibility of MDS to also gather information from other available sources, such as the Ministries of Agriculture and Economy, Industry and Trade. Given the current level of operations of other donors and IFIs, it will be the responsibility of MDS to liaise with these organizations to gather any data that may be pertinent to their role.

It will also be the responsibility of MDS to undertake, compile and maintain a database of supply and value chain analyses for both primary and processed agri-products.

Trade advisory services

It is clear that there are currently many barriers to both domestic trade (e.g., lack of finance/logistics) and export (e.g., customs procedures, finance). Given that many of these barriers are due to a lack of knowledge or know-how, it will be the responsibility of the MDS, assisted by the TLC, to develop their understanding of the current barriers and to develop creative solutions to such problems. It will be important that this process will be undertaken on a continuous basis and this can be maintained by liaison with parties such as ABCC clients, Customs, transport companies, banking institutions, and others.

Many participants in the agri-business sector do not have a detailed understanding of the law of contract or sale and that it may be possible to increase their use of the currently available legislation to normalize their trading relationships. It is therefore envisaged that the MDS will make use of the services of the resident lawyer within the ABCC to draft standard form sales/purchase contracts and to prepare a basic information pamphlet on contractual rights. It is also envisaged that the MDS will offer clients the ability to apply to them for initial legal opinion in the case of potential legal disputes. The MDS will also liaise with the new arbitration organization that has been established with the help of DFID in the southern region of Kyrgyzstan.

Re-active sales services

In response to ABCC clients (or other fee paying clients) requesting help in marketing their goods in either the domestic or export markets, MDS will identify potential partners, undertake due-diligence of the counter-party (in so far as they are capable), facilitate negotiations (if required) and advise their clients with regards to contract requirements and execution.

The knowledge and contacts that are gained in executing the above function will be compiled and used for future re-active marketing or as a basis for the development of pro-active marketing activities below.

In order to ensure that this activity is successful and targeted to results, as opposed to execution, it will be systematized, enabling ABCC management to track performance and success of the operations of the MDS staff.

This service may, over time, be supplemented by the employment of TPOs (Trade Promotion Officers) in specifically targeted markets (e.g. Russia, Kazakhstan, China) as an alternative to the proposed foreign TLC described above. The TPOs would operate as minimal overhead single units, employed on retainers, but with the provision for bonuses based on successfully executed trades. It is important that the activities of the TPOs are targeted, in the re-active marketing function, to the sale of existing and identified products (i.e. volumes, qualities, availability etc).

Through the interventions of other donors (e.g. GTZ, Pragma, IFDC) a number of producer associations have been created throughout the country. It appears that the main rationale for the creation of these associations has been the establishment of co-dependent financing systems. Approaches have been made to the project preparation team from these donors to help intervene with these new associations for the purposes of helping them to market their produce. Given the dynamic relationship between the ABCC and the processing and retail sectors, it is foreseen that the ABCC will use their position to facilitate off take contracts between producer associations and processors/retailers.

Pro-active marketing services

As a specific function, MDS will be required to undertake pro-active marketing functions. This may consist of identification of new markets and partners for currently existing goods, or the identification of new goods demanded by current/newly identified partners. Such activities should be systematically designed, implemented and quality management of product strictly adhered to. Such a system could be based on the European model of tele/web/contact marketing. "Leads" management needs to be implemented to ensure that there is sufficient filtering of opportunities to avoid time wastage at higher levels of ABCC management and for clients who receive such services/advice.

The MDS will undertake domestic market surveys and studies to identify the retail and wholesale market opportunities currently existing in the major urban centers. It will then be the task of the MDS to facilitate closer and operable links between domestic processors and the retail/wholesale chain. Facilitation of this linkage would normally be executed by distribution companies. However, in Kyrgyzstan, there is at present only one established distributor. It is foreseen that the successful intervention of the ABCC and MDS will lead to greater interaction between processors and the consumer markets. It is expected that the logistics role in this sector will become more active and that a number of distributors will enter the market with increasing trade volumes.

Sales and marketing training services

One of the development functions of the ABCC will be the provision of consultancy services to its clients in the areas of management, processing, financial controls, business development and marketing. It is proposed that the source of consultancy for this last area should be supported by the staff of the MDS, whose daily operations will consist of developing such knowledge and expertise. Whilst there are certain specifics with regard to the marketing of different products, it is true that a vast synergy exists in general marketing principles, approaches and execution plans. MDS will develop knowledge and expertise in such areas as advertising and product marketing development (packaging, sales promotions, etc). With the centralization of this function within MDS, it will be possible to avoid replication of operations and knowledge throughout the ABCC structure.

Sourcing

It is envisaged that many of the ABCC clients will need to procure new or replacement equipment as part of their involvement with the project. It will be the responsibility of MDS to identify product/equipment sources in response to requests from the clients, through the ABCC management team.

Given that many of the processors currently complain that they find it difficult to obtain raw materials for their operations, the task of sourcing such raw materials will also be the responsibility of MDS.

<u>MDS structure</u>

At the initial stages it is proposed that MDS will be staffed by a manager, a data/market/information analyst and three SPOs (sales promotion officers). Depending on workload and success, it may be necessary to expand the size of the team through the hiring of more SPOs. The manager of the MDS will report to the Director of the ABCC. He will be responsible for monitoring the performance of the SPOs and for managing/developing identified leads. He will also be responsible for concept innovation and motivation of the SPO team. The manager will receive a base salary and will be incentivised by the provision of a bonus upon successful execution of trades.

The analyst will be responsible for the collation of identified data, its management and general analysis. They will also be responsible for the maintenance and running of the MDS database, both physical and computer based.

The SPOs will work closely with the manager to establish marketing plans, product development, leads collection and provision of services to ABCC clients. The SPOs will work on the basis of fixed-term contracts with right of extension based on performance. They will earn a base salary and will receive incentive payments based upon concluded transactions that they have initiated.

Access to Credit Component

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 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.

Program of Training

Training materials. Training manuals will be developed by international consultants jointly with national consultants, who will deliver the training to the financial intermediaries. It is expected that the manuals will be left with the Bank Training Center and the commercial banks, as part of the know-how transfer. The local consultants will work closely with the international consultants, to ensure transfer of skills and knowledge of the international consultants.

Training seminars. The training will be started with a one-week per PFI identification of the gaps in lending, including risk management, skills in the PFIs, which will serve as the basis for design of appropriate training programs. The technical assistance to the financial intermediaries will be a combination of training seminars and hands-on support to the PFI staff helping in carrying out the actual lending operations. The initial round of training will be followed by refresher courses at regular intervals.

International consultants will be teamed up with local consultants, to ensure transfer of know-how and availability of trainers in the above-mentioned subjects after the closing of the project. A preliminary agreement has been reached that the local consultants will be trained in cooperation with the Bank Training Center.

(a) The ***Investment Training*** will comprise of initial seminars, which will be open for loan officers of all interested commercial banks in Kyrgyzstan. The training will be followed, in the participating financial institutions, by hands-on support from the international and local consultants, who will help loan officers of the PFIs to apply the newly acquired skills.

(b) The ***Risk Management Training*** will be organized only for the project's participating financial institutions, with a follow-up on-the-job training of the loan officers, during which the consultant will help to analyze and structure "pilot" deals.

(c) ***Refresher Courses*** will be offered in the years 2-4after the initial round of training by the international consultants. Thereafter, any identified new training needs and/or refresher courses will be handled by the trained local consultants.

Upon completion of the training, qualified selected participating financial institutions will have access to a credit facility, for lending for viable business activities.

Potential participating financial institutions (PFIs).

All credit products will be disbursed through commercial financial intermediaries, such as Ineximbank, Kyrgyz Agricultural Finance Corporation (KAFC) and Kyrgyz Investment and Credit Bank (KICB). Ineximbank and KAFC are already active PFIs of the Second Rural Finance Project (RFP II, closing June 30, 2005). KICB (and subsequently any other commercial bank willing to participate in the Credit Line) will have to undergo a review according to due diligence procedure. The eligibility criteria for PFIs are detailed in Annex 4-1.

The PFI will be responsible for identifying prospective borrowers and carrying out appraisal of the proposals submitted for financing for their operational and financial sustainability, and will assume full lending risks for the projects financed. The appraisal and selection of sub-loans for financing will be done on the basis of eligibility criteria, whose compliance (including compliance with environmental safeguards) will be monitored throughout project implementation. Detailed terms and conditions of the credit facility are set forth below in Annex 4-2.

Terms and Conditions of the Subsidiary Loan

The principal amount of the Subsidiary Loan shall be repaid by PFIs over a period of 15 (fifteen) years, inclusive of a grace period not exceeding 3 (three) years, in accordance with an amortization schedule that will be furnished to the PFI by MOF. The Subsidiary Loan will be available for withdrawal by PFIs and further on-lending, in two currencies, US$ or KGS.

Interest Rate and Repayment Terms. The Subsidiary Loan shall be charged a variable (floating) interest rate: (a) on the Subsidiary Loan denominated in US$, it will be equal to the reference rate of 6-month LIBOR US$ rate, subject to revision semi-annually, on February 1 and August 1 of each year, plus a spread of 1 (one) percent, to compensate the Borrower for the costs associated with administration of the Credit and Subsidiary Loans and maintenance of the PMU; and (b) on the Subsidiary Loan denominated in KGS, it will be a variable (floating) interest rate based on the reference rate which shall be equal to the average between the annual inflation rate projected by NBKR for the current year and the actual inflation rate of the preceding year. The reference rate shall be revised semi-annually, on February 1 and August 1 of each year. In addition to the reference rate, a fixed margin of 1 (one) percent shall be added at all times to compensate the Borrower for the administration costs, and a variable margin of no less than 1 (one) percent to cover the foreign exchange risks borne by the Borrower.

Maximum Financing Share (Declining Percentages). The maximum amount to be made available by the Borrower to each PFI out of the proceeds of the Credit Line will be equivalent to 100% of sub-loan disbursements made by the PFI and withdrawn from the Credit Account until December 31, 2006. Thereafter, the maximum amount which shall be eligible for withdrawal by PFIs will not exceed 80% of the aggregate sub-loan disbursements.

Credit Line Management Unit

A separate management unit - CLMU - will be used for implementation of this component. The Component will use the PMU of the 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, including liaising with the financial intermediaries, review of the sub-loan proposals, disbursement, and financial management. 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.

The CLMU's terms of reference will be the overall coordination of the Access to Credit Component, and financial management for the whole project, including: (a) overseeing and monitoring the implementation of the Access to Credit Component; (b) performing the financial management functions, including disbursement and special account operations, for the whole project; (c) preparing the financial management reports for the donors and the Government; reporting on the Access to Credit Component implementation progress to the Government and IDA; and (d) monitoring the implementation of the technical assistance component to the PFIs, and ensuring feedback to IDA and the TA provider; (e) consolidating progress reports for the whole project for presentation to the Government, IDA, and other relevant parties.

Project Monitoring and Advisory Office Component

A Project Monitoring and Advisory Office (PMAO) will be established in the MAWRPI on the basis of the existing Project Preparation Unit, consisting of three staff: Director, Liaison Officer, and Assistant. Its functions will include: (a) acting as the liaison between the MAWRPI and the MOEIT with respect to the Project's activities; (b) having responsibility for implementation of the Public Sector Capacity Building sub-component, on the basis of decisions of the Supervisory Board of the ABCC; (c) acting as liaison for the flow of information between the MAWRPI and the ABCC; and (d) acting as the liaison between the MAWRPI and the CLMU in respect of the Project monitoring data reflected in the Financial Monitoring Reports (FMR).

Annex 4-1. Eligibility Criteria for Selection of Participating Financial Institutions

In order to be a Participating Financial Institution (PFI), commercial banks and KAFC have to meet at all times a set of financial and management criteria, namely, that such institution:

A. <u>General Standards</u>:

(i) Be in compliance with all banking laws and prudential regulations of the National Bank of the Kyrgyz Republic (NBKR) acceptable to IDA.

(ii) Be interested and committed to servicing the range of clients, who are the intended beneficiaries of ABMP.

(iii) Undergo an annual audit that is conducted in accordance with the International Standards on Auditing (ISA).

(iv) Have the necessary staff, knowledge, physical and other resources to implement the credit line under the Project.

B. <u>Financial Standards</u>:

(i) At all times, meet the prudential regulations issued by the NBKR, with a particular focus on the following:

a. Ensure the required minimum level of capital as established by the NBKR from time to time;

b. Limit its exposure to a single, related, connected borrower and insider parties to a percentage of the PFIs' total capital (K 1.1 – 1.4), as defined and prescribed by the NBKR;

c. Maintain at all times the required minimum capital adequacy ratio (K 2.1 – 2.3)as established by the NBKR;

d. Maintain a level of loan loss provisions at all times at least equal to the minimum required according to the regulations of the NBKR;

e. Be in full compliance with the legal reserve requirements of the NBKR;

f. Meet the minimum level of liquidity ratio (K 3) as established by the NBKR;

g. Meet the maximum risk exposure limits in respect of deposits of private individuals (K 5) as established by the NBKR;

h. Maintain the permissible open foreign currency position limits (K 4);

i. Maintain the fixed asset and other non-financial asset investment / own capital ratio within the permissible limits;

j. Maintain the maximum exposure to investments in non-bank companies within the permissible limits;

(ii) Have a positive net income for the current and immediately preceding financial years, as reflected in the financial statements audited in accordance with ISA.

(iii) Have acceptable asset quality and quality management policies, procedures and skills.

C. Corporate Governance and Managerial Standards:

(i) Have a Board of Directors responsible for setting the overall bank policy and perform appropriate oversight of the bank's operations;

(ii) Have a qualified and capable management team;

(iii) Have a sound business plan and appropriate budgeting and budget control procedures;

(iv) Have sound lending policies and procedures, including in respect of the entire credit cycle, problem loan management, write-offs of assets, credit approval authority, etc.

(v) Have satisfactory internal control and audit procedures, including accounting principles and procedures, and financial documents, internal controls and reporting, and operational controls, confirmed by external auditors;

(vi) Is not exposed to undue interest rate risk, confirmed by annual audited financial statements;

(vi) Have an internal reporting and management information system capable of providing sufficient information necessary for managing the bank's operations, performance and risks.

Annex 4-2. Eligibility Criteria, Approval Procedures and Principal Terms and Conditions of Sub-loans

Sub-component A. – Investment Lending

This sub-component will provide access to investment capital for the emerging producer organizations and private businesses involved in production, processing and marketing of agricultural produce.

Eligible Beneficiaries: Eligible beneficiaries would include private producer organizations and private businesses involved in agricultural production, processing, and marketing, operating as joint stock companies, limited liability companies, farmers' associations, cooperatives, partnerships, or in any other legal form.

Maximum Loan Amount. The maximum cumulative outstanding loan amount (maximum exposure) to a single borrower, aggregate of sub-components A and B, shall not exceed US$ 200,000 equivalent.

Eligibility Criteria for Sub-projects: The ultimate objective of the investments made is to facilitate and increase the sales of the beneficiary company. Eligible investments will include:
(a) investments in development of storage, grading, packing, marketing and other related activities of handling agricultural produce;
(b) investments in processing facilities for agricultural produce;
(c) investments facilitating domestic marketing and export of agricultural products.
All proposed sub-projects should be supported by sound business plans, demonstrating technical and financial viability, satisfactory cashflows and loan repayment capacity.

Choice of Currency of Sub-loans. Sub-loans to beneficiaries would be denominated and repayable in either US$ or KGS, as determined by each sub-borrower at the time of signature of the sub-loan agreement with the PFI. However, only beneficiaries with income in foreign currency would be able to borrow in US$.

B. Sub-component B – Structured Finance Facility

This sub-component will provide working capital financing for contractual arrangements throughout the agricultural produce supply chain:

(a) 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.

(b) transaction finance with warehouse-backed risk mitigation tools to allow expansion of the collateral base and increase in agricultural processing and marketing.

Eligible Beneficiaries: (i) agro-processing and marketing companies, willing to forge a contractual farming relationship with producer organizations, which will use the proceeds of the sub-loan to provide inputs for producer organizations against a guaranteed delivery of the agricultural produce for subsequent processing and/or sale; and (ii) agro-processing companies, requiring transaction financing to allow a significant increase in the size of their borrowings from financial institutions using their stocks of processed goods and stocks of production consumables as collateral.

The Beneficiaries shall meet the following criteria:

(i) be a legally registered enterprise ;
(ii) be 100% privately owned;
(iii) have a financeable, commercially viable business proposal;
(iv) have signed / preliminary agreed on a forward contract for sale of agricultural commodities (where applicable);
(v) have the necessary resources in place for successful implementation of the project, including, be willing to pay for agro-technical consulting services, if necessary.

Maximum Sub-loan Amount: The maximum exposure to one beneficiary (aggregate of sub-components A and B) shall not exceed US$ 200,000 equivalent.

Eligibility Criteria for Sub-projects. Working capital loans for structured finance deals and contractual arrangements (production contracts or marketing contracts) in the food supply chain. The arrangement should be considered economically and financially viable, technically feasible, have an acceptable business plan, and, on the basis of the projected cash flow, demonstrate the ability of the sub-borrower to service the sub-loan according to the repayment terms agreed between the PFI and the sub-borrower.

Currency of Sub-loans. All sub-loans under sub-component B will be denominated and repayable only in KGS.

C. General Conditions Applicable to all ABMP Sub-loans

The purchase or lease of land, dwelling construction or improvement, the refinancing of any existing debts, production, processing and trade of tobacco and tobacco products, or purchase of pesticides would not be eligible for financing from the Credit Line.

Criteria for Selection and Appraisal of Sub-projects. PFIs are responsible for identifying prospective sub-borrowers, and for following the eligibility criteria for investments and sub-loan beneficiaries described in the SLA and the Agri-Credit Guidelines (ACG). PFIs will have full autonomy in sub-loan approval, and they will bear the lending risks associated with the particular sub-loans. Sub-loans shall be made for sub-projects, selected by PFIs on the basis of detailed and careful appraisal by the PFI.

Beneficiary Participation. The Beneficiaries shall be required to make a cash and/or in-kind contribution in the amount of 20% of the estimated cost of the sub-project.

Annex 5: Project Costs

KYRGYZ REPBUBLIC: AGRIBUSINESS AND MARKETING PROJECT

	Local (US$)	Foreign (US$)	Total (US$)
Component 1: Market Development			
A. Supply Chain Management	$1,010,000	$3,379,410	$4,389,410
B. Export Promotion	$50,000	$1,200,000	$1,250,000
C. Public Sector Investment	$600,000	$400,000	$1,000,000
D. Public Sector Capacity Building		$100,000	$100,000
Subtotal Component 1	**$1,660,000**	**$5,079,410**	**$6,739,410**
Component 2: Access to Credit			
A. Technical Assistance to Banking Sector	$169,620	$516,900	$686,520
B. Investment Credit Facility	$1,600,000	$2,400,000	$4,000,000
C. Revolving Working Capital Fund	$600,000	$400,000	$1,000,000
D. Credit Line Management Unit	$282,470		$282,470
Subtotal Component 2	**$2,652,090**	**$3,316,900**	**$5,968,990**
Component 3: Project Monitoring and Advisory Office	**$96,600**		**$96,600**
TOTAL BASELINE COSTS	**$4,408,690**	**$8,336,310**	**$12,805,000**
Physical and Price Contingencies	$70,000	$100,000	$170,000
Front-end Fee			
Total Financing Required	**$4,478,690**	**$8,436,310**	**$12,975,000**

Kyrgyz Republic

Agribusiness and Marketing Project

Disbursement Accounts by Financiers

(USD '000)

	IDA		Japan PHRD		The Government		Total	
	Amount	%	Amount	%	Amount	%	Amount	%
Public Sector Investment	1,000.0	100.0%					1,000.0	7.7%
Goods	84.0	100.0%					84.0	0.6%
Consultant Services, Training and Audit	1,436.0	22.8%	4,750.0	75.3%	125.0	2.0%	6,311.0	48.6%
Sub-loans	5,000.0	100.0%					5,000.0	38.5%
Incremental Operating Costs	410.0	100.0%					410.0	3.2%
Unallocated	170.0	100.0%					170.0	1.3%
Total	8,100.0	62.4%	4,750.0	36.6%	125.0	1.0%	12,975.0	100.0%

Kyrgyz Republic

Agribusiness and Marketing Projct (ABMP)

Components by Financiers

(USD '000)

	Japan PHRD		IDA		The Government		PFI		Beneficiaries		Total	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
A. Market Development	3,971.41	58.9%	2,643.00	39.2%	125.00	1.9%					6,739.41	45.8%
1. Supply Chain Management	3,871.41	88.2%	518.00	11.8%							4,389.41	29.8%
2. Export Promotion			1,125.00	90.0%	125.00	10.0%					1,250.00	8.5%
3. Public Sector Investment Program			1,000.00								1,000.00	6.8%
4. Public Sector Capacity Building	100.00	100.0%									100.00	0.7%
B. Access to Credit	702.69	8.9%	5,266.30	66.9%			650.00	8.3%	1,250.00	15.9%	7,868.99	53.5%
1. Technical Assistance to Banking Sector	531.52	77.4%	155.00	22.6%							686.52	4.7%
2. Investment Credit Facility			4,000.00	72.5%			520.00	9.4%	1,000.00	18.1%	5,520.00	37.5%
3. Structured Finance Facility			1,000.00	72.5%			130.00	9.4%	250.00	18.1%	1,380.00	9.4%
4. Credit Line Management Unit	171.17	60.6%	111.30	39.4%							282.47	1.9%
C. Project Monitoring and Advisory Office	75.90	78.6%	20.70	21.4%							96.60	0.7%
Total Disbursement	4,750.00	32.3%	7,930.00	53.9%	125.00	0.9%	650.00	4.4%	1,250.00	8.5%	14,705.00	100.0%

Annex 6: Implementation Arrangements

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

The implementation arrangements for the Project are designed to separate public and private sector functions, and to delineate the credit line activities from the market development support activities. For the **Market Development Component**, the Agribusiness Competitiveness Center will be established for implementing the support to private sector clients (for a description of the ABCC see the main text and Annex 4). The ABCC will be established with the legal form of entity (uchrezhdeniye) with the Government as the sole founder. A Supervisory Board will be established for the ABCC composed of the Ministry of Economy, Industry, and Trade as chair, the MAWRPI, and the Ministry of Finance. In addition there will be four representatives from the private sector to be forwarded to IDA for prior review by Government. .

The Supervisory Board will have responsibility for oversight of the activities of the ABCC. Any issues requiring attention or action will be referred to the Government and IDA for consideration.

The Supervisory Board will meet as necessary to review the issues of private/public sector interface in the area of agribusiness and marketing, including proposals for amendments to legal and regulatory documents and improvement in cooperation between the two sectors. The Board will also serve as a forum for coordination with other donor activity underway or planned in the areas of agribusiness and marketing.

The participating financial institutions will have control over lending decisions associated with the lines of credit. The **Access to Credit Component** will be coordinated by the Project Management Unit of the Second Rural Finance Project (closing date June 30, 2005). The PMU, which under ABMP will be renamed 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) overseeing and monitoring the implementation of the Access to Credit Component; (b) reviewing the compliance of the proposed sub-loans from PFIs, to ensure that intended beneficiaries are indeed receiving support, according to the criteria set forth in the ACG; (c) liaising with the participating financial institutions, and monitoring compliance by PFIs with terms and conditions of Subsidiary Loan Agreement and the ACG; (d) provision of relevant progress reports to the Government, the Supervisory Board of the ABCC, and IDA; (e) monitoring the implementation of the technical assistance component to the PFIs, and ensuring that feedback is sent to IDA and the TA provider; and (f) performing all financial management functions for the Project activities, including disbursement and special account operations, for the project, including the IDA-financed and PHRD-financed parts of the Project, and providing the required financial management reporting to the donors and the Government.

The Ministry of Finance (MOF) will sign SLA with the eligible PFIs, and on-lend the credit proceeds under the SLAs. 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 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.

Procurement will be handled by the ABCC, as this organization will be directly involved with the bulk of the procurement to be undertaken by the Project. Development of terms of reference for consultant services and goods under the Supply Chain Management Sub-Component will be the responsibility of the ABCC. Development of terms of reference for the procurement of consultant services for the Access to Credit Component, the Trade Linkage Office, and for goods and works associated with the Public Sector Infrastructure Sub-Component will be contracted out. The ABCC will be responsible for completing the bidding packages for contracts on the bases of these TORs.

The PMAO will be responsible for liaison between the MAWRPI and other bodies involved in implementation of the Project. The PMAO will also be responsible for administering the Public Sector Capacity Building Sub-Component.

Phasing of Project Implementation

Market Development Component

Phasing of the implementation of the Market Development Component will be tied to the establishment and capacity building of the ABCC, and to preparatory work with the identified clients. It is foreseen that the start up period of the project will require the involvement of one full-time foreign consultant to train the newly formed management of ABCC. This will enable them to develop the management capacity needed to obtain maximum impact from the consulting firms hired to assist clients of the ABCC.

The foreign consultant should have a strong commercial background. It is planned that, based on this experience, the consultant will create and implement various trading and management systems to enable the local staff of the MDS as well as the rest of the ABCC to manage their operations professionally. This process must be undertaken with the involvement of the senior management of the ABCC/MDS, in order to ensure that they understand both the structure and ethos of the systems introduced. It will be the responsibility of the local staff to draw the maximum know-how and knowledge transfer from the foreign consultant at this crucial formative stage. It is further foreseen that this TA should be continued in year 2 of the Project to ensure that the local staffers are effectively inter-acting with the foreign consulting firms and are truly managing this aspect of the Project.

During the critical start-up phase, the ABCC will benefit greatly from technical assistance support from similar organizations within the CIS that are currently operating. These consultants from within the region will provide invaluable experience on operational issues, liaison with Government, potential clients, and other stakeholders, and in building a focus on results.

During the first year of operation, the major activities for the ABCC will be staff training and capacity building, conducting an initial diagnostic of the business needs of potential client organizations, drafting the terms of reference (TORs) and bidding documents for the first round of consulting assistance to client organizations, and conducting this tender.

From the beginning of implementation of the Project, the ABCC will disseminate information to potential clients and the market in general on the concepts, goals and ethos of the project. This will include general information on intended interventions, training programs and other services, including those of the MDS. This will be facilitated through advertising in the media, creation and dissemination of information pamphlets to identified interest groups (e.g. associations, chambers of commerce, ministries) and the delivery of presentations by project staff. A contact management system will be put in place in order to collate the contacts that are generated from the advertising campaign. Such a system should provide for the collection of basic information on the contact (name, address, contact details, business sector etc).

The first three months of implementation will be used for the initial identification of potential clients for the project and the creation of a corresponding "long list".

Following the first three months of implementation, the process of information gathering and client assessment will begin. This task will be the responsibility of the ex-pat advisor and the ABCC staff. The assessment will be carried out through the execution of detailed questionnaires. On the basis of the questionnaires, the potential clients will be categorized and prioritized in relation to the Project's criteria. Potential clients who take pro-active steps to attract project interventions will receive higher prioritization.

Once this categorization has been achieved, the potential clients will receive more detailed assessment at their places of business by a team of consultants who have experience with similar projects in other countries of the CIS for the purposes of drawing base line data, needs assessment and business diagnostic. The potential clients will also be assessed for any interventions that are of a specific nature to their activities. It will be important that this assessment is carried out in cooperation and consultation with the potential clients, so that there is a true client sense of ownership of the diagnostic and subsequent TA interventions. It should be noted that local consultants will accompany the hired consultant team and that they will learn from them the necessary skills to enable them to undertake such studies themselves at a later stage in the project.

On the basis of the in-depth analysis of potential clients, a short list will be identified for the first stage of the project (by month 9). The requirements of the clients will be collated in order to identify synergies of interventions to enable the ABCC to draw up a plan of work and match this with TA requirements.

The first technical assistance contract with client organizations will commence in the second year of implementation. For this first package, priority will be given to two main objectives; building local capacity in general consulting, and demonstration of successful interaction with the first set of clients in order to create confidence and disseminate positive information to the private sector and the Government. The winning consulting firm will need to exhibit three characteristics: (1) ability to assess agri-business from an overall perspective; (2) knowledge of the products in question, including specific technical knowledge; and (3) ability to sell consulting services to the client organizations.

The assignment will be for two years. The consulting firm will meet with the client to review the findings of the initial diagnostic review following which the client will be in position to sign a contract with the ABCC and the consulting firm on implementation of an agreed action plan. During implementation of the action plan, special expertise may be required from the consulting firm that will be brought in on a short-term, as needed basis. Local capacity building will be intensive during this initial package of technical assistance with client organizations, both for the clients themselves as well as for the local consultants that will be hired through the ABCC to work directly with the foreign consulting firm.

The effectiveness of the TA and client satisfaction will be monitored by the ABCC. On the basis of the monitoring, ABCC will take steps to adjust or improve the interventions of the TA or will advise the clients that they are not performing in accordance with the originally identified TA package. At any stage during the intervention, the TA providers or the client will be free to make representations to ABCC with regard to the execution of the intervention.

Any representations that provide for further necessary interventions (not previously identified) will be considered by ABCC. In the situation where the intervention is considered to be warranted, then the existing plan will be altered or provision would be made for further interventions at a later stage. It should also be considered that, where a client requests further interventions, the client will be expected to contribute in a significant manner to the costs of the intervention.

Based on the experience under the first package, the terms of reference for the second package will be prepared and that assignment tendered. This will likewise be a two-year assignment and will take place in years three and four of implementation. In this package increased attention will be given to pursuing specific commodities where business prospects are most promising and to bringing participating clients together through the auspices of the ABCC in an open and collaborative way. The third and final round of technical assistance with clients will be carried out in years four and five of the Project.

Access to Credit Component

Implementation of the component will be phased, with training and technical assistance programs both to the potential participating financial institutions (PFI) who will be qualified to participate in the credit line implementation, and any other commercial bank willing to train its lending staff to improve their skills in agricultural lending specifics and risk management. The training program will start with an initial round of seminars for loan officers, estimated about two weeks on both subjects. The training seminars will be followed by hands-on support to the PFI staff helping in carrying out the actual lending operations. Such rounds of technical assistance will be continued throughout the project implementation period as necessary, but at least once a year, to train new loan officers and/or deliver refresher courses.

After the initial round of technical assistance and training, qualified PFI will be able to start withdrawing credit line funds to finance eligible sub-projects. Skills of the PFIs in agricultural lending and risk appraisal will continue to be improved throughout the project implementation through training and hands-on support by the consultants in appraising specific lending proposals.

Annex 7: Financial Management and Disbursement Arrangements

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

Financial Management

The Credit Line Management Unit (CLMU) will have the overall responsibility for financial management, including disbursement , of both IDA-financed and PHRD-financed parts of the Project. The CLMU will also perform the respective transfers of funds from the budgetary funds, as required. The staff of the CLMU has obtained relevant financial management, disbursement and credit line management experience working in the PMU of the Second Rural Finance Project (which will be closing June 30, 2005).

Existing Accounting Structure, Systems and Controls. The World Bank Financial Management Specialist conducted a financial management capacity assessment of the CLMU in the Fall of 2003, and made the conclusion that the CLMU's capacity will be adequate for carrying out all tasks related to the Project financial management, disbursement, and overall credit line implementation. Upon a thorough review of the CLMU, such as staffing arrangements, staff experience, including implementing donor-funded projects, accounting procedures, accounting systems, financial reporting, internal controls, and the physical infrastructure (hardware and software), it was concluded that the CLMU's financial management capacity and arrangements are acceptable to the World Bank for the implementation of the Second Rural Finance Project (RFPII).

Financial Management Software. The CLMU, for the purposes of implementation of the RFP II, is currently using accounting software 1C Enterprise System, which will be modified to embrace both project implementation progress and financial management aspects. The respective CLMU staff have been trained in the application of the software. The necessary adjustments to the 1C system, to allow for initial ABMP-related task run in parallel to the tasks for the Second Rural Finance Project, will be finalized by the Effective Date, to ensure the capacity of the CLMU in handling the financial management for ABMP.

Financial Management Manual will be ready by the Board The manual sets out the relations, tasks and responsibilities of the parties involved in the financial management tasks, internal control procedures, as well as specify the flow of documents. A draft manual has already been prepared and commented on by the FMS. The final version of the manual will be submitted to the FMS for clearance by the Board date.

Reporting. Project management-oriented Financial Monitoring Reports (FMR) will be used for project monitoring and supervision, subject to the foregoing. During the Negotiations, it was agreed that the formats of the FMRs will be in compliance with the Guidelines on Financial Monitoring Reports, and will be based on the formats used by the CLMU for monitoring of other IDA projects and taking into account the modifications agreed for the Project. The formats and content of the FMRs, i.e., financial statements, procurement reports and output monitoring reports, are included in the Project's Financial Management Manual (FMM). The CLMU will produce a full set of FMRs quarterly throughout the life of the project. FMRs will not be used for disbursement purposes, but rather Bank-financing will be disbursed under the Bank's established procedures, including Statements of Expenditures (SOEs).

Audits. The World Bank's Audit Policy for this Project will require the selected auditors to issue a single project audit, irrespective of the sources of funding, which, however, will include a review of transactions of the Special Account and SOEs. A separate audit report on annual basis will be required for the ABCC. These arrangements will be included in the procedures that the auditors will carry out in order to express an opinion on the financial statements for both the Project and ABCC, and the DCA will specifically require audit procedures to take this into account. The audit will be carried out by an independent auditor

in accordance with International Standards on Auditing (ISA) and terms of reference acceptable to the Bank. The annual audit requirement will be included in the auditing arrangements administered and funded by IDA.
Financial Covenants. CLMU will be required to maintain a financial management system, including records and accounts, and prepare financial statements in a format acceptable to the Bank, adequate to reflect the operations, resources and expenditures related to the Project. In addition they will be required to have these accounts and statements audited each year and audit submitted to the Bank no later than six months after end of each fiscal year of implementation.

Financial Management capacity of the Agribusiness Competitiveness Center (ABCC). ABCC will be set up as an independently-operated Government-owned legal entity. In view of the substantial financing the ABCC will receive under the Project, it requires full financial management capacity. During the Negotiations, it was agreed that the ABCC's financial management system will be fully implemented and operational no later than March 31, 2006 (dated covenant). Upon completion of the setting-up of the financial management system, the ABCC will undergo the financial management assessment by the IDA's financial management specialist. In the meantime, to permit take-off and operation of the ABCC, the CLMU financial manager will temporarily handle the accounting requirements for the newly established entity.

Disbursements

The Project will start in CY05, with the expected disbursement period of six years. The Project Completion date will be June 30, 2010. Disbursement will follow normal IDA procedures and will be made against eligible expenditures. The table below shows allocation of the Credit proceeds.

Table 7-1. Allocation of Credit Proceeds

Expenditure Category	Amount in US$'000	Financing Percentage
1. Public sector investment	1,000	100%
2. Goods	85	100%
3. Consultant Services and Training, including audit	1,435	90% of foreign consultants; 100% of local consultants
4. Sub-loans	5,000	100% of amount disbursed by the PFIs on or before December 31, 2006; 80% thereafter
5. Incremental Operating Expenses	410	100%
6. Unallocated	170	
TOTAL	8,100	

Incremental Operating Expenses. The project will finance 100% of qualified operating expenditures, based on the new Country Financing Parameters, upon agreement with IDA of the annual budgets of such expenses during the life of the project. The project executing and monitoring agencies, i.e., ABCC, CLMU and PMAO are non-revenue generating entities and do not have their own resources from which to cover expenses related to executing their responsibilities under the project. In addition, the currently high indebtedness of the country and related international agreements impose strong fiscal constraints on the Government's ability to provide substantial counterpart financing for operating expenditures related to the project.

Disbursements will be administered by CLMU, which will collect and compile the necessary documents for withdrawal of funds from the credit line from the PFIs, and perform the disbursement transactions.

The specific responsibilities of the CLMU, as well as of counterpart institutions involved in disbursements from the credit line will be provided in detail in the Project Implementation Manual. The disbursements will be made through the Special Account (SA).

Eligible Financing Period: Disbursements from the credit line will only be made for expenditures that have not been made earlier than 90 days prior to the date on which CLMU shall have received the withdrawal application from the PFI.

Statements of Expenditure (SOEs): All disbursements will be made against SOEs and other necessary documents supporting the disbursement application. SOEs will be used for(a) goods costing less than $100,000 equivalent per contract; (b) works costing less than $350,000 equivalent per contract; (c) services of individual consultants costing less than $25,000 equivalent per contract; (d) services of consulting firms under contracts costing less than $50,000 equivalent per contract; (e) training; (f) Sub-loans; and (g) incremental operating costs. For all contracts financed under the credit lines, full documentation in support of the SOE will be retained in MOF for at least 2 years after the closing date. This information will be available for review by the IDA missions during project supervision and by the project's auditors.

SOEs will be audited in conjunction with the annual audit of the project (see description of the project's financial management arrangements above).

Special account (SA). To facilitate the Project implementation, the MOF will open for the project two Special Accounts (SA), separately for PHRD and IDA funds, before the credit effectiveness and maintain them until Project completion. The SAs will be opened in a commercial bank acceptable to IDA, and on terms and conditions acceptable to IDA. The SA will be drawn upon to meet payments to contractors, suppliers, and consultants under the project. Disbursement of sub-loans to final beneficiaries from IDA SA will be based on the terms of payment in the sub-loan agreements and according to the actual expenditures incurred.

The selected bank should have: (a) significant foreign correspondence network covering all currencies; (b) reasonable capacity and experience for issuing letters of credit, making direct foreign payments and other international transactions; (c) capacity to perform a wide range of banking services at local branches, including cash payments, transfers to other domestic and regional banks, issuance of debit notes, application of conversion rates from foreign currencies; (d) the capacity to maintain adequate accounts for the SAs as required by IDA, and provide monthly statements to CLMU; (e) willingness to issue a Comfort Letter to ensure that amounts deposited in the SAs will not be set off or otherwise seized or attached to satisfy amounts due to a commercial bank by the Borrower.

The Special Accounts will be audited in conjunction with the annual audit of the project (see description of the financial management arrangements above).

SA Allocations. The total authorized allocation both for the Credit and PHRD Special Accounts will be limited to US$ 0.5 million. The initial deposit to the Credit SA will be limited to 50% of the authorized allocation until the aggregate amount of withdrawals from the Credit shall be equal to or exceed SDR 1.5 million. Replenishment applications should be submitted at least every three months and must include reconciled bank statements as well as other applicable supporting documents. Project accounts will be operated and funded with direct transfers or from the Special Account, based on disbursement applications signed by the authorized officials.

Technical Annex 8: Procurement Arrangements

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

A. General

Procurement for the proposed project would be carried out in accordance with the World Bank's "Guidelines: Procurement Under IBRD Loans and IDA Credits" dated May 2004; and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004, and the provisions stipulated in the Legal Agreement. The general description of various items under different expenditure category are described below. For each contract to be financed by the Grant, the different procurement methods or consultant selection methods, the need for prequalification, estimated costs, prior review requirements, and time frame are agreed between the Borrower and the Bank project team in the Procurement Plan. The Procurement Plan will be updated at least annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

The Project is demand driven, with US$5 million to be disbursed through two credit lines. Commercial practices will be applied for these funds. In addition, US$1 million is set aside in the Public Infrastructure Investment Sub-component for financing of sub-projects to be identified and appraised during the course of implementation.

Procurement of Works: Procurement of the civil works under this project will be done using the Bank's Standard Bidding Documents (SBD) for all ICB and appropriate standard bidding documents for NCB, which shall contain draft contract and conditions of contract acceptable to the Bank.

Procurement of Goods: Goods identified for procurement at the time of appraisal include office equipment, furniture, and vehicles. The procurement will be done using Bank's SBD for all ICB and appropriate standard bidding documents for NCB, which shall contain draft contract and conditions of contract acceptable to the Bank.

Procurement of non-consulting services: Technical services under the project will be procured in accordance with the appropriate bidding documents, which shall contain draft contract and conditions of contract acceptable to the Bank.

Selection of Consultants: Consultant services to be procured under the Project include: technical assistance programs for clients of the ABCC; capacity building assistance for the ABCC itself; capacity building for the PFIs; export promotion; staffing of the ABCC, CLMU, and PMAO; and recruitment of local consultants to work with the ABCC and the international TA provided to the PFIs. Short lists of consultants for services estimated to cost less than $100,000 equivalent per contract may be composed entirely of national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Operational Costs: The project will finance the following for the ABCC, CLMU, and PMAO: office supplies, office rent, utilities and communications, travel and subsistence, and vehicle fuel and maintenance costs. The ABCC, CLMU and PMAO will prepare an annual budget to be agreed with the Association.

B. Assessment of the agency's capacity to implement procurement

Most of the issues/ risks concerning the procurement component for implementation of the project have been identified and include:

(i) Government officials, who would be involved in project procurement through Tender Committees may not be familiar with procurement procedures;

(ii) The bureaucratic system creates opportunities for informal interference in procurement process by senior officials;

(iii) The above mentioned risks would be a basis for delays of the procurement processes;

The corrective measures which have been agreed are:

(i) That procurement of consultant services for clients of the ABCC will be managed by the ABCC itself. The ABCC, through direct knowledge of business issues facing its clients will be best placed for specifying and evaluating the technical assistance to be provided. The management of ABCC will be provided training in the Bank's procurement guidelines for procurement of consultant services.

(ii) A procurement specialist will be recruited for the ABCC, and should receive training in international procurement based on regional workshops and seminars

(iii) The evaluation of technical assistance for the PFIs will be managed by the Ministry of Finance, with assistance of the CLMU. Both organizations have experience and demonstrated competence in this area.

Thresholds for Procurement Methods. It is recommended that the following thresholds be applied under this project:

Procurement Method	Threshold
ICB: Goods	>US$100,000
Shopping: Goods	<US$100,000 per contract
NCB: Works	<US$350,000
Shopping (Works)	<US$50,000
Quality and Cost Based Selection (QCBS) for Consultant Services	>US$200,000 per contract (International shortlist) <US$100,000 (National shortlist)
Selection Based on Consultants' Qualifications	<US$200,000 per contract

<u>Suggested Thresholds for Prior Review</u>

Taking into account high risk rating the following procurements are subject to prior review by the Bank:

a. All contracts awarded through ICB (estimated to cost more than US$100,000)

b. First NCB contract for works (estimated to cost less than US$350,000)

c. All TORs for consulting services, irrespective of the contract value

d. Contracts with consulting firms (≥US$50,000) and contracts with individual consultants (US$25,000) or more

e. Single source or direct contracting is a subject to justification

The above thresholds can be subject to revision as the project implementation progresses..

Procurement Plan

The Borrower, at appraisal, developed a Procurement Plan for project implementation which provides the basis for the procurement methods. This plan has been agreed between the Borrower and the Project Team on October 7, 2004 and is available at the PMU (future CLMU) of the Ministry of Finance. It will also be available in the Project's database and in the Bank's external website. The Procurement Plan will be updated in agreement with the Project Team semi-annually or as required to reflect the actual project implementation needs and improvements in institutional capacity.

D. Frequency of Procurement Supervision

In addition to the prior review supervision to be carried out from Bank offices, the capacity assessment of the Implementing Agency has recommended once a year supervision missions to visit the field to carry out post review of procurement actions.

Attachment 1. Details of the procurement arrangement

1. Goods and Works:

1	2	3	4	5	6	7	8	9
No.	Contract Description	Estimated Cost (US$)	Procur Method	P-Q	Domestic Preference (yes/no)	Review by Bank (Prior / Post)	Expected Bid-Opening Date	Comments
1	Equipment of ABCC/MDC	13,500	Shopping	N/A	N/A	post	Nov 10, 2005	
2	Vehicles	24,000	Shopping	N/A	N/A	prior	Dec 10, 2005	
3	Equipment of ABCC/MDC and CLMU	42,000	Shopping	N/A	N/A	prior	Apr 1,2005	

2. Consulting Services:

1	2	3	4	5	6	7
No.	Description of Assignment	Estimated Cost (US$)	Selection Method	Review by Bank (Prior / Post)	Expected Proposals Submission Date	Comments
1	Staff of ABCC/MDC		Ind.	prior	March 1, 2005	
2	Staff of CLMU		Ind.	prior	June 30, 2005	
3	Staff of PMAO		Ind.	prior	March 1, 2005	
4	Capacity building of ABCC	150,000	Ind	prior	Feb 20, 2005	
5	Capacity building of ABCC	95,000	CQ	prior	Feb 20, 2005	
6	Investment lending TA and training	140,000	FBS	prior	Feb 15, 2005	
7	Structured finance TA and training	60,000	CQ	prior	Feb 15, 2005	
8	National banking consultant		Ind	prior	Apr 1, 2005	
9	Environmental training consultant	37,000	Ind	prior	June 15, 2005	
10	Team leaders for supply chain management TA		Ind	prior	June 15, 2005	
11	Staff of ABCC/MDS Southern office		Ind	prior	Aug 15, 2005	
12	Audit for 2005	10,000	CQ	prior	Feb 10, 2006	
13	TA package for ABCC clients	1,500,000	QCBS	prior	March 15, 2006	

Annex 9: Economic and Financial Analysis

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

The economic benefits of the Project will accrue through two channels: (i) direct interaction with clients of the ABCC; and (ii) assistance to other private sector actors, improvement in the functioning of markets, and enhanced public sector capacity. The second channel of benefits will be realized through the public sector work of the Project on infrastructure and capacity enhancement, introduction of necessary regulatory and policy changes, work of the MDS which is provided to organizations that are not included in the programs of TA run by the ABCC, provision of credit under the two credit lines, and capacity building of participating financial institutions.

Because of the diverse nature of these benefit streams, an overall economic and financial analysis for the Project has not been undertaken. However, analysis of the specific benefits to the budget has been carried out for the first channel listed above – direct interaction with clients of the ABCC. The Access to Credit Component, will provide two demand driven credit lines and it is not possible to foresee the specific activities that will be financed. However, according to the lending guidelines for participating financial institutions, each sub-loan approved will be required to have rates of return above on-lending rates of interest and to demonstrate the repayment capacity of the borrower.

Direct Interaction with ABCC Clients -- Supply Chain Management Sub Component

The Supply Chain Management Subcomponent follows the design of similar private sector development projects implemented in Moldova, Georgia and the Ukraine, where significant benefit to enterprise performance has been recorded.

The benefits will be direct and indirect. Direct benefits for enterprises will include increased value added, productivity, and level of capacity utilization

Indirect benefits include the productivity improvement in firms which did not participate in the project, but copied the newly introduced technologies and management mechanisms from participating firms.

The Access to Credit Component will provide two-fold benefits:

(a) *increase capacity and willingness of commercial lenders* to lend for, currently underserved, agricultural and agri-business clients, by improving the relevant loan appraisal skills in the banks, and providing them with a set of tools allowing for improved risk management in agricultural lending. The technical assistance activities are designed to trigger increased lending to the agricultural and agro-processing sectors, as banks will be able to apply the new skills, and thus expected to complement the project funds with other available funding.

(b) *increase the overall investment* **in the agricultural and agro-processing sector.** Based on the lending activities for agro-processing in KAFC and the commercial banking sector, it is projected that during the project period, in addition to the US$ 5 million made available under the project, the commercial banks and KAFC will make additional loans to agro-processing and marketing companies in the amount of US$ 5 million equivalent from their own funds or other available credit lines.

Financial Analysis

Overall, the agricultural reforms are relatively advanced in the country, and there are no major distortions in the economy, thus there is little rationale for an overall economic analysis, and only financial analysis has been attempted, where applicable.

Investment lending. Due to the demand-driven nature of the project's activities, there will be no attempt to *a priori* calculate the financial return rates on the specific investments to be financed under the Investment Facility sub-component. Instead, the participating financial institutions will carry out analysis of the proposed investments and only proposals with sufficient rate of return, considered bankable by the PFIs will receive financing.

Transaction finance. For the transaction finance product of credit line, it was attempted to develop a model to show the financial benefits to the sub-borrowers obtaining loans for this product. Transaction finance enables the lender to isolate the financing of a sound transaction from the overall account of the company. Thus, the product 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.

Three models, for initial loan amounts of US$10,000, US$20,000, and US$40,000, were developed with and without the project, for an agro-processing company (tomato paste production), with a need to maximize the purchase of raw material during the post-harvesting season between August and October. Without the project, in view of limited available collateral, it was assumed that the borrower would be able to borrow the initial loan amount, to be used for purchase of tomatoes, and any subsequent purchases of raw material would be financed from the proceeds of sale of the tomato paste. With the project scenario envisaged use of the stock of the ready product (tomato paste) as additional collateral, thus permitting subsequent borrowing from the financial institution.

The Cash Flows and Income Statements of the three different scenarios produced the following results (the ranges depend on the size of the loan – the larger the initial loan, the larger the additional benefit):

(i) the additional collateral permitted to increase the size of borrowing, on average 4 to 4.5 times above the initial loan size;

(ii) the company was able to increase the raw material purchases during the post-harverst season by 55%-70%;

(iii) as a result, the stock of ready products increased accordingly, between 55% and 70%;

(iv) income from sales of tomato paste increased by 55%-83%;

(iv) the net profit in each case was 65% to 93% bigger than in the respective scenario without the project.

As an example, summary Income Statements without and with the project are attached below, for the loan amount of US$ 40,000. Full calculations are available in the project files.

Summary Income Statements: US$ 40,000 initial loan

Without Project:

Income Statement	
Sales	305,500
Total costs	177,190
Warehousing costs	0
Interest paid	2,600
Net income	125,710

With Project:

Income Statement	
Sales	558,333
Total costs	298,860
Warehousing costs	3,474
Interest paid	12,988
Net income	243,012

Annex 10: Safeguard Policy Issues

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

Environmental Assessment

General

The ABMP has a number of features of an FI category project, however, due to certain aspects of the Project it has been classified as a Category B and as such requires an EIA. Although there are a number of agribusiness activities (specifically agro-processing) that will be financed, like a typical FI category Project it is unknown as to which ones will be financed and to their location. The EIA will be strategic in nature, dealing with groups of agribusinesses (e.g. meat processing, fruit and vegetable processing, dairy processing, oilseed processing) although there will be a number of common features for each group. This does not negate the necessity of an EA for a sub-project for which an EA may normally be required. Not all lending will be for agro-processing activities for which it is clear that EIAs will be required. Accordingly, the participating financial intermediaries (PFI) will be required to ensure that borrowers conduct an appropriate EA, where warranted, for each sub-project. Before approving a sub-project, the PFI will verify that the sub-project meets the environmental requirements of the Bank even though national requirements may have been met.

The ABMP itself is environmentally benign. The overall effect of the sub-projects will be positive. The loans will result in improved agricultural production, improved marketing, and in general, improved socioeconomic conditions of the rural population. The Project will further contribute to the country's food security, hopefully contribute to the generation of foreign exchange through increased agricultural exports, and most of all, the Project, through the sub-projects, will significantly contribute to the alleviation of rural poverty. However, the Project's primary objective does not include a contribution to the enhancement of the environment. In the past ten years rates of chemical inputs in agriculture have been significantly reduced, resulting in cleaner watercourses, lower levels of soil contamination and relatively chemical free food. The Project could lead to an increase in the use of farm inputs but mitigation measures and training associated with the Project could minimize any potential environmental impacts. To some extent, it is presumed that some of the industries under the former socialist regime which created significant environmental problems may be refurbished to operate more efficiently and without the major environmental contamination of the past. In theory, current environmental regulations should prevent a return to serious environmental issues.

Category A and Category B Sub-projects

The World Bank requires that any sub-project that would normally fall within Category A or Category B would require an EIA. The onus of recognizing sub-loan applications for sub-projects that may fall into one of these categories rests with the CLMU and the PFI loan officers of the various lending institutions.

The portion of sub-projects anticipated will involve the renovation or improvement of agro-processing industries. Some of the sub-projects may involve transportation, warehousing, marketing and agricultural production. It is likely that only the agro-processing activities would fall within the World Bank's Categories A or B.

Adequate and appropriate environmental review is normally assured by MEES (most likely through the oblast offices). However, to ensure that the World Bank's environmental requirements are not overlooked it will be necessary for the CLMU to establish an adequate and appropriate environmental review and monitoring procedure. the CLMU will establish procedures for screening and scoping of sub-project proposals including, as appropriate, consultation with local state environmental inspectors

(MEES) and the public. Based on preliminary review of the potential impacts and the scale of sub-projects (screening and scoping) and in consultation with MEES experts at raion or oblast level, the CLMU would provide advice to sub-project proponents in determining the level of environmental analysis required.

It must be remembered that '*'....it is the extent of the impacts, not the sector, that determines the extent of the environmental assessment and, hence, the category.*[1]' and as such it will be important that the CMLU and PFI loan officers have sufficient knowledge to recognize the significance of any impacts that may occur for any particular sub-project being assessed for a loan.

Management

The CLMU will be responsible for monitoring the environmental aspects of the Credit Line implementation. This Unit should have a staff member or a consultant with an environmental background (through training) to ensure that projects being supported are not ones that would unduly affect the environment. The individual would be responsible for screening the sub-project (although the PFI would also provide screening recommendations) that would result in designating the sub-project a World Bank category (A, B or C). Guidelines for screening sub-projects are provided in as Annex 3 to the Agri-Credit Guidelines. The individual should also be in close collaboration with relevant MEES staff and concerned NGOs.

Mitigation of any environmental effects will be the responsibility of the sub-project proponent. However, it will also be the responsibility of the lending agency, the MEES, concerned public and the CLMU to ensure that mitigation is carried out successfully.

The most appropriate good practices for agribusinesses relate to safety and health. Agro-processing activities must maintain high hygiene standards and all businesses must ensure safety instruction to their employees as well as the provision of protective clothing where appropriate. Those businesses requiring cold storage facilities (e.g. abattoirs, dairy plants and some warehouses) must ensure that all new purchases of refrigeration equipment are ozone friendly.

Table 1 provides some suggested good practices related to agricultural production.

Table 1: Some Agricultural Good Practices – Towards a Protected Environment and Sustainable Agriculture

ACTIVITY	***Good Practices***
Seed	. selection of seed with lowest agro-chemical input requirements to achieve high yields . selection of seed with minimal level of pest and disease vulnerability . rigorous sanitation facilities and procedures for imported seed . rigorous sanitation facilities and procedures for exported seed . extension services provide advice on appropriate fertilizer and pesticide applications . where possible, extension service to promote sustainable agricultural practices including IPM, minimum tillage, contour ploughing, crop rotations, and green manuring

[1] World Bank. 1998.

Fertilizers	. selection of best fertilizers for crop and prevailing soil conditions . application levels as per recommended by manufacturer and extension service
Pesticides	. IPM is a priority and pesticides to be applied sparingly and only where absolutely necessary . careful handling of pesticides; protective clothing and equipment to be used
Pedigree livestock	N/A
Livestock for finishing	. manure handling facilities designed to ensure zero runoff
Land rental/purchase	. land to be rented or purchased not to be environmentally sensitive – check with MENR before finalizing agreement
Tractors	. purchase of engine efficient tractors that provide highest ratio of power and work to fuel input . tractors with high efficiency emissions control . tractors no larger than necessary for the most extensive work anticipated
Farm implements	. implements suitable for minimal tillage and others which are applicable to organic farming methods
Land preparation	. contour ploughing, minimum tillage, grassed waterways, etc.
Small equipment	. energy efficient equipment
Grain drying equipment	. energy efficiency to be a prime concern
Irrigation equipment	. highest efficiency equipment . equipment that assists in the use of irrigation water in an efficient manner
Vehicles	. low emission vehicles/vehicles with high efficiency engines
Farm buildings for stock, machinery, and chemicals	. location of buildings where least disturbance of resources required . energy efficient building design including heating, ventilation . building design to minimize materials and use of environmentally friendly materials
Storage facilities	Same as above
Fencing materials	N/A
Primary processing equipment	. high efficiency equipment including low emission fuels (e.g. gas, solar)
Fuel, lubricants, spare parts and other operating requirements	. safe storage of fuels, lubricants and chemicals
Veterinary services	. zero use of hormones and minimal use of drugs . alternative medicine

To ensure timely and effective mitigation, an effective monitoring system will be implemented and guidelines for developing a monitoring system are discussed in Section 4.

Monitoring

The project's PFI loan officers will be responsible for ensuring that sub-projects comply with Bank environmental requirements and Kyrgyz environmental legislation. However, loan officers are not environmental specialists. With some basic training (see Section 5 and Table 2) they will be able to monitor the sub-projects but often they will have to rely on consultations with the CLMU environmental specialist (assuming that one of the Unit's officers will receive appropriate training) and/or MEES staff for guidance and advice. If there are to be a large number of sub-projects monitoring will likely be conducted on a sample basis. From an environmental viewpoint, those groups of sub-projects which have the potential for creating the most serious environmental problems should be given highest priority for sampling. For monitoring to be effective, results must be acted upon, and as such, monitoring results will be considered when loan applications are reviewed and conditions are placed on subsequent loans.

Although the legal authority and responsibility of monitoring rests with the MEES and other civil authorities (e.g. MoH, MAWPRI) the capacity for monitoring and enforcement of these agencies is limited. The CLMU will need to ensure that an effective monitoring program is built into the sub-projects. For sub-projects with potential for significant impacts, a monitoring plan would be required as part of the documentation for sub-project approval. The results of monitoring would be taken into account in consideration of subsequent requests for financing.

Loan officers of PFIs will be responsible for:

- monitoring all sub-projects (with assistance from MEES) that have required an EA to ensure that mitigation is carried out as planned and to ensure that no unanticipated effects have occurred.
- randomly reviewing, with field visits, projects that have not required EAs, to ensure that they are environmentally acceptable (he/she will use a checklist to determine whether or not the borrower is complying with the environmental requirements).
- where necessary, prescribing corrective actions to be taken, without which the loan will be cancelled/not renewed.
- taking into account the cumulative effect of a number of projects in a small area, particularly within a critical watershed.

Bank supervision missions should consider including an environmental specialist once a year to audit monitoring procedures and results and as well, provide an assessment of the effects, if any, that the Project may be having on cumulative impacts.

Table 2 provides a summary of monitoring and reporting responsibilities for ABMP.

Environmental Capacity Development

To ensure that all elements of the ABMP management structure (CLMU, PFIs and MEES) are fully aware of the environmental screening, assessment, management and monitoring activities that are incorporated in ABMP implementation, the project will need to invest in appropriate training for each of these links in the management chain.

Table 2: Summary of Monitoring Responsibilities

Monitoring Requirements	Responsibility	Frequency
Ensure borrowing enterprises are in compliance with EE passport requirements (dealing with discharges, emissions and solid wastes). Make recommendations where appropriate.	MEES (head office or oblast staff)	Monthly – unannounced visits. Scientific measurements required.

Review of EE passport monitoring results. Ensure follow up on recommendations.	CLMU	Bi-annually, to ensure that monitoring is regular and that borrower is meeting environmental requirements
Examine environmental aspects (other than discharges, emissions and solid wastes) as indicated in enterprise's environmental management plan, for compliance. Make appropriate recommendations.	PFIs with CLMU	Bi-annually – unannounced visits (no measurements required)
Examine environmental effects of enterprises that did not require EIAs and make recommendations.	PFIs	Bi-annually
Review of PFI monitoring reports (see above) and ensure follow up of recommendations.	CLMU	Bi-annually
Review efficiency and effectiveness of overall monitoring – process and results.	World Bank	Annually
Investigate selected enterprises for compliance and make any necessary recommendations.	World Bank	Annually
Review selected EIAs of borrowing enterprises for completeness re: WB requirements. Visit selection of enterprises to test accuracy of EIA.	World Bank	Annually
Examine the cumulative effect of selected enterprises.	CLMU	Annually

CLMU

The CLMU staff needs to be generally aware of the procedures established for environmental screening, scoping, assessment, review, management, mitigation and monitoring. They also need to be aware of types of projects that are ineligible for financing under World Bank guidelines and the general procedures and costs that may be associated with carrying out environmental assessment of potential Category A or B sub-projects.

To ensure compliance of ABMP financed sub-projects with existing environmental regulations and those that may be promulgated in the future, the CLMU should have an environmental specialist on staff or arrange a contract with a qualified non-governmental organization to: provide guidance on initial project screening and review; develop terms of reference for sub-project review or assessment; review environmental management and monitoring plans submitted as part of the sub-project appraisal process, and; periodically determine that monitoring is being carried out to appropriate standards.

Activities to be carried out by the environmental specialist or contractor would include:

- review of applications for sub-project financing (whether or not these require permits from MEES) to identify potential environmental impacts and carry out field inspections as needed;
- review of sub-projects requiring an environmental assessment under MEES or World Bank guidelines;
- develop terms of reference for environmental assessments for sub-projects for which these are required;
- review environmental assessments, environmental management and monitoring plans for sub-projects requiring them;
- provide guidance to sub-project proponents on environmental mitigation that can be incorporated into project implementation;
- monitor all sub-projects requiring an environmental assessment to ensure that mitigation is being carried out as planned and no unidentified effects have occurred;
- selectively undertake field visits to sub-projects for which environmental clearance permits were required to monitor compliance;
- randomly carry out field visits to sub-projects that do not require environmental clearance permits to ensure that acceptable environmental standards are being met.

The environmental specialist or contractor will ensure that applicable national standards and guidelines are being achieved or followed. Where multiple sub-projects are being carried out in geographical proximity, assess the possible cumulative effects on the environment (in particular natural habitats, forests, soil, air and water quality).

The environmental specialist or contractor will provide guidance and backstopping to PFI loan officers on the application of project environmental screening procedures to sub-project proposals.

In addition to having an environmental specialist on staff, or the use of an environmental consultant, the staff should be generally environmentally aware and have a general knowledge of the potential impacts of various types of sub-projects, the types of sub-projects that are ineligible for financing, and the requirements of MEES for environmental clearance.

At the minimum, CLMU staff should attend a two-day environmental awareness and analysis workshop that will demonstrate how sub-projects financed by project sub-loans can affect the environment and the steps to be taken to avoid impacts.

PFI Loan Officers

Participating private retail banks are not in the environment business. Their main function will be to approve and administer loans. These organizations do not have the knowledge, or the official responsibility for environmental protection. The PFI loan officers will need to be familiar with the sub-project screening methods and criteria, and project requirements for including appropriate mitigation and monitoring in the costs to be financed. They will also need an understanding of the content of environmental management and monitoring plans and the general nature of mitigation requirements for "typical" sub-project investments. They need to be generally aware of MEES requirements for environmental clearance and the permitting process for waste discharge. They need to be aware of the MAWRPI and MOH roles in monitoring and enforcement of water quality standards.

PFI loan officers need to be familiar with the environmental screening procedures for initial sub-project review that will determine the level of environmental assessment a given sub-project may require. They should also be generally aware of the kinds of environmental problems that may be associated with different types of projects and the kinds of mitigation options that may be required to address them. They need to be familiar with the structure and general content of environmental management plans (including monitoring activities) that may be required for some types of sub-projects. They need to be aware of MEES procedures for environmental review and clearance of those projects requiring environmental review as well as any reporting or monitoring responsibilities of the project proponent to assure compliance with national permit requirements for waste discharge or conformance with other environmental standards.

Key personnel from the organizations should attend a half-day environmental awareness workshop and all loan officers should attend an environmental awareness and analysis workshop.

Environmental review guidelines will be provided to loan officers (as well as CLMU staff) in determining the World Bank category of projects and the impacts that can be expected for various types of sub-projects.

Agribusiness Entrepreneurs

Agribusiness entrepreneurs are businessmen first and foremost. They generally meet government environmental requirements but in all likelihood are not always aware of the consequences of not meeting these requirements. With a better understanding of the environment and how their particular activities can cause impact on the environment, they may become more pro-active in their business planning and actions. It is recommended that they attend an environmental awareness workshop.

Table 3 summarizes the environmental capacity building requirements for the ABMP.

Table 3: Summary of Environmental Capacity Building Requirements

Target Audience	Type of Capacity Building	Description	Inputs Required
1. CLMU director, senior PFI staff	Environmental awareness workshop	Half day seminar discussing the importance of the environment and the consequences for not addressing issues.	1.5 days of international consultant time and 1.0 days of local consultant time.
2. Participating agro-processing borrowers	Environmental analysis workshop	One-day workshop on environmental awareness but with additional depth related to their specific operations. Beyond environmental awareness with emphasis on impacts and their consequences, and mitigation; outline of relevant legal	Four days of international consultant time (extra time required to further research environmental effects of specific operations (e.g. tanning, abattoirs); Four days of local environmental legal consultant.

		requirements.	
3. PFI staff (loan officers) as well as CLMU staff and selected MEES (young field professionals)	Environmental analysis including environmental impact assessment procedures	Two day workshop on environmental analysis and impact assessment with emphasis (i) on national and World Bank requirements for environmental assessment, mitigation, monitoring and reporting; (ii) screening and scoping procedures including checklists; (iii) the generic procedures for environmental assessment required by the World Bank and national authorities (MEES); (iv) management plan content; and (v) monitoring and reporting requirements of the World Bank for sub-project supervision. Field studies will be included.	Eight days of international consultant time for first group of 24 officers; four days of consultant time for each additional group of 24.
4. PFI loan officers and others	User friendly manual	A manual describing, step by step, how to screen (categorize) projects and to provide impacts to be expected and how to mitigate such impacts	Done
5. Loan officers, PCLMU staff and junior MEES field staff	Basic environmental monitoring techniques	Three day workshop on monitoring techniques and systems	Eight days of international consultant time

Annex 11: Project Preparation and Supervision

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

	Planned	Actual
PCN review		November 6, 2003
Initial PID to PIC		November 11, 2003
Initial ISDS to PIC		November 11, 2003
Appraisal		October 7, 2004
Negotiations		November 10, 2004
Board/RVP approval	December 14, 2004	
Planned date of effectiveness	March 14, 2005	
Planned date of mid-term review	September 30, 2007	
Planned closing date	December 31, 2010	

Bank staff and consultants who worked on the project included:

Name	Title	Unit
Edward Cook, TTL	Sr. Agriculture Economist	ECSSD
Sandra Broka	Rural Financial Specialist	ECSSD
Talaibek Koshmatov	Operations Officer	ECSSD
Juergen Venema	Junior Professional Associate	ECSSD
Nana Adeishvili	SME Development Specialist	consultant
Marc Sadler	Agribusiness and Marketing Specialist	consultant
Stan Peabody	Lead Social Scientist	ECSSD
Anarkan Akerova	Counsel	LEGEC
Hannah Koilpillai	Senior Finance Officer	LOAG1
Andrina Ambrose	Senior Finance Officer	LOAG1
John Ogallo	Financial Management Specialist	ECSPS
Naushad Khan	Procurement Advisor	ECSPS
Nurbek Kurmanaliev	Procurement Assistant	ECCKG
Valencia Copeland	Team Assistant	ECSSD
Irina Sarchenko	Team Assistant	ECCKG

Bank funds expended to date on project preparation:

1. Bank resources:
2. Trust funds:
3. Total:

Estimated Approval and Supervision costs:

1. Remaining costs to approval:
2. Estimated annual supervision cost:

Annex 12: Documents in the Project File

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

1. Environmental Impact Assessment, Agribusiness and Marketing Project, April 2004.

2. Guidelines for Identification, Assessment and Mitigation of Environmental Impacts of Sub-Projects, Agribusiness and Marketing Project, February 2004.

3. Social Assessment for the Development of the Agribusiness and Marketing Project in the Kyrgyz Republic, Final Report, March 2004

4. Proposed Project Outline for an Agribusiness and Marketing World Bank Credit Line, Final Report, AFC Consultants, November 2003

4. Agri-Credit Guidelines, for use by the CLMU in Project Implementation, November 2004

5. Summary Income Statements for Commodities under the Structured Finance Facility, October 2004

6. Preparation mission Aide Memoires, October 2003, February 2004, June 2004, October 2004

7. National Business Opinion Survey, International Business Council, June 2003 (funded by EU-TACIS and CIM(GTZ))

8. Strategia razvitiya promyshlennosti po pererabotke ovoschei i fruktov v Kyrgyzstane, Helvetas, 2004 (funded by SECO)

9. Rapid Market Assessment: Identifying Opportunities for Kyrgyz Agro-Processors in the Russian Markets, June 28, 2002, USAID SME Development Project, the Pragma Corporation

10. Kyrgyz Republic: Agriculture and Agribusiness – Growth Opportunities and Obstacles, Poverty Reduction and Economic Management Unit, Europe and Central Asia Region, World Bank, June 30, 2002

Annex 13: Statement of Loans and Credits

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

			Original Amount in US$ Millions						Difference between expected and actual disbursements	
Project ID	FY	Purpose	IBRD	IDA	SF	GEF	Cancel.	Undisb.	Orig.	Frm. Rev'd
P074881	2004	PYMNT/BANK SYST MOD	0.00	9.00	0.00	0.00	0.00	8.93	0.00	0.00
P073973	2004	VILLAGE INVESTMENT	0.00	0.00	0.00	0.00	0.00	15.29	0.32	0.00
P071061	2003	GOV SAC	0.00	20.00	0.00	0.00	0.00	15.45	1.68	0.00
P071063	2003	GOV TA	0.00	7.78	0.00	0.00	0.00	8.42	0.13	0.00
P036977	2002	RURAL WS & SAN	0.00	15.00	0.00	0.00	0.00	15.99	5.15	0.00
P051372	2001	HEALTH 2	0.00	15.00	0.00	0.00	0.00	10.09	4.71	-0.22
P050719	2001	URBAN TRANS/MAINT.	0.00	22.00	0.00	0.00	0.00	3.32	-19.41	0.00
P035810	2001	CONSOLIDATION SAC	0.00	35.00	0.00	0.00	0.00	17.66	17.75	17.75
P049719	2000	LAND REGISTRATION	0.00	9.42	0.00	0.00	0.00	5.31	3.31	0.00
P069814	2000	CONSLD TA	0.00	5.00	0.00	0.00	0.00	3.16	2.46	0.00
P049723	2000	ON-FARM IRRIGATION	0.00	20.00	0.00	0.00	0.00	17.97	7.35	0.00
P064585	1999	RUR FIN 2	0.00	15.00	0.00	0.00	0.00	3.40	3.24	0.00
P046042	1998	IRRIGATION REHAB	0.00	35.00	0.00	0.00	0.00	8.04	6.09	0.00
P040721	1998	ASSP	0.00	14.98	0.00	0.00	2.03	5.37	6.90	0.02
P008519	1996	POWER & DIST HEAT	0.00	20.00	0.00	0.00	0.00	16.78	1.96	21.75
		Total:	0.00	243.18	0.00	0.00	2.03	155.18	41.64	39.30

KYRGYZ REPUBLIC
STATEMENT OF IFC's
Held and Disbursed Portfolio
In Millions of US Dollars

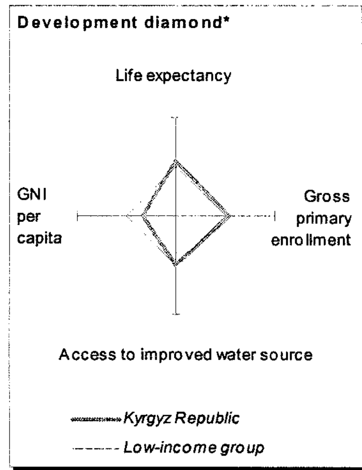
		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic.	Loan	Equity	Quasi	Partic.
2004	AKB Kyrgyzstan	1.50	0.00	0.00	0.00	0.55	0.00	0.00	0.00
1996/03	Demirbank Kyrgyz	0.00	0.11	0.00	0.00	0.00	0.11	0.00	0.00
2001	FINCA	0.00	1.00	0.00	0.00	0.00	1.00	0.00	0.00
1995	Kumtor Gold	0.00	0.00	10.00	0.00	0.00	0.00	10.00	0.00
2001	SEF Akun Ltd.	1.40	0.00	1.00	0.00	0.40	0.00	1.00	0.00
1999	SEF Altyn-Ajydar	0.15	0.00	0.00	0.00	0.15	0.00	0.00	0.00
2000	SEF KICB	0.00	1.40	0.00	0.00	0.00	1.40	0.00	0.00
	Total portfilio:	3.05	2.51	11.00	0.00	1.10	2.51	11.00	0.00

		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic.
	Total pending committment:	0.00	0.00	0.00	0.00

Annex 14: Country at a Glance

KYRGYZ REPUBLIC: AGRIBUSINESS AND MARKETING PROJECT (ABMP)

POVERTY and SOCIAL	Kyrgyz Republic	Europe & Central Asia	Low-income
2002			
Population, mid-year *(millions)*	5.0	476	2,495
GNI per capita *(Atlas method, US$)*	290	2,160	430
GNI *(Atlas method, US$ billions)*	1.5	1,030	1,072
Average annual growth, 1996-02			
Population *(%)*	1.2	0.1	1.9
Labor force *(%)*	2.0	0.4	2.3
Most recent estimate (latest year available, 1996-02)			
Poverty *(% of population below national poverty line)*	64	..	..
Urban population *(% of total population)*	34	63	30
Life expectancy at birth *(years)*	65	69	59
Infant mortality *(per 1,000 live births)*	54	25	81
Child malnutrition *(% of children under 5)*	11	..	..
Access to an improved water source *(% of population)*	77	91	76
Illiteracy *(% of population age 15+)*	..	3	37
Gross primary enrollment *(% of school-age population)*	101	102	95
Male	103	103	103
Female	100	101	87

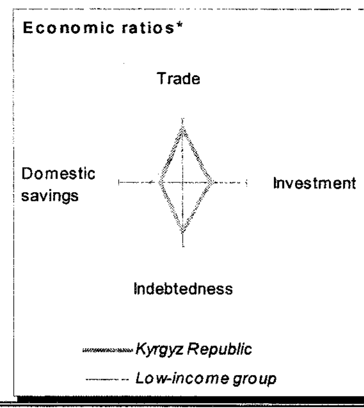


Development diamond*

KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1982	1992	2001	2002
GDP *(US$ billions)*	..	2.1	1.5	1.6
Gross domestic investment/GDP	..	19.9	18.0	18.1
Exports of goods and services/GDP	..	35.6	36.7	38.6
Gross domestic savings/GDP	..	7.9	17.7	14.4
Gross national savings/GDP	..	10.8	16.8	14.9
Current account balance/GDP	..	..	-1.3	..
Interest payments/GDP	..	0.0	2.9	1.5
Total debt/GDP	..	0.3	112.2	112.7
Total debt service/exports	..	0.0	29.8	24.2
Present value of debt/GDP	..	..	87.0	..
Present value of debt/exports	..	..	223.1	..

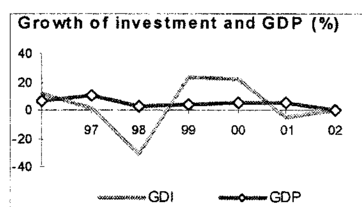
	1982-92	1992-02	2001	2002	2002-06
(average annual growth)					
GDP	1.3	0.7	5.3	-0.5	..
GDP per capita	-0.6	-0.4	4.5	-1.5	..



Economic ratios*

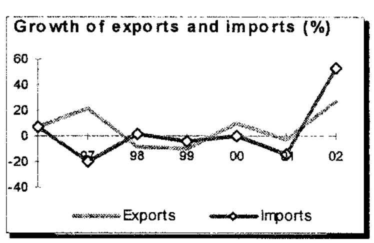
STRUCTURE of the ECONOMY

	1982	1992	2001	2002
(% of GDP)				
Agriculture	..	39.0	37.3	38.6
Industry	..	37.8	28.3	26.2
Manufacturing	..	33.7	10.8	10.5
Services	..	23.2	34.4	35.2
Private consumption	..	70.7	64.8	72.7
General government consumption	..	21.4	17.5	12.9
Imports of goods and services	..	47.6	37.0	42.3



Growth of investment and GDP (%)

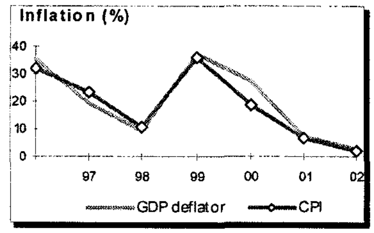
	1982-92	1992-02	2001	2002
(average annual growth)				
Agriculture	0.5	4.5	7.3	3.3
Industry	-3.5	-3.5	5.2	-11.2
Manufacturing	..	-10.7	-3.0	3.1
Services	6.4	-0.7	3.3	4.2
Private consumption	..	-3.2	2.2	-100.0
General government consumption	..	-4.0	-1.3	-100.0
Gross domestic investment	..	1.4	-5.6	0.0
Imports of goods and services	..	-5.7	-13.8	53.4



Growth of exports and imports (%)

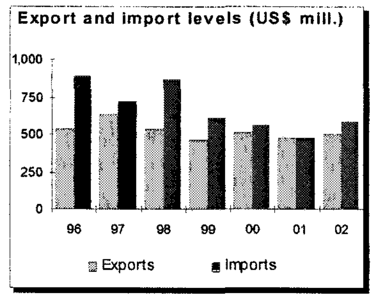
PRICES and GOVERNMENT FINANCE

	1982	1992	2001	2002
Domestic prices				
(% change)				
Consumer prices	..	..	6.9	2.1
Implicit GDP deflator	..	830.2	7.3	2.3
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	..	20.3	22.6
Current budget balance	..	..	-1.7	-0.6
Overall surplus/deficit	..	..	-5.8	-5.2



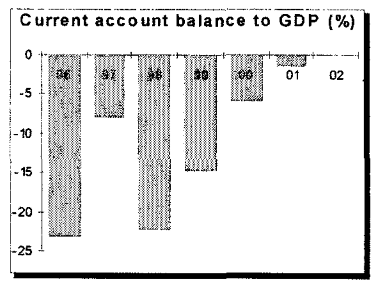
TRADE

	1982	1992	2001	2002
(US$ millions)				
Total exports (fob)	..	..	480	501
Electricity	..	..	47	22
Gold	..	..	225	163
Manufactures	..	..	106	125
Total imports (cif)	..	..	472	590
Food	..	..	36	47
Fuel and energy	..	..	121	151
Capital goods	..	..	58	114
Export price index *(1995=100)*	..	..	104	..
Import price index *(1995=100)*	..	..	95	..
Terms of trade *(1995=100)*	..	..	110	..



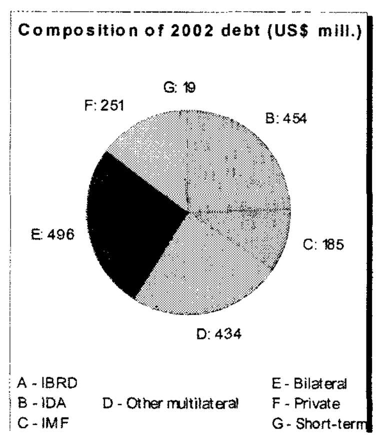
BALANCE of PAYMENTS

	1982	1992	2001	2002
(US$ millions)				
Exports of goods and services	..	..	561	630
Imports of goods and services	..	400	565	691
Resource balance	..	-115	-5	-61
Net income	..	0	-66	-57
Net current transfers	..	22	51	66
Current account balance	..	..	-20	..
Financing items (net)	..	..	38	..
Changes in net reserves	..	127	-18	-34
Memo:				
Reserves including gold *(US$ millions)*	..	..	285	311
Conversion rate *(DEC, local/US$)*	..	0.4	48.4	46.1



EXTERNAL DEBT and RESOURCE FLOWS

	1982	1992	2001	2002
(US$ millions)				
Total debt outstanding and disbursed	..	6	1,712	1,839
IBRD	..	0	0	0
IDA	..	0	389	454
Total debt service	..	0	177	154
IBRD	..	0	0	0
IDA	..	0	3	3
Composition of net resource flows				
Official grants	..	0	35	..
Official creditors	..	4	86	73
Private creditors	..	0	-78	-17
Foreign direct investment	..	0	5	..
Portfolio equity	..	0	0	..
World Bank program				
Commitments	..	0	15	15
Disbursements	..	0	27	33
Principal repayments	..	0	0	0



MAP SECTION