

**REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE
BOARD OF DIRECTORS
ON
PROPOSED LOANS
AND TECHNICAL ASSISTANCE GRANT
TO THE
REPUBLIC OF KAZAKHSTAN
FOR THE
FARM RESTRUCTURING SECTOR DEVELOPMENT PROGRAM**

October 2000

CURRENCY EQUIVALENTS **(as of 16 October 2000)**

Currency Unit	—	Tenge (T)
T1.00	=	\$0.007008
\$1.00	=	T142.70

- (i) Until April 1999, the exchange rate of the tenge was determined under a system of managed float through periodic foreign exchange auctions. The Government now uses a freely floating system.
- (ii) For the purpose of calculations in this report, an exchange rate of T144 to \$1.00, the rate prevailing in July 2000, has been used.

ABBREVIATIONS

ADB	-	Asian Development Bank
ASP	-	Agriculture Sector Program (Loan No. 1406-KAZ)
AgSP	-	Agency for Strategic Planning
BME	-	benefit monitoring and evaluation
COA	-	Chamber of Auditors
DEL	-	Department for External Loans
DOA	-	Department of Agriculture
EIRR	-	economic internal rate of return
EU-TACIS	-	European Union- Technical Assistance for the Confederation of Independent States
FIRR	-	financial internal rate of return
FSU	-	Former Soviet Union
GDP	-	gross domestic product
MOA	-	Ministry of Agriculture
MOF	-	Ministry of Finance
MOJ	-	Ministry of Justice
NBK	-	National Bank of Kazakhstan
NGO	-	nongovernment organization
NPV	-	net present value
O&M	-	operation and maintenance
PCB	-	participating commercial bank
RAU	-	Rural Advisory Unit
RWC	-	Republican Working Committee
SCF	-	standard conversion factor
SDP	-	Sector Development Program
SLA	-	subsidiary loan agreement
TA	-	technical assistance
USAID	-	United States Agency for International Development
WUA	-	water user association

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this Report, "\$" refers to US dollars.

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LOAN AND PROGRAM SUMMARY

Borrower	The Republic of Kazakhstan
The Proposal	The proposed Farm Restructuring Sector Development Program includes a \$25 million policy loan and a \$20 million investment project loan. Technical assistance (TA), Deepening of Agricultural Reforms and Development Programs, will be provided on approval of the proposal.
Rationale	<p>Kazakhstan's transitional agriculture sector has reached a turning point. Major market reforms have been adopted, but many farms, although privatized, have yet to adopt financially viable management structures and operations suited to a market economy. The banking system provides limited lending to farms. The farms use minimal inputs acquired largely by barter, grow largely traditional, low-valued crops, and maintain excessive social obligations. As a result, they are not financially profitable. To achieve the profitability that Kazakhstan's soils and climate permit, a two-pronged approach is required involving (i) advisory and financial support to farms and rural communities undergoing restructuring, and (ii) refinement and more effective implementation of the policy and legal framework for agriculture. The proposed Sector Development Program (SDP) will integrate (i) a project component to directly support farm restructuring in East Kazakhstan oblast; and (ii) a policy component to accelerate the Government's ongoing efforts to strengthen the policy, legal, and regulatory framework underlying farm restructuring and commercial lending to agriculture, with the specific objective of creating a suitable environment for implementation of farm restructuring.</p>
Classification	Economic growth
Environmental Assessment	<p>Category B</p> <p>An initial environmental examination was prepared and a summary of the results is presented as an appendix.</p>
The Sector Development Program	
Objective and Scope	<p>The objective of the SDP is to promote agricultural recovery and rural growth through a combination of policy reform, institutional development, and investment to develop financially sustainable farm enterprises and agribusinesses, and reestablish and/or expand nonfarm employment. The policy reforms will be nationwide in scope, but institutional development and investment activities will focus on East Kazakhstan oblast.</p>

Policy Framework and Actions

With prior Asian Development Bank (ADB) support,¹ the major market-oriented reforms have largely been completed in Kazakhstan's agriculture sector. The proposed policy component will support the Government's initiatives to deepen, refine, and more effectively apply the policy and legislative measures already undertaken, with the specific objective of promoting effective farm restructuring and viable commercial lending to agriculture. The SDP's policy support measures will (i) strengthen sector monitoring, analysis, and programming; (ii) promote transparent farm management and secured lending to agriculture; (iii) improve the understanding and effectiveness of legislation on, among others, land and farm ownership, accounting, auditing, bankruptcy, and mortgages; (iv) promote efficient agricultural taxation and use of water fees; (v) facilitate local private initiatives and the formation of voluntary rural associations; (vi) promote efficient pricing of agricultural inputs; and (vii) encourage private investment in agriculture.

Capacity Building

Kazakhstan's transition to a market economy requires a much deeper understanding of economics, finance, and commercial law than exists at present. A wide range of on-the-job and formal training will be provided to develop the necessary skill levels as quickly as possible. Training opportunities will be provided to all beneficiaries, commercial bank staff, and the numerous public institutions involved in the complex process of restructuring farms and regenerating rural economies.

The Investment Project

The Project comprises three basic components: institutional development, training, and credit. Activities include the following:

- (i) A rural advisory unit (RAU) will be established in East Kazakhstan oblast to provide advice and formal training on the legal and financial aspects of farm restructuring and business management in a market economy.
- (ii) The process of farm restructuring will involve a reduction in direct employment and the social obligations borne by the larger farm enterprises. The RAU, working in cooperation with local nongovernment organizations, will support skills training and the expansion of rural employment in nonfarm microenterprises.

¹ Under Loan 1406-KAZ: *Agriculture Sector Program*, for \$100 million, approved on 23 November 1995. The Program was implemented satisfactorily and the second tranche was released in June 1997.

- (iii) Farms, agribusinesses, and microenterprises that demonstrate a commitment to sound management will be eligible to apply for credit at market rates for working capital and longer term investment through local commercial banks.
- (iv) Training and capacity building in commercial banks, local public agencies, East Kazakhstan's agricultural research and educational institutions will be supported, and an implementation unit established within the Ministry of Agriculture (MOA).

Social and Environmental Measures

The marked increase in rural poverty in Kazakhstan can only be arrested by a combination of profitable farms, well-managed support services, and growth of off-farm employment. The policy component and the investment Project provide specific interventions to mitigate the undesirable social impacts of farm restructuring. The Project's microenterprise component is directly targeted at the rural communities and social groups likely to lose direct farm employment as the result of farm restructuring. The policy support measures will reinforce the project interventions by providing information to rural communities about their rights, obligations, and opportunities, as well as strengthen the legal and institutional framework for land and farm ownership, rural small business development, and the formation of voluntary rural associations.

The Project's net environmental impacts will be positive, principally by (i) removing marginal land from agricultural use (ii) reducing the cultivation of sloping land, and (iii) using more diversified cropping patterns that improve soil fertility. With support from the RAU, the responsible Government agencies will (i) ensure subborrower compliance with all applicable environmental assessment and mitigation requirements, and (ii) monitor relevant environmental parameters such as agrochemical use and soil/water effluents.

The Policy Loan

Loan Amount and Terms

The proposed \$25 million loan from ADB's ordinary capital resources will have a term of 15 years, including a grace period of 3 years, with interest calculated in accordance with ADB's pool-based variable lending rate system for US dollar loans, and a commitment charge of 0.75 percent per annum on the undisbursed portion of the loan. The Government will pay ADB a front-end fee equal to 1 percent of the loan. The fee will be capitalized in the loan.

Program Period and Tranching

The policy component will be implemented over two years from 30 November 2000 to 30 November 2002. The loan

will be utilized over two years from the date of effectiveness of the Loan Agreement, and will be disbursed in two equal tranches.

Executing Agency

Ministry of Finance (MOF)

Procurement

The proceeds of the policy loan will be used to finance a broad range of imports (excluding items specified in the negative list to be provided to the Government and imports financed by other bilateral and multilateral sources of aid). The Government will be required to submit with each withdrawal application a certificate that the volume of eligible imports exceeds the amount of ADB's projected disbursements under the loan in a given period. ADB will have the right to audit the use of the loan proceeds and to verify the accuracy of the Government's certification.

Counterpart Funds

The local currency proceeds to be generated from the loan will be used by the Government to finance (i) the costs of implementing the SDP's policy reforms; and (ii) the local counterpart costs of high-priority development projects and TA in the agriculture sector, particularly those financed by ADB.

The Investment Loan

Loan Amount and Terms

The proposed loan of \$20 million from ADB's ordinary capital resources will have a term of 25 years, including a grace period of 5 years, with interest calculated in accordance with ADB's pool-based variable lending rate system for US dollar loans, and an annual commitment charge of 0.75 percent. The Government will pay ADB a front-end fee equal to 1 percent of the loan amount. The fee will be capitalized in the loan.

Executing Agency

MOA

Implementation Arrangements

MOA will supervise implementation and monitor progress through its project office in Astana and a coordinating office in Ust-Kamenogorsk. In East Kazakhstan, the Project will be implemented by MOA through the RAU, and coordination will be provided by the oblast administration (Akimyat), including the East Kazakhstan Department of Agriculture.

Relending and Onlending Terms

The Borrower will relend the proceeds of the loan to qualified commercial banks under subsidiary loan agreements with interest rates reflecting the cost of ADB funds, plus an assessed level of risk allowance and administrative costs, and a repayment period of not more than 15 years, including 3 years grace. The onlending

interest rates to be charged by the commercial banks will be market-based. Loans to subborrowers will be made in either US dollars or tenge. The risks of foreign exchange and interest rate fluctuations will be borne by the subborrowers or the commercial banks concerned in accordance with arrangements satisfactory to ADB.

Procurement

All goods and services financed under the ADB loan will be procured in accordance with ADB's *Guidelines for Procurement*.

Consulting Services

Project implementation will require 76 person-months of international and 360 person-months of domestic consulting services, and the TA, 20 person-months of international and 28 person-months of domestic consulting services. Consultants will be recruited in accordance with ADB's *Guidelines on the Use of Consultants*.

Time Frame

The Project will be implemented over five years with completion expected on or about 31 November 2005.

Project Benefits

Over five years, the Project will restore crop and livestock productivity to competitive levels on a core group of farms covering some 400,000 hectares. The Project will support the development of agroprocessing enterprises and promote nonfarm microenterprise employment to stabilize incomes in communities affected by farm restructuring. Financial internal rates of return for indicative farm and agribusiness restructuring and investment initiatives are estimated to be between 33 and 38 percent, while economic returns range from 36 to 48 percent.

Technical Assistance

The TA grant of \$800,000 will serve two distinct purposes: (i) facilitate SDP implementation by assisting MOA and other concerned agencies in evaluating and refining agricultural policies and legislation; and (ii) support the Project by developing a program of applied agricultural research and technology dissemination, focusing on East Kazakhstan. The TA will be financed by ADB from the Japan Special Fund, funded by the Government of Japan.

Risks and Safeguards

Given Kazakhstan's institutional transition and frequent changes in key Government personnel, the SDP's major risk is that the Government's commitment to full program implementation falters. However, the reforms supported by the SDP build directly on the constraints identified in farm and rural community consultations, as well as the sector analyses and medium-term strategic agenda prepared by MOA and other agencies. Stakeholders' support for the reforms is expected to continue. Kazakhstan's budgetary constraints and some uncertainty in the exchange rate and

financial sector are likely to persist for at least the next one or two years. These circumstances lead to risks of counterpart funding shortfalls, as well as to greater caution among commercial banks in lending to agriculture. The Government has initiated endeavors to improve the public expenditure program. The policy component of the SDP has been designed to encourage greater commercial lending to agriculture by leveling the playing field for the banks in respect of the legal framework for secured lending, farm accounting/auditing, liquidation, and bankruptcy. The investment Project faces a number of risks for which safeguards have been built into the Project to minimize the risks. These risks mainly involve the timely development of business skills suited to the needs of a rural market economy, the adoption of improved crop technology, and the development of credit discipline.



I. THE PROPOSAL

1. I submit for your approval the following Report and Recommendation on two proposed loans to the Republic of Kazakhstan for the Farm Restructuring Sector Development Program (SDP). The report also describes proposed technical assistance (TA) for Deepening of Agricultural Reforms and Development Programs, and if the proposed loans are approved by the Board, I, acting under the authority delegated to me by the Board, shall approve the TA.

II. INTRODUCTION

2. During the Asian Development Bank (ADB) Country Programming Mission to Kazakhstan in 1996, the Government requested TA to prepare a project to help farmers adapt to the postprivatization environment. The Farm Restructuring and Development TA¹ was conducted in two phases during May 1997–January 1998. The first phase (i) reviewed the performance of the agriculture sector; (ii) assessed Kazakhstan's comparative advantage in selected agricultural commodities; (iii) confirmed the need to establish advisory services for privatized farms and rural enterprises, strengthen the capacity of the commercial banks, and improve the accessibility of working and investment capital for farmers who are adapting to the postprivatization environment; and (iv) developed criteria for the selection of regions (oblasts) suitable for a project that would respond to these needs. During the TA's second phase, detailed preparation of a farm restructuring project was conducted in East Kazakhstan oblast. The TA's extensive consultations with farmers, rural communities, and Government agencies at the local and national levels indicated the need to combine project financing with additional support for the refinement of the policy and legal framework underlying farm privatization and restructuring. The Appraisal Mission visited the project area during May–June 1999.² The main findings of the Appraisal Mission were updated in June 2000. This report is based on the consultants' studies; the findings of the missions; and discussions with the national and local government agencies, the potential participating banks, and farmers in the project area.

III. THE SECTOR

A. Macroeconomic Context

3. Recent economic and social trends in Kazakhstan have underscored the need to accelerate growth by diversifying the mix of productive activities, employment, and trade. Five difficult years of macroeconomic disarray followed Kazakhstan's separation from the former Soviet Union (FSU) in 1991. Gross domestic product (GDP) declined by about 50 percent, then began stabilizing in 1995. The hyperinflation of 1992–1994 was reduced to about 17 percent in 1997 and to about 2 percent in 1998. GDP grew positively, albeit modestly, at about 1.5 percent annually during 1996–1997, but in 1998, the economy contracted by 2.5 percent due to the combined effects of lower international prices for Kazakhstan's primary exports (oil, copper, zinc, and grain); the economic crisis in the Russian Federation,³ which accounts for 46 percent of Kazakhstan's trade; and the ongoing East Asian recession. GDP grew by about 1.7 percent in 1999, and is expected to grow by 7 percent in 2000, spurred by higher world commodity

¹ TA 2737-KAZ: *Farm Restructuring and Development Project*, for \$1.2 million, approved on 31 December 1996.

² The Appraisal Mission comprised F. Roche, Senior Project Economist and Mission Leader; H. Wang, Senior Economist and Resident Representative, Kazakhstan Resident Mission; N. Bestari, Project Economist; O. Tiwana, Counsel; L. Wu, Economist; and R. Gaynor, Legal Specialist and Staff Consultant. The report was updated by F. Roche, N. Bestari, and P. Kamayana, Programs Officer.

³ For details, see IN.289.98: *The Impact of the Russian Economic Crisis on the Central Asian Republics*, 9 December 1998.

prices and a significant increase in industrial production. Nonetheless, despite this growth, Kazakhstan's GDP will remain at about two thirds of its 1989 level.

4. The upsurge in industrial production is encouraging, because Kazakhstan's macroeconomic performance during the last three years illustrates how the narrow productive base—energy, minerals, grain, and construction—and continued interdependence with FSU countries make the economy vulnerable to external shocks. In April 1999, in the face of declining competitiveness because of exchange rate depreciation in neighboring countries, the National Bank of Kazakhstan (NBK) ceased its managed float of the tenge, leading to a devaluation of 33 percent and consequent inflationary pressure. Inflation was estimated to be about 18 percent in 1999, but should be much lower in 2000. Since late 1999, the tenge-dollar exchange rate has been stable.

5. Although the signs are positive, Kazakhstan's macroeconomic recovery is fragile. Since independence, the Government has been committed to a sound stabilization framework and market-oriented reforms in the policies, laws, and institutions regulating the economy. This commitment was reconfirmed in December 1999, when the Government and the International Monetary Fund agreed on economic guidelines for the next three years. The guidelines focus on prudent monetary policy, consolidation of public finances, and continued structural reform. Greater foreign investment to expand the industrial base is being actively encouraged. These efforts must be broadened to other sectors if growth is to accelerate and be more broadly felt. Fiscal constraints will severely limit the level of direct public investment during the medium term. The Government is committed to ensuring high efficiency and cost recovery in its investments, which, in turn, necessitates a high degree of beneficiary participation and ownership.

1. Social Issues

6. The major social issues in Kazakhstan directly reflect the impacts of the macroeconomic disarray. Real wages fell precipitously as a result of hyperinflation during 1992-1994; the decline was exacerbated by delayed wage payments in many sectors, including agriculture. Formal employment declined by 30 percent between 1994 and 1997, although this was offset to some degree by growing economic activity in the private sector, which Kazakhstan's statistical system does not yet fully capture. As the command economy collapsed and many industries (including agriculture) were privatized, Kazakhstan's formerly well-developed social services and safety nets went into a steep decline. The problem of pensions has received the highest attention of the Government; ADB⁴ and the World Bank have supported pension system reform. Health care and education services provided directly by state enterprises under the command economy were transferred to local governments, which typically have inadequate financial resources to bear the responsibility.

7. According to the United Nations Development Programme, about 43 percent of the population lived in poverty in 1998, reflecting a sharp rise since 1992. As measured by monetary income, the incidence of poverty is 48 percent in rural areas and 39 percent in urban areas.⁵ At the same time, rural households almost universally own small plots that are intensively cultivated, while farm shareholders also usually have access to grain and livestock feed. Together, these resources provide a degree of food security that the urban poor do not enjoy. However, rural households are at a distinct disadvantage in terms of access to health

⁴ Under Loan 1589-KAZ: *Pension Reform Program*, for \$100 million, approved on 16 December 1997.

⁵ United Nations Development Programme. 1999. *Human Development Report, Kazakhstan*. The cited figures are based on per capita monthly minimum subsistence income as estimated by Kazakhstan's National Statistics Office.

care and other social services, particularly in isolated areas. Kazakhstan's economic transition has been accompanied by increasing inequality of income. The share of income received by the lowest three quintiles of the population fell by 19 percent between 1989 and 1997, a decline that was almost exactly counterbalanced by the 21 percent increase in the share of the top quintile. Regionally, the incidence of poverty is far higher in the southern and eastern oblasts than in the far north and west.

2. Incidence of Poverty

8. The existence of poverty was never officially acknowledged by the FSU, which, in any event, had well-established safety nets in place. Thus, in response to the postindependence social trends, the Government has had to develop the capacity to monitor poverty among vulnerable groups, including the unemployed, households with many dependent children, pensioners, and invalids. The Government's strategy for poverty reduction focuses on employment generation, supplemented by programs providing monthly cash allowances to people who are unable to work. In 1998, a presidential decree established the National Fund for Support of Low-Income Citizens to provide subsidized microcredits of up to \$400 equivalent for small, largely rural, enterprises. In the same year, the Agency in Support of Small Business was created to support small-scale, private entrepreneurial initiatives. However, in 1999, financing for these programs was severely curtailed by the growing budgetary crisis. Technical and other advisory services to encourage employment-generating activities remain scarce, while the legislative basis for pro-poor activities such as voluntary cooperative organizations needs to be strengthened.

9. In April 2000, the ministries of economy, and labor and social protection drafted the National Program for Fighting Poverty and Unemployment 2000-2002. ADB and the United Nations Development Programme provided short-term consulting services to assist the Government to formulate this program, which has the specific objective of reducing unemployment from 13 percent to 9 percent over three years. The Government estimates that accomplishing this goal will require resources equivalent to 0.8 percent of GDP in 2000 and 1 percent in 2001 and 2002. However, the program does not address many aspects of poverty that are not income-based. Nor was the program discussed widely enough to gain strong stakeholder ownership, including by nongovernment organizations (NGOs) and the private sector, to support its effective implementation. In its most recent country assistance plan, ADB committed to participating fully with the Government in its poverty reduction efforts, including provision of TA in 2000 to assist the Government in preparing a more comprehensive medium-term poverty reduction strategy. The strategy will consider the full range of human, income, and governance dimensions of poverty in Kazakhstan. The strategy will be prepared in a manner that ensures strong stakeholder ownership and will be implemented during 2003-2010. Based on the strategy, ADB's operational strategy for future assistance to Kazakhstan, with a principal focus on poverty reduction, will also be updated in 2001.

B. Sector Description and Recent Performance

10. Agriculture presently accounts for about 10 percent of GDP, 14 percent of employment, and 10 percent of export earnings. Kazakhstan's rural areas are home to about 47 percent of the country's population and a majority of the poor. Agriculture encompasses extensive grain and livestock production primarily in the northern and central oblasts, and more intensive cotton and cereal production in irrigated areas of the south. The dry continental climate and short growing season generally restrict agriculture to a single crop each year. Timely and judicious management of soil, labor, and other farm resources are critical in all farming systems. The rain-

fed areas are cultivated under severe moisture constraints that limit productivity, increase risk, and by comparison with most ADB developing member countries, necessitate very large-scale, capital-intensive farm operations.

11. Since becoming independent of the FSU, the Government has, with ADB support under the Agriculture Sector Program (ASP),⁶ initiated major policy, legal, and institutional reforms intended to accelerate the transition to a market economy. In the agriculture sector, almost all of the former state-owned farms and agribusinesses have been privatized; most subsidies eliminated, together with direct national interventions in input and output markets; and a legal framework for market-led growth introduced. The progress in farm privatization has been dramatic. State enterprises now account for less than 10 percent of the cultivated area, comprising primarily agricultural research institutes and agricultural subsidiaries of state industrial enterprises. Three basic types of private farms have come into existence: (i) production cooperatives: 2,380 units nationwide as of April 1999, averaging 14,000 hectares (ha) per farm; (ii) corporate partnerships and joint-stock companies: 2,790 units and averaging 8,500 ha; and (iii) the relatively small, so-called peasant farms: approximately 85,000 units averaging 450 ha.⁷ Overall, it is estimated that production cooperatives occupy about 43 percent of the cultivated area, partnerships and joint-stock companies about 30 percent, and peasant farms about 16 percent. While the large farms have generally retained management and operational practices similar to those of the FSU period, the peasant farms constitute an entirely new class of independent units, created with shares of land and other assets redeemed from the former state farms.

12. The country's macroeconomic disequilibrium and the breakdown of formerly secure FSU markets have complicated the transformation of state farms into viable private enterprises. The elimination of subsidies initially contributed to a sharp decline of the agriculture sector's terms of trade. Cultivated areas, input use, wage payments, and productivity of almost all crops and livestock declined sharply during the immediate postindependence years. Irrigation systems were poorly maintained, while farm machinery and other capital assets depreciated as a result of physical deterioration and lack of spare parts. The rural financial system, originally developed primarily to direct subsidized credits to state farms, floundered as a result of accumulating arrears and poor management. Social services formerly provided by the farms deteriorated because of the contraction of farm income and the inability of the national (Republican) and local governments to fund these services through budgetary resources.

13. Because of the loss of FSU markets and the nascent entrepreneurial capacity of many of the newly privatized farmers, competitive forces and market-led growth have emerged slowly. Agronomic and economic potential for diversification exists in the country's better endowed regions, but most farms continue to rely on a narrow range of crops and livestock largely unchanged since the FSU period. Inherent agroclimatic variability affects rain-fed agriculture in most of Kazakhstan. Grain production, which accounts for about two thirds of agricultural output, declined by 28 percent between 1991 and 1995, but showed encouraging gains of 18 percent in 1996 and 10 percent in 1997 as a result of good weather and improved prices. However, in 1998, drought, compounded by a sharp decline in international wheat prices, led to a 19 percent drop in the total value of agricultural output. Grain production declined by about 30 percent,

⁶ Loan 1406-KAZ: *Agriculture Sector Program*, for \$100 million, approved on 23 November 1995, was implemented satisfactorily and the second tranche was released in June 1997.

⁷ The average figures obscure the considerable regional heterogeneity of farm size associated with land productivity. Peasant farms as small as 10-15 ha are common in the irrigated areas of southern Kazakhstan, but peasant farms can be as large as several thousand ha in the rain-fed, grain-producing regions, where the production cooperatives and other corporate entities may be as large as 80,000 ha.

while the livestock economy, most noncereal crops, and many agroprocessing industries continued to stagnate.⁸ Agriculture experienced a bumper year in 1999, despite serious locust damage in some localities. Due in part to favorable weather during the growing and harvest periods, grain production more than doubled as compared with 1998. Equally encouraging, private investment in agriculture, mainly in postharvest processing, has increased rapidly during the past two years, albeit from a small base. However, these developments are now threatened by a growing problem with locusts that reflects, in part, a decline of the standard of farm cultivation practices and weaker public sector capacity to directly support agriculture.

14. If the sector's performance can be sustained, Kazakhstan can solidify its position as an efficient agricultural exporter. During the medium term, there will be growing opportunities to export competitive grain, livestock products, oilseeds, and commercial crops to emerging markets in Central Asia, the Middle East, and the People's Republic of China. However, the agronomic potential varies considerably by region, generally being highest in the southern irrigated areas and in the northern and eastern regions where there are relatively fertile soils and reliable rainfall. In Kazakhstan's arid steppes, conditions for agriculture are marginal and the distance to markets is a formidable economic barrier. Many farms—created by fiat under the FSU rather than in response to market forces—will have great difficulty, even with good management, in becoming financially viable in a market economy. Recognizing this, the Government has focused on measures to facilitate the transition and ease its social costs in its recent strategy formulation for the agriculture sector. The Government also recognizes that the first, and comparatively easy, phase of legally privatizing farms is over, while a second and more complicated phase has been initiated in which support services must be provided to directly encourage the establishment of truly viable farm enterprises. This new phase will require the refinement of policy reforms at the national level, and equally important, the more effective understanding and application of policies and legislation at the oblast and district (*raion*) levels.

C. Constraints and Issues

15. Despite the reforms and signs of stabilization in grains, the problems of Kazakhstan's agriculture sector are reflected starkly in average output and incomes that are well below their potential, the limited diversification and commercial orientation, and the precarious financial position of many farms. Overall, the sector has been trapped in a lingering equilibrium of low inputs, low productivity, and low income, in which barter has become the predominant form of exchange. Privatization and market liberalization alone have not been sufficient to bring about recovery and growth. Three major groups of constraints have been addressed in the design of the Farm Restructuring SDP.

1. Inefficient Farm Management and Operations

16. There is an emerging core of relatively well-managed farms, but the great majority of farm managers and shareholders have yet to adapt their farms to the realities of a market economy. The essence of farm restructuring is to take the necessary steps to

- (i) adopt clear, stable, and legally sound ownership structures that are consistent with Kazakhstan's laws;

⁸ As a result of unrecorded production and sales, particularly among the smaller, individually managed farms, agricultural output may be significantly underestimated in official statistics. For example, the Food and Agriculture Organization concluded that cereal production was underestimated by about 26 percent in 1996.

- (ii) ensure independent financial viability in the absence of subsidies by rationalizing farm costs and shedding unprofitable activities;
- (iii) respond to market opportunities by adopting more diversified, commercially oriented farming systems; and
- (iv) particularly for the larger corporate farms, form a medium-term farm (3-5 year) business development plan encompassing debt resolution;⁹ improved management and cash flow; and new investment, primarily in machinery stock.

17. Even on the best lands, many of Kazakhstan's large, corporately owned farms typically bear an unaffordable burden of labor and social obligations held over from the command economy era. The dilemma is that wage and social costs must often be reduced drastically if the farms are to become financially viable, so attention must simultaneously be given to the creation of sustainable new employment for the redundant workforce.

18. Occupying the largest share of the cultivated area, the country's production cooperatives present the greatest challenge for future farm restructuring efforts. Despite being fully privatized, most of these farms have retained essentially unchanged management structures. Originally conceived as a convenient vehicle for facilitating the initial transition from state ownership, the legal framework underlying production cooperatives complicates their internal management and makes them inherently unstable enterprises that have great difficulty attracting commercial credit and outside investment.¹⁰ The alternative forms of corporate farm ownership—limited liability partnerships and joint-stock companies—have come about more recently and constitute a step up the evolutionary ladder by providing a clearer and more flexible legal structure. However, even among these farms, the farming systems are dominated by traditional cereal crops and livestock, produced with minimal inputs for markets that no longer exist. This even occurs in regions where soil and water availability would permit more intensive, diversified production.

19. The individually managed peasant farms have grown rapidly in number and are grappling with a different set of problems. Peasant farm owners—for example, former tractor drivers—often have little farm management experience; unfortunately, suitably tailored extension and support services do not exist. Owners also face difficulties because the basic rural facilities on which they depend—irrigation, roads, household utilities, and social services—were designed to suit the needs of the former state farms. Because of their small scale, they have difficulty obtaining inputs and marketing outputs. The scope for assisting peasant farms is considerable and includes forming agricultural cooperatives and other voluntary associations for activities such as credit, input provision, marketing, and irrigation management.

20. On both large and small-scale farms, farmers typically cite the lack of working and investment capital, and the rapidly deteriorating condition of their farm equipment as the major constraints to profitable operation. Fuel, agrochemicals, and machinery are available in markets, but the financial capacity of the farms to purchase these inputs is extremely limited, and at

⁹ As of April 1999, the aggregate outstanding debt of Kazakhstan's corporate farms was estimated by the Ministry of Agriculture at about \$800 million equivalent, or approximately \$150,000 per farm. This seemingly onerous figure works out to less than \$10 per ha on average. It should readily be within the capacity of well-managed farms in Kazakhstan's better endowed areas to resolve such debt, a large part of which has been rescheduled by Government decrees. Nonetheless, there is considerable variation in the debt burden and repayment capacity among regions, which is contributing to the accelerated liquidation of nonviable farms in marginal areas.

¹⁰ Kazakhstan's law requires that all shareholders in a production cooperative must also be employed on the cooperative: this inhibits outside investment by nonshareholders. Management decisions may be subject to unpredictable shareholder votes, while the land and assets owned are subject to sudden change when shareholders opt to establish independent peasant farms.

times, complicated by the unresolved debts inherited from the former state farms.¹¹ Few farms presently use fertilizer and other agrochemicals, and farm machinery and equipment has rarely been replaced during the past several years. Assuring the necessary timeliness of farm operations has become increasingly difficult.

2. Limited Commercial Lending to Agriculture

21. Under the guidance of NBK, considerable progress has been made over the past three years in strengthening Kazakhstan's financial system. In 1994, there were more than 200 commercial banks, composed of remnants of the former Soviet system and small, often family-managed start-up operations of dubious financial health. Through the strict application of NBK's prudential requirements and a guided process of mergers and closures, this number was reduced to 102 in late 1996 and to 63 as of late 1999. A core group of private banks now operates on market-based principles in Kazakhstan's second tier financial system.¹²

22. However, with the principal exception of Kazagroprom Bank, the former state-owned institution most active in the agriculture sector, the commercial banks provide little credit to farms at present. The banks are cautious about lending to farms and agricultural enterprises because of the risks arising from (i) the farms' often uncertain ownership structures and management capacity; (ii) the inherent agroclimatic and biological variability of agriculture; (iii) the incomplete legal framework for secured lending, bankruptcy, and debt resolution;¹³ and (iv) weak markets for land and other collateral assets.

23. Loan amounts and terms are almost entirely determined by the collateral offered rather than the projected financial performance of the farms' proposed investments. Collateral requirements—ranging from 150 to 200 percent of the value of requested loans—are difficult for farms to meet, particularly since land and other immovable farm property are rarely accepted. Although most farmers presently possess certificates of long-term or permanent land use rights, the slow development of a land market effectively reduces the level of bankable credit demand. Collateral requirements are particularly onerous for the small peasant farmers who inherited land from the former state farms, but typically few other capital assets.

24. Aside from Kazagroprom, the agricultural portfolios of the major commercial banks are limited to short-term loans, largely to agribusiness and agroprocessing enterprises. Agricultural loans make up less than 5 percent of their total lending. Even Kazagroprom tightened its farm credit policy in the face of the macroeconomic uncertainty and rising loan arrears in 1999. Because of the perceived risks and to avoid frequent interference by oblast and raion administrations in private business affairs,¹⁴ responsibility for credit approval in the regional bank branches now rests predominantly with headquarters in Almaty.

¹¹ Given the scarcity of credit, the farms have resorted to a variety of means to secure fuel, seed, and machinery services. The most common arrangement is forward contracting of a crop in exchange for inputs, often at low realized crop prices. The smallest farms often finance seasonal production costs through the sale of livestock and other assets, and the largely informal sharing of farm machinery with neighbors and farms.

¹² These banks include TuranAlem Bank, Kazkommerts Bank, Halyk Savings Bank, and Centre Credit Bank.

¹³ The Government has adopted legislation governing mortgage and pledging of property, but operational guidelines and procedures are not yet fully applied. Kazakhstan's bankruptcy law, passed originally in 1997 and amended in 1998, gives considerable authority to public agencies in both instituting bankruptcy proceedings and administering these proceedings, whether or not the Government is a major creditor.

¹⁴ Interference in the affairs of private farms and rural businesses takes many forms, e.g., efforts to ensure local food security by encouraging the planting of food crops; aggressive tax collection, including abrupt seizure of bank accounts; mediation between farms and creditors in regard to overdue debts; and solicitation of voluntary contributions from successful enterprises for local poverty reduction programs.

25. In the eyes of commercial bank personnel, farms are generally perceived as poorly managed and largely insolvent, but the banks' reluctance to lend exacerbates financial difficulties faced by the farms. In turn, given the lack of commercial credit, farmers have come to fulfill most of their working capital requirements through barter trade and forward contracting with input suppliers and commodity traders. The opaque, informal nature of barter trade complicates the assessment of the financial capacity of potential borrowers and acts as a disincentive for lending by the banks.¹⁵

26. The uncertainty associated with the depreciation of the tenge led the banks to increasingly resort to dollar-based lending. In the tight monetary environment triggered by Kazakhstan's financial crisis in 1999, interest rates rose to 14-18 percent per annum in dollar terms, reflecting the rising opportunity cost of funds for the banks.¹⁶ Currently, most lending is for short-term working capital for periods no greater than six months and limited largely to established trading, service, and manufacturing enterprises. Commercial bank personnel have serious doubts about the capacity of farms and rural enterprises to service dollar-equivalent debts on these terms, especially given the significant foreign exchange risk that is borne by the borrowers. Overall, these conditions have significantly curtailed the demand for long-term loans. Since many farms have become discouraged about their prospects for obtaining loans, the volume of loan applications currently reported by the banks reflects only a small share of the demand that exists.

27. Simply augmenting the supply of funds for credit will not solve these problems. The risks of lending to agriculture are a more fundamental constraint than bank liquidity; Kazakhstan's commercial banks have limited experience in critically appraising and managing agricultural loans in a market economy. Suitable training and capacity building in the rural financial sector are necessary to encourage banks to gradually move from collateral-based to performance-based lending. This capacity building must be accompanied by support to establish a core group of successful farms that demonstrate that performance-based lending can be prudent and profitable.

3. Lack of Understanding of Agriculture in a Market Economy

28. For farms, rural communities, banks, and rural public agencies, equitable rural growth is constrained by lack of information and knowledge. The information gap encompasses two dimensions: (i) lack of understanding—among rural communities and local administrations—of legal rights and opportunities, and (ii) lack of knowledge about business management in a market economy. Kazakhstan now has a reasonably comprehensive body of legislation on matters such as land and property rights, farm ownership, taxation, secured lending, and bankruptcy. While refinements of this legislation are needed, the major challenge is to ensure that the legal framework is correctly understood and applied at the local level. The process of privatization involved little or no provision of information and guidance to rural communities about their legal options, rights, and obligations. During 1996 and 1997, many rural families, encouraged by the former state farm managers, and often by oblast and raion administrations, transferred their shareholding rights to the farm managers in exchange for legally undocumented

¹⁵ Although lending to farms has been scaled back, the banks have increased their lending to food processing industries, which, in turn, often extend seasonal loans to farms under forward contracts. Although no data are available on the extent of this onlending, these arrangements are accepted by the banks because the risks are borne by the processing enterprises.

¹⁶ Short-term dollar-based deposit rates for up to 12 months also increased to 10-15 percent per annum in late 1999. In tenge terms, the interest rates rose to 25-30 percent per annum by late 1999, and declined to 18-21 percent by July 2000.

promises of continued employment, dividends, and in-kind services. In 1997 and 1998, the Ministry of Agriculture (MOA) organized oblast-level seminars to explain the new policy and legal framework for agriculture. But, in a country as vast as Kazakhstan, much greater effort is needed to ensure that the necessary information reaches the rural communities.

29. The pace and equity of the transition to a market economy will depend critically on the depth of understanding of market economics, finance, and commercial law at all levels of society. Farm restructuring cannot succeed without a significant upgrading of agribusiness management skills to international standards. Farmers need new knowledge on subjects such as farm business planning and accounting; recent developments in markets; crop and livestock production technology; and the formation of voluntary, cooperative organizations. At present, there is little of the necessary expertise in these areas at the local level. Competent technical specialists are often available, but there is a need to supplement their skills with knowledge about recent advances in production technologies, as well as basic market economy principles.

D. Government Expenditure

30. After Independence, and with the termination of subsidies from the FSU, public expenditures fell sharply from 33 percent of GDP in 1990 to 18 percent in 1994, and ranged from 19 percent in 1995 to 21 percent in 1999. Government budgetary operations in agriculture amounted to T7.2 billion in 1995, T6.7 billion in 1996, T6.5 billion in 1997, and T4.8 billion in 1999 (all in 1995 prices). Almost half of the Republican budget for MOA in 1999 consisted of investment projects that were partly financed by external sources of funds. In 1999, local government budgets for agriculture, forestry and fishery amounted to T1.6 billion in current terms, representing less than 18 percent of the total public spending on agriculture. Compared with public spending on other sectors, public expenditures on agriculture are small. With tight fiscal constraints and significant reduction in subsidies, Government spending on agriculture decreased from 3.5 percent of the total public expenditures in 1995 to 1.9 percent in 1999.

E. Government Objectives and Strategy

31. The Government has given considerable attention to the agriculture sector in its long-term strategic planning. MOA, in cooperation with the Agency for Strategic Planning (AgSP), recently prepared a medium-term strategy for the accelerated completion of reforms in the agriculture sector.¹⁷ This strategy includes measures to (i) complete the process of farm restructuring, in part by applying, when required, bankruptcy procedures specific to the needs of agriculture; (ii) develop market infrastructure and market information services; (iii) stimulate the formation of cooperatives and voluntary farmer associations; (iv) enhance access to financial services; and (v) stimulate domestic and foreign private investment in the sector. The objectives and scope of the SDP are fully consistent with this medium-term strategy.

32. The Republican Working Committee was formed in February 1998 to analyze progress in farm restructuring, focusing on the country's remaining production cooperatives. The committee recommended steps to (i) legally register all shares in such cooperatives, and (ii) encourage their restructuring into more financially viable farm structures. The committee also recommended action to monitor and strengthen the financial performance of the country's large

¹⁷ In November 1997, the Government issued a long-run strategic statement, Kazakhstan 2030. Government line agencies, including MOA, have collaborated closely with AgSP to draft medium-term plans to realize this vision at the sector level.

corporate farms, and to provide information to farm shareholders on their farm restructuring options. These efforts will be enhanced under the proposed SDP.

33. Although medium-term fiscal constraints will severely limit the Government's capacity for direct investment in the sector, including that financed through external borrowing, MOA has, in part with ADB assistance,¹⁸ strengthened its efforts to monitor and support the agriculture sector, recently conducting a nationwide survey and analysis of the operational and financial performance of Kazakhstan's relatively large-scale, corporately owned farm enterprises. In early 1999, MOA was reorganized to consolidate its capacities to (i) analyze national and international market developments, (ii) refine and more effectively implement market economic reforms, (iii) provide technical support services and facilitate the provision of credit, and (iv) encourage private sector investment. Activities proposed under the SDP will complement and reinforce MOA's institutional strengthening efforts.

34. The Government's strategy has increasingly addressed the need to generate new employment in rural areas. In addition to the National Fund for Support of Low-Income Citizens (para. 8), the Small Business Development Fund was created in 1997 to provide investment credits to small- and medium-size nonfarm enterprises.¹⁹ The Government is preparing a new national program for fighting poverty and unemployment 2000-2002 (para. 9). To further the goals of the newly established Agency in Support of Small Business, the Government issued a decree in 1998, clarifying the legal rights of citizens for freedom of business activity. The proposed SDP will enhance the effectiveness of these efforts.

F. External Assistance to the Sector

35. Besides ADB, several international financial agencies and bilateral sources are assisting Kazakhstan's agriculture sector. The SDP was prepared in close coordination with these organizations. Of most direct relevance to the SDP are the programs financed by the World Bank, the European Bank for Reconstruction and Development, the European Union's Technical Assistance for the Confederation of Independent States (EU-TACIS), and the United States. In 1997, the World Bank approved the Real Estate Registration Pilot Project for \$10 million, followed in 1998 by the Agricultural Post-Privatization Support Project for \$15 million.²⁰ The European Bank for Reconstruction and Development and the United States Government are financing credit lines for onlending to micro, small, and medium-size enterprises, including those in the agriculture sector. Access of SDP beneficiaries to these funds as an alternative to project financing will be explored, where appropriate, during project implementation.

36. EU-TACIS has implemented three pilot projects for the restructuring of privatized farms and agribusinesses into more profitable units.²¹ In 1998, EU-TACIS commenced the

¹⁸ ADB-financed TA has supported MOA's institutional strengthening, including TA No. 2356-KAZ: *Strengthening the Implementation of Agriculture Sector Reforms*, for \$600,000, approved on 4 July 1995; and TA No. 2448-KAZ: *Study on Market Reforms in the Agriculture Sector*, for \$1.044 million, approved with the ASP on 23 November 1995. TA 2449-KAZ: *Study on Rural Credit and Savings*, for \$0.47 million, approved on 23 November 1995, provided a comprehensive analysis of the rural financial sector.

¹⁹ The Small Business Development Fund has been financed, in part, with second-tranche proceeds of the ASP.

²⁰ Both projects are being implemented in the oblasts of Akmola and Almaty. The SDP's farm restructuring component and the Agricultural Post-Privatization Support Project have similar objectives (although different design) and will logically share common implementation arrangements within MOA. A follow-on to the Real Estate Registration Pilot Project is presently under preparation and will extend the Government's real estate registration system into two new oblasts, including East Kazakhstan.

²¹ These include (i) Support to Food Processing in Aktubinsk Oblast, (ii) Private Farmers Organizational Support, and (iii) Pilot Development of Private Farming and Food Processing in Akmola Oblast.

implementation of a project, Support to Rural Credit Improvement, that will provide technical advice and training to commercial bank staff in Almaty and Akmola oblasts. The Agricultural Management and Market Information System Project, completed in mid-1998, developed a comprehensive database on prices and markets for nationally disseminated publications. During the coming few years, MOA intends to expand this system so that it provides more regionally disaggregated information in high-priority agricultural oblasts. Finally, in 2000, EU-TACIS initiated a two-year project, Support to Establish a Vertical Market Structure, with objectives to (i) establish assembly markets, possibly including input supply; (ii) strengthen oblast market information systems and link these to the national system; (iii) strengthen farmer cooperatives; and (iv) promote efficient competition among agricultural traders and business persons. All of the EU-TACIS-supported projects are highly complementary to the objectives of the SDP, and formal linkages to their activities will be made where appropriate.

37. The United States Agency for International Development (USAID) is financing a variety of projects that are highly complementary to the SDP. Of particular relevance are the Commercial Law and Accounting Reform projects, which are helping the ministries of justice and finance (MOJ/MOF) and other agencies (i) prepare the legal framework for private sector investment and (ii) develop private financial institutions, including legislation related to mortgage, accounting, auditing, and bankruptcy. The Fiscal Reform Project is providing training and policy advice in support of the efforts of MOF to rationalize and improve the efficiency of Kazakhstan's tax system. If fully implemented, the recommendations of this project will substantially improve the transparency and equity of the tax burden borne by farms. USAID's Kazakhstan Community Loan Fund is presently setting up the country's first credit union in a pilot project that is being monitored closely by NBK. In the area of environment, USAID-financed projects have assisted MOA's Committee for the Management of Water Resources in forming pilot water user associations (WUAs) and in drafting legislation on water pricing. USAID's Farmer-to-Farmer Program and the joint USAID/Israeli Cooperative Development Program are providing TA, training, and farm demonstration activities in animal husbandry, greenhouse farming, irrigation, crop production, and food processing.

G. ADB's Operations and Strategy in the Sector

38. The objectives of ADB's operational strategy for Kazakhstan include (i) encouraging the transition to a market economy, (ii) promoting rehabilitation of the environment, (iii) strengthening the long-term potential for sustainable growth through investment in physical infrastructure and human resources, and (iv) encouraging private sector investment. Since commencing lending operations in Kazakhstan in 1995, ADB has been a major source of external finance and advisory TA in the agriculture sector. The SDP is a logical step in ADB's phased sequence of (i) support for market-oriented policy reforms, and (ii) direct investment in sustainable, environmentally sound projects to promote growth. The proposed loans would be the fourth and fifth for ADB in the agriculture sector, after the ASP (footnote 6) and the Water Resources Management and Land Improvement Project.²² ADB is also preparing assistance to strengthen the Government's capacity to deal with the recent upsurge of locusts in Kazakhstan's northern grain-producing regions.²³

²² Loans 1592/1593(SF)-KAZ: *Water Resources Management and Land Improvement Project*, for \$40 million, approved on 17 December 1997.

²³ Under TA 3442-KAZ: *Preparation of the Locust Management Project*, for \$100,000, approved on 19 May 2000. Based on the outcome of the TA and a request from the Government, ADB will provide a separate technical assistance in 2001 to Kazakhstan to help MOA and other agencies formulate and implement an environmentally sound strategy for locust management.

39. Although ADB's experience in implementing agriculture sector projects is relatively limited in Kazakhstan, several important lessons have been applied in formulating of the SDP. First, the situation in the sector may be depressed, but it is hardly static. There has been and will continue to be significant dynamism in the institutional and policy framework, as well as in the domestic and external economic environment. Hence, projects and TAs must be designed with enough flexibility to respond proactively to changes and emerging opportunities. To ensure that this occurs, there must be sustained monitoring and evaluation of the impacts of policies, laws, and economic incentives. More importantly, in a country as large as Kazakhstan, central guidance must ensure that national policies and laws are properly understood and implemented at the local level.²⁴ Second, because of the major downsizing of national agencies during the last few years, as well as the country's fiscal constraints, project and TA design requires a high degree of decentralization to, and ownership by, the local agencies and beneficiaries who will bear most of the responsibility for cost recovery. The SDP and its investment Project reflect the findings of extensive consultations with farmers and rural communities about the financial, institutional, and technical constraints to rural employment and income growth.²⁵ Third, the Government has made a major effort during the past two years to recruit a new generation of energetic, reform-minded personnel, but this has not been sufficient to overcome the lack of knowledge about managing agriculture in a market economy. While experience has been gained in the administrative procedures of ADB and other international institutions, the roster of personnel in public agricultural agencies has been in constant transition. Training and capacity building will continue to be needed in areas such as market economics, project management, and environmental assessment.

IV. THE SECTOR DEVELOPMENT PROGRAM

A. Rationale

40. Kazakhstan's transitional agriculture sector has reached a turning point. Major market reforms have been adopted, but widespread understanding of the reforms has not been achieved and their expected impacts have not fully materialized at the oblast level. The farms have been privatized and almost fully separated from state support systems, but most have yet to adopt financially viable management structures and operations suited to a market economy. Under NBK supervision, the rural banking system is being strengthened, but only limited lending is available to farms. The farms, in turn, use minimal inputs that are acquired largely by barter; grow primarily traditional, relatively low-value crops; and maintain excessive social obligations. As a result, most are not financially profitable. To escape this moribund equilibrium and achieve the profitability that Kazakhstan's soil and climate would permit, a two-pronged approach is required: (i) provision of information, and advisory and financial support to the farms and rural communities that undergo restructuring; and (ii) refinement and more effective implementation of the policy and legal framework for agriculture. Thus, the SDP will integrate (i) an investment project component to directly support farm restructuring; and (ii) a policy component to support and accelerate the Government's ongoing efforts to strengthen the comprehensiveness, understanding, and application of the policy, legal, and regulatory framework underlying farm restructuring and commercial lending to agriculture. The reforms supported by the policy loan will be instrumental in creating a suitable environment for the implementation of the Project. In the absence of such interventions, the future will see continuing stagnation of many farms and

²⁴ IN.206-99: *Agriculture Sector Program*, August 1999.

²⁵ These consultations were conducted throughout Kazakhstan's major agricultural oblasts during the first phase of the project preparatory TA (para. 2) and subsequently focused on the project area as the SDP's design was finalized.

increasing rural unemployment despite the agronomic and economic potential for regeneration and growth.

B. Objective and Scope

41. The SDP's objective is to promote agricultural recovery and rural growth by (i) refining the policy, legal, and institutional framework for market-led agriculture; (ii) providing public information and education on agriculture nationwide; (iii) directly supporting the development of financially sustainable farm enterprises and agribusinesses; (iv) directly supporting the reestablishment and/or expansion of nonfarm employment and income-generating activities in rural communities; and (v) strengthening capacity in local government agencies and participating commercial banks (PCBs) so that they can better serve the needs of agriculture and the rural communities. Appendix 1 presents the logical framework for the Farm Restructuring SDP.

C. Policy Framework and Actions

42. With prior ADB assistance under the ASP, the major market-oriented reforms for the agriculture sector have been largely completed at the national level. Since the release of the second tranche of the ASP in June 1997, the Government has endeavored to improve its monitoring, analysis, and response to the identified problems of agriculture, even though its financial and human resources are very limited relative to the country's size. As detailed in the development policy letter (Appendix 2) and the policy matrix (Appendix 3), the Government's initiatives have included the following:

- (i) since 1997, (a) continued strengthening of MOA's capacity for market analysis and information provision; (b) substantial efforts to deepen the legal and regulatory framework for property rights, mortgage, secured lending, farm accounting, auditing, and agricultural bankruptcy; (c) initial efforts to promote wider public understanding of the legal and policy framework for agriculture; and (d) the promotion of simplified and more transparent agricultural taxation;
- (ii) since 1998, (a) an ongoing nationwide survey of the financial status of corporate farms; (b) efforts to promote restructuring of production cooperatives into more stable, efficient farm structures; and (c) efforts to directly promote and protect the rights of microenterprises and small private businesses;
- (iii) in 1999, (a) reorganization and rationalization of the functions of MOA and other central ministries concerned with agriculture; and (b) passage of the Law on Rural Consumer Cooperatives; and
- (iv) also in 1999, the submission to Parliament of a draft land law to replace the existing Presidential Decree on Land (No. 2717 of 1995). Among other measures, the draft land law provided for conversion of land use rights to ownership rights by individual citizens. With Government encouragement, the draft land law was widely publicized within Kazakhstan. In the ensuing public discussion, widespread concern was expressed that Kazakhstan was not yet ready to cede permanent land ownership rights to private individuals. As a result, the land law was withdrawn from Parliament for amendment and resubmission at a later date. Although public opinion does not yet favor full land ownership, this experience illustrates the Government's intent to deepen the reform process and

its increasing efforts to involve the public in the consideration of major policy issues.²⁶

43. The SDP was formulated in the light of the Government's commitment to market reforms despite severe public resource constraints. Rather than requiring dramatic new reforms, the policy component is evolutionary and will support the Government's initiatives to deepen, refine, and more effectively apply the institutional, legislative, and policy measures already undertaken, with the specific objective of promoting effective farm restructuring and viable commercial lending to agriculture. Thus, the policy component is fully consistent with the Government's agriculture sector strategy, and will enhance eight areas of reform:

- (i) The policy component will deepen MOA's efforts to strengthen sector monitoring, analysis, and programming. MOA's surveys of sector and farm performance will be expanded in coverage, a system of computerized market information centers will be established, and with support from the accompanying TA (para. 94), domestic agricultural research programs will be strengthened.
- (ii) The growth of agriculture will be promoted by creating a stronger collateral basis for commercial lending to farms, and supported by expanding the system for registering rights to immovable property into East Kazakhstan and at least one other high-priority oblast.
- (iii) More transparent farm management and a stronger legal framework for secured lending will be promoted through the adoption by MOF of international accounting and auditing standards, and the application of suitable accounting and auditing standards to farms and agribusiness enterprises that are legal entities. With TA support, the Government will also evaluate and refine, as necessary, legislation on agricultural bankruptcy, and on the pledging of movable property and mortgage of immovable property.
- (iv) Through a nationwide public information campaign, the policy component will directly promote greater understanding of agriculture in a market economy. Using mass media, publications, training courses, and seminars, the campaign, to be prepared with TA support, will include the legal rights, obligations, and economic and financial opportunities associated with alternative forms of land tenure and farming structures; pledging of movable and immovable property; agricultural taxation; bankruptcy; formation of voluntary farmer associations; and conflict resolution, including conflicts that arise from interference by local administrations in farm decisions.
- (v) To promote more efficient collection of agricultural taxes and use of water fees, the Government will continue its reforms of agricultural tax policy and administration. In addition, based on the findings of ongoing ADB-financed TA,²⁷ the Government will improve procedures to collect water fees and rationalize the allocation of these fees between oblast administrations and the national Government. Starting in 2002, a line item in the Republican budget will provide funding for operation and maintenance of drainage and irrigation infrastructure, taking into account the level of collection of water fees for past years.

²⁶ From the standpoint of the SDP, the legal framework for land tenure embodied in the 1995 Presidential Decree on Land provides adequate incentives for the development of competitive agriculture as it allows long-term land use rights to be bought, sold, exchanged, bequeathed, leased, and mortgaged.

²⁷ TA 2946-KAZ: *Institutional Development and Policy Reforms for Improving Water Management*, for \$600,000, approved on 17 December 1997 attached to Loan 1592/1593 (SF)-KAZ: *Water Resources Management and Land Improvement Project*, for \$40 million, approved on 17 December 1997. The TA commenced in June 2000.

- (vi) The policy component will encourage local private initiative through measures to reduce interference by local administrations in farm and rural business affairs, and to facilitate the formation of voluntary rural associations, including cooperatives and water user groups. With TA support for critical reviews of the Civil Code and other existing laws governing voluntary associations, new or, as appropriate, revised legislation will be prepared to facilitate the establishment and functioning of such associations. A specific goal is to establish clear legal procedures for the transfer of irrigation and drainage systems to water users.
- (vii) Efficient pricing of agricultural inputs, a key thrust of the ASP, will be continued. The Government's programs for subsidized farm and microenterprise credits, suspended since late 1998, will not be reintroduced except as specifically agreed upon by the Government, ADB, and World Bank. In addition, except as otherwise agreed, the Government will continue its policy of not subsidizing meat, wool, fertilizer, and other production inputs used in agriculture.
- (viii) Recognizing that encouraging foreign private investment will facilitate the market-led diversification of agriculture, the Government will conduct a survey of potential foreign investors, and prepare and implement recommendations to improve foreign investment incentives. Domestic oilseed processing is a key subsector in which a sharp decline in capacity over the past seven years now constrains potential crop diversification by farmers. Hence, as part of the policy component, MOA will review the recent developments in oilseed production and processing, and prepare recommendations to encourage the efficient revival of this industry.

D. Capacity Building

44. Training of trainers and beneficiaries is an indispensable part of the SDP. Staff of farm enterprises, rural businesses, private farmer associations, and participating NGOs will be provided with a range of training opportunities to achieve the necessary skill levels as quickly as possible. On-the-job and formal training financed by the investment Project will include (i) agriculture and farm management in a market economy; (ii) awareness training for all beneficiaries; (iii) agricultural law; (iv) microenterprise development, including bookkeeping and accounting in addition to vocational and marketing skills; and (v) cooperative development. In addition, formal linkages will be developed with relevant capacity building efforts of other external agencies, particularly EU-TACIS and USAID (paras. 36-37).

45. The investment Project will provide a variety of training opportunities for microenterprise development workers and business owners in areas such as credit delivery, business accounting and management, marketing and product development, and specialized vocational skills. The Project will also support training and capacity building within the participating banks. A long-term agricultural credit specialist (Appendix 4) will advise the banks, other financial intermediaries, and the concerned public agencies on the organization of agricultural and small-scale lending activities at the oblast and raion levels, including the formulation of procedures and methods for rural credit appraisal and loan monitoring.

46. Numerous public and private institutions will be involved in the complex process of restructuring farms and regenerating rural economies. These include the national, oblast, and raion offices of MOA, the PCBs, oblast administration personnel responsible for poverty reduction programs, and the agricultural research and training institutions, together with local offices of MOJ, the courts, and the State Committee for Land Tenure and Land Relations (*Goskomzem*). On-the-job and formal training will be provided to ensure that these agencies are

prepared to implement and manage the Project, to sustain the activities beyond the period of ADB financing, and to independently replicate the project approach elsewhere in Kazakhstan. The key inputs for accomplishing these tasks will include (i) long-term consulting advisers in farm and agribusiness management and agricultural credit; (ii) short-term specialists, recruited as needed, to strengthen skills in diverse areas such as farm machinery and equipment, project management, and water and environmental management (Appendix 4); and (iii) the institutional strengthening support to be provided under the accompanying TA (para. 94).

E. The Investment Project

1. The Project Area

47. East Kazakhstan oblast occupies the northeastern corner of the country, and is bordered on the north by the Russian Federation and on the east by the People's Republic of China. The oblast's population of 1.6 million people is 43 percent rural. The oblast covers some 288,000 square kilometers and is characterized mainly by three distinct agroecological zones: (i) mountainous areas in the south and north, where annual precipitation is greater than 500 millimeters (mm); (ii) the relatively fertile upper foothills and lower-lying floodplains in the center, which have precipitation of 350-500 mm and receive significant growing-season runoff from the mountains; and (iii) the semiarid steppes in the west, where annual precipitation usually is below 300 mm. Overall, the agricultural potential of the foothills and floodplains is considerable, far exceeding that of the steppes. The lower mountain areas also have good agricultural potential, but require suitable soil conservation techniques.

48. The selection of East Kazakhstan for inclusion in the Project was based on careful consideration of a variety of criteria, including (i) nature and potential of the agricultural economy; (ii) farming structure, including the need and scope for restructuring; (iii) level of farm indebtedness; (iv) availability of potential participating bank branches in rural areas; (v) receptiveness and capacity of local agricultural agencies, including research and training institutions; and (vi) socioeconomic characteristics.²⁸ East Kazakhstan has a large rural population in a predominantly agricultural oblast. Its agroecological zones are representative of Kazakhstan's high potential rain-fed areas. Farm debt levels in the oblast are generally manageable, while the basic capacities of the public institutions and banks are judged to be above average. Local farmers and public agency personnel have expressed considerable interest and commitment to the proposed activities of the Project.

49. Not all of East Kazakhstan's 15 raions have the required agroclimatic potential for financially sustainable growth in a market economy. The foothill areas of highest potential are concentrated in the oblast's northern, northeastern, and east central regions. These areas cover a total of eight to nine of the oblast's raions and will, initially at least, be the primary focus of the Project. Areas of low potential include the upper mountains, steppes, and semideserts where the low rainfall and short growing season are formidable constraints to financially viable agriculture. Subject to the availability of project resources, these low-potential regions may be covered by the Project beginning about two years after its commencement.

²⁸ The first phase of project preparation involved a detailed study of all of Kazakhstan's major agricultural regions and a systematic ranking of oblasts based on these selection criteria.

2. Project Activities

50. The Project comprises three basic components: institutional development, credit, and training. The logical sequence of the project activities is as follows:

- (i) A rural advisory unit (RAU) will be established in Ust-Kamenogorsk, the capital of East Kazakhstan oblast, to provide advice and formal training in the legal and financial aspects of farm restructuring and business management in a market economy, as well as the technical and marketing skills required for farm diversification.
- (ii) The revitalization of input supplies and agroprocessing facilities is essential to encourage more productive, diversified farming systems. Hence, the RAU will also provide training and advisory services to selected agribusinesses that have strong forward and backward linkages to the farms. In East Kazakhstan, candidate enterprises for such support may include machinery repair and custom hire services, medium-scale processing of sunflower and other oilseeds, and small-scale dairy processing.
- (iii) The process of farm restructuring has involved a significant reduction in the direct employment provided by the larger farm enterprises. This loss of employment is expected to continue during the restructuring of the farms that are the primary target group of the Project. To counteract this, the RAU, working in cooperation with local NGOs, will complement the Government's antipoverty efforts with support for skills training and the expansion of employment in rural nonfarm micro and small business enterprises that build, to the maximum degree possible, upon existing skills and other resources in the oblast.
- (iv) Farms, agribusinesses, and microenterprises that adopt viable business plans and demonstrate their commitment to sound management practices will be eligible to apply for credit at market rates under the Project for seasonal working capital and longer term investment through the local commercial banks. Both banks and borrowers will make significant contributions to the investment financing. Potential subborrowers will be able to approach the banks directly for relatively small working capital loans, but all applications for large investment loans must be accompanied by a detailed farm restructuring plan, and will need to be reviewed and cleared by the RAU. Thus, the RAU will serve as a linkage between the large rural enterprises and the PCBs.
- (v) Since these banks need stronger abilities to appraise and manage rural loans, the Project will provide consulting services and training to build capacity in the rural financial system. As has been initiated under the Government's microenterprise program, support for the establishment of joint liability lending will be explored to widen the Project's potential borrower base.
- (vi) Finally, the Project will support (a) training and capacity building in local public agencies; (b) strengthening of applied agricultural research, education, and outreach capacity within East Kazakhstan; and (c) development of project implementation capacity within MOA, which will be responsible for recruitment of consultants and procurement, project monitoring and evaluation, coordination with other Government agencies, ensuring that ADB procedures are followed, and routine reporting to ADB.

3. Cost Estimates and Financing

51. The Project's total estimated costs and financing plan are shown in tables 1 and 2. The total cost of the Project is estimated at \$30.7 million, composed of \$16.9 million in foreign exchange and \$13.8 million in local currency. ADB will finance 65 percent of the investment project cost. The ADB financing amounts to \$20.0 million equivalent, covering all foreign exchange costs and \$3.1 million equivalent of the local currency costs.

Table 1: Estimated Project Cost
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost	% Foreign Exchange
A. Base Costs				
1. Institutional Development ^a	263	1,582	1,845	14
2. Training	234	406	640	37
3. Credit Line ^b	11,272	11,272	22,544	50
4. Consulting Services				
a. International	1,900	0	1,900	100
b. Domestic	0	315	315	0
Subtotal (A)	13,669	13,575	27,244	50
B. Contingencies				
1. Physical Contingencies	120	115	235	51
2. Price Contingencies	68	150	218	31
Subtotal (A + B)	13,857	13,840	27,697	50
C. Interest and Service Charge				
1. Interest During Construction	2,446	0	2,446	100
2. Commitment Charges	433	0	433	100
3. Front-End Fee	200	0	200	100
Total	16,936	13,840	30,776	55

^a Includes costs of renovating and equipping the Rural Advisory Unit (RAU) and project offices, agronomic field trials, vehicles, and the recurrent costs of the RAU and project-related activities in the participating commercial banks.

^b Credit lines are to be allocated initially to eligible farms, agribusinesses, and microenterprises on a first-come, first-served basis. Allocation of credit between local currency and foreign exchange is based on an estimated breakdown of investment and working capital loans, and estimated direct and indirect foreign exchange.

Table 2: Financing Plan
(\$'000)

Source	Foreign Exchange	Local Currency	Total Cost	Percent
Asian Development Bank	16,936	3,064	20,000	65.0
Commercial Banks ^a	0	3,493	3,493	11.3
Beneficiaries ^b	0	3,381	3,381	11.0
Local Government ^c	0	148	148	0.5
Government	0	3,754	3,754	12.2
Total	16,936	13,840	30,776	100.0

^a Commercial bank cofinancing will be provided extensively by the participating commercial banks and will require no cofinancing or guarantee support from the Asian Development Bank.

^b Beneficiary contributions will include any equity capital and the imputed market value of land (or land-use rights), equipment, buildings, and other physical assets, which are essential inputs into the subprojects.

^c Does not include the costs of oblast administration staff seconded to the Rural Advisory Unit as part of the oblast contribution to the Project.

52. Details on the project cost estimates and financing are in Appendix 5.

F. Social and Environmental Measures

1. Social Analysis

53. Detailed surveys of social conditions in representative rural communities of East Kazakhstan were conducted as part of the investment Project preparation. These surveys confirmed that nationwide unemployment, low and declining incomes, and deteriorating social services are also significant social problems in the area. Potentially vulnerable groups include households with no stable employment, those that never received or those that transferred farmland and property shares, and pension-dependent families, particularly those headed by women. A marked share of the rural population in the working age group, including a disproportionately large share of women, has lost formal employment as a result of farm privatization, restructuring, and the collapse of economic activity in rural Kazakhstan. The loss of direct farm employment is expected to continue as an inevitable part of the processes of farm restructuring and the rationalization of production costs.

54. The investment Project's microenterprise development initiatives will mitigate this problem by providing training, advisory support, and financing aimed at adding value to readily available, largely agricultural, raw materials that provide a source of cash income. The activities will focus on farm communities that, with project support, commence a process of comprehensive restructuring involving a significant rationalization of costs. Over time, and depending on demand, the microenterprise development may expand to other areas of the oblast and is expected to have particular benefits for women.

55. The microenterprise development will complement the oblast's ongoing microenterprise programs managed by NGO Microcredit and the Regional Fund for Support to the Low-Income Population.²⁹ The Project will build upon the experience gained and clientele base established under these programs, working to help poor families that have successfully established an initial credit record to graduate to larger loans on commercial terms. The subloans for microenterprise development will likely fall within the range of \$1,000–\$10,000 equivalent, with lending arrangements similar to those described in paras. 80-81 for farm and agribusiness enterprises.

2. Impact on Poverty

56. The increase in rural poverty can only be arrested by a combination of profitable farms, well-managed farm support services, and growth of off-farm employment. These are the main focus of the Project. The SDP and the Project, in particular, provide specific interventions to mitigate the undesirable social impacts of farm restructuring. The Project's microenterprise development is directly targeted at rural communities and social groups most likely to lose direct farm employment as the result of farm restructuring. The project activities are intended to be both sustainable and replicable. In addition, the SDP's policy support measures will reinforce the project interventions by providing information to rural communities about their rights, obligations, and opportunities, as well as by strengthening the legal and institutional framework

²⁹ These programs operate under the umbrella of the National Fund for Support of Low-Income Citizens (para. 8) and offer credits of up to \$400 equivalent, largely to underemployed rural households, for the establishment or expansion of microenterprises. State funding of the programs was suspended in late 1998 due to budgetary constraints. Unemployed women, particularly those in households with a large number of children, were a specific target group of these programs, and will receive attention under the Project.

for land and farm ownership, rural small business development, and the formation of voluntary rural associations.

3. Environment

57. The Project was classified by ADB as environmental category B, meaning that potentially adverse environmental impacts must be assessed, and if required, appropriate mitigation measures incorporated. Accordingly, an initial environmental examination, summarized in Appendix 6, was conducted during project preparation. It concluded that the Project would cause no significant adverse environmental impacts. Indeed, the net environmental impacts are expected to be positive, principally through (i) the removal of marginal land from agricultural use; (ii) a reduction in the cultivated area, especially sloping land; (iii) the use of more diversified cropping patterns to promote soil fertility and biodiversity, and prevent the buildup of plant diseases; and (iv) reduced use of inefficient energy-consuming technologies. Only modest incremental fertilizer and agrochemical use by farms is expected as a result of the Project. East Kazakhstan's pump irrigation systems were capable of functioning only under conditions of heavily subsidized energy costs. In the present economic environment, these systems will certainly continue to decline in area even as farm profitability recovers. The Project will focus predominantly on rain-fed agriculture and will have no significant implications for on-farm water use.³⁰ Finally, the agribusiness and microenterprise investments envisioned under the Project—for example, machinery services, oilseed and dairy processing, and small household crafts and services—will entail negligible increases in effluents and wastes. Hence, a full environmental impact assessment was not required for the Project. Nonetheless, the RAU and participating staff of the oblast Department of Agriculture (DOA) will coordinate with the oblast Department of Environment and Natural Resources to (i) monitor subborrower compliance with the applicable environmental assessment and mitigation requirements of the Government and ADB, and (ii) monitor relevant environmental parameters such as agrochemical use and soil and water effluents. Submission of an initial environmental examination in accordance with ADB guidelines will be a condition for ADB clearance of all agroprocessing subloans in excess of \$100,000 in value. Agroprocessing investments financed by subloans below \$100,000 must be in compliance with applicable Government and ADB environmental guidelines, and certification of such compliance will be maintained as part of PCB loan records.

V. THE LOANS

A. The Policy Loan

1. Amount of Loan, Terms, and Source of Funds

58. Implementation of the SDP's policy reforms (para. 43) will include substantial costs for (i) a nationwide public information and education campaign on agriculture; (ii) the expansion of the system for registering rights to immovable property; (iii) a market information system; (iv) implementation and monitoring of new accounting and auditing requirements; (v) a national survey of farm financial performance, cropping patterns, and profitability; and (vi) various studies and evaluations required to the legal framework. To support the implementation of the

³⁰ At present, the main potential for irrigation development exists in low-lying regions of the oblast, where soil and water table characteristics make groundwater irrigation feasible. This development will not be financially justified with the present mix of largely low-value cereal crops, but the viability of the investment may improve as farm restructuring and diversification occur. Should farmers show interest, the RAU will assist them in evaluating financially and environmentally sound technologies and promote WUAs.

SDP's policy component, a loan of \$25 million is proposed from ADB's ordinary capital resources, with a term of 15 years, including a grace period of 3 years, interest calculated in accordance with ADB's pool-based variable lending rate system for US dollar loans, and a commitment charge of 0.75 percent per annum on the undisbursed portion of the loan. The Government will pay to ADB a front-end fee equal to 1 percent of the loan amount. The fee will be capitalized in the loan.

2. Implementation Arrangements and Executing Agency

59. The policy component will be implemented over two years from 30 November 2000 to 30 November 2002. MOF will be the Executing Agency for the policy loan and will take overall responsibility for the policy component implementation, which will be jointly monitored by a steering committee to be established immediately after the policy loan becomes effective. The committee will be composed of senior personnel of MOA, AgSP, MOJ, and the Ministry of Economy.

3. Procurement and Disbursement

60. The proceeds of the policy loan will be disbursed against a broad range of imports with the exclusion of items contained in a short negative list and imports financed by other bilateral and multilateral sources. Disbursement will be in accordance with the simplified disbursement procedures and related requirements for program loans. The Government will be required to submit with each withdrawal application a certificate that the volume of eligible imports exceeds the amount of ADB's projected disbursements under the loan in a given period. ADB will have the right to audit the use of the loan proceeds and to verify the accuracy of the Government's certification.

4. Counterpart Funds

61. The counterpart funds to be generated from the proceeds of the loan will be used by the Government to finance (i) the costs of implementing the SDP's policy reforms; and (ii) the local counterpart costs of high-priority development projects and TA in the agriculture sector, particularly those financed by ADB.

5. Monitoring and Tranching

62. MOF will be responsible for monitoring the implementation of all measures contained in the policy matrix, and for semiannual reporting of progress to ADB. The proceeds of the loan will be utilized over 24 months and released in two equal tranches of \$12.5 million. The first tranche will be released upon loan effectiveness. Release of the second tranche is expected to occur in November 2001 upon satisfactory completion of the following Government actions:

- (i) prepare a phased plan, in a manner satisfactory to ADB, and submit a proposal to Parliament in the draft law on the Republican budget for 2002 to finance a system of computerized market information centers that routinely disseminate price and other market information to farms;
- (ii) accept the application of either the international accounting standards of the International Accounting Standards Committee or equivalent standards satisfactory to ADB; and adopt a timetable satisfactory to ADB for the implementation of the accounting standards;

- (iii) prepare and commence implementation, in a manner satisfactory to ADB, of a phased plan to apply internationally accepted auditing and accounting standards, or equivalent standards satisfactory to ADB, to farms and agribusiness enterprises that are legal entities;
- (iv) propose to Parliament in the draft law on the Republican budget for 2002 the provision of a budget, in an amount to be agreed upon by ADB, to finance the nationwide public information and education program on agriculture, which will disseminate knowledge through publications, mass media (newspapers, television, and radio), and training courses and seminars;
- (v) evaluate the impact of oblast and raion-level administration interference in the decisions of private farmers on land use, cropping patterns, and input-output marketing, including the adequacy of grievance procedures; and based on the results of this review, submit to the President's Administration, for approval, measures necessary to reduce administrative interference in the activities of private farms and agribusinesses; and
- (vi) submit to Parliament a draft law on WUAs, or adopt a regulation on WUAs, specifying procedures for the transfer of irrigation and drainage systems to WUAs, and removing any legal obstacles to WUA formation.

B. The Investment Loan

1. Amount of Loan, Terms, and Source of Funds

63. A loan of \$20 million from ADB's ordinary capital resources is proposed, with a term of 25 years, including a grace period of 5 years, and with interest calculated in accordance with ADB's pool-based variable lending rate system for US dollar loans, and an annual commitment charge of 0.75 percent. The Government will pay to ADB a front-end fee equal to 1 percent of the loan amount. The fee will be capitalized in the loan.

2. Implementation Arrangements and Executing Agency

a. Organization and Financing of the RAU

64. The RAU will be staffed initially by domestic and international specialists, together with a small number of oblast administration personnel, with suitable experience in farm and agribusiness management, microenterprise development, agricultural training, accounting, law, marketing, and other required specialties on an as-needed basis. The RAU will be headed by a long-term, locally recruited director with suitable experience in farm and agribusiness management, and detailed knowledge of the legal and financial aspects of farm privatization and restructuring. It will have an advisory board, comprising representatives of the oblast administration, DOA, participating banks, NGOs, and farmers, and will be supervised by MOA. The advisory board will set general policies and strategies for the RAU, and review the progress and impacts of the onlending and other project activities, but the RAU's director and staff must retain autonomy in their day-to-day operations, including all decisions to endorse onlending. It will be critical—as MOA and the oblast administration have agreed—for the RAU to be an objective organization that fairly and transparently applies strict eligibility and financial criteria in identifying, appraising, and endorsing subloans.

65. During its first two years of operation, the RAU will be fully financed by the Project through the contributions of the ADB loan (80 percent) and the Republican budget (20 percent). At the end of the second year, the Government and ADB will undertake a comprehensive

midterm review (para. 89), during which the performance of the RAU and the participating farms will be evaluated, and a phased plan for RAU cost recovery through user fees will be prepared and initiated. Thereafter, the RAU will continue as a permanent, independent organization funded increasingly through user fees for the services provided, with a corresponding decrease in funding by the Project. Besides the borrowing farms and enterprises, possible financial contributors include the commercial banks, agricultural input supply and agroprocessing firms, and other organizations with a stake in a profitable agriculture sector.

b. Structure and Characteristics of Participating Farms

66. As of late 1999, East Kazakhstan oblast had a total of 7,085 farms: 6,869 peasant farms with a median size of about 300 ha, and the remainder much larger corporate entities averaging about 21,000 ha. The process—rather than the discrete event—of the restructuring of the former state farms constitutes a dynamic element of social change in the project area. The total number of peasant farms has grown by about 20 percent since mid-1998 as the result of the liquidation and reform of bankrupt corporate entities, and the entrepreneurial desire to undertake private farming. This desire has been fueled by a variety of forces, including the declining work hours and wages on the corporate farms; the market reforms that have freed crop and input prices, and limited nonfarm job opportunities; and a reassertion of the basic independence and initiative of individual rural households.

67. Nonetheless, although the large corporate units comprise just 3 percent of the farms, they collectively account for more than 50 percent of the oblast's agricultural area.³¹ The April 1999 survey of the oblast's corporate farms conducted by MOA and DOA concluded that 36 percent were performing profitably (group I), 33 percent were in need of fundamental rehabilitation and restructuring (group II), and 31 percent would likely face liquidation (group III). In contrast, as of mid-1998, only 4 percent of the peasant farms were judged to be bankrupt, while 70 percent were performing profitably. These results are indicative of the efforts already being made by MOA and DOA to categorize and target specific types of farms, and also show that it is the large corporate farms that are most frequently in need of restructuring support. Group II farms constitute the primary target group for the RAU's farm restructuring advisory support. In general, group III farms, whether corporate or peasant, will not be eligible for project support until the outcome of liquidation/bankruptcy proceedings is clear. Group I farms, particularly the smaller peasant units, should find it relatively easy to access credit without additional restructuring, but much will depend on the precise circumstances of each farm. Some group I farms, although structurally stable and deemed profitable, may not be able to meet commercial bank lending criteria for major investments unless there are fundamental changes in management practices. Such farms will also be assisted by the RAU if they wish to access significant investment credit under the Project.

68. The Project will seek to assist a core group of farms that are (i) committed to rehabilitation and restructuring; (ii) have a sound farm development plan; (iii) have demonstrated ability to produce a strong cash flow, repay loans, and resolve any outstanding debt; and (iv) have the ability to meet other commercial bank criteria, such as collateral (with or without any risk cover). However, the RAU will have limited human (advisory) and financial

³¹ The size distribution of peasant farms is skewed by the 1 percent of this class that are essentially production cooperatives averaging 2,400 ha. The large peasant units were formed to avoid the more complicated registration and tax procedures for corporate farms that must register as legal entities. If the large peasant farms are added to the corporate farms, then East Kazakhstan's largest farms comprise 4 percent of total farms, but occupy almost 70 percent of the farm area.

resources relative to the oblast's overall need. To make the most effective use of those resources, only 50-60 corporate farms will be targeted for detailed restructuring over five years. With careful selection, this number of farms, although small, will represent a significant proportion of the oblast's agricultural resources, covering more than 400,000 ha of agricultural land, of which about 200,000 ha are arable and 10,000-20,000 ha are irrigated.

69. The farms, agribusiness enterprises, and commercial banks must meet a detailed set of eligibility criteria if they are to receive advisory support and significant credit access under the Project. These eligibility criteria are discussed in Appendix 7.

c. Roles and Responsibilities of the Oblast Administration

70. In 1998 the East Kazakhstan DOA was actively involved in the national Republican Working Committee's survey of farm financial performance, and in the screening and subsequent endorsement to local commercial banks of farm applications for the Government's 1998/99 subsidy program for interest charges on agricultural loans.³² Although the Project's lending arrangements and terms will differ, this activity is essentially similar to the function that will be performed by the RAU. In addition, given East Kazakhstan's enormous size and the RAU's staff constraints, it is inevitable that the RAU will depend heavily on the oblast and raion-level DOAs to facilitate communications and project activities. For the past two years, the staff of the oblast governor have been involved in implementing the Government's small- and medium-size enterprise development programs, an activity that also closely parallels the Project's support for community microenterprise development. These considerations make it logical to establish a formal role for the administration's personnel in RAU operations. As part of its contribution to the Project, DOA will assign at least one suitably qualified staff member with experience in farm management, finance, and lending to work with the RAU on a full-time basis. In addition, at least one suitably qualified staff from the oblast administration will be assigned, on at least a part-time basis, to support the Project's microenterprise development.

71. The direct involvement of oblast personnel will allow the project activities to be coordinated closely with the Government's related programs, and will ensure that these personnel benefit from the project training and institutional development activities. However, despite this involvement, it is understood that the RAU must retain autonomy for selecting potential subborrowers, providing advice on restructuring and other matters, and providing onlending recommendations to the PCBs. This independence will be critical if the RAU is to gain trust as an objective, credible partner of the farms and participating banks.

72. DOA will coordinate the Project at the oblast level and will take responsibility for reporting progress to MOA and MOF's Department for External Loans at intervals and in a format to be agreed upon by the Government and ADB. The Project will be supervised by an oblast coordination committee, to be established within one month following effectiveness of the investment loan. The committee will comprise the oblast governor as chairperson, the directors of DOA and the RAU, oblast and raion-level representatives of the PCBs, the participating farms and NGOs, and key private sector representatives involved in input and output marketing.

³² Under this program, the Government contributed interest-free matching funds to those of the commercial banks for small- and medium-size farm loans that were used largely for working capital. The bulk of such loans extended by the East Kazakhstan Kazagroprom branch in 1998 was in the range of \$5,000-\$20,000 equivalent. Due to budgetary constraints, this program was suspended in the second half of 1998, and, in accord with the conditions of the SDP's policy component, it will not be reintroduced.

d. Roles and Responsibilities of Other Oblast Organizations

i. Raion Agriculture Departments

73. One officer in each of the selected raion offices of DOA (para. 49) will be nominated as farm restructuring coordinator, and will be assigned the responsibilities of (i) disseminating information about the Project and RAU support services; (ii) assisting rural enterprise managers in communicating with the RAU; preparing the information that will be required for RAU screening of the farm's legal, financial, and operational status; and assessing the need for, and appropriateness of, detailed RAU assistance; (iii) helping prepare subloan application documents; and (iv) monitoring the use of subloan funds, the enterprise's operational and financial performance, and subloan repayment.

74. During the first three months of project implementation, the farm restructuring coordinators will be provided with initial training about the Project, including enterprise selection criteria and financial assessment methods. Later in the Project, the coordinators, together with selected oblast staff, will receive more detailed training in areas related to agriculture in a market economy, including farm economics, finance, and management; agronomy, livestock, horticulture, and rangeland management; and marketing and cooperative development.

ii. Participating Banks

75. During SDP preparation, Kazakhstan's main commercial banks were approached, and their interest and capacity for participating in the Project determined. Their participation will be subject to ADB approval and to their meeting the eligibility criteria outlined in Appendix 7, including: (i) full compliance with NBK prudential requirements; (ii) sound governance, financial management, and loan tracking systems; (iii) annual audited financial statements, prepared in accordance with international accounting standards; (iv) an adequate branch network and human resources to serve the rural areas in East Kazakhstan; and (v) commitment to contribute at least 15 percent of the capital to subloans over the project period and to participate in capacity-building activities. Following approval of the SDP, the PCBs will be evaluated and selected by MOF in close consultation with ADB.

76. Kazagroprom has confirmed its interest in participating in both the farm onlending activities and the project's training and capacity-building programs, and is expected to formally apply for consideration as a PCB following approval of the SDP.³³ Two additional banks—Kazkommerts and TuranAlem—have also expressed strong interest in participating in the Project. Other banks are expected to formally express interest once the Project is under way and the RAU is established. Such participation will be actively sought to improve the competitiveness of onlending. The mix of banks meeting the Project's selection criteria will have an impact on the types of subloans. Consistent with its corporate identity and strategy, Kazagroprom would likely concentrate on subloans to farms and microenterprises, whereas Kazkommerts and TuranAlem would focus more on loans to agroprocessing enterprises, with which they have greater experience.

³³ The East Kazakhstan branch of Kazagroprom is presently managing a modest agricultural loan portfolio that will accommodate the relatively small microenterprise loans to be provided under the Project. In addition, this bank has expressed interest in exploring the formation of borrower groups for joint liability lending during the Project's implementation as a means of reducing both the risks and transaction costs of lending to small borrowers.

iii. Nongovernment Organizations

77. A significant part of the training and community preparation for the Project's microenterprise activities will be subcontracted to a suitably qualified NGO or NGOs. NGO participation will ensure that appropriate services are provided to the Project on a cost-effective basis. Fieldwork and consultations under the 1997 project preparatory TA (footnote 1) and during loan processing in 1998/99 demonstrated that several NGOs are already successfully working in rural small-scale employment activities in East Kazakhstan. The NGOs visited expressed keen interest in participating in the Project's outreach and capacity-building activities. Since that time, the number of active NGOs has grown rapidly.³⁴ In light of this growth, the experience and capacities of the NGO community will be recanvassed early during project implementation. Participating NGOs will then undergo formal evaluation and recruitment through competitive tender by MOA in consultation with DOA and ADB.

iv. East Kazakhstan Scientific Research Institute for Agriculture

78. Symptomatic of the agriculture sector's incomplete adjustment to the postprivatization economic environment, most of Kazakhstan's farms still rely on a narrow range of crop and livestock activities essentially unchanged since the FSU period. Overall, there has been little market-led diversification of agriculture. Crops with strong market potential that can be successfully integrated into Kazakhstan's farming systems must be identified. To accomplish this, the East Kazakhstan Scientific Research Institute for Agriculture, in close coordination with the RAU, will participate in the Project by undertaking a program of field trials and economic evaluation of potentially profitable, environmentally sustainable new crops.³⁵ To strengthen its capacity for economic analysis and its linkages to the international agricultural research system, the institute will be supported under the Project's associated TA (para. 94).

v. Training Institutions

79. To ensure sustainability and replicability, the training strategy will focus initially on strengthening the skills of staff at East Kazakhstan Agricultural College, the oblast's leading institution, in critically deficient areas such as agricultural economics, farm management, marketing, and cooperative development, as well as upgrading disciplines such as crop, livestock, and rangeland management in a market economy.³⁶ Following this, the college is expected to take on the major responsibility for implementing the RAU's training programs for farmers and public agency personnel.

e. Flow of Funds and Onlending Arrangements

80. MOF will onlend the loan proceeds, together with the Government's financing share of the credit line, to the PCBs under subsidiary loan agreements (SLAs) with market-based terms and conditions satisfactory to ADB. Execution of an SLA between MOF and each PCB, on

³⁴ The NGO Confederation of Kazakhstan reported in June 2000 that the country now has a total of about 1,000 officially registered NGOs (including some 110 in East Kazakhstan), and estimated that 2,000 NGOs have not yet officially registered. In 1997, fewer than 250 NGOs were estimated to exist nationwide.

³⁵ The research program will focus initially on nitrogen-fixing crops with good market prospects such as soybeans and other legumes. Other crops that have regional or international export potential, short-season annual forage crops that would utilize residual soil moisture, and medicinal plants will be studied as the program evolves.

³⁶ There is scope for collaboration in training and curriculum development between East Kazakhstan Agricultural College and strong national institutions such as the Kazakhstan Institute for Management, Economics, and Planning, and the Institute of Agribusiness Economics, both located in Almaty.

terms and conditions satisfactory to the ADB, will be required prior to disbursement of funds to the relevant PCB. Conditions for the proportional allocation of subloans between working capital and investment and for the rollover of project funds will be specified as part of each SLA. The PCBs will onlend the funds to eligible subborrowers under suitable subloan agreements. The terms and conditions for relending to the PCBs will be similar to those of the Loan Agreement between ADB and the Government, but with a maximum 15-year term and 3-year grace period, and reflecting the cost of ADB funds, plus an assessed level of administrative costs and risk allowance. The onlending interest rates to be charged by the PCBs will be market-based. Loans to subborrowers will be made either in US dollars or tenge, depending on the purpose of the loan. The risks of foreign exchange and interest rate fluctuations will be borne by the subborrowers or the PCBs concerned in accordance with arrangements satisfactory to ADB.

81. Due to (i) the RAU's resource constraints, (ii) the expected high demand by farms for relatively small loans for seasonal working capital, and (iii) the generally satisfactory performance of the agriculture sector loan portfolio of East Kazakhstan's potential PCBs, it is neither necessary nor desirable for the RAU to closely scrutinize and endorse all subloan applications. Therefore, it is envisioned that applicants for loans of up to \$50,000 equivalent and 12 months' duration will be able to approach the PCBs directly without review and endorsement by the RAU. For loans greater than \$50,000 equivalent, and for all investment loans with a repayment period exceeding 12 months, the subborrower will need to (i) prepare, in consultation with the RAU, an appropriate medium-term enterprise restructuring and development plan; and (ii) obtain endorsement of the loan application from the RAU. In addition to RAU endorsement, all subloans in excess of \$350,000 will be reviewed by ADB prior to approval by the PCBs. In addition, ADB clearance will be required for the first five subloans under the Project, regardless of their size.

f. Project Supervision

82. MOA will be the Executing Agency for the Project. In Astana, MOA will establish an adequately staffed project office, headed by a suitably qualified director selected with ADB agreement. In Ust-Kamenogorsk, MOA will establish a coordinating office for the Project, headed by an office manager. MOA will (i) ensure that the Project is implemented in a manner consistent with its objectives and complies with all applicable ADB guidelines and procedures; (ii) coordinate intergovernment activities associated with the Project in liaison with MOF's Department for External Loans; (iii) monitor and evaluate PCB lending operations, the RAU's activities, and consultant performance; (iv) monitor compliance with environmental assessment and impact mitigation measures; (v) maintain appropriate expenditure accounts and supporting documentation for project-related activities; and (vi) prepare, with inputs from the PCBs, Department for External Loans, and the RAU, quarterly progress reports and other project reports, in formats agreed to by ADB.

83. Project supervision at the national level will be provided by an interministerial coordination committee to be established within three months of loan effectiveness and comprising the minister of agriculture (chair); the project and RAU directors; and appropriate senior personnel from MOF, the Ministry of Economy, AgSP, the PCBs, and the East Kazakhstan oblast administration. The Project monitoring and reporting responsibilities of MOA and MOF are described in paras. 85-87. Project coordination at the oblast level is described in para. 72.

g. Disbursement, Accounts, Audits, and Reports

84. An imprest account will be established immediately after loan effectiveness, at a bank to be agreed upon by the Government and ADB. Initially \$200,000 will be deposited; this is based on an estimate of expenditures to be incurred during the first six months of project implementation. At the option of the PCB concerned, the Government may establish a separate imprest account (PCB imprest account) for disbursements to each PCB for financing subprojects under the credit component of the investment Project. The initial amount to be deposited into the PCB imprest account will not exceed \$350,000. The imprest accounts will be established, managed, replenished, and liquidated in accordance with ADB's *Loan Disbursement Handbook* and other procedures agreed upon between the Government, ADB, and the PCBs concerned. ADB's statement of expenditure procedures may be used for reimbursement of eligible expenditures and liquidation of advances to the imprest accounts. Any individual payment to be reimbursed or liquidated under the statement of expenditure procedures will not exceed the equivalent of \$50,000.

85. MOA will maintain separate accounts and financial statements for the Project, covering separately the activities of the RAU and the project office, which will be audited annually by independent auditors acceptable to ADB. Certified copies of the audited financial statements will be submitted to ADB by MOA through MOF within nine months after the end of the fiscal year to which they relate. MOF will submit to ADB consolidated statements on the Project's credit component and the activities of the PCBs within a similar time period. In addition, the PCBs will submit audited annual financial statements to ADB, through MOF. The auditor's report will also include the auditor's opinion on use of the imprest accounts and the statement of expenditure procedure. Both the financial statements and auditor's report will be in the English language. The Government and MOA were informed of a new ADB policy on submission of audited accounts, which covers failure to submit audited accounts and financial statements within the due time. A formal warning will be issued for accounts more than six months overdue and disbursements will be suspended for accounts that are 12 months overdue.

86. MOA will provide ADB with quarterly progress reports on project implementation, to be submitted within one month after the end of the quarter to which they relate, and such other reports and information relating to the Project as ADB may reasonably request. In addition, within three months after physical completion of the Project, MOA will submit to ADB, through MOF, a project completion report including information on project implementation, use of the loan proceeds, and the extent to which the project objectives have been achieved.

87. The Appraisal Mission judged MOA's capacity to manage the Project to be acceptable.³⁷ MOA has gained implementation experience during the past three years with projects financed by ADB and the World Bank. To ensure compliance with ADB procedures and policies, the Project provides for short-term consultants and training on an as-needed basis in areas such as accounting, project management, and environmental assessment.

h. Implementation Schedule

88. The Project will be implemented over five years, 2000-2005, with completion expected on or about 30 November 2005. The initial year will be devoted primarily to (i) setting up the

³⁷ An assessment of MOA's capabilities will be undertaken during the loan inception mission in line with ADB's internal guidelines for assessment of borrower/executing agency internal control, accounting system, and capabilities for the use of imprest account and statement of expenditures procedures.

RAU, including recruitment of staff and consultants; (ii) establishing consultative linkages between the RAU and PCBs; (iii) finalizing subcontracts with NGOs based on an analysis of needs in key communities; and (iv) arranging for foreign and domestic training programs. Initial advisory services will be provided to a core group of farms identified during loan preparation. The initial extension of credit is expected to occur in time for the 2002 planting season. From year 2 the RAU will be in full operation. An average of 10-15 large farms each year will receive detailed restructuring analyses and advice, while a larger group of smaller farms will receive training and guidance on agrarian law, taxation, marketing, and farm business management. Appendix 8 shows the envisioned implementation plan in detail.

i. Midterm Review

89. In addition to regular review missions, the Government and ADB will undertake a comprehensive midterm review at the end of the second year of project implementation to scrutinize progress and achievements, identify any problems and constraints, and recommend midcourse corrections that may be warranted to achieve all objectives. In assessing performance, the midterm review will give particular attention to (i) the realization of monitorable indicators;³⁸ (ii) impacts of the policy and legal reforms, and (iii) the effectiveness of the associated TA (para. 94). The review of the Project will focus on (i) the operations of the RAU (relevance and quality of its services; numbers of farms served and the demand for RAU services; views of farm managers, rural communities, and oblast agencies on the work of the consultants; and prospects for cost recovery); (ii) progress in farm, agribusiness, and microenterprise lending, including appraisal procedures, loan utilization, monitoring, and repayment; and (iii) the anticipated economic and social impacts of the Project.

j. Benefit Monitoring and Evaluation

90. A benefit monitoring and evaluation (BME) system to monitor progress in farm restructuring, farm and agribusiness performance, and rural microenterprise activities will, within six months of loan effectiveness, be established within the RAU with the assistance of the project consultants. BME will include (i) the farms, agribusinesses, and microenterprises served by the RAU; (ii) crop and livestock productivity; (iii) farm and nonfarm employment of men and women; (iv) farm financial performance and profitability; (v) loan utilization and repayment; (vi) project environmental impacts; (vii) average incomes and the incidence of poverty at the farm and community level; and (viii) the gender-specific impacts of farm restructuring and the interventions supported by the Project. The BME system will be integrated with the MOA and DOA databases used in the 1998 survey of farm financial performance and databases to be established as part of the market information system under the SDP.

3. Procurement and Consulting Services

91. Two types of procurement will occur under the Project: (i) procurement by subborrowers, and (ii) procurement by Government agencies. Goods and services procured by subborrowers

³⁸ Verifiable indicators of SDP performance will include (i) establishment and operation of oblast-level information services, real estate registration offices, and programs for crop agronomic improvement; (ii) comprehensiveness and quality of studies and evaluations of property registration, bankruptcy, extralegal interventions by local administrations, small business development, and foreign investment, together with the legislation adopted and other actions taken on the basis of these studies/evaluations; (iii) coverage, quality, and impact of the nationwide public information and education campaign for agriculture; (iv) progress in farm restructuring, farm profitability, and commercial lending to agriculture, both nationwide and in East Kazakhstan; and (iv) budgetary expenditures for irrigation operation and maintenance, credit, and agricultural inputs in the agriculture sector.

will include agricultural inputs (seed, fuel, agrochemicals), farm machinery, spare parts, equipment for microenterprises, and small- and medium-size agroprocessing equipment. Such goods and services will typically be procured directly in local markets by the subborrowers. The PCBs will be required to (i) demonstrate that the procurement procedures are appropriate in the circumstances; (ii) ensure that goods and services financed by such subloans are purchased at a reasonable price, taking account of factors such as time of delivery, suitability and reliability of the goods, availability of maintenance facilities and spare parts, and in the case of services, their quality and the competence of the parties rendering them; and (iii) ensure and certify that all goods procured have satisfied ADB's country-of-origin and eligibility requirements. Depending upon demand, bulk procurement of inputs and machinery may prove to be an efficient option and could be facilitated and coordinated by the RAU at the option of the subborrowers, in which case procurement will be competitive and in accordance with ADB's *Guidelines for Procurement*.

92. Procurement by Government agencies will be limited largely to equipment and materials required for the project offices, training, and vehicles required for project implementation and monitoring. All procurement will be undertaken in accordance with ADB's *Guidelines for Procurement*. Procurement of vehicles with an estimated total value in excess of \$100,000 will be undertaken using international shopping procedures. Other procurement contracts by Government agencies are expected to cost well below \$100,000, primarily for equipment and materials. Since such contracts are unlikely to be of interest to international suppliers and will be for goods that are available locally at competitive prices, local competitive bidding procedures acceptable to ADB or direct purchase will be used. MOA will be responsible for supervising all procurement.

93. The Project will require 76 person-months of international consulting and 360 person-months of domestic consulting services for the RAU, and training and capacity building in the rural communities, participating banks, educational institutions, and government agencies. MOA will recruit these consultants, including specialists engaged through NGOs, in collaboration with the East Kazakhstan DOA and in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants. To ensure that the best qualified people are selected, MOA has agreed that recruitment of RAU professional staff will involve a well-publicized nationwide search to be undertaken in consultation with ADB. Appendix 4 summarizes the terms of reference for the international consultants and for the director of the RAU.

VI. THE TECHNICAL ASSISTANCE

94. The Government asked ADB to finance advisory TA, Deepening of Agricultural Reforms and Development Programs. The TA will serve two distinct purposes in furthering the SDP's objectives. It will (i) facilitate SDP implementation by providing assistance to MOA and other concerned agencies (AgSP, MOF, and MOJ) with the evaluation and refinement of agricultural policies and legislation, and the design and preparation of the market information system and the public information and education campaign on agriculture; and (ii) complement the Project by developing a program of applied agricultural research and technology dissemination focusing on East Kazakhstan, and strengthening linkages between East Kazakhstan Scientific Research Institute for Agriculture, other domestic agricultural research institutions, and international institutes such as the International Maize and Wheat Improvement Center and the International

Center for Agricultural Research on Dry Areas.³⁹ MOA will be the Executing Agency for the TA, which will be supervised by a steering committee comprising representatives from MOJ, MOF, Ministry of Science and Higher Education, and AgSP. The TA will require 20 person-months of international consulting and 28 person-months of domestic consulting, provided over 24 months estimated to begin in April 2001. All consultants will be recruited by ADB in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants. The TA is estimated to cost \$1,140,000 equivalent, of which \$800,000 will be financed by ADB on a grant basis from the Japan Special Fund, funded by the Government of Japan, and \$340,000 equivalent will be provided by the Government for in-kind support and the costs of data compilation, land and materials for the field crop trials, counterpart travel and per diem, use of state television and radio facilities for the public information campaign, and contingencies. The Government has given assurance that adequate budgetary provision for these financial costs will be made so that the TA can be implemented expeditiously. Appendix 9 provides the detailed rationale, terms of reference, and costs of the TA.

VII. BENEFITS AND RISKS

A. Expected Impacts

1. Financial and Economic Analyses

95. Emerging private farms have been caught in a low input-low output equilibrium. Most farms have abandoned the use of fertilizers and agrochemicals, and are unable to undertake timely farm operations, with the result that reported yields have declined to 60-70 percent of pre-Independence levels.⁴⁰ Profitability has worsened for many farms as they continue to face excessive labor costs and social obligations, high administrative costs, disproportionate management and overhead costs, and excessive machinery maintenance and repairs due to aging equipment. With poor access to commercial banks, farms have increasingly relied on suppliers and traders to finance their working capital requirements in exchange for farm outputs at harvest. While these barter arrangements appear to provide guaranteed markets for farm outputs, the costs of this form of financing are opaque and probably high.

96. The Project aims to enable private farms to improve farm productivity and achieve higher income by (i) emphasizing measures to improve their commercial viability, and (ii) helping them formulate viable business plans that can be used when applying to commercial banks for working capital and investment loans. Farms will have to undertake several initiatives to improve their commercial and financial viability, including (i) restoring productivity rapidly; (ii) performing benefit-cost analyses to guide their financial decisions; (iii) eliminating activities that contribute to losses; (iv) streamlining the workforce to reduce labor costs; (v) rationalizing farm machinery operations to reduce maintenance and repair costs; (vi) making management more efficient and market-responsive; (vii) introducing a needs-based approach to minimize administration and overhead costs; and (viii) preparing, implementing, and abiding by an investment and operational plan to improve productivity and realize cost savings. The negative impacts of the

³⁹ These two international institutes have a keen interest in extending their programs in Central Asia. The International Maize and Wheat Improvement Center opened a country representational office in Almaty in June 1998.

⁴⁰ The decline in productivity is real, but it must also be noted that an unknown share of the apparent yield decline is due to the combined effects of (i) incomplete statistical coverage of privatized farms; (ii) difficulty recording output traded under barter arrangements; and (iii) farmer reluctance to report actual production, which is taxable.

loss of direct farm employment will be ameliorated by the Project's closely related support for the development of rural microenterprises.

97. Four indicative models were developed for the purpose of illustrating the financial and economic viability of the Project's farm and agribusiness initiatives:

- (i) a rain-fed arable farm with landholdings of 4,000 ha, consisting of 1,920 ha of arable land and 2,080 ha of extensive pastures (in any given year, 20 percent of the arable land is left fallow); the farm also has 100 head of beef cattle;
- (ii) a rain-fed arable farm with landholdings of 10,000 ha, consisting of 5,500 ha of arable land and 4,500 ha of extensive pastures (in any given year, 20 percent of the arable land is fallow); the farm has 200 head of beef cattle;
- (iii) a beef cattle fattening farm starting with a herd of 100 head, and using feed rations of mixed concentrates and crop by-products; and
- (iv) a wheat flour mill, with an installed processing capacity of two tons of grain per hour, operating on two eight-hour shifts per day over 260 days a year.

98. Financial internal rates of return (FIRRs) for farm restructuring and investment are estimated to be at 34.4 percent for the 4,000 ha farm, 33.4 percent for the 10,000 ha farm, and 37.4 percent for the beef fattening farm. These farms are anticipated to generate economic internal rates of return (EIRRs) of 47.5 percent (4,000 ha), 45.6 percent (10,000 ha), and 41.8 percent (beef fattening farm). International wheat prices fell by about 15 percent in 1999. While wheat prices are projected to rise over the next five years, they are expected to decline over the long run. When a wheat price decline of 10 percent is applied across these projections, the EIRRs fall to 31.3 percent (4,000 ha) and 31.1 percent (10,000 ha). However, the FIRRs are less robust, and decline to 20.2 percent and 20.3 percent, respectively. When the projected yields of all crops are reduced by 10 percent simultaneously, the FIRRs of these farms are reduced to 5.1 percent (4,000 ha) and 4.1 percent (10,000 ha), although their EIRRs remain attractive at 16.8 percent (4,000 ha) and 16.0 percent (10,000 ha). Such reductions in yield are unlikely if fertilizers and agrochemicals are applied at the modest levels used in the model, but the sensitivity of yields reinforces the need for close RAU guidance of the participating farms and for project support to applied agronomic and economic research in East Kazakhstan.

99. The viability of farm restructuring very much depends on the overall financial and commercial viability of the restructuring initiatives. Given the short growing season and moisture constraints of the project area, successful farm restructuring must combine astute financial and business planning with sound crop agronomy and farm management. While FIRRs on investment are expected to be well above the cost of capital, the level of loan financing and repayment schedules must be determined on a case-by-case basis to match the overall earning capacity and cash flows of the farms. The FIRRs are sensitive to decreases in benefits and to increases in operating costs, but less sensitive to increases in investment costs. A 9 percent increase in operating costs would reduce the FIRR of the cattle fattening farm to 12 percent. Similarly, the FIRRs of both the 4,000 ha and 10,000 ha farms would fall to 12 percent when the operating costs of these farms rise by about 10 percent.

100. Under the base scenario, the wheat flour mill generates an FIRR of 35.4 percent and an EIRR of 36.7 percent. The FIRR is moderately robust for declines in output and prices of wheat grains and wheat flour, and for increases in investment and operating costs. The FIRR is sensitive to price fluctuations of wheat flour when prices of wheat grains remain constant. Although this scenario is unlikely, the FIRR is reduced to 12 percent when benefits decline by 7.0 percent, a case when flour prices alone decline by 7.0 percent without a similar drop in the

price of wheat grains. Similarly, the EIRR falls to 31.1 percent when output declines by 10 percent, and to 28.3 percent when wheat grain and wheat flour prices simultaneously drop. Details on financial and economic viability and results of the sensitivity analysis are presented in Appendix 10.

2. Impact on Poverty

101. The poverty impact assessment (Appendix 11) concluded that the measures supported under the SDP will, on balance, have modest net benefits for the poor, primarily through the mechanisms of (i) better access to commercial credit; (ii) better informed decision making on agriculture through improved access to information about the legal, policy, and economic environment; (iii) more transparent procedures for farm accounting, property registration, secured lending, and bankruptcy; and (iv) greater private initiative in small businesses and voluntary rural associations. At the same time, it must be recognized that the SDP is intended, first and foremost, to encourage market-led growth. The SDP will reinforce irreversible long-run trends in Kazakhstan's agriculture that are inherent in the country's transition to a market economy, particularly the rationalization of farm ownership structures and costs, the exit from agriculture of financially unsustainable farms and redundant labor, and the elimination of subsidies for irrigation and other inputs. The positive impacts of this transition are likely to be greatest and most rapidly felt in relatively nonpoor regions that have high potential for agricultural growth due to factors such as irrigation, soil quality, length of the growing season, and accessibility to markets. In contrast, the negative impacts of the transition on the poor will be largest among marginal regions and farms. The Government is fully cognizant of these negative impacts, and within its presently severe resource constraints, is committed to ameliorating them. To this end, the SDP will, in coordination with the activities of other external assistance agencies, strengthen the Government's capacity to monitor, evaluate, and refine both the content and the application of agricultural policies and legislation, with the intent of improving transparency, effectiveness, and equity.

102. Given the necessary scale and capital intensity of financially sustainable farming in the rain-fed areas of East Kazakhstan, it is inevitable that the process of farm restructuring will, at least during the short run, have adverse impacts on employment in potentially vulnerable rural communities.⁴¹ But in the long run in a market economy, the creation of financially healthy farms is the only sustainable way to ensure household food security and access to social services. The Project's microenterprise development initiatives will directly address the antipoor impacts of the market transition. The microenterprise activities will, in the first instance, be specifically targeted at the communities dependent on large farms that initiate a significant program of restructuring and downsizing of their labor force. Thus, the Project will prevent rural households from slipping into poverty. In addition, to the extent warranted by bankable demand and project resources, the microenterprise activities will expand to cover other regions of East Kazakhstan that suffered employment losses through farm restructuring and bankruptcy prior to the Project. Over the life of the Project, it is envisioned that at least 200 microenterprises and small businesses including craft industries and women's groups will be supported in over 60 rural communities. The Project will train about 50 community development workers and 200 apprentices in craft and services industries. A quick start-up for this component is assured

⁴¹ Although there will be loss of direct employment, most rural households will continue to own shares in the farms. Hence, during the medium term, the loss of direct labor income should be at least partially offset by the increasing dividends paid to shareholders as the farms become more profitable. Alternatively, households that are successful in finding new nonfarm employment may opt to sell their farm shares.

because it has been designed to complement and build on the oblast's ongoing Regional Fund for Support to the Low-Income Population.

B. Risks and Safeguards

103. Given Kazakhstan's rapid macroeconomic and institutional transition and frequent changes in key Government personnel, the SDP's major risk is that the Government's commitment to full program implementation falters. However, the ASP (footnote 6) was implemented successfully during a similar period of rapid change (footnote 24). More importantly, the reforms supported by the SDP build directly on the constraints identified in farm and rural community consultations, as well as the sector analyses and medium-term strategic agenda prepared by MOA and other agencies. Nonetheless, several SDP measures—budgets for the agricultural information initiatives and for irrigation operation and maintenance financing—depend on approval by Kazakhstan's Parliament, thus, there is an element of political uncertainty.

104. The investment Project faces a number of macro and micro risks to successful implementation and the attainment of anticipated benefits. Kazakhstan's macroeconomic difficulties—entailing budgetary constraints and some uncertainty in the exchange rate and financial sector—are likely to persist for at least the next one or two years. These difficulties lead to risks of counterpart funding shortfalls, as well as to greater caution among commercial banks in lending to risky sectors like agriculture. It is beyond the scope of the Project to directly address such risks, but at the same time, they are considered manageable and worth taking.⁴² The Government has provided assurances that adequate counterpart funding will be provided for the Project. Recently the Government has (i) initiated endeavors to improve the quality of the public expenditure program; (ii) limited new external borrowing within the ceiling established by the International Monetary Fund under the enhanced fund facility; and (iii) initiated a review of ongoing foreign-funded projects, in order to cancel projects that do not meet criteria for impact/effectiveness, return on investment, and sustainability. At a time of great pressure on foreign exchange reserves, rationing of dollars is a risk, but NBK has consistently reiterated the Government's commitment to a freely traded tenge. Indeed, the depreciation of the tenge will bring significant benefits to sectors like agriculture, which produce tradable goods. Finally, despite the financial sector uncertainty, several commercial banks have expressed strong interest in participating in the Project, and more are expected to do so once the Project is actually under way.

105. The micro risks were addressed in the project design. Given the scarcity of rural business skills suited to the needs of a market economy, it is unlikely that a credit line alone would be either disbursed or utilized efficiently. Hence, the Project provides a package of mutually complementary advisory and financial support. Nonetheless, there are risks that the rural enterprises may not perform as expected if they do not implement agreed-upon management practices, including land use, cropping patterns, and inputs. The Project's financial and economic analyses assume conservative yields, well below the potential of good farm management in the project area. The Project and the associated TA will initiate and support efforts to locally adapt and extend improved crop technology to the farms. It is believed that productivity can be readily improved if farming operations are performed correctly with modest levels of inputs. The farms will be required to adopt and implement agreed upon restructuring programs on a phased basis; failure to do so will result in termination of credit facilities. The

⁴² There are significant risks in doing nothing. Continuing farm and rural stagnation are to be expected in the absence of public support to restore productivity and promote growth.

RAU will have responsibility for monitoring the restructuring and onlending processes, and keeping financial institutions informed. Financing institutions may also be required to provide crop insurance.

106. Although the RAU will be established within agencies of the oblast administration, its credibility in the eyes of participating farms and the commercial banks will depend critically on its objectivity and strict application of the eligibility and financial criteria for the identification, appraisal, and endorsement of subloans. The importance of the RAU's independence is acknowledged by both national and local authorities, whose commitment to this independence was reconfirmed during the Appraisal Mission, when a framework and timetable for the legal establishment of the RAU was agreed upon. Intensive monitoring by ADB is required during the Project's first year of implementation to get the RAU up and running, to ensure smooth consultant recruitment and mobilization, and to advise on the terms and execution of SLAs with the commercial banks.

107. Even if the expected productivity is achieved, lack of credit discipline by borrowers could contribute to poor loan repayment. To reduce this risk, borrowers will be carefully assessed and required to contribute an equity share in any investment. The RAU must contribute to an objective, rigorous analysis of potential loans by applying strict financial and economic criteria that have been missing from the farm privatization process to date. This approach is designed to ensure the recovery of costs that is central to the Government's borrowing strategy.

108. The commercial banks will contribute their own resources to the onlending and bear the risk of loan default. Thus, disbursement under the Project will be slowed if the banks prove excessively cautious in lending. The training and capacity building provided to bank staff, and the RAU's roles in encouraging the formation of stable farm structures and in screening large loans are intended to reduce this risk. Moreover, the policy component is specifically designed to encourage greater commercial lending to agriculture by leveling the playing field for the banks in respect of the legal framework for secured lending, farm accounting and auditing, liquidation, and bankruptcy.

109. Some farmers may not wish to become involved with the Project if it means rationalizing or divesting of their traditional activities. This is the prerogative of the farm managers and shareholders. While the SDP, including the Project, include measures to inform shareholders of their options and the benefits of farm restructuring, the Project will only support farms and rural communities that are motivated and willing to accept the proposed changes.

110. The provision of working capital should enable farm enterprises to free themselves from barter deals and trade freely for cash. However, farmers may not wish to do so if there is a risk of tax authorities seizing cash in bank accounts. While the Project will require the use of a bank account, the policy component will require the adoption of sound, transparent accounting and auditing practices, as well as continued reform of tax policy and administration. The Project will work primarily with farms that have revenue-generating potential to repay any outstanding debt; if successful, these farms will face reduced risk of having their bank deposits seized.

VIII. ASSURANCES

A. Specific Assurances

111. The Government has given the following specific assurances, in addition to the standard assurances, which have been incorporated in the legal documents.

1. For the policy loan, assurances include the following:
 - (i) The policies adopted and actions taken as detailed in the development policy letter will continue throughout the implementation period of the policy component and subsequently.
 - (ii) The policies and actions set out in the development policy letter will be carried out in accordance with the schedule of policy reforms detailed in the policy matrix (Appendix 3).
 - (iii) The counterpart funds generated from the proceeds of the policy loan will be used by the Government to finance the implementation of the SDP's policy reforms.

2. For the investment loan, assurances include the following:
 - (i) Prior to onlending by PCBs of the investment loan proceeds (a) the first five subloans and all subloans greater than \$350,000 will be reviewed and approved by ADB; (b) an acceptable summary initial environmental examination, in accordance with ADB guidelines, will be submitted to ADB for all agroprocessing subloans in excess of \$100,000.
 - (ii) The Project will be accorded high priority and included as a specific line item for annual budgetary allocations, and such annual budgetary allocations will be made available on a timely basis.
 - (iii) During project implementation, the RAU will be organized and managed to promote maximum autonomy and independence in its decision-making, administrative, and operational activities and will have adequate resources and staff to carry out its assigned activities in an effective and timely manner.
 - (iv) Employees of public agencies who receive training under the Project will be obligated to remain in service for at least one year after such training, either in their originally assigned positions under the Project or in a capacity relevant to the training provided.
 - (v) Within six months of loan effectiveness, a BME system satisfactory to ADB will be established within the RAU to monitor progress in farm restructuring, farm and agribusiness performance, and rural microenterprise activities supported by the Project. The BME system will be integrated with the MOA and DOA databases used in the surveys of farm financial performance and those established as part of the market information system and will monitor (a) the farms, agribusinesses, and microenterprises served by the RAU; (b) crop and livestock productivity; (c) farm and nonfarm employment by gender; (d) farm financial performance and profitability; (e) loan utilization and repayment; (f) project environmental impacts; (g) average incomes and poverty incidence at farm and community levels; and (h) gender-specific impacts of farm restructuring and project interventions.
 - (vi) The implementation of the Project, including selection, design, and approval of subprojects, will be carried out in accordance with relevant environmental regulations of the Borrower and applicable ADB environmental guidelines, and any monitoring and mitigation measures specified in the summary initial environmental examination (SIEE) undertaken for the Project, and in approved subproject SIEEs, will be promptly undertaken in accordance with their terms.

B. Conditions for Loan Effectiveness

112. The Government and ADB have agreed that, as conditions of effectiveness of the investment loan, the following actions will have been completed to the satisfaction of ADB:

- (i) The RAU will have been duly registered and established as a closed joint stock company in accordance with the laws of Kazakhstan.
- (ii) The Government will have (a) assigned office facilities and suitability qualified full-time administrative staff for the project office in Astana and the project coordinating office in Ust-Kamenogorsk, (b) appointed the project director with qualifications and experience acceptable to ADB, and (c) established separate accounts for project operations.
- (iii) The Government will have undertaken a nationwide recruitment search, in a manner satisfactory to ADB, for the RAU director and all long-term RAU professional staff.
- (iv) The Government will have selected, through a selection board comprising representatives of MOA and East Kazakhstan oblast, the RAU director with qualifications and experience acceptable to ADB.
- (v) The Government will have caused the East Kazakhstan oblast administration to (a) provide adequate RAU office premises sufficient for use by at least 12 professional staff and associated support staff, and for training activities contemplated under the Project; and (b) assign to the RAU, with qualifications and experience acceptable to ADB, at least one part-time RAU staff member with direct experience in Government micro and small-scale lending programs.

C. Conditions for Disbursement

113. In addition to satisfying the tranching conditionalities specified for disbursement of the policy loan, the Government and ADB agreed on the following as conditions for disbursement of the investment loan.

- (i) There will be no disbursements of the investment loan until the Government has selected, through a selection board comprising representatives of MOA and East Kazakhstan oblast, all long-term RAU professional staff with qualifications and experience acceptable to ADB.
- (ii) There will be no disbursement to a PCB from the credit line component of the investment loan until an SLA is executed between MOF and the PCB concerned, on terms and conditions satisfactory to ADB.

IX. RECOMMENDATION

114. I am satisfied that the proposed loans would comply with the Articles of Agreement of ADB and recommend that the Board approve:

- (i) the loan of \$25,000,000 from the ADB's ordinary capital resources to the Republic of Kazakhstan for the Farm Restructuring Sector Development Program, with a term of 15 years, including a grace period of 3 years, and with an interest to be determined in accordance with the ADB's pool-based variable lending rate for US dollar loans and such other terms and conditions as are substantially with those set forth in the draft Program Loan Agreement presented to the Board; and

- (ii) the loan of \$20,000,000 from the ADB's ordinary capital resources to the Republic of Kazakhstan for the Farm Restructuring Sector Development Project, with a term of 25 years, including a grace period of 5 years, with interest to be determined in accordance with the ADB's pool-based variable lending rate system for US dollar loans and such other terms and conditions as are substantially in accordance with those set forth in the draft Project Loan Agreement presented to the Board.

TADAO CHINO
President

19 October 2000

APPENDIXES

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SUPPLEMENTARY APPENDIXES
(available on request)

A	Statistics on the Agriculture Sector
B	Social Assessment of the Project Area
C	Summary Initial Environmental Examination
D	Training Programs under the Project
E	Detailed Financial and Economic Analyses
F	Profiles of Selected Commercial Banks and Nongovernment Organizations

LOGICAL FRAMEWORK

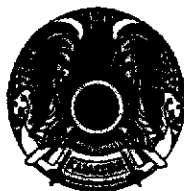
Project Design Summary	Goals/Targets	Monitoring Mechanisms	Assumptions
1. Sector Goals Maximize agriculture's contributions to national income growth and export earnings. Promote profitable, sustainable farming on privatized corporate and family farms supported by efficient input supply, rural finance, processing, and marketing. Engender a dynamic process of rural growth and regeneration.	Restore crop and livestock productivity to competitive levels within five years. Create a more diversified, market-led agriculture based on Kazakhstan's comparative advantage. Establish competitive, financially sound banking and agroprocessing. Promote diversified rural employment growth and social equity.	Benchmark surveys Benefit monitoring and evaluation (BME) reports National and provincial statistics	Agriculture remains the most viable rural economic activity. National Government commitment to market-oriented institutional and policy change continues. Adverse environmental impacts are adequately addressed in public development projects and programs.
2. Program Objectives Promote rural economic development and growth by strengthening the policy and legal framework for market-led agricultural and rural growth.	Improve the legal framework for voluntary farmer associations, including water user groups. Develop more transparent, efficient procedures for farm accounting, auditing, taxation, and bankruptcy. Revise legislation and policies that influence the financial sector so as to promote the viability of the rural banks, greater commercial lending to agriculture, and savings and deposit mobilization. Promote freer and more competitive farm and microenterprise development. Promote widespread understanding within rural communities of their legal rights, obligations, and economic opportunities.	Steering committee reports submitted by the Ministry of Agriculture Loan review missions Consultants' reports	Government remains committed to necessary policy reforms. Government ownership of the reform program will be sustained despite any changes of Government personnel. Local administrations support effective implementation of the reforms.

Project Design Summary	Goals/Targets	Monitoring Mechanisms	Assumptions
<p>3. Project Objectives</p> <p>Create appropriate mechanisms to facilitate farm restructuring in high-potential raions.</p> <p>Build capacity for sustained management of the RAU and the independent replication of the RAU approach elsewhere in Kazakhstan.</p> <p>Provide farming communities with legal, accounting, and farm business planning advice.</p> <p>Ensure that restructured farms have access to input supplies and marketing outlets. Promote private enterprises undertaking input supply, machinery hire and servicing, and transport, storage, processing, and marketing.</p> <p>Reduce the social costs of farm restructuring through alternative employment and income generation.</p> <p>Develop competitive financial services and increase the volume of commercial credit to farms/agribusinesses that have undergone restructuring.</p> <p>Strengthen key public and private sector institutions concerned with farm development.</p>	<p>Establish an independent, financially self-sustaining rural advisory unit (RAU) in East Kazakhstan oblast.</p> <p>The RAU provides detailed restructuring guidance to approximately 50-60 large corporate farms over five years, covering some 400,000 hectares (ha) of agricultural land.</p> <p>Improve incomes of project beneficiaries by at least 20 percent in real terms over five years.</p> <p>Support development of 10-15 agroprocessing enterprises. Establish at least one machinery repair station and one producer marketing cooperative in the oblast.</p> <p>Establish microenterprises in areas worst affected by farm restructuring. Promote nonfarm employment in at least 60 communities.</p> <p>Establish credit delivery mechanisms for farms, agribusinesses, and microenterprises.</p> <p>Achieve on-time loan repayment rate of 95 percent or better.</p> <p>Upgrade the skills and practices of national and oblast level agencies, the banks, and agricultural training and research institutions.</p>	<p>BME reports, loan review missions, project completion report, and postevaluation studies</p> <p>Asian Development Bank (ADB) supervision and monitoring must be particularly intensive during the initial period of RAU establishment and staff recruitment, and while subsidiary loan agreements are being negotiated.</p> <p>Loan monitoring</p>	<p>National (Republican) and oblast governments accept need for autonomy of RAU's decision making.</p> <p>The Government maintains appropriate market-oriented trade and distribution policies.</p> <p>Commercial banks are willing to participate.</p> <p>Adequate financing for training and consultancy support is provided.</p> <p>Competent consultants recruited promptly and able to establish effective working relationships with counterparts.</p> <p>Public agencies can be reoriented to the required participatory approaches.</p> <p>Close and effective coordination with World Bank and other assistance agencies.</p> <p>The National Bank of Kazakhstan and the Ministry of Finance play required supervision roles.</p> <p>Government discipline can be developed and sustained.</p> <p>Environmental impacts are minor or can be readily addressed in project design.</p>

Project Design Summary	Goals/Targets	Monitoring Mechanisms	Assumptions
<p>4. Project Outputs</p> <p>Profitable farms, farm advisory services, and competent farm management</p> <p>Support to commercial banks and nonbank financial institutions</p> <p>Agribusiness development including input supplies, equipment sales and repairs, processing facilities, and market and procurement information</p> <p>Training of agribusiness managers</p> <p>Support to microenterprises in rural areas financed by beneficiaries</p> <p>Stronger institutions and human resources within the agriculture sector</p>	<p>Create a core group of 200 profitable farms, including 50-60 corporate farms, over five years.</p> <p>Ensure cost recovery for a financially sustainable RAU.</p> <p>Some 700 farm managers and owners trained in farm business management, including business planning and record keeping</p> <p>100 staff trained in farm credit appraisal, loan monitoring and evaluation, and legal procedures</p> <p>Establish at least one machinery service center.</p> <p>Increase vegetable oil output by 10,000 tons per year.</p> <p>Provide support to at least 200 microenterprises over five years, including craft industries and women's groups.</p> <p>Train 8 RAU personnel in agricultural economics and market economy aspects of technical disciplines, and other topics.</p> <p>Train 20 staff of agricultural education institutes as trainers.</p> <p>Train 120 staff of oblast and raion administrations and agencies in specific disciplines.</p> <p>Train at least 50 community development workers and 200 apprentices in craft and services industries.</p>	<p>BME and progress reports, project review missions</p>	<p>Timely consultant recruitment</p> <p>Adequate training programs can be developed either locally or within the region.</p> <p>The Government is able to provide adequate counterpart funding.</p> <p>Foreign exchange is available to finance the necessary imports of inputs and equipment.</p>

Project Design Summary	Goals/Targets	Monitoring Mechanisms	Assumptions
5. Project Activities Rural advisory unit Credit lines Training program Project management, monitoring, and reporting Strengthen policy analysis and evaluation, and effectiveness of agronomic research.	Inputs 76 person-months of international and 360 person-months of domestic expertise \$19.6 million credit (excluding own equity contribution of \$3.38 million) to farms, agribusinesses, and microenterprises More than 1,000 trainees in total Short-term consultancy and training, as required, in financial management, environmental assessment, and BME systems Advisory TA for Deepening of Agricultural Reforms and Development Programs	Benchmark surveys, project progress reports, BME reports, and project review missions	Adequate budgetary commitments are made by national and oblast authorities. The RAU provides useful services for which farms and other rural enterprises are increasingly able and willing to pay. Appropriate institutional capacity exists or can be developed. Human resource skills exist or can be created in the needed economic and business management disciplines. Farm communities are involved adequately during the preparation of programs. Willingness to engage in policy dialogue exists at oblast level.

ҚАЗАҚСТАН
РЕСПУБЛИКАСЫНЫҢ
ҮКІМЕТІ



GOVERNMENT
OF THE REPUBLIC
OF KAZAKHSTAN

11, Beibitshilk Str., Astana, 473000

Ref. No 17-13/10690

Astana
October 02, 2000

Dear Mr. President,

As you know, agriculture is an important sector of Kazakhstan's economy, contributing a significant share of GDP. Rural areas are home to almost one half of the population, including most of the poor. Further growth and development of this sector have been key Government objectives since independence in 1991. Therefore agriculture has been a central area of reform and constitutes an integral component of the Government's overall strategy to transform Kazakhstan into market economy.

Kazakhstan's road to transition has not been smooth. Exacerbated by the macroeconomic disarray of our separation from the former Soviet Union and consequence of many factors the agricultural sector was significantly reduced. Among them is loss of traditional markets of the former Soviet Union, deterioration of the sector's terms of trade; a sharp reduction of cultivated areas, input use, and productivity of all crops and livestock; and the floundering of the rural financial system as a result of the dire financial conditions of the sector.

Faced with these difficulties, the Government embarked soon after independence on the path of transformation, focusing on restoring macroeconomic stability and initiating structural reforms. By 1995, the protracted economic downturn had been arrested and inflation brought under control. Under these circumstances, the Government, assisted by the International Monetary Fund (IMF) has designed and followed a consistent strategy in order to stabilize the economy and resume growth. On the fiscal side, renewed efforts have focused on further rationalizing public spending.

In April 1999 a crucial step was taken to float the tenge. This major policy adjustment not only aligned the tenge with currencies of Kazakhstan's major neighboring countries, but also began to ease the tremendous pressure on domestic producers, including farmers. With support from the World Bank, the Asian Development Bank (ADB) and other funding agencies, the Government has continued its efforts in major areas of structural reforms, including pension reform, privatization of large state-owned enterprises (the "Blue Chip" program), civil service and trade liberalization.

Mr. Tadao Chino
President
Asian Development Bank
Manila, Philippines

Жауап кайтарарда міндетті түрде біздің № және күні көрсетілуі керек.
При ответе обязательно ссылаются на наш № и дату.

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Mr. President, ADB has always been a staunch supporter of the Government's efforts in macroeconomic stabilization and structural reforms. Your Bank has played a particularly important role in the agricultural sector. With support of the ADB's Agricultural Sector Program, considerable progress was made in a wide range of agricultural reforms.

Despite severe financial constraints during the past two years, the Government did not stand still in its agricultural sector reforms. The further development step, which is fully consistent with ADB's recent rededication to the task of poverty alleviation, was the Government's drafting of a National Program for Fighting Poverty and Unemployment in 2000-2002. This program focuses specifically on reducing unemployment and will require a major commitment of resources during the coming three years. We look forward to ADB's full participation in our efforts to reduce poverty.

Mr. President, the Government is determined to take further steps to lift agriculture from these circumstances and bring the sector to its fullest potential. Our strategy for agriculture is consistent with the Republic's long-term strategic development goals, first enunciated in "Kazakhstan 2030" by President Nazarbayev in October 1997.

Our strategy for agriculture encompasses three lines. First, while legally or formally privatising farms – a relatively easy phase – has been completed, the sector has entered a new phase in which a wide range of support services are needed in order to encourage the stable establishment of viable farm enterprises. Secondly, with the broad legal, regulatory and policy framework now in place at the national level, the focus must shift toward more effective understanding and application of this framework in the oblasts and rayons. Third, the public agencies involved in agriculture must continuously monitor the sector, analyse the markets and evaluate the impact of policies and laws, and take subsequent steps to refine and deepen the reforms in order to encourage market-led growth.

This strategy directly underlines the Government's request for ADB support under the proposed Farm Restructuring Sector Development Program, which will provide direct information, consulting and financial support to the farms and rural communities; refine the policy and legal framework for agriculture; and enhance capacity in republican and oblast public agencies, as well as in the rural banking systems. The focus will be on restructuring farms in order to make them efficient and profitable, the key objective of the reforms in agriculture. The components of the Sector Development Program are interrelated and mutually supportive. The project component provides with direct material support the farms, while the program component will be instrumental in creating the enabling environment that allows for the successful implementation of the project.

The specific actions to be taken by the Government under the proposed Sector Development Program are enumerated in the attached matrix. The principal features of this Program include:

- (i) Strengthening the institutional capacity for sector monitoring and analysts to support farm restructuring and growth;
- (ii) Facilitating transfer of land rights by citizens and legal, strengthening the implementation of existing legal framework for registering rights to land and other immovable property;
- (iii) Making farms more attractive for market-based investment and secured lending;
- (iv) Ensuring wide availability of adequate information on agriculture and related legislation on farming structures, land, pledge and mortgage,

- bankruptcy, taxation, conflict resolution and the formation of voluntary farmer associations;
- (v) Promoting transparent, fair and efficient agricultural taxation to facilitate on the one hand, the establishment of a more stable and predictable tax environment for farms and agribusiness, and on the other hand, the sector's contributions to national and regional budgets;
 - (vi) Encouraging local private initiative by (a) taking steps to reduce unwarranted interventions by local administrations in farm and rural business affairs for purposes of tax collection and other reasons; (b) strengthening the legal framework for the formation of voluntary rural associations; and (c) increasing participation and cost recovery from irrigation users by facilitating the legal framework for irrigation management transfer through the formation of Water User Associations and voluntary farmer associations;
 - (vii) Promoting efficient growth of the sector by continuing the removal of direct agricultural subsidies to farms; and
 - (viii) Encouraging private, public and foreign investment in the sector. Particular emphasis is on (a) preparing a set of measures to improve incentives for foreign investment; and (b) preparing measures to revive the domestic oilseed production and processing industry.

I should note, that the above measures have been designed to directly complement the ongoing efforts of other external agencies working in Kazakhstan's agriculture, financial and legal sectors, in particular the World Bank, the United States Agency for International Development (USAID) and EU-TASIS/ Thus, the Program reflects the intention of the Government of the Republic of Kazakhstan to focus and coordinate external assistance in order to optimize its development impact.

Mr. President, Kazakhstan's transitional agricultural sector has reached a turning point. While proud of the achievements so far, the Government is fully aware of and totally committed to continuing with the unfinished agenda of reform in the agricultural sector. Despite Kazakhstan's present fiscal difficulties, the Government is determined to carry on the structural reforms which together with policies to maintain macroeconomic stability, provide the only sure way to economic recovery and sustainable long-term growth and prosperity. It is within this context that the farm Restructuring Sector Development Program has been designed. Due to increasing budgetary constraints, ADB's support for the proposed Program is critical. The Government firmly believes that these fresh reform efforts, aimed at the core of the systemic deficiencies, will be another milestone in the sector's transformation process.

Yours truly,



Erzhan Utembayev
Deputy Prime Minister

POLICY MATRIX

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
1. Strengthen the capacity of the Ministry of Agriculture (MOA) and agricultural research agencies for sector monitoring and analysis, and to support farm restructuring and growth in a market economy.	1.1 Provide sound analyses on which to base policy recommendations for farm development and growth.	The Republican Working Committee (RWC) was formed in February 1998 to analyze the financial performance of farms having the status of legal entities. A nationwide survey of these farms was completed in 1998, and is now being updated monthly.		MOA will expand its monitoring and analysis of farm performance by conducting, on at least a biennial basis, surveys of the profitability of different crops and cropping patterns on farms of differing sizes and organizational structures in Kazakhstan's main agroclimatic zones (over the program period).
	1.2 Improve price monitoring and market analysis capacity in high-priority regions.	With support from the Asian Development Bank (ADB) and European Union-Technical Assistance for the Confederation of Independent States (EU-TACIS), market and price analysis have been strengthened within MOA since 1995. In December 1997, the Government issued Regulation No. 1805, Creation of a Unified Market Information System for the Agro-Industrial Complex.	MOA will prepare a plan, satisfactory to ADB, for establishment and sustainable operation of a system of computerized market information centers, which routinely disseminate price and other market information to the public. The plan will include cost estimates for the system and proposals for cost recovery. MOA and Ministry of Finance (MOF) will submit to Parliament in the draft law on the Republican budget for 2002 budgeted amounts, satisfactory to ADB, to finance the plan.	A market information system will be set up operating in at least four high-potential agricultural oblasts, including East Kazakhstan (October 2002).
	1.3 Enhance the capacity of public institutions to support agricultural growth in a market economy and in the face of severe public resource constraints.	Continuing a downsizing that commenced in the early 1990s, MOA in early 1999 reduced the number of its departments from 6 to 4 and rationalized their functions. At the same time, the ministries of science and high education were merged, ultimately to consolidate agricultural postsecondary education with agricultural		East Kazakhstan Scientific Research Institute for Agriculture, with MOA, is to design and commence implementation, with ADB-financed technical assistance (TA), of a pilot program of field trials and economic evaluation for high-potential crops in East Kazakhstan (May 2001).

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
		research systems previously supervised by the National Academic Center for Agrarian Research. Kazakhstan's institutions for agricultural technology development and diffusion are now preparing medium-term plans, including stronger links to international organizations, to respond to the opportunities and constraints faced by farms in a market economy.		Kazakhstan's agricultural research agencies, in coordination with MOA, will expand collaboration with international agricultural research institutions under the Consultative Group system (over program period).
2. Increase the use of agricultural land as collateral to encourage farm investment and growth.	2.1 Strengthen implementation of the legal framework for registering rights to land and other immovable property.	With assistance from the World Bank-financed Real Estate Registration Pilot Project, the Ministry of Justice (MOJ) has established a registration system for immovable property in Almaty and Akmola oblasts, including the cities of Almaty and Astana.		<p>The Government will commence implementation of the system for registering rights to immovable property in East Kazakhstan and at least one other high-priority oblast (June 2002).</p> <p>The Government will supervise the continued implementation throughout Kazakhstan of the system for registering rights to immovable property (over the program period).</p>
3. Promote transparent farm management and make farms more attractive for market-based investment and secured lending.	3.1 Improve financial management of farms by introducing internationally accepted accounting and auditing requirements for legal entity farms.	The Law on Audit was passed by Parliament in October 1998. The law authorizes the activities of a nonprofit, legally and financially independent chamber of auditors (COA). The COA will adopt auditing standards consistent with international practice, provide training, supervise issuance of qualification certificates, monitor compliance with laws, and establish mechanisms for dispute resolution. The law also makes general provisions for (i) MOF to issue licenses and to supervise COA; (ii) the	<p>Department of Accounting and Auditing Methodology to (i) confirm acceptance of application of the International Accounting Standards adopted by the International Accounting Standards Committee or equivalent standards satisfactory to ADB; and (ii) adopt a timetable with specified milestones satisfactory to ADB, for implementation of application of the accounting standards referred to in (i).</p> <p>MOF, in consultation with the COA or any successor</p>	<p>MOF to apply accounting standards specific to agriculture as they are applied by the International Accounting Standards Committee.</p> <p>MOF to approve auditing standards recommended by the COA or any successor organization thereto, provided such standards comply with internationally accepted standards of audit (June 2002).</p> <p>The Government will monitor the implementation of the plan to apply internationally</p>

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
	3.2 Evaluate and refine legislation on bankruptcy.	<p>professional obligations and liabilities of auditors; and (iii) administrative, civil, and criminal liability for violations of audit legislation.</p> <p>Kazakhstan's initial Law on Bankruptcy was passed by the Parliament in January 1997. To provide for the specific features of agriculture, in December 1997, Regulation No. 1816, Concerning Adoption of Provisions on Specific Features of Application of Bankruptcy Procedures to Agricultural Organizations, was adopted. Since that time, an amended Law on Bankruptcy was approved by Parliament in July 1998.</p>	organization thereto, to prepare and commence implementation of a phased plan, satisfactory to ADB, to apply internationally accepted auditing and accounting standards, or equivalent standards satisfactory to ADB, to farms and agribusiness enterprises which are legal entities.	<p>accepted accounting and auditing standards, or equivalent standards satisfactory to ADB, to farms and agribusiness enterprises, which are legal entities (over remaining program period).</p> <p>The Government, with TA, will (i) evaluate the implementation of agricultural bankruptcy procedures; and (ii) based on this evaluation, prepare a report proposing appropriate amendments to legislation and bankruptcy procedures for submission to Parliament or the relevant agency concerned to (a) promote the consistent application of bankruptcy procedures; (b) reduce the costs and time required to resolve bankruptcy cases; and (c) ensure equity among debtors, farm shareholders, and creditors (December 2001).</p>
	3.3 Evaluate and, as required, refine legislation to facilitate the use of movable and immovable property as collateral.	The Decree of the President, Valid as Law, On State Registration of Immovable Property Rights and Transactions with Them, was issued in December 1995. In June 1998, Parliament passed the Law on Registration of Pledges of Movable Property, which provides for the creation of a system for registering pledges of movable property. In February 1999, MOJ issued the order Concerning		The Government will review, with TA, the implementation of legislation on the pledging of movable property and mortgage of immovable property, and, if appropriate, to prepare suitably revised legislation or regulations (December 2001).

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
		Implementation of the System for Registering Pledges of Movable Property.		
4. Promote market-led growth of agriculture by ensuring the availability to the public of adequate information on agriculture and related legislation on farm structures, land, pledge and mortgage, bankruptcy, taxation, conflict resolution, and the formation of voluntary farmer associations.	4.1 Increase the level of public knowledge of current legislation for agriculture.	During 1997 and 1998, MOA personnel conducted a series of oblast-level seminars to explain the new policies and legislation on privatized agriculture. The RWC recommended action to provide further information to farm shareholders on their farm restructuring options.	MOF, in consultation with MOA, is to submit to Parliament in the draft law on the Republican budget for 2002 the provision of a budget, in an amount to be agreed upon with ADB, to finance the nationwide information and education program on agriculture.	The Government, with TA, will prepare a detailed plan and cost estimates, which will be subject to ADB approval, for a nationwide information and education program on agriculture. The program will be conducted beginning in the 2002 fiscal year (July 2001).
5. Promote transparent, fair, and efficient agricultural taxation to facilitate the sector's contribution to national and regional budgets.	5.1 Improve the predictability and fairness of farm taxation. 5.2 Strengthen the linkage between water fees and the costs of maintaining water resources infrastructure.	To begin rationalizing the agricultural tax system, the Government in 1997 introduced a simplified tax procedure for peasant farms. In February 1998, the Government commenced a nationwide program of tax administration and tax policy reform in cooperation with the United States Agency for International Development (USAID). With support under the Agriculture Sector Program (ASP), the Government in August 1997 issued Regulation No. 1227, Concerning Adoption of the Provisions on the Procedure for the Calculation, Collection and Payment for Use of Surface Water Sources for Branches of the Economy of the Republic of Kazakhstan, which was the first step toward a long-		The Government will continue reforms, satisfactory to ADB, of agricultural tax policy and administration (over the program period). The Government, based on the recommendations submitted by the consultants under TA 2946, ¹ will revise or draft, as appropriate, legislation to (i) improve procedures for the collection of water fees and related charges; and (ii) establish procedures for annual allocation of such fees and charges between oblast administrations and the

¹ TA 2946-KAZ: *Institutional Development and Policy Reforms for Improving Water Management*, for \$600,000, approved on 17 December 1997, together with Loans 1592/1953-KAZ: *Water Resources Management and Land Improvement Project*, for \$40 million.

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
		run policy of full recovery of the investment and operational costs of irrigation infrastructure. So far, these fees have been used as a source of general revenue by oblast administrations.		<p>Government, in appropriate proportions, to finance the cost of operation and maintenance of drainage and irrigation infrastructure (December 2000).</p> <p>The Government will include as a line item in the draft law on the Republican budget for the year 2002 and in subsequent years, funding for the costs of operation and maintenance of irrigation and drainage infrastructure, taking into account the level of collection of revenues generated from water fees and delivery charges for past years (October 2001 and thereafter).</p>
6. Promote rural growth by encouraging local private initiative and investment.	6.1 Reduce extralegal interventions by oblast and raion administrations that impede development and growth of private farms and rural enterprises.	Created in April 1998, the Agency in Support of Small Business has prepared and initiated implementation of the State Program in Support of Small Business for the years 1999-2000 which covers (i) steps for monitoring and enforcing provisions of the Presidential Decree on Protection of the Rights of Citizens and Legal Persons for Freedom of Business Activity; (ii) specific subprograms to rationalize the tax code for small businesses; (iii) support for small business development; and (iv) specific goals and target dates for the achievements of the Program in Kazakhstan's regions.	MOA to (i) critically evaluate the impact of oblast and raion-level administration interference in the decisions of private farmers on land use, cropping patterns, and input/output marketing, including the adequacy of grievance procedures; and, (ii) based on the results of this review, submit, for approval by the President's Administration, recommended measures to reduce the level of administrative interference in the activities of private farms and agribusinesses of all sizes.	

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
	6.2 Encourage small-scale rural employment and the formation of voluntary rural associations.	Kazakhstan's Civil Code permits the formation of noncommercial organizations like agricultural cooperatives. ² To rectify practical problems for such organizations, the Law of Rural Consumer Cooperatives was adopted by Parliament in July 1999. MOA has proposed additional amendments to Articles 108 and 110 of the Civil Code.		MOA and other concerned agencies will review, with TA, ³ the impacts of the existing legal and regulatory framework on the establishment of agricultural cooperatives, water user associations, and other voluntary farmer associations (December 2000). Based on this review, the concerned Government agencies will prepare and/or revise, as appropriate, legislation necessary to facilitate the establishment and functioning of such associations (October 2001).
	6.3 Encourage the formation of water user associations (WUAs) to manage and maintain irrigation and drainage systems.	Several pilot projects to form WUAs have been undertaken. These projects demonstrated that the present legal environment presents barriers to the formation of nonprofit service organizations like WUAs. Recognizing this deficiency in legislation, a series of seminars has been conducted to discuss the legal framework for WUAs, culminating in a national conference in February 2000. Based on the seminar, a draft law on WUAs has been prepared, and is presently under review by Parliament's Agrarian Committee.	MOA and the Agency for Water Resources within the Ministry of Environment and Natural Resources either to formally submit to Parliament a draft Law on Water User Associations, or to adopt a regulation on WUAs. The Law or regulation will be satisfactory to the ADB, and will specify procedures for the transfer of irrigation and drainage systems to WUAs, and will remove any legal obstacles to the formation of such associations.	

² The term agricultural cooperative is used to refer to a western-style organization whereby several separate farms come together to pursue mutually beneficial activities like purchasing inputs and machinery, managing irrigation and drainage systems, obtaining and providing credit, or marketing products. Such a cooperative is different from a production cooperative, which under Kazakh law is a single farm.

³ TA to support this review is being provided under TA 2946-KAZ (footnote 1) and USAID's project for Environmental Policies and Institutions in Central Asia.

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
7. Promote efficiency in agriculture through appropriate pricing.	7.1 Continue the removal of direct agricultural subsidies to farms.	Since 1996, the Government has largely sustained the reforms initiated under the ASP, which phased out direct subsidies for agricultural inputs. In 1998 the Government initiated two programs of subsidized credits, one to farms and one to microenterprises. Both were subsequently suspended due to budgetary constraints.		<p>The Government will not recommence any programs of subsidized credits to farms or rural enterprises, except for programs specifically discussed and coordinated with ADB and the World Bank (over the program period).⁴</p> <p>Except as otherwise agreed with ADB, the Government will continue the policy of unsubsidized pricing of meat, wool, fertilizer, and other production inputs used principally in agriculture (over the program period).⁵</p>
8. Promote growth through investment in agriculture.	8.1 Encourage private investment in the agriculture sector.	The Government has prepared a public investment program for 1999-2000, including a plan for agriculture sector assistance by international development institutions. Steps are needed to attract greater private domestic and foreign investment in the agriculture sector. Such investment should be targeted to promote the efficient growth of export-oriented and import-substituting industries, which have declined due to the economy's contraction during recent years.		<p>The Government will (i) conduct a survey of potential foreign investors, and prepare, in consultation with ADB, a report and recommendations to promote foreign private investment in the agriculture sector; and (ii) approve and commence implementation of a set of measures to improve the incentives for such investment (December 2001).</p> <p>MOA will review the development of domestic oilseed production and processing since 1994, and prepare a report containing a set of recommendations, e.g., offering incentives to domestic investors, or providing information on markets and</p>

⁴ This condition duplicates and reinforces an agreement reached under the World Bank-financed Agricultural Post-Privatization Project.

⁵ Exceptions to this policy will include public programs to develop and diffuse improved agricultural technology (seed and livestock breeds), and emergency interventions to arrest pest and disease outbreaks.

Medium-Term Objectives	Specific Policy Tasks	Actions Completed Prior to Board Consideration	Conditions for Release of the Second Tranche (30 November 2001)	Other Actions during the Program Period
				farm technology, to encourage the economically efficient revival of this industry (December 2001).

TERMS OF REFERENCE FOR CONSULTANTS

A. International Experts

1. Farm and Agribusiness Adviser (24 person-months)

1. The farm and agribusiness adviser will act as the chief technical assistance adviser to the project and its participating institutions. He/she will work closely with the director of the Rural Advisory Unit (RAU) by advising and contributing directly to all matters relating to the formulation of business plans for farms and agribusinesses, the monitoring of such businesses, and the review and endorsement of applications for project funds. He/she will also play a key role in designing and undertaking programs of formal and on-the-job training for RAU staff, oblast and raion personnel, and farmer-beneficiaries.

2. Specifically the adviser is expected to

- (i) review and assist in preparing farm or agribusiness plans in collaboration with the farm management specialist, the accountant/financial analyst, and the commercial banks;
- (ii) become familiar with the legal framework relating to farm ownership, land and water use;
- (iii) become familiar with the agroecological characteristics and associated farming systems in the selected oblasts;
- (iv) assist in preparing awareness campaigns among farm shareholders and promoting the role of the RAU in farm restructuring;
- (v) assist in preparing and implementing training programs relating to the upgrading of farm management skills;
- (vi) help identify trainees;
- (vii) endorse the farm business plans submitted to participating commercial banks for credit assessment and loan extension;
- (viii) supervise the work of other RAU staff recruited to assist in analyzing and preparing farm accounts and farm business plans;
- (ix) promote the RAU within the domestic and international agribusiness community with a view to obtaining sponsorship; and
- (x) take responsibility for establishing project financial management and reporting procedures, benefit monitoring, and evaluation systems in accordance with Asian Development Bank (ADB) guidelines.

2. Agricultural Credit Specialist (24 person-months)

3. The agricultural credit specialist will have specific responsibility for advising the participating commercial banks, other financial intermediaries, and the concerned agencies of the oblast administration on the operational requirements of their agricultural and small-scale rural enterprise lending activities. He/she will play the lead role in designing and undertaking programs of on-the-job and formal training for commercial bank personnel.

4. Specifically, the specialist will be required to

- (i) advise on the organization of agricultural and small-scale lending activities at the oblast and raion level;

- (ii) support the formulation of appropriate procedures and methods, including necessary manuals, for rural credit assessment;
- (iii) provide on-the-job training in rural credit assessment and subsequent loan monitoring;
- (iv) advise on the development of management information systems relating to agricultural credit extension at the oblast and raion levels;
- (v) advise nonbanking financing institutions on appropriate credit assessment and loan monitoring procedures to ensure consistency with commercial banking practices;
- (vi) advise on the need for additional training of oblast level staff in any aspect of rural credit extension; and
- (vii) take responsibility for establishing project financial management and reporting procedures, benefit monitoring, and evaluation systems in accordance with ADB guidelines.

3. Short-Term Trainers (16 person-months)

5. The trainers, who will work under the direction of the RAU director and the farm and agribusiness adviser, should be staff of established agricultural universities or colleges in a market economy, with at least five years teaching experience of agricultural economics and farm management, plus a working knowledge of Russian. Familiarity with distance learning methods and transitional economies would be decided advantages. Ideally, the recruitment of short-term trainers will take place within the context of an exchange agreement between the market economy education institute and a Kazakh agricultural university or oblast agricultural college. The foreign partner would be responsible for the provision of training materials, which would be made available in Russian.

6. Specifically, the trainers will be required to

- (i) act as liaison for the foreign partner to ensure the appropriate focus of training modules;
- (ii) organize with local partners the scheduling and venues for the prescribed courses;
- (iii) prepare necessary background materials, which should include informal exercises to be undertaken by trainees on their own time; and
- (iv) facilitate the use of training modules by providing supplementary expertise at formal course sessions.

4. Microenterprise Specialists (8 person-months)

7. The specialists will

- (i) advise the microenterprise development manager on productive and service activities with high economic potential, focusing primarily on the large farms undergoing significant restructuring in conjunction with the Project;
- (ii) design, supervise, and support the community mobilization and training activities;
- (iii) provide specialist services and technical guidance in vocational skills, appropriate technology, microenterprise management and bookkeeping, and market analysis and marketing development; and
- (iv) assist in establishing and implementing procedures for the monitoring and evaluation of the microenterprise activities.

5. Unallocated Short-Term Specialists (4 person-months)

8. These specialists will be recruited as needed in consultation with the Government during Project implementation, adding appropriate short-term skills in disciplines such as farm machinery and equipment; project management, accounting, and auditing; water resources engineering; and environmental assessment.

B. Domestic Experts - Director of Rural Advisory Unit (RAU)

9. The director of the RAU will be recruited initially for a three-year period in accordance with the following guidelines. He/she will be a citizen of Kazakhstan, but not necessarily residing in East Kazakhstan. Candidates will be interviewed separately by a selection board, including representatives of the Ministry of Agriculture and East Kazakhstan oblast. The selected candidate will be subject to approval by ADB. He/she will have the following qualifications:

- (i) at least 10 years' relevant experience in farming and agribusiness, e.g., work in the private sector over the past five years and experience in agricultural banking, or farm/agribusiness management with a joint-stock company;
- (ii) experience in the legal and financial aspects of farm and agribusiness privatization and restructuring;
- (iii) a university-level education in agricultural economics, finance, or business management;
- (iv) experience in managing a team of well-qualified professional staff;
- (v) knowledge and ability to work closely and in harmony with commercial banks, oblast agencies concerned with agriculture sector development, and farm management;
- (vi) personality and presentation skills to represent the RAU in public, explain its functions, and defend its positions; and
- (vii) ability to promote the RAU as an independent entity and seek sponsorship.

COST ESTIMATES
Table A5.1: Project Investment Component - Estimated Project Costs and Financing Plan
(\$'000)

Item	ADB		Commercial Banks		Beneficiaries		Local Government ^a		Government of Kazakhstan		Total		Foreign Exchange
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	
A. Investment Costs													
1. Credit Line	12,624	56.0	3,381	15.0	3,381	15.0	0	0.0	3,156	14.0	22,543	73.2	11,272
2. Office Renovation	19	70.0	0	0.0	0	0.0	8	30.0	0	0.0	27	0.1	11
3. Agronomic Trial Materials	63	70.0	0	0.0	0	0.0	27	30.0	0	0.0	91	0.3	45
4. Training	564	80.0	0	0.0	0	0.0	0	0.0	141	20.0	705	2.3	258
5. Vehicle	133	100.0	0	0.0	0	0.0	0	0.0	0	0.0	133	0.4	133
6. Office Equipment	93	80.0	0	0.0	0	0.0	0	0.0	23	20.0	116	0.4	94
7. Consulting Services													
a. International Consultant	2,044	100.0	0	0.0	0	0.0	0	0.0	0	0.0	2,044	6.6	2,044
b. Domestic Consultant	213	60.0	0	0.0	0	0.0	0	0.0	142	40.0	355	1.2	0
Subtotal (A)	15,752	60.6	3,381	13.0	3,381	13.0	35	0.1	3,462	13.3	26,012	84.5	13,856
B. Recurrent Costs													
1. Recurrent costs - RAU	705	80.0	0	0.0	0	0.0	0	0.0	176	20.0	882	2.9	0
2. Recurrent costs - RAU Office Space	0	0.0	0	0.0	0	0.0	112	100.0	0	0.0	112	0.4	0
3. Recurrent costs - Project Offices	463	80.0	0	0.0	0	0.0	0	0.0	116	20.0	579	1.9	0
4. Recurrent costs - Commercial Banks	0	0.0	112	100.0	0	0.0	0	0.0	0	0.0	112	0.4	0
Subtotal (B)	1,169	69.4	112	6.6	0	0.0	112	6.6	292	17.3	1,684	5.5	0
C. Interest and Commitment Charges During Project Implementation	2,879	100.0	0	0.0	0	0.0	0	0.0	0	0.0	2,879	9.4	2,879
D. Front-End Fee	200	100.0	0	0.0	0	0.0	0	0.0	0	0.0	200	0.6	200
Total	20,000	65.0	3,493	11.4	3,381	11.0	147	0.5	3,754	12.2	30,776	100.0	13,856

RAU = Rural Advisory Unit

^a Does not include contribution associated with (i) the assignment of oblast administration staff to support the Project's microenterprise development initiatives; and (ii) the assignment of Department of Agriculture staff to work with the RAU.

Table A5.2 Rural Advisory Unit (RAU) - Detailed Costs

Item	Unit	Quantities						Unit Cost	Totals Including Contingencies (\$'000)					
		2001	2002	2003	2004	2005	Total		2001	2002	2003	2004	2005	Total
A. Investment Costs														
1. Agronomic Field Trials ^a	amount								0	22	22	23	23	91
2. Renovation of the RAU Office ^b	amount								27	0	0	0	0	27
3. RAU Office Equipment														
a. Computer	set	7	0	0	0	0	7	2	15	0	0	0	0	15
b. Printer	set	4	0	0	0	0	4	0.75	3	0	0	0	0	3
c. Computer Accessories	amount								5	0	0	0	0	5
d. Fax Machine ^c	set	16	0	0	0	0	16	0.4	7	0	0	0	0	7
e. Photocopier	set	1	0	0	0	0	1	5	5	0	0	0	0	5
f. Video Unit	set	1	0	0	0	0	1	3.5	4	0	0	0	0	4
g. Overhead Projector	set	1	0	0	0	0	1	1	1	0	0	0	0	1
h. Office Furniture	amount								11	0	0	0	0	11
i. Miscellaneous Equipment	amount								11	0	0	0	0	11
Subtotal (3)									62	0	0	0	0	62
4. Vehicles for RAU														
a. 4-Wheel Drive Vehicles	unit	4	0	0	0	0	4	25	106	0	0	0	0	106
5. Training														
a. Training Program for Farm Restructuring														
i. Business, Economics, and Management	amount								0	5	11	6	0	22
ii. International: Agronomy, Livestock, Horticulture, and Range Land	amount								0	22	0	23	0	45
iii. International: Marketing, Cooperative Development and Management	amount								0	11	11	0	0	22
Subtotal (a)									0	38	22	29	0	89
b. Microenterprise Development														
i. Introductory Course for Regional Program Officers	amount								5	0	0	0	0	5
ii. Microenterprise Credit Delivery	amount								3	3	4	6	0	17
iii. Microenterprise Management	amount								5	5	6	6	0	22
iv. Marketing and Product Development	amount								0	5	6	6	6	23
v. Accounting and Record Keeping	amount								2	2	2	2	0	9
vi. In-service Apprenticeships for Microenterprise Staff	amount								13	13	13	14	0	53
vii. Vocational Training for Microenterprise Staff	amount								11	22	22	23	23	101
Subtotal (b)									39	51	54	56	29	230
c. Institutional Capacity Development														
i. Training of Trainers for Agricultural Universities/Colleges	amount								69	71	0	0	0	140
ii. Training for Oblast and Raion Agencies	amount								0	61	7	7	7	82
iii. Training for Agribusiness/Farm Managers	amount								0	44	4	5	5	57
iv. Training of Farmer Organizations	amount								0	0	27	2	2	31
v. Mortgage, Liquidation and Bankruptcy	amount								16	16	0	0	0	32
Subtotal (c)									85	192	38	14	14	343
Subtotal (5)									124	281	114	98	43	661
6. Consulting Services														
a. International Consultants ^a														
i. Agribusiness Adviser	person-month	12	12	0	0	0	24	25	319	327	0	0	0	646
ii. Short-Term Microenterprise Specialists	person-month	4	4	0	0	0	8	25	106	109	0	0	0	215
iii. Short-Term Trainers	person-month	8	8	0	0	0	16	25	213	218	0	0	0	431
iv. Unallocated specialists	person-month	4	0	0	0	0	4	25	106	0	0	0	0	106
Subtotal (a)									744	654	0	0	0	1,398
b. Domestic Consultants														
i. Microenterprise NGO contracts	amount								43	54	84	86	88	355
Subtotal (6)									787	708	84	86	88	1,753
Subtotal (A)									1,106	1,011	220	207	155	2,699

^a Contracts to local research institutions.^b RAU Office space to be provided by the oblast government.^c One unit for the RAU, and one for each raion agricultural department.^d Unit cost includes fees, international travel, domestic travel, housing, per diems, and overheads.

Table A5.2 Rural Advisory Unit (RAU) - Detailed Costs
(continued)

	Unit	Quantities						Unit Cost	Totals Including Contingencies (\$'000)					
		2001	2002	2003	2004	2005	Total		2001	2002	2003	2004	2005	Total
B. Recurrent Costs														
1. RAU Staff Salaries and Benefits ^e														
a. Professional Staff														
i. Director of RAU/Agribusiness Specialist	person-month	12	12	12	12	12	60	1	13	13	13	14	14	67
ii. Farm Management Specialist	person-month	12	12	12	12	12	60	0.8	10	10	11	11	11	54
iii. Accountant/Financial Analyst	person-month	12	12	12	12	12	60	0.8	10	10	11	11	11	54
iv. Training Manager	person-month	12	12	12	12	12	60	1	13	13	13	14	14	67
v. Microenterprise Development Manager	person-month	12	12	12	12	12	60	0.8	10	10	11	11	11	54
vi. Various part-time specialists	person-month	12	12	12	12	12	60	0.8	10	10	11	11	11	54
Subtotal (a)									66	68	70	71	73	349
b. Support Staff														
i. Office Staff	person-month	12	12	12	12	12	60	0.5	6	7	7	7	7	34
ii. Interpreter/Translator	person-month	12	12	12	12	12	60	0.5	6	7	7	7	7	34
iii. Driver	person-month	48	48	48	48	48	240	0.4	20	21	21	22	23	107
Subtotal (b)									33	34	35	36	37	174
Subtotal (1)									100	102	105	107	110	523
2. RAU Travel and Transportation														
a. Per Diem for travel accomodation and meals ^f	day	450	450	450	450	450	2,250	0.02	10	10	10	10	11	50
b. Local Air Travel	round trips	15	15	15	15	15	75	0.4	6	7	7	7	7	34
c. O&M of Vehicles	vehicle-month	48	48	48	48	48	240	0.4	20	21	21	22	23	107
Subtotal (2)									36	37	38	39	40	191
3. RAU: Other Operational Expenditures														
a. Conamountables - various office supplies	amount								10	10	10	10	11	50
b. Communications	amount								13	13	13	14	14	67
c. Utilities	amount								10	10	10	10	11	50
d. Office Space Rental ^g	amount								21	22	22	23	23	112
Subtotal (3)									53	54	56	57	59	279
Subtotal (B)									189	194	199	204	209	994
Total (A+B)									1,295	1,205	419	411	364	3,693

^e Estimated costs include salaries, pension contributions, medical insurance and other benefits.

^f Allowance for out-of-town travel in the Oblast.

^g Office space for RAU to be provided by the local Oblast Government.

Table A5.3: Credit Line and Technical Support - Detailed Costs

Item	Unit	Quantities						Unit Cost	Totals Including Contingencies (\$'000)					
		2001	2002	2003	2004	2005	Total		2001	2002	2003	2004	2005	Total
A. Investment Costs														
1. Credit Line ^a														
a. Credit Line Financing for subprojects	amount								1,400	4,000	5,000	5,850	6,293	22,543
2. Training for Staff of Participating Banks	amount								11	16	17	0	0	44
3. Consulting Services														
a. International Consultant: Agricultural/ Agribusiness Credit Adviser ^b	person-month	12	12	0	0	0	24	25	319	327	0	0	0	646
Subtotal (A)									1,730	4,343	5,017	5,850	6,293	23,233
B. Recurrent Costs														
1. Office Space and Facilities of Commercial Banks ^c	amount								21	22	22	23	23	112
Subtotal (B)									21	22	22	23	23	112
Total									1,751	4,365	5,039	5,873	6,316	23,344

^a No allowances included for price and physical contingencies, and taxes. Expenditures using the credit line are assumed to have 50 percent foreign content.

^b Unit cost per person month includes fees, international travel, domestic travel and transportation, per diems, housing, and overhead.

^c To be provided in-kind by the participating commercial banks.

Table A5.4: Project Implementation Unit (PIU) - Detailed Costs

Item	Unit	Quantities						Unit Cost	Totals Including Contingencies (\$'000)					
		2001	2002	2003	2004	2005	Total		2001	2002	2003	2004	2005	Total
A. Investment Costs														
1. Coordinating Office - East Kazakhstan														
a. Office Equipment														
i. Computer	set	4	0	0	0	0	4	2	9	0	0	0	0	9
ii. Printer	set	2	0	0	0	0	2	0.75	2	0	0	0	0	2
iii. Software	amount								5	0	0	0	0	5
iv. Fax Machine	set	1	0	0	0	0	1	0.4	0	0	0	0	0	0
v. Photocopier	set	1	0	0	0	0	1	5	5	0	0	0	0	5
vi. Office Furniture	amount								5	0	0	0	0	5
vii. Miscellaneous Equipment	amount								11	0	0	0	0	11
b. Vehicle														
i. 4-Wheel Drive Vehicle	unit	1	0	0	0	0	1	25	27	0	0	0	0	27
Subtotal (1)									64	0	0	0	0	64
2. Project Office - Astana														
a. Office Equipment														
i. Computer	set	2	0	0	0	0	2	2	4	0	0	0	0	4
ii. Printer	set	1	0	0	0	0	1	0.75	1	0	0	0	0	1
iii. Software	amount								2	0	0	0	0	2
iv. Fax Machine	set	1	0	0	0	0	1	0.4	0	0	0	0	0	0
v. Photocopier	set	1	0	0	0	0	1	5	5	0	0	0	0	5
vi. Office Furniture	amount								2	0	0	0	0	2
vii. Miscellaneous Equipment	amount								2	0	0	0	0	2
Subtotal (2)									17	0	0	0	0	17
Subtotal (A)									81	0	0	0	0	81
B. Recurrent Costs														
1. Coordinating Office - East Kazakhstan														
a. Staff Salaries and Benefits														
i. Manager	person-month	12	12	12	12	12	60	1	13	13	13	14	14	67
ii. Accountant	person-month	12	12	12	12	12	60	0.8	10	10	11	11	11	54
iii. Bilingual Administrative Assistant	person-month	12	12	12	12	12	60	0.5	6	7	7	7	7	34
iv. Office Staff	person-month	12	12	12	12	12	60	0.5	6	7	7	7	7	34
b. Travel and Transportation	amount								6	6	6	7	7	32
c. Operational Expenditures	amount								35	36	37	38	38	183
Subtotal (1)									77	79	81	83	85	403
2. Project Office - Astana														
a. Staff Salaries and Benefits														
i. Director	person-month	12	12	12	12	12	60	1	13	13	13	14	14	67
ii. Bilingual Administrative Assistant	person-month	12	12	12	12	12	60	0.5	6	7	7	7	7	34
b. Travel and Transportation	amount								3	3	3	3	3	13
c. Operational Expenditures	amount								12	12	12	13	13	61
Subtotal (2)									33	34	35	36	37	175
Subtotal (B)									110	113	116	119	122	579
Total (A+B)									191	113	116	119	122	660

SUMMARY OF MAIN PROJECT ENVIRONMENTAL IMPACTS

1. Overall, the Project will have positive environmental impacts and is not expected to have any significant adverse environmental impacts that would require detailed environmental impact assessment. During project implementation, specific attention will be given to management of agroprocessing wastes, and to improved soil and water quality. By and large, current farming systems are financially unsustainable. To be eligible for project support, farms will implement sound financial practices and more sustainable management of soils, water, and the landscape.¹ Higher productivity levels will increase the incomes of farms, farm employees, and shareholders. Families losing direct farm employment will be given the opportunity to establish alternative income-generating activities. The enhanced welfare of rural communities will slow the migration to urban areas and even the total abandonment of some villages. Finally, higher rural incomes will reduce pressure on natural resources. Table A6 summarizes the Project's main potential environmental impacts and the corresponding monitoring and mitigation measures. A more detailed assessment is presented in the supplementary Summary Initial Environmental Examination report, which is available on request.

Table A6: Summary of Environmental Impacts and Mitigation Measures

Project Activity and Potential Impacts	Monitoring and Mitigation Measures
<p>Farm Restructuring and Development</p> <p>Agrochemical use is projected to rise from very low levels at present to moderate levels as a result of the Project, e.g., to about 50 kilograms of nutrient equivalent per hectare of all fertilizers, and modest amounts of environmentally sound herbicides.</p> <p>Soil erosion caused by wind and water runoff is a risk in steeply sloping areas due to inappropriate cultivation practices. Since 1994, there has been a marked deterioration in the observance of various soil-conserving recommendations. The generally poor profitability of farms has led to a breakdown of rotations, and cultivation has not been timely. All have contributed to reduced soil cover.</p> <p>Water management is not a significant issue since irrigation is a very minor input in East Kazakhstan's agriculture. However, the technical potential for groundwater irrigation exists in some low-lying regions and may become financially justifiable as the result of farm diversification and improved profitability.</p>	<p>The Rural Advisory Unit (RAU) will monitor the use of agrochemicals and other environmental aspects as part of the Project's benefit monitoring and evaluation system. The RAU will assist the oblast Department of Ecology and Bioresources in monitoring compliance with Government regulations on permissible herbicides.</p> <p>Slope and soil quality will be used as subproject selection criteria. Farmland not meeting these criteria will be excluded from project support. The Project will reintroduce the use of sustainable rotations. The adoption of more diverse cropping systems, minimum tillage technologies, and sound rotations will also help restore and maintain soil fertility, and reduce the incidence of weeds, crop pests, and diseases. Overall, the use of marginal land for annual cultivation is expected to decline significantly as a result of the Project.</p> <p>If farmer demand exists and is financially and environmentally justified, the RAU will advise on the evaluation of sound technologies and on formation of a model water user association to develop and manage a small pump irrigation system in one of the oblast's well-suited regions. Monitoring of water quality will also be undertaken in any subproject concerned with water management.</p>

¹ Appendix 7 provides a description of enterprise and subloan eligibility criteria.

Project Activity and Potential Impacts	Monitoring and Mitigation Measures
<p>Agribusiness Support</p> <p>Waste disposal. Increased wastes and effluents are possible as a result of subloans for agroprocessing and farm machinery services.</p>	<p>Subloan proposals will be reviewed by the RAU, and will include provisions for environmentally sound waste disposal. In many cases, by-products will have their own markets, e.g., for livestock feed. Submission of an initial environmental examination in accordance with Asian Development Bank (ADB) guidelines will be required for ADB clearance of agroprocessing subloans in excess of \$100,000. Other agroprocessing subloans will comply with applicable Government and ADB environmental guidelines. Certification of such compliance will be maintained as part of loan records. Effluent disposal will be subject to monitoring to prevent discharge of untreated effluent into watercourses.</p>
<p>Microenterprise Component</p> <p>Waste disposal. Increased wastes and effluents are possible as a result of microenterprise subloans for activities such as livestock raising on household plots and small-scale craft industries.</p>	<p>The small-scale and dispersed nature of the microenterprise activities is expected to preclude any significant increase in waste and effluent problems. Barnyard wastes are presently the major source of fertilizer. The RAU will monitor the utilization and impact of microenterprise subloans.</p>

ELIGIBILITY CRITERIA FOR PARTICIPATING COMMERCIAL BANKS, FARMS, AND AGRIBUSINESS ENTERPRISES

A. Eligibility Criteria for Participating Commercial Banks

1. Through participating commercial banks (PCBs), the Project will provide a credit line to private farms and agribusiness enterprises that can demonstrate financially viable farming and commercial activities. Under this credit line, the Asian Development Bank (ADB) loan to the Government will be onlent to the commercial banks. Onlending terms and conditions between the Government and a PCB will be covered in detail under a subsidiary loan agreement. Participation is open to all interested banks that meet the following eligibility criteria. The participating banks must

- (i) be legally registered and licensed in Kazakhstan;
- (ii) have a system of governance with an independent board of directors and clear operational guidelines;
- (iii) comply with all banking laws and regulations, and satisfy the prudential regulations and criteria set by the National Bank of Kazakhstan;
- (iv) have annual audited financial statements, prepared in accordance with international accounting standards, and an accounting system with adequate internal controls;
- (v) have a loan tracking system, capable of providing an updated weekly situation on the total loan portfolio, including the age distribution of arrears;
- (vi) have a financial projection system, that provides reliable financial forecasting for the bank, especially cash flow;
- (vii) have an adequate branch network to serve the rural areas in East Kazakhstan;
- (viii) have experience in serving agriculture and the rural sector;
- (ix) have adequate human resources for prudent management of project funds, and be willing to engage in training and cooperate with technical assistance provided under the Project;
- (x) demonstrate a serious interest in the Project, capacity and commitment to contribute at least 15 percent of the capital to subloans over the project period, and willingness to participate in the Project's capacity-building activities;
- (xi) agree and ensure that the terms and conditions of all subloan agreements will appropriately reflect the onlending terms and conditions agreed upon in the PCB's subsidiary loan agreement with the Government; and
- (xii) except as otherwise agreed by ADB, assure that at least (a) 40 percent of subloans will be for working capital; and (b) 67 percent of subloans will be rolled over and relent to subborrowers on the basis, among others, of the applicable criteria listed in paras. 2-6.

B. Loan Terms for Participating Farms and Agribusiness Enterprises

2. Two types of financing will be made available: (i) a working capital loan facility; and (ii) an investment loan facility. The terms of the loans will be determined by the PCBs, and will include the following provisions

- (i) The working capital loan facility will be for up to 12 months to finance seasonal requirements or initial working capital. Depending on the nature of the farms and agribusiness enterprises, this loan facility may be used to purchase fuel, fertilizers, agrochemicals, spare parts, seeds, livestock feeds, veterinary

- supplies, materials, various inventories, and other seasonal needs as appropriate.
- (ii) The investment loan facility will finance farm and agribusiness investments. Terms of these investment loans will be based on projected cash flows and debt service capacity of the borrowers, and such terms will not exceed 10 years.
- (iii) Working capital and investment loans will not be used to refinance existing debts.
- (iv) Noncommercial investments such as construction of housing and social and community facilities will not be eligible for loan financing under the Project.

C. Eligibility Criteria for Participating Farms

3. The PCBs will have ultimate responsibility for reviewing the eligibility of each farm and its loan application. To be eligible to obtain loans under the Project, the farms must

- (i) be legally registered according to the prevailing legal code, and recognized as either a peasant farm or a legal entity in the form of a joint-stock company, a production cooperative, or a partnership;
- (ii) have completed privatization, and be 100 percent privately owned;
- (iii) have a transparent and fully documented shareholding structure; transfers of shares between shareholders, including the terms and conditions of such transfers, must be fully documented in a formal sales or lease agreement;
- (iv) either have completely undergone restructuring, be currently undergoing restructuring, or have emerged as a result of a restructuring process;
- (v) have an acceptable accounting system in place, and be able to present financial statements for, at least, the most recent fiscal year;
- (vi) be able to demonstrate in a business plan, prepared not earlier than six months prior to submitting a loan application (a) overall financial and commercial viability, (b) financial viability of the proposed uses of working or investment financing, (c) a financing plan, and (d) loan repayment capacity with a projected debt service coverage¹ ratio of at least 1.3 over the entire duration of the loan period; and
- (vii) be able to contribute at least (a) 10 percent of the value of proposed investments in rehabilitation, replacement, and modernization; and (b) 20 percent of the value of investments in new ventures and expansion. These contributions will include any equity capital and the imputed market value of land (or land-use rights), equipment, buildings, and other physical assets that the farms must utilize for the subprojects.

D. Eligibility Criteria for Participating Agribusiness Enterprises

4. To be eligible for financing under the Project, agribusiness enterprises must

- (i) be legally registered according to the prevailing legal code, and recognized as a legal entity;
- (ii) be 100 percent privately owned;
- (iii) have a transparent and documented shareholding structure;
- (iv) be operating a business that is either horizontally or vertically linked to agricultural farms, and such forms of business activities may include market intermediaries, processing, service industries, and supply enterprises;

¹ Debt service coverage as defined by the ratio of (net income excluding provision for depreciation, noncash operating charges, interest and other charges on debt) against (debt service requirements including the aggregate amount of loan repayments, interest, and other charges on debt, plus lease payments).

- (v) have an acceptable accounting system, and be able to present financial statements for, at least, the most recent fiscal year;
- (vi) be able to demonstrate in a business plan, prepared not earlier than six months prior to submitting a loan application (a) overall financial and commercial viability of the enterprise, (b) financial viability of the proposed working capital or investment financing, (c) a financing plan, and (d) loan repayment capacity with a projected debt service coverage ratio of at least 1.3 over the entire duration of the loan period;
- (vii) be able to provide an own-financing contribution of at least (a) 10 percent of the value of proposed investments in rehabilitation, replacement, and modernization; and (b) 20 percent of the value of investments in new ventures and expansion; and
- (viii) demonstrate that the proposed investments can be completed within 18 months from the date of signing a loan agreement with a PCB.

5. The RAU and associated staff of the oblast Department of Agriculture, working in coordination with the Department of Ecology and Bioresources, will ensure subborrowers comply with the applicable environmental assessment and mitigation requirements of the Government and ADB. Submission of an acceptable initial environmental examination in accordance with ADB guidelines will be required for ADB clearance of agribusiness subloans in excess of \$100,000.

E. Scope of a Farm Business Plan

6. A farm business plan submitted for a subloan application should describe the

- (i) objective and purpose of the farm, and its current stage of development;
- (ii) market outlook for the farm products, and marketing strategy;
- (iii) market-oriented production plan including (a) distinct aspects of the products and services of the farm, (b) types and quantities of inputs to be used and assurance of their availability, (c) soil types and slope characteristics, (d) innovative aspects of the farming system, including technology and rotations used, soil and water conservation practices, and other relevant environmental aspects, and (e) input-output benefit and cost analysis;
- (iv) available farm resources and market-oriented changes anticipated in the future concerning (a) landholdings including leases and land-use rights, (b) land capability and land use, (c) possession of productive assets such livestock and equipment, (d) labor requirement and its implications on employment and labor costs; and (e) buildings and other fixed assets;
- (v) form of organization the farm operates under, and the reasons for this arrangement;
- (vi) key management skills and personnel valuable to the farm;
- (vii) key support groups such as technical advisers, consultants, accountants, or lawyers available to the farm;
- (viii) present financial status and financial performance, and scope for improvement;
- (ix) proposed restructuring plan, including proposed investments;
- (x) financial and commercial viability of the restructuring and investment plans; and
- (xi) financing plan and financial projections, including balance sheets, income statements, statements on sources and uses of funds, and debt service capacity.

IMPLEMENTATION SCHEDULE

Project Component	Year Quarter	1				2				3				4				5			
		1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
1. Project Mobilization																					
Subsidiary Loan Agreements																					
- MOF and PCBs																					
Establishment of Project Offices																					
Establishment of RAU																					
- registration / legal status																					
- location																					
- recruitment of RAU director																					
- detailed TOR and modus operandi for RAU																					
Appointment of Consultants/Staff																					
- agribusiness adviser																					
- agricultural credit																					
- microenterprise manager																					
- NGO tender and appointments																					
- recruitment of RAU staff																					
- assignment and initial training of Farm Restructuring Coordinators in raions																					
2. Farm Restructuring Activities																					
Formulation of Farm Restructuring Strategy and Enterprise Selection Process																					
Provision of Farm and Agribusiness Services																					
- legal advice, farm accounts, farm business plans																					
Selection of Trainees and Training Program																					
Monitoring and Supervision of Farm Performance																					
3. Community Microenterprise Activities																					
- Identify key communities based on farm restructuring program																					
- Assess potential microenterprise activities using participatory methods																					
- Identify skilled craftsmen workers for focus of training activities																					
- Assess markets and potential outlets																					
- Formulate strategic approach to microenterprise promotion																					
- Train local staff																					
- Prepare specific microenterprise proposals																					
- Process microenterprise loans and monitor																					
4. Finance and Credit																					
- training of PCB staff																					
- establishment of consultative mechanisms between RAU and PCBs at oblast level																					
- Credit assessment and approval of loans within prescribed procedures																					
5. Institutional Development Component																					
- tendering and selection of foreign counterpart education institute																					
- preparation of training modules and training of trainers																					
- organization of training programs, venues and trainees																					
- implementation of institutional training at oblast and raion levels																					
6. Project Monitoring and Evaluation																					
- undertake baseline study																					
- establishment of reporting systems																					
- review missions																					

MOF = Ministry of Finance, NGO = nongovernment organization, PCBs = participating commercial banks, RAU = Rural Advisory Unit
 TOR = terms of reference

TECHNICAL ASSISTANCE FOR DEEPENING OF AGRICULTURAL REFORMS AND DEVELOPMENT PROGRAMS

A. Rationale and Objective

1. Kazakhstan has substantial resources to support an agriculture sector that is efficient, competitive, and environmentally sound. The country is capable of producing for a population far larger than the domestic market. At present, however, the sector is performing well below its potential because of the farms' incomplete adjustment to the postprivatization environment and the failure, so far, to establish strong linkages to new markets outside of the former Soviet Union. Crops with market potential that can be successfully integrated into Kazakhstan's farming systems must be identified. However, the country's agricultural research system—in disarray for several years—will need support if it is to contribute to the transition. The process of reestablishing the research system must focus on the new opportunities offered by domestic and international markets. Equally important is the need to encourage more widespread knowledge and understanding within rural communities of the legal basis and options for farm restructuring and other rural economic activities. Finally, the Government needs assistance in carefully evaluating the implementation and impact of the market reforms, in order to refine, as appropriate, the policy and legislative framework for market-led agriculture. The objective of the technical assistance (TA) is to assist the Government in undertaking all of these tasks.

B. Description of Tasks

1. Program for Agronomic Field Trials for High-Potential Crops

2. This component of the TA will (i) identify opportunities for crop development and the diversification of cropping systems in Kazakhstan; (ii) strengthen linkages between national agricultural research agencies and relevant institutions associated with the Consultative Group for International Agricultural Research (CGIAR); and (iii) upgrade national applied agricultural research skills by participating in a crop trials program and training at selected international institutes. The component will be implemented over two years and will include (i) review of recent agricultural research in Kazakhstan, (ii) implementation of an agronomic and economic evaluation program for selected crops in East Kazakhstan oblast, and (iii) development of a medium-term (3-5 years) program for applied research, information diffusion, and institutional development for the national agricultural institutes in cooperation with relevant CGIAR institutions.¹ The TA will be coordinated by a field crop agronomist and an economist in collaboration with the Ministry of Agriculture (MOA), the Kazakhstan Academy of Sciences' National Academic Center for Agrarian Research, and its satellite institute, the East Kazakhstan Scientific Research Institute for Agriculture (EKSRIA), which is located in Ust-Kamenogorsk and has extensive experimental sites around the oblast. The specific tasks of the experts include the following.

¹ These might include the International Maize and Wheat Improvement Center (CIMMYT) and the International Center for Agricultural Research on Dry Areas (ICARDA), both of which have keen interest in extending their programs in Central Asia. CIMMYT opened a country representational office in Almaty in June 1998.

a. Crop Trials Program

3. The tasks include

- (i) review the farming systems and agricultural practices in East Kazakhstan, identifying the major agronomic constraints to higher productivity;
- (ii) with the assistance of the Rural Advisory Unit (RAU), and oblast and raion departments of agriculture, identify a short list of possible crops and varieties that could potentially be integrated into the existing farming systems;² and
- (iii) design and implement a two-year program of field trials, analyze the results, and present the findings in a technical report.

b. Economic Assessment

4. The consultants will

- (i) relate the crop trial results to current and potential farming systems and, with the assistance of the RAU, assess the economic prospects for adoption;
- (ii) provide a detailed economic justification for any recommendations to promote particular crops, focusing on their market potential and suitability for the existing farming systems;
- (iii) assess the capacity of the research institute to undertake similar work, and formulate detailed recommendations on the need, design, and resource requirements of follow-on applied research programs that could be implemented largely by oblast agricultural agencies; and
- (iv) prepare a summary report for the Government and the Asian Development Bank (ADB).

c. Institutional Development

5. Tasks include

- (i) arrange short-term training for domestic research staff at selected international agricultural research institutes to become familiar with their research programs and to establish cooperative links;
- (ii) assess EKSRIA's capacity to sustain the field trial program and, consistent with present budgetary realities in Kazakhstan; and prepare recommendations for skills upgrading, facilities development, and realistic financing mechanisms; and
- (iii) explore and promote within the funding community interest in contributing to this development.

2. Refining and Promoting Understanding of Agricultural Legislation

6. Nationwide in scope, this TA component will promote wider understanding within Kazakhstan's rural communities of the new legal and institutional environment for agriculture, and will contribute to the refinement of legislation related, among others, to farm and land

² These crops include various legumes and medicinal plants such as camomile, fennel, and calendula; other crops that have regional or international export potential based on CGIAR experience; and short-season annual forage crops.

ownership, secured lending, agricultural bankruptcy, the legal rights of farms and small businesses, and the formation of voluntary rural associations.

a. Information Dissemination

7. This component will assist the Government in designing, preparing, and evaluating a nationwide public information and education campaign on the legal and policy framework for agriculture, which will disseminate knowledge through publications, state and private mass media (newspapers, television, and radio), and training courses and seminars. The activities will be coordinated by specialists in agricultural education law and institutions, who will work closely with other TA specialists in bankruptcy, and secured lending, as well as relevant specialists funded by other aid agencies. The educational program will include (i) land and property shares; (ii) agricultural land ownership, covering Kazakhstan's new Law on Land, including legal requirements to qualify for land ownership, registration, and certification procedures; state rights to repossess agricultural land; and the advantages and disadvantages of land ownership as compared with long-term leasing or land use rights; (iii) legal entities; (iv) secured lending; (v) taxation; (vi) bankruptcy; (vii) voluntary rural associations; (viii) rights of farms and small businesses; and (ix) sources of technical and other assistance.

8. A specialist in agricultural education with experience in the mass media of the transitional economies will assist in preparing and implementing the public information and education campaign. He/she will

- (i) assemble and provide to the Government public education materials developed in connection with farm restructuring programs in other transitional economies (e.g., Russian Federation, Ukraine, and Moldova);
- (ii) assess, in coordination with the other specialists and in light of their reviews and evaluations of the progress in farm restructuring, the needs for regionally focused information on the problems and potentials of agriculture; analyze the nature and content of the information that must be provided depending upon factors such as agroecology, the dominant farming systems, market economic incentives, and gender, ethnic, and linguistic considerations;
- (iii) assist in conceptualizing, planning, implementing, and evaluating the campaign, including analysis of the costs and effectiveness of different forms of public education such as television, radio, newspapers, printed manuals, and public seminars, with an emphasis on efficiently targeting farm communities and other stakeholders in the agriculture sector; and
- (iv) work in cooperation with state-owned television and radio companies, private-sector stations and public relations firms, and state and private publishers; and plan and oversee the production, broadcasting, and publication of materials for the information campaign.

b. Review of Agricultural Bankruptcy Legislation

9. A bankruptcy adviser will work with relevant Government agencies, including Ministry of Justice (MOJ), Ministry of Agriculture (MOA), Ministry of Finance, Ministry of State Revenue, and State Agency for the Reorganization and Liquidation of Enterprises (SARLE). He/she will undertake the following tasks:

- (i) Assist in the review of agricultural bankruptcy legislation required under the Program. The review will identify ambiguities, inconsistencies, and other

problems in legislation that are hindering or delaying the application of bankruptcy legislation to agricultural businesses. It will also examine whether the legislation establishes an equitable balance of the interests of all participants in the bankruptcy process, including SARLE, government and nongovernment creditors, secured and unsecured creditors, debtors, and farm members.

- (ii) Conduct a study of bankruptcy cases in selected oblasts focusing on (a) the number of bankruptcy cases filed; (b) the number of licensed rehabilitation managers and liquidators qualified to manage agricultural bankruptcies; (c) the legal structures of bankrupt farms; (d) the farming activities of bankrupt farms; (e) the debt structure of debtor farms; (f) the length of time between filing a bankruptcy case and appointment of a rehabilitation manager or liquidator; (g) the length of time from initiation to completion of bankruptcy proceedings; (h) cost of processing a bankruptcy case (in terms of costs to creditors, debtors, and the judicial system); (i) creditors' opinions of the process particularly in terms of ability to effectively use bankruptcy legislation to force restructuring or final debt collection; (j) debtors' opinions of the process, particularly in terms of adequate protection of their rights and whether the process facilitates rehabilitation and restructuring; and (k) competence of rehabilitation managers, liquidators, and judges.
- (iii) Gather comparative data on bankruptcy cases involving both agricultural and nonagricultural enterprises to identify problems specific to agricultural bankruptcies.
- (iv) Prepare a report recommending amendments to legislation and practical procedures to correct deficiencies identified by the legislative review and the study. The report will also make recommendations regarding whether additional training is required for rehabilitation managers, liquidators, and judges.
- (v) Prepare amended legislation or other materials recommended in the report.
- (vi) Prepare materials on bankruptcy to be included in the public information and education campaign.

c. Review of Legislation and Procedures for Secured Lending

10. A secured lending adviser will undertake these tasks:

- (i) Review legislation and practical procedures relating to secured lending to identify ambiguities, inconsistencies, and other problems that are obstacles to the granting of secured loans to agricultural enterprises. The review will include analysis of (a) land ownership and tenure forms and the extent to which the existing legislation detracts from their value as collateral; (b) forms and procedures for the granting of security interests in movable and immovable property collateral; (c) procedures and costs associated with registering security interests in movable and immovable property collateral; (d) general effectiveness of registration systems; (e) cost, timing, and effectiveness of judicial and nonjudicial procedures for foreclosure on collateral, including eviction procedures; and (f) consistency of other legislation, including the Law on Bankruptcy, the Tax Code, the Law on Joint Stock Companies, and the Law on Executory Proceedings and the Status of Judicial Executors, with the Law on Pledge and the Law on Mortgage in terms of clearly establishing the rights and relative priorities of different classes of creditors.
- (ii) Conduct a study of secured lending in the agriculture sector focusing on the following issues: (a) the extent to which secured loans are being made to

- agricultural borrowers; (b) the types of banks and other lenders making loans in the agriculture sector; (c) lenders' policies on the use of movable and immovable property security, including preferences for some types of collateral over other types, and preferred debt collateral ratios; (d) whether loan terms meet the needs of farmers; (e) use of guarantees, mortgage insurance, or other mechanisms for risk sharing; (f) lenders' opinions of legislation and procedures particularly in terms of ability to effectively assess risk and foreclose on the collateral, if necessary; (g) borrowers' opinions of the process, particularly in terms of clarity and protection of their rights; (h) number of security interests registered in movable and immovable property registration systems; (i) number of cases involving enforcement of security interests, including both judicial and nonjudicial proceedings; and (j) costs and average length of foreclosure cases.
- (iii) Prepare a report recommending amendments to legislation and practical procedures to correct deficiencies identified by the legislative review and the study.
 - (iv) Draft amended legislation or other materials recommended in the report.
 - (v) Prepare materials on secured lending to be included in the public information and education campaign.

d. Improving Market Information

11. Building upon MOA's earlier work in cooperation with TA financed by the European Union,³ a market information and database specialist will advise MOA on the establishment and sustainable operation of a system of computerized market information centers to routinely provide price and other market information to the public. By the end of 2002, it is expected that the system will be equipped and operating in at least four high-potential agricultural oblasts, including East Kazakhstan. The specialist will review, in conjunction with the TA's program of agronomic field trials, the market prospects for crop diversification and for the expansion of Kazakhstan's traditional cereal crops. Based on this review and an assessment of existing channels for price and market information, a plan will be prepared for the market information system, covering (i) data needs, sources, and processing requirements; (ii) plans for the production, broadcast, and publication of materials; (iii) computer hardware and software needs; (iv) institutional development and training; (v) detailed cost estimates for establishing and running the system; and (vi) mechanisms for user cost recovery to ensure that the system is financially sustainable.

C. Implementation Arrangements and TA Costs

12. MOA will be the Executing Agency for the TA. A TA steering committee will be composed of representatives of the Ministry of Science and Higher Education, MOJ, Ministry of Finance, and Ministry of Culture, Information and Public Harmony. The TA will require approximately 20 person-months of international expertise and 28 person-months of domestic expertise, with these inputs to be provided over 24 months, expected to commence in April 2001. All consultants will be recruited by the ADB in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants.

13. The TA is estimated to cost \$1.140 million equivalent, of which \$800,000 equivalent will be financed by ADB on a grant basis from the Japan Special Fund, funded by the Government

³ Under the Agricultural Management and Market Information System project, completed in mid-1998.

of Japan, and \$340,000 equivalent will be provided by the Government as in-kind support and the costs of data compilation, land and materials for the field crop trials, counterpart travel and per diem, use of state television and radio facilities for the public information campaign, and contingencies. The Government has assured that adequate budgetary provision for these financial costs will be made so that the TA can be implemented expeditiously. Detailed cost estimates are in Table A9.

Table A9: Estimated TA Cost and Financing Plan
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International	445.1	0.0	445.1
ii. Domestic	0.0	124.9	124.9
b. International and Local Travel	60.0	24.0	84.0
c. Reports and Communications	2.0	0.0	2.0
2. Training	20.0	0.0	20.0
3. Field Program Costs ^b	10.0	0.0	10.0
4. TA Administration and Support	0.0	4.5	4.5
5. Contract Negotiations	7.0	0.0	7.0
6. Contingency	78.9	23.6	102.5
Subtotal (A)	623.0	177.0	800.0
B. Government Financing			
1. Office Space	0.0	20.0	20.0
2. Data Compilation	0.0	15.0	15.0
3. Counterpart Staff and Support	0.0	40.0	40.0
4. Travel and Per Diem of Counterparts	0.0	20.0	20.0
5. Field Program Costs ^b	0.0	46.0	46.0
6. State Mass Media Facilities	0.0	100.0	100.0
7. Workshops and Seminars	0.0	17.0	17.0
8. Land Rental	0.0	10.0	10.0
9. Logistical Support in Field	0.0	26.0	26.0
10. Contingency	0.0	46.0	46.0
Subtotal (B)	0.0	340.0	340.0
Total	623.0	517.0	1,140.0

^a Financed from the Japan Special Fund, financed by the Government of Japan.

^b Includes imported and local seed, fertilizers, agrochemicals, field labor, machinery hire, irrigation and water fees, transport, field equipment, packaging/storing/cleaning of crops, and crop security/supervision.

FARM RESTRUCTURING PROJECT COMPONENT FINANCIAL AND ECONOMIC ANALYSES

A. Background

1. The Project aims to enable private farms to improve productivity and achieve higher incomes by (i) promoting measures to improve their commercial viability, and (ii) assisting these farms in formulating viable business plans for submission to commercial banks so as to obtain working capital and investment loans to be provided under the Project. Although it is not possible to predetermine the types and composition of investment plans that will be financed through the line of credit, the approach adopted for the financial and economic analyses is to present indicative farm and agribusiness models that represent potential and typical situations in East Kazakhstan. Four indicative models were developed (details presented in Supplementary Appendix E).

- (i) A rain-fed farm with landholdings of 4,000 hectares (ha), consisting of 1,920 ha of arable land and 2,080 ha of extensive pastures. In any given year, 20 percent of the arable land is left fallow. The farm also has 100 beef cattle.
- (ii) A rain-fed farm with landholdings of 10,000 ha, consisting of 5,500 ha of arable land and 4,500 ha of extensive pastures. In any given year, 20 percent of the arable land is left fallow. The farm also has 200 beef cattle.
- (iii) A beef cattle fattening farm, starting up with a herd of 100, with feed rations utilizing mixed concentrates and crop by-products.
- (iv) A wheat flour mill, with an installed processing capacity of 2 tons (t) of grain per hour, operating on two eight-hour shifts per day over 260 days a year.

B. Major Assumptions

2. Without the Project, the cropping pattern is expected to continue with winter and spring wheat (48 percent), other cereals (25 percent), and sunflowers (7 percent). With the Project, only minor changes in cropping patterns are expected, with more timely farm operations to allow for a modest increase to 15 percent for sunflowers. Also with the Project, only minor medium-term changes in cropping patterns are expected. As the result of improved capacity for more timely farm operations, winter wheat would tend to substitute for spring wheat, in turn permitting larger areas to be planted to relatively profitable sunflowers. Without the Project, crop yields are expected to remain low, on average below 1.0 t/hectare without significant applications of fertilizers. With low rainfalls, only small amounts of fertilizers (10-25 kg of Nitrogen and Phosphorus nutrient contents) are needed. With the Project, crop yields are expected to level off by year 3: winter wheat, 1.8 t/ha; spring wheat, 1.7 t/ha; barley, 1.7 t/ha; winter rye, 1.7 t/ha; buckwheat, 0.9 t/ha; peas, 0.8 t/ha; and sunflowers, 1.3 t/ha.

3. Local inflation is projected at 10 percent per year for 2000-2002, and 6 percent per year from 2003. Foreign inflation is assumed to follow the World Bank's projection of the manufacturing unit value indices (MUV). Foreign inflation is projected 2.5 percent in year 2000, 2.3 percent in 2005, and 2.48 percent in 2010.

4. Both financial and economic analyses are conducted over 10 years in 2000 constant prices and in the local currency, tenge (T). Year 1 represents 2001, the year in which the Project is expected to commence. The exchange rate is assumed at T144 to \$1.00 (actual, July 2000). Adjusting for inflation, projected profit and loss statements, cash flows, and debt service calculations are presented in current terms.

5. Wheat and fertilizer prices are projected using the World Bank's commodity price projections (January 2000). Various adjustments for transport, handling, storage, insurance, marketing margins, and physical losses are made to determine farm-gate prices. The economic and financial farm-gate prices of urea and phosphate, as derived on an import parity basis, are expressed in terms of nitrogen and phosphorus nutrient contents.

6. Kazakhstan is a wheat exporting country. Its wheat exports to the Russian Federation compete with wheat exports from the United States and Canada. Faced with low international wheat prices, vast distances to major markets, and high intermediary costs, financial farm-gate prices of wheat of average grades are expected to remain at about \$60/t in 2000. However, wheat prices are expected to strengthen over the next five years. In local markets, farm-gate prices of barley and rye are priced 10 percent lower than wheat prices. Prices of wheat flour of grade 1 (premium) and grade 2 qualities at the mill-gate are projected at 200 and 160 percent, respectively, of wheat prices at the elevators gate. Wheat prices at the mill-gate include transport, drying, storage, losses, and elevator's margin. Sunflower seeds are anticipated to remain firm at about T27,500 (\$190.97) per ton in 2000 at farm gate. Sunflower prices are closely correlated with international prices of soybeans.

7. The economic analysis is based on the world price level numeraire. Adjustments mainly reflect removal of taxes, duties, and debt service charges, and the application of a standard conversion factor (SCF) of 0.95 on nontraded inputs and outputs. Farm wages in mid-2000 in East Kazakhstan are estimated to vary from T165/day for seasonal unskilled labor to T440/day for skilled labor. Given a situation where there is less than full employment in the rural areas, and that farms are expected to restructure, operate more efficiently, and employ less people, a shadow wage rate factor of 0.9 is applied. Consequently, a conversion factor of 0.855 is applied on labor costs.

C. Incomes and Rates of Return

1. Rain-Fed Farm (4,000 ha)

8. Without restructuring, the farm would incur net operating losses in constant 2000 terms of about T2.1 million in year 1, T1.4 million in year 2, and T1.2 million in year 3. Apart from agronomic improvements and adjustments to the cropping pattern, key restructuring initiatives assumed in the model are the following:

- (i) Rationalize fuel consumption by introducing disciplinary measures to restrict use of tractors and vehicles to farming purposes only. Fuel savings of about 15 percent can be realized over five years.
- (ii) Increase labor productivity so that labor requirements during peak periods can be reduced by about 18 percent over five years, from a workforce of 45 to 37 people. A 15-20 percent reduction in the workforce is considered modest, as emerging private farms still grapple with an underutilized permanent workforce.
- (iii) Rationalize the labor force, minimize redundant labor, reduce social obligations, and engage seasonal workers for peak seasons.
- (iv) Reduce management and administration costs, including the cost of surplus labor, by more than 40 percent over three years — T770/ha to T440/ha in 2000 constant terms. Management and administrative costs are frequently excessive primarily due to overstaffing and privileges enjoyed by managers and staff.
- (v) Improve discipline on preventive maintenance, and undertake an investment plan to replace and recondition machinery and equipment. Maintenance and repair

costs of equipment could reasonably be reduced by about 28 percent over two years from \$18/ha of arable land to \$13/ha in constant 2000 terms.

9. An initial investment of about T31 million in 2000 terms (\$215,000) was broadly estimated for the farm. This investment plan is assumed to be phased over three years: \$90,000 in year 1, \$72,000 in year 2, and \$53,000 in year 3. These initial investments are indicative in nature, and primarily include urgent replacement of aging farm equipment and provisions for spare parts. Farms of this size are assumed to have existing fixed assets, which are revalued conservatively at T15 million. Additionally, the farm is expected to spend T16 million (\$111,000) in 2000 terms for further equipment replacements over a period of four years from year 7.

10. With the above restructuring initiatives, including measures to improve crop yields and livestock performance, the farm can potentially generate a net operating income, in constant 2000 terms, of T3.2 million in year 1, T6.5 million in year 2, and T9.1 million in year 3. By year 3, the farm would be able to produce 1,650 t of wheat, 98 tons of barley, 98 t of rye, 104 t of buckwheat, 56 t of peas, and 374 t of sunflower seeds. However, net operating incomes are expected to decline, in constant 2000 terms, from about T9.9 million in year 6 to T8.3 million in year 10. This decline is primarily due to projected shifts in input and output prices.

11. To estimate financial internal rates of return (FIRR) on investments before financing, and economic internal rates of return (EIRR), incremental operating incomes are projected under two scenarios:

- (i) Case 1. In this scenario, without the Project, the farm is allowed to incur net operating losses for a maximum period of three years, after which the farm ceases to operate. Continuing losses are not sustainable. Estimation of incremental benefits due to the Project includes forgone financial losses of these three years only.
- (ii) Case 2. In this scenario incremental benefits due to the Project exclude the Case 1 forgone losses. Without restructuring initiatives as proposed under the Project, the farm ceases to operate immediately, and therefore net operating income without the Project is assumed at zero level.

12. Case 1 illustrates an upper limit for deriving benefits that can be attributed to project initiatives. Farms may in fact sustain operating losses over a period longer than three years by selling off its assets and relying heavily on mounting debts and arrears to their creditors, including their workers through unpaid wages. The prevalent barter trade also complicates the assessment of continuing financial insolvency. Conservatively, for the purpose of this analysis, a three-year limit to operating losses is considered the maximum for the without-project scenario.

13. Under Case 1, the FIRR before financing is estimated at 46.8 percent. Assuming an opportunity cost of capital of 12 percent per annum, the financial net present value (NPV) amounts to T18.0 million. Correspondingly, the EIRR is estimated at 52.1 percent and the economic NPV at T22.3 million. The FIRR and EIRR are considerably high mainly because of the incremental benefits due to forgone losses. Under Case 2, when forgone losses are excluded from the incremental benefits, the FIRR and financial NPV are estimated at 34.4 percent and T14.1 million, respectively. The EIRR and the economic NPV are at 47.5 percent and T21.2 million, respectively. Under both cases, the FIRRs before financing are significant. Farms of this size in East Kazakhstan generally have significant underutilized resources. The proposed investment plan is complementary to existing assets. This incremental capital investment, combined with small increases in direct expenses in the form of fertilizers,

agrochemical, and improved seeds, enables these farms to capture significant benefits from rapid increases in crop yields and cost savings induced by the restructuring initiatives.

2. Rain-Fed Farm (10,000 ha)

14. Similar restructuring measures can be introduced to large farms 10,000 ha in size. Without restructuring, farms of this size would suffer from unsustainable net operating losses of about T7.4 million in constant 2000 terms over three years. An initial investment of about T90.7 million in 2000 constant terms (\$630,000) over three years is required: \$282,000 in year 1, \$198,000 in year 2, and \$150,000 in year 3. This investment includes replacement of equipment and spare parts. The farm is assumed to have existing fixed assets of about T30 million. The farm can potentially generate net operating incomes, expressed in constant 2000 terms, of about T10.2 million in year 1, T19.5 million in year 2, and T26.7 million in year 3. However with unfavorable shifts in input and output prices, net operating incomes are expected to decline from about T29.0 million in year 6 to T24.4 million in year 10.

15. Similar to the 4,000 ha model, FIRR before financing and EIRRs on investments are estimated under two cases, although in reality there is a continuum of possibilities between these two cases. Under the case 1 assumption, the FIRR before financing is estimated at 39.7 percent with a financial NPV of T43.7 million, while the EIRR is higher at 44.6 percent with an economic NPV of T55.4 million. Under case 2, when forgone financial losses are excluded from the incremental benefits, the FIRR declines to 33.4 percent with a financial NPV of T37.6 million. However, the EIRR in case 2 is not lower than that in case 1. When converted into economic prices, the farm (without the Project) does not incur economic net operating losses. Instead, the farm generates economic net operating incomes of about T2.2 million in constant 2000 terms over the three years. Consequently, the EIRR of 45.6 percent in case 2 is higher than that in case 1. At an opportunity cost of capital of 12 percent per annum, the economic NPV is estimated at T57.0 million.

3. Beef Cattle Fattening Farm

16. The model examines the benefits and costs of maintaining a beef fattening operation on an existing rain-fed farm to generate additional returns by maximizing the use of available crop by-products that are presently underutilized. With modest investments for new equipment and improvements to the existing stable and storage facilities, the farm's herd size with the Project is projected to increase by 40 head from 99 to 139 over five years. Without such investments, the farm's herd could increase by 8 head over the same period.

17. Livestock mortality rate (age 6-24 months) is presently 5 percent per annum. This rate is anticipated to decline over five years to 3 percent. With simultaneous improvements in sanitation, health care, and feed rations, the mortality rate is expected to decline to 3 percent in year 1 with the Project, and stabilize at 2 percent from year 3. Calves of about 12 months old and 120 kg/head are purchased and kept for a year, and sold as heifers and bulls at an average live weight of 420 kg/head (with the Project) and at 350 kg/head (without the Project).

18. With incremental investments of T1.3 million (constant 2000), the beef fattening operation is expected to yield an FIRR before financing of 37.4 percent and a financial NPV of T0.8 million. The model also shows that the incremental investment and improvements could tap the existing potential of the farm, and generate an EIRR of 41.8 percent and an economic NPV of T0.9 million.

4. Wheat Flour Mill

19. A flour mill with a processing capacity of 2 t of grain per hour requires an initial investment of T50.3 million in 2000 constant prices. The mill produces two grades of flour: grade 1 (premium) and grade 2. By-products are sold as livestock fodder. On average, processing outputs against wheat grain inputs are assumed to comprise 39 percent of grade 1 flour, 31 percent of grade 2 flour, 28 percent fodder and 2 percent losses including dust. As a base case, the flour mill operates on two eight-hour shifts over 260 days per year. The mill is anticipated to operate for 10 years. It requires four operators per shift, a loading crew of three persons, and a manager. Electricity consumption is rated at 135 kilowatts per hour of operations. The mill has an effective processing capacity of 90 percent of the installed capacity. While the present electricity tariff is at T4.4 per kilowatt-hour (kWh), the long-run marginal cost of electricity is estimated at \$0.06 per kWh. Production expenses mainly include (i) wheat grains, (ii) electricity, (iii) wages and benefits, (iv) maintenance of machinery and building facilities, (v) packaging, and (vii) handling and transport.

20. On the basis of 4,160 operating hours per year, a total of 7,488 t of wheat can be milled to produce 2,920 t of grade 1 flour, 2,321 t of grade 2 flour, and 2,097 t of fodder. Net operating incomes, before financing and income taxes, are expected to range from T17.0 million in year 2 to T20.9 million in year 7. Variation is due to anticipated fluctuations of wheat and flour prices. Under a base case scenario, these net operating incomes generate an FIRR of 35.4 percent on the invested capital, and a financial NPV of T48.1 million. The investment is expected to generate an EIRR of 36.7 percent and an economic NPV of T46.1 million.

D. Net Incomes, Cash Flows, and Debt Service Capacity

21. For projection purposes, the farms require an investment loan to finance 85 percent of the proposed investment costs, and a working capital loan to cover 50 percent of the annual and seasonal direct expenses of the farms. To estimate profitability and debt service, the following assumptions are made.

- (i) For simplicity, and based on prevailing rates in mid-2000, the nominal interest rates for working capital and investment loans are projected at 20 percent per annum, in tenge. This interest rate, after adjusting for expected local inflation in 2000, is equivalent to 10 percent per annum in real terms. In dollar terms, the nominal interest rate is about 12 percent per annum.
- (ii) Working capital loans are for an average period of seven months. The investment loan is for seven years, applicable to loan withdrawals of each year, with a one-year grace period on loan principal repayment. Interest charges are to be serviced during the grace period.
- (iii) Depreciation of fixed assets, excluding land, is calculated on a straight-line basis over 10 years.
- (iv) An income tax rate of 10 percent is applied against taxable income (net operating income less depreciation allowance and interest charges).
- (v) No provision is made for payment of dividends to shareholders. This assumption is made to show cash balances that reflect full retained earnings.

1. Rain-Fed Farm (4,000 ha)

22. Net income after tax is projected to steadily rise in current terms from no profits in year 1 to T3.6 million in year 5 and T5.9 million by year 10. In 2000 constant terms, net income after

tax rises to T2.6 million in year 5 and T3.2 million by year 10. The debt service coverage ratio¹ is projected to be healthy, averaging 2.0 over the 10-year period; and it is not expected to average below 1.2 over any two consecutive years. Although the farm has a potentially strong debt repayment capacity, borrowing and loan repayment terms should be designed to suit the farm's earning capacity and cash flows. While the investment plan developed for this model is indicative in nature, the farm would be able to borrow and repay an investment loan of about T30 million and leave enough room to maintain healthy cash balances during debt service. The farm's end-of-year cash balance is expected to rise in current terms from T0.9 million in year 1 to T8.0 million in year 5 and T20.3 million by year 10. In constant 2000 terms, this cash balance steadily rises from T0.9 million in year 1 to T5.7 million in year 5 and T10.8 million by year 10.

2. Rain-Fed Farm (10,000 ha)

23. The debt service coverage ratio is projected to be healthy, averaging 2.0 during the 10-year period. This ratio is not expected to average below 1.2 over any two consecutive years. The farm has a potentially strong debt repayment capacity, provided that borrowing and loan repayment terms are designed to match the farm's earning capacity and cash flows. The farm would be able to borrow and repay an investment loan of about T87.1 million and still maintain adequate cash balances during debt service. Net income after tax is projected to be steadily rising in current terms from T3.2 million in year 1 to T13.4 million in year 5 and T19.3 million by year 10. In 2000 constant terms, net income after tax rises more modestly from a profit of T3.1 million in year 1 to T9.5 million in year 5 and T10.3 million by year 10. The farm's end-of-year cash balance is expected to rise rapidly in current terms from T2.3 million in year 1 to T23.1 million in year 5 and T42.8 million by year 10. In constant 2000 terms, this cash balance rises steadily from T2.2 million in year 1 to T16.5 million in year 5 and T22.8 million by year 10.

E. Sensitivity Analysis

24. The FIRR and EIRR of the three farm models are moderately robust. Table A10.1 shows the impacts of yield reduction, output price decreases, and increases in investment and operating costs on these rates of return. Wheat prices are projected to be recovering and stable, after experiencing a 15 percent decline over the last year. In constant 2000 terms, the World Bank's commodity price projections (January 2000) show that American wheat prices² are expected to reach \$115/t in 2000, \$134/t in year 2005, and \$126/t in year 2010. When a further price decline of 10 percent is applied across these projections, the FIRRs of the 4,000 ha and 10,000 ha farms are reduced to 20.2 percent and 20.3 percent, respectively. Nevertheless, the EIRRs remain attractive at 31.3 percent for the 4,000 ha farm, and 31.1 percent for the 10,000 ha farms.

25. In an unlikely event, when projected yields are reduced by 10 percent throughout the 10-year period, the FIRRs of these farms are reduced to 5.1 percent (4,000 ha) and 4.1 percent (10,000 ha), although the respective EIRRs remain attractive at 16.8 percent for the 4,000 ha farm and 16.0 percent for the 10,000 ha farm. Such reductions in yields are highly unlikely if fertilizers and agrochemicals are applied to the crops of arable farms in zones III and IV.

26. The viability of the farm very much depends on the overall financial and commercial viability of the restructuring initiatives. Switching values, for rates of return not to fall below 12

¹ The ratio of net income (excluding depreciation, noncash charges, interest, and other charges on debt) against debt service (including long-term loan principal repayments and interest charges on all debts).

² US No. 1 hard red winter wheat, free-on-board basis, US Gulf Port.

percent, are presented in Table A10.2. Although there is room for absorbing unfavorable impacts, these results show that farm restructuring requires astute financial management, business planning, and farm management. While FIRR on investments may show to be above the cost of capital, the level of loan financing and its repayment schedules should be evaluated to match the overall earning capacity and projected cash flows of the farms.

27. The FIRRs of these farms are sensitive to decreases in benefits. In the event benefits are reduced by 7-8 percent across all projected years, the FIRRs fall to 12 percent, a level assumed to be the opportunity cost of capital. Similarly, the FIRRs are also sensitive to overall increases in operating costs. The FIRRs would again fall to 12 percent when operating costs rise by about 10-11 percent. However, the FIRRs are less sensitive to increases in the investment costs. The FIRR of the cattle fattening model is sensitive to increases in operating costs. A 9 percent increase in the operating costs (with the Project) would reduce the FIRR of the cattle fattening farm to 12 percent.

28. In the case of the flour mill, the base FIRR is moderately robust to declines in output and prices of wheat grains and wheat flour, and to increases in investment and operating costs. Table A10.1 shows that the FIRR is reduced to 29.9 percent when output declines by 10 percent, and to 27.8 percent when prices of wheat grains and wheat flour decline simultaneously by 10 percent. For the FIRR to fall to 12 percent, the investment costs must rise by 107 percent or the operating costs must increase by 64.3 percent. The FIRR is sensitive to price fluctuations of wheat flour when prices of wheat grains remain constant. Although this scenario is unlikely, the FIRR is reduced to 12 percent when benefits decline by 7.0 percent, a case when flour prices alone decline by 7.0 percent without a similar drop in the price of wheat grains. Similarly, the EIRR falls to 31.1 percent when output declines by 10 percent, and to 28.3 percent when wheat grain and wheat flour prices simultaneously drop by 10 percent. The EIRR is reduced to 12 percent when (i) investment costs rise by 114 percent; (ii) operating costs increase by 56.0 percent; or (iii) benefits drop by 6.6 percent. The FIRR and EIRR will also fall to 12 percent when the operating hours of the mill are reduced from 4,160 hours (2 shifts) by about 39 percent.

29. The sensitivity of the FIRRs to depreciation of the local currency equivalent to the US dollar was tested (Table A10.3). In the event the tenge experiences a further 20 percent depreciation, from T144.00/\$1 to T188.00/\$1, the FIRRs are expected to rise to 47.8 percent (4,000 ha), 43.4 percent (10,000 ha), 45.8 percent (cattle fattening), and 38.8 percent (flour mill). Depreciation of the tenge would cause prices of tradable inputs (equipment) and outputs (grains and sunflower) in tenge to rise to maintain their dollar equivalents, while prices in tenge of nontradable inputs would lag behind. Nontradable inputs and outputs are estimated to have 50 percent foreign content, while transport costs have up to 80 percent foreign content. As the overall prices of farm outputs are more sensitive than nontraded input prices in general to fluctuations of the foreign exchange rate, the net effect of local currency depreciation on the FIRRs is favorable.

Table A10.1: Sensitivity of Rates of Return to Declines in Yields and Prices, and Cost Increases

Models	Base Case ^a		10% Decline in All Yields or output		10 % Wheat Price Decline		10 % Increase in Investment Costs		10% increase in Operating Costs	
	NPV T '000 12%	IRR %	NPV T '000 12%	IRR %	NPV T '000 12%	IRR %	NPV T '000 12%	IRR %	NPV T '000 12%	IRR %
Financial										
4,000 ha	14,110	34.4	(4,065)	5.1	5,145	20.2	10,974	28.1	482	12.8
10,000 ha	37,572	33.4	(12,401)	4.1	14,342	20.3	27,920	26.8	1,009	12.6
Beef farm	754	37.4	(329)	0.3	—	—	649	31.6	(104)	8.5
Flour mill	48,096	35.4	35,832	29.9	31,318 ^b	27.8 ^b	43,602	31.7	40,622	32.1
Economic										
4,000 ha	21,238	47.5	2,942	16.8	11,962	31.3	18,103	39.4	8,155	24.8
10,000 ha	56,966	45.6	6,643	16.0	32,927	31.1	47,314	37.4	21,691	24.4
Beef farm	850	41.8	(233)	3.7	—	—	750	35.5	34	13.2
Flour mill	46,091	36.7	34,765	31.1	29,190	28.3	42,038	32.9	37,852	32.6

— = not applicable, IRR = internal rate of return, NPV = net present value.

^a In the sensitivity analysis on 4,000 ha and 10,000 ha farm models, the forgone net operating losses (without the Project) are not captured as incremental benefits due to the Project. Net operating incomes without the Project are assumed to be zero, the case when the farms cease to operate without assistance from the Project.

^b In the case of simultaneous declines in the prices of wheat and wheat flour.

Table A10.2: Switching Values at 12% for FIRR and EIRR

Models	% Decrease in Benefits	% Increase in Investment Costs	% Increase in Operating Costs ^a	% Decrease in Operating Hours of the Flour Mill
Financial				
4,000 ha	7.8	45.0	10.4	—
10,000 ha	7.5	39.0	10.2	—
Beef farm	7.0	72.3	8.8	—
Flour mill	7.0	107.0	64.3	39.2
Economic				
4,000 ha	11.6	67.6	16.2	—
10,000 ha	11.3	59.0	16.0	—
Beef farm	7.8	85.3	10.4	—
Flour mill	6.6	114.0	56.0	39.3

— = not applicable, EIRR = economic internal rate of return, FIRR = financial internal rate of return.

^a Operating costs of the farm with the Project.

Table A10.3: Sensitivity of FIRR to Local Currency Depreciation

Models	Base FIRR (%)	FIRR (%) with 20 percent Tenge depreciation (\$1.00=T180)	FIRR (%) with 50 percent Tenge depreciation (\$1.00=T288)
4,000 ha	34.4	47.8	74.8
10,000 ha	33.4	43.4	61.8
Beef farm	37.4	45.8	58.2
Flour mill	35.4	38.8	44.0

FIRR = financial internal rate of return.

POVERTY IMPACT ASSESSMENT

A. Introduction

1. Poverty impact assessment was conducted for the major groups of program measures, including (i) information provision; (ii) refinement of legislation on farm accounting, auditing, bankruptcy, and mortgage; (iii) more effective cost recovery in public irrigation; and (iv) encouragement of small-scale rural employment and the formation of voluntary rural associations.

B. Measures to Improve Information and Knowledge about Agriculture

2. Measures under this category will (i) strengthen sector monitoring, analysis, and information provision by the Ministry of Agriculture; (ii) improve the legal framework for land ownership; and (iii) promote, through a nationwide public information campaign, more widespread understanding of the current legislation and policy framework for agriculture.

Channel	Short-Run/Direct	Medium-Term/Indirect	Macro	Nonpoor
Demand for Unskilled Labor	No immediate impacts of the market information system are expected, since it will take time for users to gain familiarity with the system. In the short run, the information campaign on farm laws and policies will encourage consolidation of farm shares and farming structures, with negative impact on labor demand.	Positive insofar as improved market information contributes to the adoption of higher-valued, more labor-intensive commercial crops; negative insofar as the information campaign quickens the trend to rationalization of farm structures and operational costs		
Prices		Information is an economic good. Its greater provision will, over time, improve agriculture's efficiency and competitiveness, thus acting to lower the prices of food and other farm products consumed by the poor.		As in the case of land reform, the information systems are likely to have the largest and most rapid impacts in relatively nonpoor regions that have high potential for agricultural growth due to factors such as irrigation, soil quality, and access to markets.
Access for Poor	The information campaign will operate through mass media (radio and TV), which are widely accessible to the poor in rural Kazakhstan.	No major impacts are expected. However, the scope of public service announcements could be widened (e.g., to		

Channel	Short-Run/Direct	Medium-Term/ Indirect	Macro	Nonpoor
		microenterprise development) to be more pro-poor.		
Transfers			The information campaign will entail a budgetary cost estimated tentatively at \$2 million-\$3 million in 2002. Given the tight budget constraint, this will absorb public resources that might otherwise be used for social programs for the poor.	
Crucial Variables & Assumptions	The Government must commit adequate budgetary resources for the information systems, both during the program period and beyond. Alternatively, the farm communities must view the information systems as sufficiently useful to warrant cost recovery through user fees. The proposed technical assistance (TA) for Deepening of Agricultural Reforms and Development Programs will assist the Government in the design, implementation, and evaluation of the campaign, and in the development of farm technology messages, which can be delivered in East Kazakhstan and agroclimatically similar regions.			
Net Impact	Positive and negative impacts balance one another. The pro-poor impact of the information campaign would be enhanced by a focus on the needs of relatively disadvantaged rural groups, e.g., farms and rural communities in marginal agroclimatic zones, and by widening the scope of the campaign's messages to cover topics such as microenterprise development and nonfarm employment opportunities.			
Narrative	Improved information and knowledge about the legal and policy framework for agriculture is expected to contribute to (i) consolidation of land- holdings, farm shares, and land tenure and ownership rights into legally sound farm structures; (ii) greater demand for commercial credit based on pledging of property; (iii) greater use of bankruptcy as a tool for farm restructuring; (iv) formation of cooperatives and voluntary organizations; and (v) greater willingness by farm communities and small businesses to resist extralegal interventions in their affairs by local administrations. Improved market information should contribute to greater responsiveness to price signals and diversification of farming based on comparative advantage.			

C. Refinement and More Effective Implementation of Legislation on Farm Accounts, Bankruptcy, Mortgage, and Taxation

3. These measures will involve (i) application of international accounting and auditing standards to farms and agribusinesses that are legal entities; (ii) improved effectiveness of legislation on agricultural bankruptcy, pledging of property, and taxation; and (iii) expanded implementation of the system for registering rights to land and other immovable property.

Channel	Short-Run/Direct	Medium-Term/ Indirect	Macro	Nonpoor
Demand for Unskilled Labor	Small impacts in the short run because the implementation of laws tends to be slow, especially in remote regions	Improved bankruptcy measures will accelerate farm restructuring and debt resolution, which will accelerate		

Channel	Short-Run/Direct	Medium-Term/ Indirect	Macro	Nonpoor
		the long-run exit of labor from farming. The decrease in labor demand on nonviable farms will be partially offset by increased demand on successful farms that are more attractive to commercial lenders.		
Prices	Unlikely to have significant short-run impacts	Over time, the measures will contribute to more efficient farm operation, greater access to credit, and higher productivity, all leading to more stable prices of agricultural products. The costs of farm borrowing should be lower because of increased bank confidence in lending to farms.		
Access for Poor	There will be more transparent financial reporting by corporate farm managers to shareholders. This will improve shareholder decisions on farm restructuring and operations.		Budgetary revenues may grow as the result of improved farm accounting and auditing, better compliance with taxes, and the collection of registration fees for land transactions and secured loans. These revenues could be used to fund social services for the poor.	
Transfers			During the medium-term, modern standards of accounting and auditing, and the expansion of the real estate registration system, will entail significant public costs. These costs may divert budget resources from social services.	

Channel	Short-Run/Direct	Medium-Term/ Indirect	Macro	Nonpoor
Crucial Variables & Assumptions	It is assumed that the Government will respond proactively to policy advice provided by the proposed TA for Deepening of Agricultural Reforms and Development Programs, as well as the recommendations of the ongoing TAs financed by the United States Agency for International Development.			
Net Impact	Modestly negative			
Narrative	The Government of Kazakhstan has demonstrated its commitment to establishing a sound legislative basis for market-led agricultural growth. The Program will provide the resources to evaluate the application and impact of this legislation, with the intent of improving its effectiveness, transparency, and equity from the standpoint of both borrowers and creditors. Widespread understanding and uniform application of the legislative changes will be promoted through the Program's public information campaign on agriculture.			

D. Encouragement of Small-Scale Rural Businesses and Voluntary Associations

4. The measures will (i) reduce extralegal interventions by local administrations in the activities of farms and small businesses; (ii) improve legislation governing the formation of cooperatives and other voluntary associations; and (iii) establish a sound legal framework for the transfer of irrigation and drainage systems to water user associations (WUAs).

Channel	Short-Run/Direct	Medium-Term Indirect	Macro	Nonpoor
Demand for Unskilled Labor	These measures will directly promote the establishment of small businesses that tend to use labor-intensive technologies.	Private investment and formation of cooperatives and WUAs will encourage labor demand in agroprocessing and marketing, as well as in irrigated farming and privatized operation and maintenance (O&M). Improved O&M through transfer of ownership to WUAs will arrest deterioration of water resources infrastructure, and sustain the farm production base and labor demand.		
Prices	The transfer of irrigation systems to WUAs will entail a greater financial burden for farmers who must pay full O&M costs. On the other hand, the formation of cooperatives will reduce costs through	Enhanced rural business activity will increase the supply and competitiveness of goods and services consumed by the poor.		The nonpoor will share in the increased costs of O&M and the benefits of cooperative marketing services in direct proportion to the size of their irrigated land holdings and

Channel	Short-Run/Direct	Medium-Term Indirect	Macro	Nonpoor
	economies of scale in input and output marketing.			production.
Access for Poor	The poor and nonpoor alike will be affected in proportion to their use of irrigation and demand for marketing services.			
Transfers	Insofar as extralegal taxes, levies, and voluntary contributions go into official local budgets, the reforms will reduce local capacity to provide social services and other transfers (including O&M subsidies) that benefit the poor.	A positive impact is anticipated through the macro channel of tax revenues and expenditures.	More rural business activity will expand the legitimate tax base and offset the decline in revenue resulting from reduced extralegal intervention by public officials. Budgetary deficits could thereby be reduced and/or spending on services for the poor increased.	
Crucial Variables & Assumptions	The most critical variables are the central Government's resolve and capacity to control unwarranted interventions by local administrations in business affairs. In addition, explicit public support is desirable to promote and nurture the development of cooperatives and WUAs. Care must be taken that transfer of irrigation management responsibilities does not exceed the capacities of the newly created WUAs. Support will be provided under (i) the Program's public information campaign on agriculture, (ii) TA 2946-KAZ: Institutional Development and Policy Reforms for Improving Water Management, ^a and (iii) related TA financed by the United States Agency for International Development.			
Net Impact	Positive			
Narrative	Market access and efficiency are presently key constraints to the growth of agriculture, so there are major potential benefits to be gained from rural cooperative organizations for input supply, marketing, and other purposes. However, the social capital for these activities was not developed during the Soviet period, when production and marketing decisions were made centrally. Although Kazakhstan's Civil Code presents few legal barriers to private business initiative and the formation of cooperatives, additional explicit legislative support is warranted. Similarly, explicit support for the formation and functioning of WUAs is urgently needed to arrest the deterioration of water resources infrastructure that accompanied the breakup of the state farms and the breakdown of O&M services provided under the command economy.			

^a Approved by the Board on 17 December 1997, for \$600,000, together with Loans 1592/1593-KAZ: *Water Resources Management and Land Improvement Project*, for \$40 million.

E. Introduce More Effective Financing of O&M in Public Irrigation

5. The principal measures will (i) improve procedures for collection of water fees and related user charges; (ii) establish procedures for annual allocation of such fees between oblast administrations and the national Government to finance the costs of O&M of drainage and irrigation infrastructure; and (iii) institutionalize explicit routine national budgeting for O&M in balance with the revenues generated by water fees.

Channel	Short-Run/Direct	Medium-Term Indirect	Macro	Nonpoor
Demand for Unskilled Labor		Over time, improved financing of O&M will lead to more reliable irrigation and drainage services, lower salinity and waterlogging, and improved farm productivity, acting to increase labor use on irrigated farms of all sizes.		No significant impacts expected. However, it should be noted that the measures will affect O&M funding in irrigated agricultural regions, which are relatively non-poor compared with the rain-fed regions.
Prices				
Access for Poor			Modestly negative if there is any reduction in public expenditures for transfers to the poor	
Transfers	The measures will more explicitly link O&M budgets with revenues presently being generated from water fees. In the short run, this will affect the allocation of public revenues, not their magnitude. To the extent this reduces the diversion of water fee revenues to uses other than O&M, it may entail a reduction in public funding of social services and direct transfers to the poor.	Same as the short-run effects	Same as short-run and medium-term effects	No significant impacts expected, but, viewed nationally, the net effect of more explicit linkage of water fee revenues and O&M may be to reduce Government funding of other services to Kazakhstan's relatively poor regions and social groups.
Crucial Variables & Assumptions	In and of themselves, the measures will have no impact on the cost of water to farmers. The present water fees are modest in size—slightly more than \$1 per hectare per year—in light of the limited financial capacity of farms. Full recovery of the economic costs of water, which would include the environmental costs of water diverted from the Aral Sea, would entail a very substantial increase in the water fee in some regions of Kazakhstan, but it is assumed that the feasibility of such a cost increase is remote during the medium term.			
Net Impact	Neutral to modestly positive. In the long run, the productivity-enhancing impacts of improved irrigation and drainage services are assumed to have benefits for the poor, which may be counterbalanced by a slight reduction in public provision of other public services to the poor.			
Narrative	In August 1997, the Government issued a regulation on the calculation and collection of fees for surface water. This was intended to be the first step toward a long-term policy of full recovery of the investment and O&M costs of irrigation infrastructure. So far, the water fees have been used as a source of general revenue by oblast administrations rather than being devoted to O&M, which continues to suffer from lack of funding. The program's measures will rationalize the budgetary relationship between water fees and publicly financed O&M.			