

PRR467-08419

ASIAN DEVELOPMENT BANK

REPORT AND RECOMMENDATION

OF THE

PRESIDENT

TO THE

BOARD OF DIRECTORS

ON A

PROPOSED LOAN

AND

TECHNICAL ASSISTANCE GRANTS

TO THE

REPUBLIC OF KAZAKHSTAN

FOR THE

AGRICULTURE SECTOR PROGRAM

November 1995

CURRENCY EQUIVALENT (As of 31 October 1995)

Currency Unit	Tenge (T)
1 Tenge	100.00
US\$ 1.00	166.00

The exchange rate of the Tenge is determined on a daily basis through periodic foreign exchange auction. For purposes of this Report, the exchange rate of 162.00 per US dollar that prevailed during appraisal has been used.

ABBREVIATIONS

APB	-	Agroprombank
ASF	-	Agriculture Support Fund
CUFC	-	Committee on Utilization of Foreign Capital
EBRD	-	European Bank for Reconstruction and Development
EU	-	European Union
FSU	-	Former Soviet Union
IMF	-	International Monetary Fund
KAE	-	Kazakh International Agroindustrial Exchange
MOA	-	Ministry of Agriculture
MOF	-	Ministry of Finance
NBK	-	National Bank of Kazakhstan
NPP	-	National Privatization Program
PCC	-	Program Coordination Committee
TACIS	-	Technical Assistance for the Commonwealth of Independent States
USAID	-	United States Agency for International Development

NOTES

- (i) The fiscal year of the Government is the same as calendar year.
- (ii) In this Report, \$ refers to US dollars.

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(i)

KAZAKHSTAN

AGRICULTURE SECTOR PROGRAM

LOAN AND PROGRAM SUMMARY

Borrower

: Republic of Kazakhstan

**Program Description
and Rationale**

: Agriculture contributes 15-20 percent of the country's gross domestic product and employs about 25 percent of the work force. The agriculture sector is undergoing fundamental structural changes as part of the overall economic policy reform process to transform the command system to a market-based system. The proposed loan for the Agriculture Sector Program (the Program) will substantially strengthen the reform process and support the ongoing transition of agriculture to a competitive, market-based system. The Program will enable some reform measures initiated in the past to be completed, such as those relating to land rights, the transfer of state farms to private entities, and the dismantling monopolies. The Program will also introduce new measures aimed at liberalizing trade and reducing Government intervention in domestic agricultural markets, such as the abolition of the export tax on grains, the removal of minimum export prices on grains, and the removal of price subsidies. The Program will also include measures to mitigate the adverse impacts of the adjustment process on vulnerable groups. The Program will complement the Government's macroeconomic stabilization and adjustment reforms, which are supported by the World Bank and the International Monetary Fund. It will also complement specific assistance programs in the sector undertaken by United States Agency for International Development, the European Union and Germany.

**Program Objective
and Scope**

: The objective of the Program is to strengthen the reform process and support the transition to a competitive, market-based agriculture sector. The Program addresses three main areas deemed critical to the reform process: (i) creating markets, (ii) promoting market competitiveness, and (iii) addressing social and environmental concerns. Specifically, the policy reform measures focus on creating an agricultural land market, transferring ownership of state farms to private entities, liberalizing external trade,

(ii)

dismantling state monopoly companies, restructuring Agroprombank, promoting a market-based rural credit and savings system, strengthening social protection for adversely affected vulnerable groups, and strengthening environmental management in the agriculture sector.

Classification	:	Economic growth.
Loan Amount and Terms	:	A loan in the amount of \$100 million will be provided from the Bank's ordinary capital resources. The loan will have a maturity of 15 years, including a grace period of 3 years, with interest determined in accordance with the Bank's pool-based variable lending rate system for US dollar loans, and a commitment charge of 0.75 percent per annum.
Utilization of Loan Proceeds	:	The proceeds of the loan are expected to be disbursed by March 1997 against a broad range of imports subject to a negative list of items. The proceeds may be disbursed to finance eligible expenditures incurred within 180 days prior to loan effectiveness. The counterpart funds to be generated from the proceeds of the loan will be used by the Government to support the transition of the agriculture sector to a market-based system.
Tranching	:	The loan will be released in two equal tranches. The first tranche will be made available upon loan effectiveness. The second tranche is expected to be released by December 1996, subject to compliance with conditions for its release.
Executing Agency	:	Ministry of Finance.
Procurement	:	Contracts for eligible items estimated to exceed the equivalent of \$5 million will be awarded on the basis of international competitive bidding (ICB), as described in the Bank's <i>Guidelines for Procurement</i> . Contracts for eligible items estimated to cost the equivalent of \$5 million or less will be awarded on the basis of normal commercial procurement practices, in the case of procurement by the private sector, or in accordance with Government's procurement procedures, in the case of procurement by the public sector. Contracts for eligible items consisting of commodities that are commonly traded in the international commodity markets will be awarded on the basis of normal commercial practices and procedures appropriate to the trade and acceptable to the Bank.

(iii)

Program Period	:	Two year period ending December 1997.
Program Benefits	:	An open and competitive market-based agriculture sector will permit the adjustment of the sector towards its optimal size based on its comparative advantages and thereby will promote sustainable development of the sector. Overall, it will elicit greater efficiency in resource use, result in improved productivity of output and have a positive impact on farm incomes and lead to a reduction in poverty. In the medium term, economic incentives will improve, which will encourage investment in agriculture. The removal of price distortions and Government interventions will improve the terms of trade of the agriculture sector. The reforms will also improve the commercial orientation of the rural financial sector. The adverse impacts of the policy adjustments on vulnerable groups will be mitigated through measures to strengthen social protection for them, while the environmentally sustainable management of agriculture will improve with greater attention to the safe disposal of chemical pesticides and to policies for range land conservation under the Program.
Program Risks	:	The principal risks are (i) the inadequate institutional capacity to implement the reform measures in the face of the country's economic crisis and the restructuring of Government agencies; (ii) the differences in outlook and commitment to reform between the central and the local authorities; and (iii) the delays in the implementation of the policy reforms, partly as a result of the adverse impacts of the structural adjustment process. To minimize these risks, the Program incorporates measures to enhance the capacity of agriculture-related agencies to strengthen and develop the skills required to implement the Program, and provides for direct support to vulnerable groups hard hit by the transition.
Technical Assistance	:	Two technical assistance (TA) grants will be provided to strengthen the Government's capacity to analyze agricultural policies, monitor the impact of reforms under the Program, and contribute to an ongoing policy dialogue between the Government and the Bank: (i) a Study on Market Reform in the Agriculture Sector (\$1,044,000 equivalent); and (ii) a Study on Rural Credit and Savings (\$470,000 equivalent). The consultants required to undertake the TAs will be engaged in accordance with the Bank's <i>Guidelines on the Use of Consultants</i> .

I. THE PROPOSAL

1. I submit for your approval the following Report and Recommendation on (i) a proposed loan to the Republic of Kazakhstan for the Agriculture Sector Program; and (ii) proposed technical assistance for a Study on Market Reform in the Agriculture Sector. The Report also describes proposed technical assistance for a Study on Rural Credit and Savings, and if the proposed loan is approved by the Board, I, acting under the authority delegated to me by the Board, shall approve such technical assistance.

II. INTRODUCTION

2. Kazakhstan is a landlocked country to the north of Afghanistan and to the west of the People's Republic of China. It was part of the former Soviet Union (FSU) and became independent in 1991. Since attaining independence, Kazakhstan has faced serious economic and fiscal crises due to the collapse of the command system under the FSU. The large fiscal transfers, estimated at 10 percent of gross domestic product (GDP), were discontinued and many traditional markets for outputs and sources of input supplies were lost. The disruptions in supplies, in particular, resulted in dramatic declines in output. The economy's real output declined by over 50 percent from 1991 to 1994 and the overall real GDP is projected to decrease by 12 percent in 1995. Immediately after independence, the country initiated fundamental policy reforms to address these crises and to begin the transition to a market-based economy.

3. The initial effects of adjustment were the decrease in budgetary expenditures. Furthermore, living standards came under severe pressure, particularly those of the rural population, many of whom are poor. Thus, the Government implemented, on a priority basis, a macroeconomic stabilization program and structural reforms aimed at containing the decline in output, decelerating inflation, and correcting the domestic and external imbalances, while moving the country towards a market economy. Since 1993, substantial assistance from the International Monetary Fund (IMF) and the World Bank has supported this program. In addition, in 1994, the Bank extended assistance for this program through a Special Assistance Project.¹ By early 1995, the macroeconomic stabilization effort had a positive impact in containing inflationary pressures, and in stabilizing the exchange rate, although economic conditions are still difficult. A sustained economic recovery can be expected only in the medium term and will require continued adherence to the reform program.²

4. The breakdown in the previous fiscal and trading arrangements has had a severe impact on the agriculture sector.³ Agricultural output has declined by 36 percent since 1992, and is expected to drop by 10-15 percent in 1995. To achieve the economy-wide goals, the Government has been implementing a reform program to transform the agriculture sector from the previous command system to a competitive market-based system. Although several measures have been initiated, the Government recognizes that the momentum in restructuring the agriculture and agro-industrial sector has been curtailed by an incomplete reform agenda.

¹ Loan Nos. 1337/1338(SF)-KAZ: Special Assistance Project, December 1994.

² For more detailed information on the recent economic developments, see the forthcoming Economic Review and Bank Operations for Kazakhstan.

³ The agriculture sector is defined to include crops, livestock, and agro-industries.

Accordingly, the Government has requested assistance from the Bank to strengthen and accelerate the reform program to support the objective of establishing a market-based agriculture sector.

5. A Reconnaissance Mission from the Bank for the Agriculture Program Loan was undertaken in February 1995, a Loan Fact-Finding Mission in May 1995, and an Appraisal Mission in July 1995.¹ This Report is based on the findings of the Bank Missions; the reports of staff consultants; reviews of various studies; discussions with staff of national and local Government ministries, departments, agencies, privatized enterprises, and farms; and extensive consultations with other aid agencies.

III. THE AGRICULTURE SECTOR

A. Background, Performance and Outlook

6. The country has three main agricultural regions: (i) the north, which is well-suited to rainfed farming and livestock production; (ii) the expansive semidesert steppe lands of the central region, which is well-suited for livestock production; and (iii) the south, where most of the irrigated crop production takes place. Prior to independence, Kazakhstan had a centrally planned agriculture sector in which collective farming was the dominant mode of production. The agricultural production took place on 2055 state farms and 430 collective farms, and was based on plan targets. At the center of the production system were state orders under which agricultural commodities were procured by the Government to: (i) supply state stores, public institutions and the military; (ii) cover deficits in some regions (*oblasts*); and (iii) fulfill trade agreements. The quantities to be procured were determined at the national level and allocated among the regions and state farms on the basis of long-standing production plans. Underpinning this production system was a centralized rural credit system in which funds were channeled to state farms through the central bank to finance the targeted production.

7. Livestock was the largest subsector within agriculture and 80 percent of the total agricultural area of 200 million hectares (ha) was used as grazing land. The annual cropped area was about 35 million ha, of which 70 percent was brought under cultivation during the Virgin Lands campaign of the 1950s. Farm sizes, including those for livestock, were very large, with many in the range of 80-100 thousand ha per farm. Crop agriculture was predominantly rainfed, with only 8 percent of total cropped area under irrigated crops. Crop production was dominated by grains, mainly wheat and fodder. Crop yields were low because of the low soil fertility and the poor farming practices. Yields also varied greatly from year-to-year because of the large fluctuations in rainfall, causing large variations in agricultural production. Kazakhstan was among the largest net grain exporting republics under the FSU with average exports of almost 5 million metric tons (t) a year. Other major agricultural exports included meat and wool.

¹ The Mission comprised S. H. Rahman (Project Economist/Mission Leader), D. Edwards (Sr. Economist), E. McGill (Counsel), E. Q. Ye (Project Economist), A. Bauer (Economist-Social Sector), and was assisted by K. Moots (staff consultant).

8. Structural transformation of the agriculture sector began immediately after independence. Under the FSU, Kazakhstan's agricultural production was based on the fulfillment of production targets with little regard for cost or profitability and therefore, did not reflect the sector's comparative advantages. Accordingly, there was little incentive to improve efficiency or to change cropping patterns. With the initiation of market-oriented reforms, in particular the withdrawal of input subsidies, a large proportion of the traditionally produced agricultural output could no longer be sustained. The liberalization of input prices caused them to increase several-fold, while the adjustments in output prices lagged behind. The large increase in input prices relative to output prices sharply eroded farm incomes. Thus, agricultural production has declined sharply in the period since independence. Concomitantly, the average share of agricultural output in total national output has declined from 38 percent in 1989-1991 to 28 percent in 1992-1994 in net material product terms. This decline represents a substantial structural change in a short period. Recent estimates of national income indicate that agriculture's contribution to GDP was 15-20 percent in 1994. It also employed at least 20 percent of the labor force and accounted for 10 percent of the country's exports.

9. Recently, the livestock sector still accounted for more than half of total agricultural output, but the herd size has fallen sharply because of an increase in the slaughter rate caused by hard economic times. Indexes for 1994 indicated that the cattle herd has declined by 20 percent, while the poultry stock has fallen by one-third relative to 1989. Accordingly, the output of animal products such as milk, wool, and eggs has also declined. The crop subsector continues to be dominated by grain grown under rainfed conditions. By far, the most important grain product is wheat which accounts for two-thirds of total crop output and 40 percent of total cropped area. Other important crops include fodder crops (barley, oats and millet), potatoes and vegetables. Wheat yields have remained at approximately their historical levels and averaged 1 t/ha recently, compared with more than 2 t/ha for rainfed wheat in other parts of Asia. Farm sizes remain very large. Although the transfer of ownership of these farms to private entities started in 1993, the emergence of individual private farms, which separated from the state farms, has been slow. Individual private farms account for only 4 percent of total cropped area, but represent significantly more efficient production units. These farms are located near urban areas and account for over one-third of the vegetable and fruit production.

10. The centralized agricultural credit disbursement system remained virtually intact until 1994. Although a specialized bank for agriculture and agro-industry - Agroprombank (APB), was established in 1991, it continued to be used as a conduit for channeling Government-directed credit to the agriculture sector until 1994. Then it came under pressure because of the Government's reforms in the financial sector initiated in late 1994. APB accounts for 80 percent of agricultural credit and has a nationwide network of 230 branches covering all the regions and districts (*raions*). It was established as a joint stock company and its major stockholders include state farms, agro-industrial enterprises and the Government. APB's lending operations were disrupted in early-1995 because of the accumulation of large loan arrears. However, alternative credit channels opened up because some commercial banks initiated operations in the sector and agro-industries engaged in marketing and processing also advanced production credit to farmers.

11. The destabilization of the agriculture sector since independence, has had a serious impact on living standards in the sector. In addition to the sharp decline in output and exports,

the sector has experienced adverse terms of trade, erosion of farm incomes, and loss of employment. At present, underemployment in agriculture is estimated at 16 percent of the rural labor force, which is twice the level of other sectors and it is expected to increase further in 1996. The average agricultural wage of T2,300 per month in mid-1995, was only half the national average wage in contrast to near parity in the early 1990s. In addition, not only have wage adjustments lagged considerably behind runaway inflation, there has been a buildup in unpaid wage estimated at T6 billion in early 1995. The consequence of these developments has been a sharp deterioration in living standards in the agriculture sector.

12. During 1993 and 1994, the contraction in agricultural output followed the decline in the overall economy (see Table 1). In the near term, the output in the agriculture sector is expected to continue to contract by about 15 percent in 1995 and by 7.5 percent in 1996 before stabilizing in 1997. This trend reflects the continued adjustment of the sector to its optimal size. There is likely to be a significant further increase in unemployment in the rural areas. The sector will experience the beginnings of adjustment to the sectoral reform program, in particular to market price signals that provide a more appropriate guide to profitability based on the country's comparative advantages. The sector will need to exploit export opportunities in other markets outside of the FSU; early signs of a positive response to this requirement are already apparent. As the more private sector-oriented production methods take hold, individual farm productivity will rise, although the sector will remain vulnerable to significant fluctuations in yields from the periodic inclement weather. The sector in the medium term, both for grain and livestock output, will also be smaller than under the previous command system in which farm profitability did not determine output levels.

Table 1. Recent Performance of the Agriculture Sector

	1992	1993	1994
Overall GDP growth (percent)	-14.9	-12.9	-25.4
Agriculture sector growth (percent)	0.5	-12.1	-24.2
Output of major products ('000 tons)			
Grains, of which:	29,772	21,631	16,454
Wheat	18,285	11,585	9,052
Maize	367	329	233
Barley	8,510	7,149	5,497
Oats	727	802	822
Rice	467	403	283
Sugar beet	1,274	909	467
Oil Seeds	236	194	182
Vegetables	9,851	8,080	7,811
Potatoes	2,570	2,296	2,040
Cotton	252	201	206

13. These developments will contribute to a structural shift in the economy. The industry sector, which is also expected to experience pressure on output as the Government implements its enterprise restructuring program, will nevertheless benefit from a projected upturn in foreign investment in the energy and minerals subsectors. This development will moderate the near-term pace of decline in the industry sector. Consequently, the overall GDP is projected to decline by 12 per cent in 1995, to contract further by 5 percent in 1996 and to stabilize in 1997. Given the rate of contraction of the agriculture sector and its share in the overall GDP, 20 percent of the overall decline in GDP in 1995 and 1996 will be caused by the decline in agricultural GDP.

14. In a more positive development, the monthly rate of inflation has fallen to less than 3 percent in mid-1995, and is projected to be below 2 percent in the second half of the year. The exchange rate of the tenge against the US dollar has also stabilized in recent months. Under the current IMF Stand-by Arrangement, the Government budget deficit is projected to decline from 7.9 percent of GDP in 1994 to 3.5 percent in 1995. The external current account balance is projected by the IMF to decline from 7.2 percent of GDP in 1995 to 5.5 percent in 1997 and to 3.8 percent in 1998, with the recovery in the growth of exports to 4 percent in 1995, and in non-oil exports to 6.5 percent through 1998. If the progress towards achieving macroeconomic stability continues, the IMF is likely to consider extending medium-term program assistance to Kazakhstan in 1996, under its Structural Adjustment Facility.

B. Government's Sectoral Policies

15. A report prepared by the Kazakh Academy of Agricultural Sciences entitled "*Conceptual Program for the Development of the Agro-Industrial Complex of Kazakhstan for 1993-1995 and until 2000*" made a major contribution to the evolution of the Government's sectoral strategy. The principal objective of the Government's agricultural policies is to facilitate the transition of the sector to a competitive, market-based system. The near term priority is to stabilize the sharp decline of the sector, which followed the breakdown of the economic relationships under the FSU. This will entail arresting the decline in sectoral production and living standards. At the same time the basis needs to be established for the: (i) adjustment of the scale and pattern of production in the sector to its long term comparative advantage derived from market-determined prices aligned to world markets; (ii) mitigation of adverse socioeconomic impacts brought about by the adjustment to a market-based system; (iii) restructuring of the rural banking sector; and (iv) correction of past ecologically unsound agrarian practices and enforcement of appropriate natural resource management standards.

16. The focus of the Government's sectoral policies is on: (i) dismantling the system of Government ownership and interventions that prevailed under the command economy; and (ii) establishing the institutional and legal framework for private sector-oriented agriculture. Aside from the pressing need for a stable macroeconomic environment within which to effect the sectoral transformation, the broad sectoral areas of Government concern are: (i) policies to improve the structure of agricultural production structure and efficiency, including land reform, farm restructuring, pricing and subsidies, credit, and agricultural finance; (ii) policies to improve food storage, processing, marketing, including reforming and restructuring enterprises as well as external and domestic trading relationships and conditions; and

(iii) redefinition of the institutional roles, including the capability to formulate and monitor sector policies and regulations, provide support services to private farms, deliver social services, and provide social protection to the rural population, and improvements in the management of natural resources.

17. The Government expects a more efficient and responsive sector to develop from: (i) the creation of basic market institutions including enforceable property rights; (ii) the establishment of competitive, market-determined price signals and trade relationships; and (iii) the reorientation of the public sector's role toward institutional support for private sector agriculture. With a broader range of entry and exit opportunities, a revitalized agriculture sector would be expected to provide significant opportunities for employment. Thus, the basis would be established for improvements in living standards in the sector. In addition, the sector would be expected to meet a sizeable proportion of domestic food requirements in a competitive manner as well as contribute to potentially profitable export markets.

C. Recent Policy Reforms

18. The Government has implemented fundamental reforms in the agriculture sector in recent years. Despite the post independence fiscal crisis and the economic hardships caused by some of the policy adjustments, the Government has shown a strong resolve to maintain the momentum of the reform process. The reforms are discussed in the remainder of this section under three broad areas: creating markets, improving market competitiveness, and addressing social and environmental concerns related to the reform process.

1. Creating Markets

19. **Land reform and farm restructuring.** The Government's land policy requires that modes of land use and management be adopted under which workers' rights to land and related property are clearly established. Land reform and farm restructuring begun with the Land Code and Farmer Facility Law enacted in 1990. The Land Code confirmed the right of individual citizens to lifetime inheritable tenure in individual farms and small plots, the right of state and collective farms to permanent tenure in agricultural land, and the right of individuals and legal entities to use or lease land on a short- or long-term basis. The Farmer Facility Law confirmed the right of family farms to acquire lifetime inheritable tenure or lease rights in agricultural land, to obtain credit, and to manage themselves as independent economic units. However, the Land Code prohibited the sale, exchange, and pledge of land rights, and the Farmer Facility Law placed substantial restrictions on the use of family farm plots.

20. The Land Reform Law of 1991 provided for the transfer of land rights to the new owners of privatized state farms, and for the right of workers on privatized state farms to be granted individual land plots. A Presidential decree issued in April 1994 confirmed that individuals and legal entities (other than state farms) may sell, bequeath, lease, and pledge their land rights. However, issues remain concerning the implementation and enforcement of these rights. The new Constitution adopted in 1995 expressly permits the private ownership of land. A new land code, mortgage law and law on the registration of rights in immovable property and related transactions are under preparation, and a civil procedure code is expected to be drafted in the near future. The new legislation should address many of the

issues relating to rights in agricultural land. However, supplemental decrees or regulations will be needed to implement effectively the new laws at the local level.

21. The Government initiated the process of transferring ownership of state and collective farms to private entities in 1993. Of the 2,055 state farms and 430 collective farms, the ownership of 1,363 state and collective farms was transferred by the end of 1994. An additional 306 farms were transferred to private entities in the first six months of 1995. As an intermediate step to granting farm workers rights in specific parcels of land, the Government initiated a program in March 1995 to issue land share certificates to the individual farm workers on the privatized state and collective farms. However, the legal rights and interests represented by these land share certificates require further clarification.

22. Despite the past reforms in land tenure, the privatization process in the farming sector is still at an early stage. In most cases, the withdrawal of the Government has meant a transfer of ownership from the state to the farm workers and the managers of the former state farm, albeit organized as private joint stock companies that assumed both the assets and the liabilities of the former state farms. The main constraint to the growth of independent family-based or individual commercial farming operations is the lack of clarity in the legal framework for agricultural land use rights. Other constraints include inadequate institutional arrangements for the use of farm capital, the use of irrigation water, and the disruption of traditional agricultural credit channels.

2. Promoting Market Competitiveness

23. **External trade policy.** External trade has been substantially liberalized under a Presidential decree issued in February 1995. Export quotas and quantitative restrictions on all agricultural commodities were abolished and the export tariff structure was substantially liberalized. However, an ad valorem export tax of 10 percent on grains remains in place. In addition, the National Price Commission sets mandatory minimum export prices for different grades of grains, in an attempt to prevent foreign exchange losses. Grain exports are managed by the newly established Kazakh International Agro-Industrial Exchange (KIAE), which was created to increase market competition in the grain market. It is an auction market for grains for both exports and domestic consumption. Private traders are permitted to participate in the grain export trade. On the import side, the liberalization concerning agricultural commodities has also been significant. Imports of inputs such as fertilizer and pesticides are free of licensing requirements, and the tariffs have been reduced substantially.

24. **Dismantling state-owned monopoly holding companies.** Reforms in the agricultural marketing and input supply system have focused on privatization of the entities engaged in marketing and processing. The Government's privatization program has gone through two phases. During the first phase, which lasted from 1991 to early 1993, 292 state-owned agro-industrial enterprises involved in processing and marketing were privatized. The second phase, which began in March 1993, was intended to speed up the process and correct problems identified during the first phase. The most sweeping changes were in the industry sector under the National Privatization Program (NPP), which initially excluded agro-industrial enterprises. The changes were intended to improve management, introduce market competition, and improve transparency. The process of ownership transfer in

agro-industry was largely a closed one, with shares of the enterprises distributed to the suppliers of the enterprise, the employees, and the state.

25. Another feature of the second phase of privatization was the establishment of 13 vertically integrated state-owned monopoly holding companies at the national level, to ensure state control over processing, marketing, and external trade in agricultural commodities. The state monopolies took over the functions of the central ministries for these economic activities. Each monopoly holding company typically consisted of a few hundred subsidiary enterprises. The presence of these monopolies has posed a major constraint to the development of competition in the output markets, including the grain market. The result is a continued pattern of low farmgate product prices and high input prices that adversely affects agriculture's terms of trade.¹ Further, the monopoly market structure has resulted in abnormal spreads between consumer and producer prices. However in late 1994, the Government decided to include the privatization of agro-industrial enterprises under the NPP to establish a more competitive market environment in the sector. During the first stage, the state monopoly holding companies were to be liquidated, and 8 out of 13 of these holding companies have already been liquidated. The liquidation has involved Government decrees and/or resolutions dissolving the national-level monopoly holding companies, and establishing all their subsidiaries as independent and mutually competing commercial entities. These entities are then privatized through the NPP in the second stage. In the interim, these independent entities operate as state-controlled commercial companies.

26. Among the most prominent of the state monopoly holding companies is Astyk, which still controls 31 grain elevators with a capacity of about 3.5 million t. The large capacity is well in excess of the Government's special needs for the defense forces and for food security.

27. **Domestic procurement policy.** The Government's agricultural output procurement system known as the state orders system was abolished in 1993 and replaced by a substantially downsized scheme known as the state needs system. In 1994, planned procurement under state needs was estimated at 40 percent of the 1990 procurement level, down from 60 percent in 1993. However the quantities involved were large - about one-third of total production, half of which was for domestic consumption and the rest for export. Local officials continued to determine procurement quotas and to influence production decisions at the farm level until early 1994. Farmers had little choice in production and marketing, resulting in serious distortions in the allocation of resources. In a bold step towards liberalizing agricultural markets, the state needs system was abolished in early 1995 for all agricultural commodities, and an open auction market for grains administered by KIAE was established. The open auction has significantly increased competition in the grain market and consequently, raised farmgate prices. Average grain prices were about \$70/t at farmgate in

¹ These state holding companies have been monopoly sellers of inputs to farmers and of agricultural products to consumers, and have therefore, charged high prices (relative to what would prevail in a competitive market environment with liberalized external trade). Furthermore, these companies have been the only (monopsonist) buyers of grains from producers, and consequently have depressed prices paid to farmers.

mid-July 1995 compared to \$50/t in the same period in 1994. At present, the Government procures grain only to meet the needs of the defense forces and for food security stocks. The procurement quota for 1995 is 1.5 million t, down from 6.5 million t in 1993 and 4.1 million t in 1994.

28. **Output pricing and subsidy policies.** Under central planning, all the commodity prices were determined by the state. However, the pricing policies have changed substantially recently. In agriculture, the administered grain prices, which had been up to 70 percent below world prices, were more than doubled in 1993 to achieve greater parity with world prices. The administered prices of meat and milk were also about 60 to 70 percent below world market prices in 1993. However, the administered pricing regime for agricultural commodities was abolished in 1994. Despite significant upward price movements since then, the domestic price of wheat at farmgate still remained 50 percent below world prices in July 1995.¹ The producer prices of domestic fodder (barley) and livestock products were also about 50 percent below world prices. Since early 1995, the Government has introduced producer price subsidies to support meat and wool prices. However, the depressed prices of agricultural products at farmgate mainly reflect the dominant influence of the monopoly state holding companies in agricultural markets. Therefore, the intervention required is to dismantle the monopoly companies. The National Price Commission established in 1994 announces minimum domestic producer prices for grains. However, the Government does not attempt to enforce these minimum prices, nor does it possess any mechanism to do so.

29. On the consumption side, the Government's concern for maintaining stable and affordable prices for bread as a basic necessity was reflected in a large consumer subsidy. The bread subsidy accounted for about 20 percent of all subsidies in the 1993 budget, and covered about 40 percent of the cost of bread. The 1994 budget allocated T810 million as bread subsidy, but the subsidy was removed at the end of that year. To protect the worst affected consumers against the several-fold price increase that accompanied the removal of the subsidy, the poor were provided direct income transfers. Although the subsidy was removed, direct controls on trade markups for bread and grain products were introduced. However, these direct controls were also eliminated in April 1995. The supply response to these measures has been substantial, in terms of increased availability of bread throughout the country.

30. **Input pricing and subsidy policies.** Price controls were eliminated on 80 percent of agricultural inputs at the wholesale level and 90 percent of inputs at the retail level, shortly after independence. Farm equipment, fertilizer, pesticide, and veterinary supplies were included in the list of inputs. However, fuel products and electricity remain under administrative price controls. Direct input subsidies in the fiscal budget were sharply curtailed from about 12 percent of GDP prior to independence to about 2 percent of GDP in 1993. The input subsidy on animal fodder was eliminated in December 1994. However, direct controls on trade markups for fodder remained until April 1995, when they were also eliminated. The reforms in input price policies undertaken by the Government have been substantial, especially because traditionally farms or farmers were not required to pay for inputs.

¹ The domestic price was \$70/t compared with world prices of \$140/t for similar grades in July 1995.

31. However, an Agriculture Support Fund (ASF) established in December 1994, reintroduced direct budgetary subsidies in the agriculture sector. The objective of ASF is to provide general development support to agriculture, and resolve the bad debts of APB and other agricultural enterprises. The revised total allocation to the ASF in the 1995 budget was T3.7 billion, which was a decrease from the T5.4 billion initially proposed in the 1995 budget. However, only T1.04 billion had actually been disbursed as of mid-July 1995. Of the total disbursement through the ASF, the major expenditures included: T496 million as price support for wool and specialized meat products; T463 million for agriculture research and extension (consisting of T220 million for quality seed production, T30 million for plant protection, and T213 million for livestock breeding stock); and T30 million for fertilizer price subsidies. The support for agriculture research and extension is considered an expenditure on public goods. The reintroduction of budgetary subsidies on meat, wool, and fertilizer constitutes a retrogressive step in the reform process, because the reforms are aimed at eliminating public intervention in agricultural markets so that prices will be determined by the market and at alleviating the severe fiscal constraints faced by the Government.

32. The use of water for irrigation is regulated through the Water Code of 1993. The irrigation system is highly inefficient. The farms use almost three times more irrigation water per ha per season compared to farms in other similar regions in Asia. The serious disrepair of the irrigation system which caused large wastage of the water withdrawn from the Syr Darya, has contributed to the shrinking of the Aral Sea. Historically, charges for the cost of water as a resource have never been levied. However, charges for irrigation service have always existed, but they have only partially recovered the cost of water distribution and of the repair and maintenance of irrigation facilities. The financial subsidy on irrigation water is estimated by the Government at 50 percent of the per ha cost of irrigation. The subsidy for irrigated water represents an indirect budgetary subsidy to the agriculture sector.¹

33. **Rural credit and subsidy policies.** The traditional rural financial system virtually collapsed in the face of financial sector reforms aimed at strengthening the commercial orientation of the banking sector by eliminating credit subsidies and reducing the dependence on central bank borrowings. The use of APB to extend highly subsidized Government-directed credit to state farms and state-owned agro-industries has resulted in loan arrears roughly estimated to be at least T15 billion as of June 1995. Consequently, APB is in serious financial distress. All the Government-directed credit, including the credit extended through the APB and credit subsidies was discontinued in early 1995, as part of the Government's macroeconomic stabilization program and financial sector reforms. Since then, the commercial banks have been required to obtain funds from competitive auctions conducted by the National Bank of Kazakhstan (NBK), the central bank, and from savings mobilized from the public. Following these reforms and the substantial deceleration in inflation since early 1995, interest rates have become positive in real terms.

34. The Government has set up a high-level commission to restructure the APB. A number of measures have been taken up to restructure APB, including downsizing the staff

¹ A World Bank irrigation rehabilitation project is under preparation which will also address irrigation cost recovery policies.

by 15 percent (1,000 persons), closing nonprofitable branches, and strengthening its commercial orientation. To resolve the problem of APB's nonperforming assets arising from its administration of the Government's directed credit program, and to restore financial solvency to APB, T5.5 billion of its nonperforming assets were transferred to ASF in July 1995. The Government plans to assume all of APB's bad debts and to transfer the remaining bad debts to ASF in phases. Following the transfer, the ASF will attempt to recover the bad loans directly from the enterprises. The APB was unable to participate in the credit auctions of NBK during the first quarter of 1995 because of its financial position. The transfer of APB's debts will enable it to meet prudential safeguards of NBK. A detailed study of APB including an audit of its accounts by an international auditor is underway, and is expected to present a more complete picture of its financial position. To ensure the long-term sustainability of the most important agricultural bank, the Government is considering the privatization of APB. However, because the state farms and the state-owned agro-industries are major shareholders of APB, their divestiture has already resulted in the partial privatization of APB. Furthermore, since earlier this year, the Government has permitted other commercial banks that meet its prudential safeguards to operate in the sector. This measure will help alleviate the credit constraint faced by the sector.

35. Analyses of economic incentives in the wheat market revealed that the export tax and the monopoly market structure have together substantially depressed producer prices for grain. The consequence of low producer prices relative to high input prices has been a substantial erosion of farm profitability and a worsening of agriculture's terms of trade. Therefore, the economic incentives for producers have weakened. The monopoly market structure has also resulted in a large price spread between the retail (consumer) prices of wheat flour and the farmgate (producer) price. While the consumer price of flour was T20 per kg, the producer price of wheat was only T5 per kg, reflecting a large spread between the two prices. While the domestic consumer price of flour was T20 per kg, its equivalent border price was only T12 per kg. Thus, the implicit tax on the wheat consumer was 40 percent. Both producers and consumers are implicitly taxed relative to a free trade-cum-competitive market scenario.¹ While the elimination of subsidies have increased consumer prices for grain products and for inputs, the monopoly market structure has raised these prices even higher.

36. In mid-1995, the ratio of the domestic farmgate price of wheat to its equivalent world price was only 0.76 implying an implicit tax on the producer of 24 percent. The ratio of domestic market prices of wheat to fertilizer at farmgate was 1:3 compared to 1:2 when fertilizer and wheat were valued at their equivalent world prices (i.e., under free trade and under competitive market conditions). Thus, one ton of wheat could be exchanged for 0.33 tons of fertilizer at prevailing domestic prices, whereas one ton of wheat could be exchanged for 0.5 tons of fertilizer, if world prices were adequately reflected at the domestic farmgate level after trade liberalization and the dismantling of the monopoly market structure.

37. The value added for wheat in domestic market prices was estimated in mid-1995

¹ The large price spread between producer and consumer prices and the substantial implicit tax on both producers and consumers are symptomatic of strong monopoly influence in the domestic market for grain and grain products.

to be only about 18 percent of the value added in equivalent world prices. The effective rate of protection on wheat was therefore -0.82.¹

38. Finally, the combined net economic impact of the policy distortions from input subsidies, depressed producer prices, and credit subsidies was a total resource transfer out of the agriculture sector estimated by the World Bank at \$760 million in 1993. In 1994, the estimated resource transfer out of agriculture was reduced, but it was still estimated to be about \$500 million.² The liberalization of international trade in agricultural commodities and the dismantling of the monopoly holding companies is urgently required to strengthen the linkage between world and domestic markets for agricultural inputs and outputs and to promote a competitive market environment in the agriculture sector.

3. Addressing Social and Environmental Concerns

39. Protecting vulnerable groups is important in sustaining broad based support for the reform program during a period when real living standards have been seriously eroded. The Government is developing targeted social protection measures that are fiscally sustainable and linked to the overall macroeconomic stabilization program. The priorities are: (i) to provide budgetary cash compensation to the lowest income groups to ameliorate the impact of price liberalization; (ii) to improve unemployment benefits and retraining programs to cope with the impact of the projected growth in unemployment; and (iii) to make adequate provisions for the essential health and education services previously provided by enterprises. Among these measures, the revenue base and unemployment compensation provisions of the Employment Fund were extended to the agriculture sector in July 1995. The Government is restructuring the Pension Fund to make it more sustainable and to improve the pension benefits for the most needy. Amendments have been introduced to the Law on Pensions regarding this restructuring. In addition, a Living Standards Measurement Survey has been initiated to assess the sources and the extent of the increase in poverty. Although the Government is strongly committed to strengthening social protection, its reform efforts have been seriously constrained by the lack of resources.

40. Environmental management as it relates to agriculture is regulated by the Water, Land and Forest Codes, as well as by the general provisions of the Environmental Protection Law. The major environmental problems in the agriculture sector include the desiccation of the Aral Sea; the degradation of range lands; the use of pesticides; the increase in soil salinity and erosion; and desertification. The surface area of the Aral Sea has shrunk by nearly 50 percent since 1960 and the salinity has increased by 2.5 times, nearly the level in the world's oceans. The main cause of the desiccation of the Aral Sea is the diversion of excessive amounts of

¹ Effective rate of protection = (value added in domestic prices - value added in world prices) / value added in world prices.

² Mission's estimate. These estimates of net resource transfer from agriculture do not include the indirect impact of exchange rate over valuation. An overvalued exchange rate can result in substantial resource outflows from agriculture since most agricultural goods are tradeable. This would be particularly true of Kazakhstan up to 1994 because the tenge was substantially overvalued until then. For more details see: Rana P. and Hamid, N, ed. *"From Centrally Planned to Market Economies: The Asian Approach"*, Vol. I, Ch. 5, ADB/Oxford University Press, 1995.

fresh water for irrigation purposes, from the two major rivers that flow into it. The serious state of disrepair of the irrigation system, the excessive use of agricultural chemicals, and the lack of adequate drainage has led to extensive water logging, salinity, and graduated pollution. However, this is a regional problem involving the other Central Asian republics as well.

41. The Government is taking steps, in coordination with the other Central Asian republics, to stabilize the Aral Sea within a sustainable range. The multicountry initiative is supported by the World Bank and the United Nations Environment Programme. Among other environmental reforms, the specifications to determine the ecological zones for the country have been almost completed. Environmental indicators for land and water are in the early stages of preparation. Amendments to the Environmental Protection Law to address the serious environmental problems are expected to be drafted by the end of 1995. The country is a signatory to an international convention on desertification. While the issues of desiccation, desertification, and soil erosion are already being addressed, albeit slowly, there is also a need to begin to address problems relating to pesticide use and range land conservation.

D. Impact of Past Reforms

42. The large distortions and inefficiencies that existed in the agriculture sector for several decades under the command system imposed high economic costs on the sector that were unsustainable. Thus, it was imperative for the Government to initiate fundamental reforms to move away from the command system toward a market-based agricultural economy. In the early stages of the transition to a market-based system, it was expected that there would be sharp adjustments in economic activity as the large distortions and inefficiencies in the sector were corrected. Consequently, the inefficient agriculture sector has experienced substantial decline since the reforms were initiated. This trend is likely to continue in the medium term as the sector adjusts to its optimal size in response to market forces. Beyond this stage, the cumulative impact of past reforms and the continuing reforms such as those included under the proposed Program will stabilize agricultural output and will improve factor productivity and resource efficiency.

43. However, the transitional difficulties in terms of the loss of agricultural output and employment and the accumulated arrears in wage payments because of the Government's weak fiscal situation have inflicted severe hardships on the rural population. Agricultural incomes have been sharply squeezed as liberalized input prices increased several-fold, while adjustments in output prices lagged behind. The domestic grain prices are still well below equivalent world prices, while consumer prices are significantly above world prices. Thus, producers and consumers are implicitly taxed. However, the adjustments in output prices since 1994 have slightly improved the terms of trade. Despite these difficulties, the gains from the policy reforms are, however, increasingly evident. The net outflow of resources from the agriculture sector because of the distorted output and input price policies and credit policies had declined significantly from 1993 to 1994. Thus, conditions in the agriculture sector had already improved in 1994 and this trend is expected to continue during the period covered by the proposed Program. The past policy reforms, especially those undertaken since late 1993, have contributed substantially towards laying the foundations for a market-based agriculture sector.

E. Constraints and Issues

44. The discussion in the preceding section raised a number of major constraints and policy issues that need to be addressed to facilitate the reform process. The policy measures pertaining to these issues comprise the core of the Agriculture Sector Program. These constraints and issues are summarized below.

1. Creating Markets

45. **Land Market.** The emergence of an agricultural land market remains constrained by lack of security of land use rights granted to farm workers. The regulatory framework and the procedures for the repossession of land for public use, compensation, settlement, resolution of disputes, pledging land as collateral need clarification. The security of tenure is also constrained by inadequate clarity of the rights and interests embodied in the land use certificates issued to individual farm workers.

2. Promoting Market Competitiveness

46. **Liberalization of external trade in grains.** The effectiveness and transparency with which world market signals are transmitted to the domestic farmgate level are undermined by the export tax and the mandatory minimum export price policy for grains. These policies adversely affect marketing efficiency and weaken the link between world and domestic prices.

47. **Dismantling monopoly holding companies.** The existence of state-owned agro-industrial monopoly holding companies is the most important remaining constraint to promoting a competitive market environment in the agriculture sector. It has depressed farmgate prices of outputs and raised the prices of inputs and has seriously eroded farm incomes, and economic incentives for production.

48. **Removal of price subsidies.** The reintroduction of price subsidies on meat, wool, and fertilizer through the ASF is a retrogressive step in the reform process. It paves the way for a possible return to subsidized agriculture as the Government's resource position improves in the future. The subsidies undermine the growth of a market based agriculture sector and constitute a drain on scarce fiscal resources that could be used more efficiently elsewhere in the economy.

49. **Institutional constraints.** There is a strong need to strengthen the Government's capacity to analyze and formulate policies because the reliance on indirect policy instruments to guide resource allocation in agriculture will increase, as the transition towards a market economy progresses. At the local level, the emergence of private water user associations and farmer associations for marketing, credit, and farm equipment leasing remains constrained by the weak legal and regulatory framework, in particular the absence of a model charter for voluntary associations of farmers to promote their socioeconomic interests at the grassroots level.

50. **Commercial orientation of agricultural credit services.** The practice until 1994, of using the APB as a conduit for channeling Government-directed credit to the agriculture

sector, and the dependence of the APB on funds from NBK has seriously weakened its financial position. It does not appear to be viable in its present form. Further restructuring is required to strengthen its financial viability, while an assessment is made of alternative mechanisms to establish market-based credit and savings services in the sector.

3. Addressing Social and Environmental Concerns

51. **Strengthening social protection.** Providing social protection for the increasing number of unemployed in the agriculture sector is constrained by budgetary resources. Strengthening social protection to vulnerable groups in the sector is also constrained by budgetary resources.

52. **Strengthening environmental management.** A major unresolved issue concerns the safe disposal of old stocks of pesticides banned under existing national and international regulations. Adequate directives and guidelines are needed to address this problem. Another critical issue is to promote environmentally sustainable management of range lands, presently constrained by an inadequate policy framework.

F. Bank's Operational Strategy

53. Bank operations in the near term are likely to be influenced by three factors: (i) macroeconomic and sector weaknesses; (ii) institutional bottlenecks; and (iii) fiscal constraints. Within this context, facilitating the transition to a market economy is the principal objective of the Bank's operational strategy.¹ For the present, this objective will entail: (i) support for macroeconomic and sectoral reforms in close coordination with the IMF and the World Bank; (ii) institutional strengthening and human resource development; and (iii) support for selected infrastructure projects, consistent with economic and fiscal developments. The initial interventions of the Bank accordingly will be aimed at sector policy reform, institutional development, and growth-oriented investments that can contribute to accelerating the transition process and can put economic development on a more solid footing. An overriding short-term concern is to ease the fiscal crisis and foreign exchange constraints by providing quick-disbursing assistance in support of sector reform and capacity building to revive production and limit the impact of falling living standards. The policy-based lending operations will be closely coordinated with other aid agencies, particularly the World Bank.

54. The capability of the Bank to finance investment projects at the present time is inhibited by logistical and absorptive capacity constraints. The initial investment operations of the Bank will focus on the rehabilitation of infrastructure. Care will be taken to ensure that projects are within the implementation capability of the Government and that these will be sustainable. To support institutional development and reform, the Bank may initiate pilot projects and technical assistance to build needed capacities and skills. Special attention will be given to strengthening capacities for sound environmental management and regulation, enhancing social safety net mechanisms, and protecting vulnerable groups during the transition to a market economy.

¹ See Informal Board paper on "The Bank's Interim Country Operational Strategies in Kazakhstan and the Kyrgyz Republic" circulated on 23 December 1993.

55. The Government's agriculture reform program evolved slowly until 1994, but since then the pace of reform has been stepped up. The Bank's strategic sectoral objective, accordingly, is to strengthen and accelerate that program with a view to establishing a competitive, market-based agriculture sector. Among the issues identified are: (i) land reform; (ii) market restructuring; (iii) enterprise reform; (iv) rural finance; and (v) water resource management. In addition, social and environmental protection issues will need to be addressed within the Bank's sectoral agenda. The strengthened reform program will include support for: (i) the stabilization of agricultural production and farm incomes; (ii) an improvement in the productivity of rural labor and a reduction in rural poverty; (iii) the establishment of market-determined prices; (iv) an improvement in market access and marketing options; (v) the enhancement of backward and forward linkages of the farming sector; and (vi) an improvement in natural resource management.

G. External Assistance to the Sector

56. In the agriculture sector, thus far, external assistance has mainly been technical assistance rather than loans for investments in projects. While much of this support has been directed at national sectoral policy issues, some of it has been directed at the regional level, in the form of pilot projects.

57. The Technical Assistance from the Commonwealth of Independent States (TACIS) program of the European Union (EU) has been particularly active in the sector. Grant funding has been provided for institutional support to the Ministry of Agriculture in: (i) policy formulation covering marketing, import and export, cooperatives, and the improvement of agricultural statistics; and (ii) the upgrading of milk, meat, fresh produce, and animal feed processing, and marketing. The TACIS program has also supported the improvement and availability of farm machinery and equipment at the national level. Its other interventions have been at the regional level including support for: (i) small private farms in Almaty and Taldy Kurban as well as for food produce wholesale and retail operations in Almaty City; (ii) cooperatives and private food distribution systems as well as research and training center for private farming and private food processing in Kazpotreboysuz and Akmola; and (iii) the reorganization of the food processing sector in Aktiubinsk.

58. In addition, the EU has helped to establish project preparation units. These units assist the NBK in identifying and formulating agro-processing projects for possible financing. Related to this development, the European Bank for Reconstruction and Development (EBRD) has had under consideration a number of investments in projects including meat, dairy and wool processing as well as grain silos. In some cases such investments would come under the purview of the NPP.

59. Among the bilateral aid agencies, Germany has been particularly involved at the regional level, including support for: (i) the restructuring of agriculture and food processing in south Kazakhstan; (ii) agricultural training and advice in Uralsk; and (iii) support for the upgrading of trainees, graduates, and lecturers at the University of Agriculture in Akmola. By contrast, the program of the United States Agency for International Development (USAID) has focused on national policy issues. Those of relevance to the agriculture sector have included its assistance to the privatization program and, in particular, to the drafting of land legislation

and commercial laws. It has also been involved in a farmer-to-farmer program assessing assistance needs for postharvest processing, distribution and marketing as well as for extension services, and in microenterprise credit.

60. The World Bank undertook an agriculture sector review in 1994 and has processed technical assistance studies that will support the formulation of projects with policy components, such as land registration and titling as well as farm restructuring projects. In addition, the World Bank is at an advanced stage of processing an irrigation rehabilitation project, formulated with assistance from the Japan International Cooperation Agency (JICA) and a financial sector adjustment loan. Furthermore, the World Bank approved in 1995 a Social Protection Project that addresses: (i) the development of the capacity of the Employment Service of the Ministry of Labor; and (ii) the promotion of the orderly divestiture of social assets from enterprises and efficient management by municipalities of a unified system of social services.

61. Of particular interest in the context of the proposed Program are the Government's measures aimed at macroeconomic stabilization and structural reform under the second Upper Credit Tranche Stand-by Arrangement with the IMF and the Structural Adjustment Loan supported by the World Bank, which were both approved in June 1995. The objectives of these reform programs are to reduce monthly inflation to low single digits, to restructure enterprises and to establish a supporting regulatory framework. In support of these objectives, fiscal and monetary policies will continue to be tight and, in the external sector, trade liberalization measures will be implemented to promote exports.

62. Some of the specific measures to be taken include: (i) accelerating the process of asset valuation and titling under the transfer of ownership of state farms; (ii) incorporating the value of land use rights as enterprise assets; (iii) enacting the draft land legislation; (iv) further liberalizing of the export regime; (v) including of agro-enterprises in the NPP; (vi) implementing a plan to privatize the grain storage facilities of Astyk and half the number of flour mills, feed mills and macaroni plants; (vii) completing the management contracts and case-by-case privatization of six large state enterprises; (viii) increasing the number of enterprises to be auctioned each month under the mass privatization program; (ix) adopting a commercial banking law; (x) improving prudential safeguards and regulations in the banking sector, and improved banking supervision; (xi) eliminating directed credits and restructuring access to NBK credit auctions to banks in good prudential standing; (xii) restructuring the largest commercial banks for which diagnostic studies have been undertaken; (xiii) adopting a revised bankruptcy law and law on secured transactions; (xiv) establishing units in banks to manage nonperforming assets; (xv) reforming the unemployment benefit system; and (xvi) designing a budgetary mechanism to finance the social services divested by enterprises.

63. Consultations with the World Bank was part of the dialogue with other aid agencies active in agriculture and related sectors. In areas of common interest such as trade liberalization, reduction of state-controlled grain storage facilities, irrigation, rural credit, and social protection, efforts were made to ensure complementarity and commonality of objectives. As in the case of formulating reform measures under the proposed Agriculture Sector Program, consultations were held with the World Bank, USAID, and the EU to coordinate the terms of reference of the two technical assistance (TA) studies proposed in conjunction with the Program.

IV. THE PROGRAM

A. Rationale

64. The agriculture sector is undergoing fundamental structural changes and has reached a critical stage in the ongoing transition to a market economy. The sector contributes a substantial share of GDP, and a large proportion of the country's labor force depends on agriculture for its income. The implementation, in a short period of time, of fundamental reforms in the agriculture sector, despite serious transitional difficulties, reflects the Government's vision and strong commitment to the reform process. While there are high financial and social costs involved and the Government's resource position is severely strained, the costs of not adjusting are much higher. The Program will deepen and widen the scope of the reforms by addressing a number of critical constraints facing the agriculture sector at the present stage in its transition. It will improve productivity and efficiency, and promote socioeconomic equity. The Government has so far managed the transition quite well, but the reform program needs to be further strengthened at this juncture. The proposed Agriculture Sector Program is designed to ensure the continuity of the reform process, and thereby to support a stable transition of the agriculture sector towards a competitive market-based system. Furthermore, the Program is an important component of the Government's overall structural adjustment program for the economy.

B. Objectives

65. The objective of the Program is to strengthen substantially the reform process, by establishing a competitive, market-based agriculture sector. In strengthening the reform process, a number of specific policy objectives will be realized. The Program will increase the security of land tenure, strengthen workers' property rights in farm enterprises, encourage the efficient use of agricultural land, provide incentives for investment in land, accelerate the liberalization of international trade in agricultural commodities, and ensure market-based farmgate prices for agricultural products by enhancing competition in the domestic market. The Program will also reduce Government intervention in the domestic agricultural market, strengthen the Government's capacity for agricultural policy formulation and analysis, promote the growth of voluntary farmer associations, strengthen the commercial orientation of rural credit and savings services, strengthen social protection to vulnerable groups, and strengthen environmentally sustainable management of the agriculture sector.

C. Program Scope

66. The Program, to be implemented over two years, will cover three broad areas: creating markets, promoting market competitiveness, and strengthening social and environmental protection. Within these broad areas, the Program includes eight areas of policy reform: (i) land reform; (ii) trade policy reform; (iii) reform of the agricultural market structure; (iv) domestic procurement and price policy reforms; (v) strengthening the capacity for analysis of agricultural policy; (vi) institutional reform; (vii) reform of rural financial markets; and (viii) social and environmental protection. A summary of the reform measures under the Program is given below.

1. Creating Markets

67. The Program measures under this part emphasize the implementation of key aspects of Government laws and decrees relating to the resolution of disputes concerning agricultural land, the provision of compensation in the event of repossession of agricultural land by the Government, the registration of rights in agricultural lands, and the pledging of agricultural land use rights as collateral. Other policies relate to the confirmation of the legal rights and interests represented by the land share certificates being issued to farm workers in the privatized state farms, and the transfer of ownership of the remaining state farms to private entities.

2. Promoting Market Competitiveness

68. The Program includes important measures to liberalize further external trade in grains and to promote competition in domestic agriculture markets. The policy reforms also aim at substantial further reduction of direct Government interventions in the form of budgetary subsidies. A review of the pricing policies for irrigation water and the establishment of a system for the collection of irrigation and user charges is also envisaged. Institutional reforms comprising capacity building in the Ministry of Agriculture (MOA) at the national level, and the preparation of a model charter to promote the growth of voluntary grassroots farmer associations at the local level are also included. In addition, reform measures to accelerate the restructuring of APB, and the preparation of a plan to restructure rural credit and savings services are envisaged.

3. Addressing Social and Environmental Concerns

69. Social protection is addressed under the Program through measures to mitigate adverse impacts of the reforms. These measures include improving access to alternative employment opportunities, and strengthening the provision of direct benefits to those worst affected by the process of transition in the agriculture sector. On the environment side, the reform measures address concerns relating to the safe disposal and use of banned pesticides and the sustainable management of range lands.

D. Program Measures

1. Creating Markets

70. The policy measures relating to land reform under the Program comprise two areas, viz., the legal and regulatory framework for land rights and the transfer of ownership of state farms to private entities. Reforms in these areas are needed to encourage the growth of a market for agricultural land. The Program will strengthen the security of land rights by undertaking a number of key measures. The Government will issue decrees and/or regulations to establish transparent procedures for: (i) state repossession of agricultural land where required to meet public needs; (ii) compensation and resettlement in cases of state repossession of agricultural land; (iii) registration of rights in agricultural land, consistent with the proposed new land code and the law on registration of rights in immovable property and related transactions; (iv) resolution of disputes concerning rights in agricultural land; and

(v) assignment of agricultural land use rights as collateral for loans. To strengthen farm workers' property rights in the privatized state farm enterprises, the Government will issue decrees and/or regulations confirming the legal status of land share certificates provided to the individual farm workers in privatized farm enterprises. These clarifications will follow a review of existing legislation relating to the privatization of state farms and the associated land rights.

71. To underscore the importance of unambiguous property rights and the security of land rights, the Program specifies the issuance of decrees and/or regulations to (i) establish transparent procedures for the registration of rights in agricultural land, and (ii) confirm the legal status of land share certificates issued to farm workers in privatized farm enterprises, as conditions to the release of the second tranche of the loan.

72. As part of the policy dialogue initiated earlier this year under the Program, the Government transferred 306 additional state farms to private entities by the end of June 1995. About 100 state farms need to be retained under state ownership for agricultural research purposes. Except for these 100 state farms, the Government will transfer all remaining state farms to private entities under the Program. These reform measures will complete the process of ownership transfer of state farms.

2. Promoting Market Competitiveness

a. Trade Policy Reforms

73. In a major step towards accelerating the liberalization of international trade in agricultural commodities, the Government will abolish the export tax on grains, prior to and as a condition to the release of the second tranche of the loan. The Government will also discontinue the practice of setting minimum export prices for grains. These measures will reduce bureaucratic impediments to export growth and improve the transparency of price signals in domestic markets. Thus, economic incentives are expected to improve significantly, paving the way for long-term investment in the agriculture sector.

b. Reform of Agricultural Markets

i. Dismantling the Monopoly Holding Companies

74. The existence of 13 vertically integrated monopoly holding companies at the national level that dominate the marketing, processing, and trade in agricultural commodities greatly distort economic incentives for producers. To strengthen farmgate product prices and to lower input prices by enhancing competition in the domestic markets, the Government has, as part of the policy dialogue under the Program, liquidated 8 of the 13 monopoly holding companies. The remaining 5 monopoly holding companies will also be liquidated prior to and as a condition to the release of the second tranche of the loan. This policy action under the Program will complete the process of dismantling all state monopoly holding companies at the national level in the agriculture sector. To follow up the process of dismantling monopoly structures in agricultural markets, the Government will also prepare a program to liquidate state-controlled monopoly holding companies at the regional level. Furthermore, this measure, along with the external trade liberalization measures, will substantially correct the existing

misalignment between world prices and domestic farmgate prices of agricultural products. The Government will also divest its remaining shares in Astyk's grain elevators through the NPP.

ii. Domestic Procurement and Price Policy Reforms

75. As part of the policy dialogue under the Program, the Government has already undertaken two key measures to reduce Government intervention in domestic agricultural markets. First, the Government established a market-based system of grain procurement through competitive auctions administered by the KIAE in April 1995. Second, the Government eliminated direct controls on trade markups for grain, bread, and fodder in April 1995. These measures have strengthened farmgate prices of grain and have also increased the domestic availability of bread and fodder.

76. Under the Program, the Government will continue to keep agricultural inputs free of direct budgetary subsidies. To improve the efficiency of market-based resource allocation, the Government will also: (i) make all budgetary expenditures and allocations extended through the ASF fully transparent and develop an expenditure reporting system for ASF acceptable to the Bank; (ii) phase out direct subsidies on fertilizer under the ASF, prior to and as a condition to the release of the second tranche of the loan; (iii) phase out price supports to meat and wool provided through the ASF; and (iv) review under TA the effectiveness of ASF expenditures and restructure the ASF, as appropriate.¹

77. To improve the efficiency of water used for irrigation, the policy framework needs to be strengthened. The Government will review under TA the pricing policies for irrigation water and will determine appropriate user charges for the different irrigation systems.² The Government will also establish procedures for setting and collecting irrigation user charges.

c. Institutional Reform

i. Capacity for Policy Analysis

78. The need to strengthen the Government's capacity for agricultural policy formulation and analysis will be addressed through a TA. Under this TA, the Government will establish an information system to collect and analyze market and socioeconomic data to strengthen the basis for analysis and formulation of policy.³

ii. Reform of Grassroots Institutions

79. The Program will also promote the growth of voluntary farmer associations in important agricultural activities. Under, TA⁴, the MOA and other concerned ministries will review the existing legal and regulatory framework for agricultural cooperatives and other

¹ See para. 100 and Appendix 2.

² See para. 100 and Appendix 2.

³ See para. 100 and Appendix 2.

⁴ See para. 100 and Appendix 2.

associations, prepare a model charter for voluntary farmer associations, and prepare decrees and/or regulations to facilitate the formation of voluntary farmer associations. Secondly, the Government will issue decrees and/or regulations to facilitate the formation of voluntary farmer associations, especially for the purposes of marketing, credit, and leasing farm equipment.

d. Reform of Rural Credit and Savings Services

80. As part of the policy dialogue under the Program, the Government transferred T5.5 billion of APB's nonperforming assets to the ASF in July 1995 to resolve the large debt problem of APB caused by the Government's directed lending policy. The Government will undertake a number of other measures to strengthen the commercial orientation of rural credit and savings services. First, the external audit of APB's 1994 accounts will be completed in accordance with international auditing practice. Second, the Government will determine the value of its remaining shares in APB. Third, the Government will prepare a timebound plan to divest substantially its remaining shares in APB.

81. To alleviate the serious difficulties in rural credit, NBK, as part of the policy dialogue under the Program, has permitted commercial banks (other than APB) that meet NBK's prudential safeguards to operate in the rural sector since April 1995. The NBK will also prepare a timebound plan, under TA, to restructure rural credit and savings services.¹

3. Social and Environmental Protection

a. Social Protection

82. As part of the policy dialogue under the Program, the Government extended the Employment Fund to include the agriculture sector in July 1995. The measure will strengthen social protection to farm workers hard hit by the transition. A number of other key reform measures will be undertaken by the Government to strengthen social protection to groups adversely affected by the transition. The Government will increase the 1995 budget of the Employment Fund from T3.0 billion to T3.5 billion and maintain the level at T3.5 billion in the 1996 budget, prior to and as a condition to the release of the second tranche of the loan. Consistent with its macroeconomic stabilization program and in further consultation with the Bank, the Government will include in the 1996 national budget an amount not less than the 1995 budget allocation of T2.6 billion, as targeted cash compensation to meet essential needs of vulnerable groups prior to and as a condition to the release of the second tranche of the loan. Also, the Ministry of Labor will develop appropriate training programs for unemployed agricultural workers, especially women, to assist them in acquiring skills suitable for the growing service sector. Furthermore, under TA, MOA will monitor and evaluate the impact of the reform measures under the Program on vulnerable groups.²

¹ See para. 103 and Appendix 3.

² See para. 100 and Appendix 2.

b. Environmental Protection

83. To strengthen sustainable management of the environment in the agriculture sector, the Government will undertake several important measures. The Government will compile an inventory of the old stocks of pesticides banned under existing regulations; it will issue directives and/or guidelines for disposal of the old stocks of banned pesticides; and it will also review and amend, as necessary, its existing pesticide regulations to ensure conformity with those recommended by Food and Agriculture Organization of the United Nations (FAO), prior to and as a condition to the release of the second tranche of the loan. In addition, the Government will prepare, with TA,¹ policy recommendations for the sustainable use of range lands which is probably Kazakhstan's most important agricultural resource, and the key to future development of its livestock sector.

E. Policy Dialogue

84. A wide range of policy issues concerning the agriculture sector at the present stage of transition has been discussed with the Government since early 1995. These issues include agricultural markets, land reform, state enterprise reform, institutional reform, rural finance, social protection, and sustainable management of land and water resources. The Bank staff were able to reach agreement with the Government on a number of substantial reform measures. These measures have been included in the Program. A number of these measures have been implemented in the course of the policy dialogue initiated earlier this year and as part of the Program. These include the transfer of 306 state farms to private entities; liquidation of eight state-owned monopoly holding companies; establishment of a competitive auction market for grains; elimination of direct controls on trade mark-ups for grain, bread, and fodder; transfer of T5.5 billion of APB's bad debts to ASF; permission to commercial banks other than APB to operate in the rural sector; and extension of the Employment Fund to the agriculture sector.

85. The Program will be supported by two Bank-funded TAs to study (i) market reform in the agriculture sector, and (ii) the restructuring of rural credit and savings. The outcome of the two TAs will provide inputs to continue the policy dialogue on further liberalization of agricultural markets and rural financial markets, in particular, the removal of subsidies and other public interventions that may yet remain in these markets. There also remain issues, about the sustainable management of water resources, rural credit and further deregulation of the livestock sector that could not be addressed under the present Program. Other issues will also emerge in the course of future policy dialogue. Such issues will have to be addressed within the context of a future program loan for the sector. The dialogue will continue to ensure the Government's commitment to policy reforms during the course of implementation of the Program, as well as during the processing of subsequent Bank assistance to the Government.

¹ See para. 100 and Appendix 2.

V. PROPOSED BANK ASSISTANCE

A. The Loan

86. It is proposed that the Bank support the Government's agriculture sector reforms by providing a loan of \$100 million to support the Agriculture Sector Program. The Borrower will be the Republic of Kazakhstan. The loan will be made available from the Bank's ordinary capital resources and will be amortized over a period of 15 years, including a grace period of 3 years. Interest on the loan will be calculated in accordance with the Bank's pool-based variable lending rate system for US dollar loans. A commitment charge of 0.75 percent per annum will also apply.

87. The loan is expected to be utilized over a period of 18 months. The loan will be released in two equal tranches. The first tranche will be made available upon loan effectiveness. It is envisaged that the second tranche will be released by December 1996, or about 12 months after the first tranche. Prior to the release of the second tranche, the Government will be expected to meet the conditions for its release and to make satisfactory progress in the implementation of the overall Program.

B. Tranche Conditions

88. Eight measures have been specified as conditions for the release of the second tranche of the loan based on their importance in achieving the objectives of the Program. These include: (i) the issuance of decrees and/or regulations establishing transparent procedures for registration of rights in agricultural land (expected by June 1996); (ii) the issuance of decrees and/or regulations confirming the legal rights and interests of farm workers in privatized farm enterprises (expected by September 1996); (iii) the abolition of the export tax on grain (expected by September 1996); (iv) the issuance of decrees or resolutions to liquidate the five remaining agro-industrial monopoly state holding companies (expected by September 1996); (v) the elimination of direct subsidies on agricultural inputs under the ASF (expected by September 1996); (vi) an increase in the 1995 budget of the Employment Fund from T3.0 billion to T3.5 billion, and maintaining this level of funding in the 1996 budget (expected by March 1996); (vii) the provision of cash compensation in the 1996 budget of an amount not less than the 1995 budget allocation of T2.6 billion (expected by March 1996); and (viii) a review of and amendments, as necessary, to the existing pesticide regulations to ensure they conform with FAO recommendations (expected by September 1996).

C. Implementation Arrangements

1. Program Execution and Coordination

89. The Ministry of Finance (MOF) will be the Executing Agency for the Program. In this capacity, MOF will be responsible for overall implementation of the Program. Under authorization from the MOF, the Committee for Utilization of Foreign Capital (CUFC) will make withdrawals under the loan and manage the imprest account (see paragraph 95 below). The documentation required for withdrawals under the loan, and accounts and records related to the imprest account and the use of the loan proceeds, will be prepared by the Project

Implementation Unit.¹ Implementation of the Program will involve MOF, MOA, CUFC, NBK, State Property Committee, State Committee on Privatization, Ministry of Justice, State Committee on Land Relations and Land Use Planning, the Ministry of Industry and Trade, the State Committee on Price and Antimonopoly Policy, the State Committee on Water Resources, the Ministry of Social Protection, the Ministry of Labor, and the Ministry of Ecology and Bioresources. The staff of the Cabinet of Ministers² will have responsibility for (i) ensuring that the policies adopted and the actions undertaken under the Program prior to loan effectiveness will continue in effect as required under the Program, (ii) ensuring the prompt adoption or undertaking of all other policies and actions included in the Program, and (iii) consulting with, and periodically reporting to, the Bank on the progress of the Program.

90. To ensure effective coordination during the implementation of the Program, a high-level Program Coordination Committee (PCC) will be formed under the chairmanship of the Deputy Prime Minister responsible for agriculture. The PCC will comprise representatives of MOF, CUFC, MOA, and other key ministries and agencies involved in implementation of the Program.

2. Eligible Items

91. The loan proceeds will be disbursed against imports, provided that the imports are produced in and procured from the Bank's member countries and that they are not included in the negative list in Appendix 1.

3. Procurement

92. For the procurement of eligible commodities which are commonly traded in the international markets, the supply contract may be awarded on the basis of normal commercial practices and procedures appropriate to the trade and acceptable to the Bank. For other eligible items financed under the loan and estimated to cost more than the equivalent of \$5 million, supply contracts must be awarded on the basis of international competitive bidding (ICB) procedures in accordance with the Bank's *Guidelines for Procurement*. Each supply contract estimated to cost the equivalent of \$5 million or less may be awarded on the basis of normal commercial procurement practices acceptable to the Bank, in the case of procurement by the private sector, or in accordance with the Government's procurement procedures acceptable to the Bank, in the case of procurement by the public sector.

93. The award of contracts for eligible items requiring ICB valued at more than \$5 million equivalent will be subject to Bank review prior to disbursement of the loan proceeds. To facilitate the review, the Government must provide the Bank with two conformed copies of each contract and such other information as the Bank may require from time to time. In relation to contracts for eligible items equivalent to \$5 million or less, which may be financed out of the imprest account, the Government must provide, together with the relevant statement

¹ The Project Implementation Unit was established within CUFC in connection with the Bank's Special Assistance Project [Loan Nos. 1337/1338(SF)-KAZ, December 1994].

² Under the new Constitution adopted in August 1995, the Cabinet of Ministers has been renamed "the Government".

of expenditures, certification that the expenditures have been incurred in accordance with the terms and conditions of the Loan Agreement and that supporting documents are available for inspection by the Bank. The Bank reserves the right to withhold disbursement of funds, or to seek reimbursement, if the Bank's subsequent review reveals that the procurement procedures agreed upon have not been followed.

4. Withdrawals and Disbursements

94. Except as described in this paragraph and the following paragraph, the proceeds of the loan will be withdrawn in accordance with the Bank's standard withdrawal procedures. Expenditures for eligible items imported within 180 days prior to the date of loan effectiveness will qualify for reimbursement.

95. An imprest account will be established at NBK to facilitate the timely release of loan proceeds. All import contracts for eligible items costing the equivalent of \$5 million or less may be financed from the imprest account. The Bank's statement of expenditures procedures will be utilized for reimbursement, and liquidation of expenditures from the imprest account for any import contracts for eligible items not exceeding \$5 million equivalent. The imprest account will be operated and maintained in accordance with the Bank's *Guidelines on Imprest Fund and Statement of Expenditures Procedures*.

5. Use of Counterpart Funds

96. The counterpart funds to be generated from the proceeds of the loan will be used by the Government to support the transition of the agriculture sector to a market based system.

6. Audits and Reports

97. Separate accounts and records will be maintained for the imprest account and will be audited annually by independent auditors acceptable to the Bank. Within six months after the end of each fiscal year during the period covered by the Program, and within six months after the closing date of the loan, the Government will furnish the Bank with certified copies in the English language of the audited accounts and records for the imprest account for the relevant period. In addition, the Government will keep the Bank informed about the progress of the Program and, more specifically, about the attainment of targets and the implementation of measures included in the Program. Within three months after the closing date of the loan, the Government will also provide a written report to the Bank on the implementation of the Program, including its cost and achievements.

7. Program Monitoring

98. Missions from the Bank will regularly review progress and continue the policy dialogue. The two TA studies to be carried out in conjunction with the Program will also provide information required to monitor the implementation and the impact of the reform measures under the Program. The Government has initiated a living standards measurement survey, which is expected to be completed by the end of 1995. The survey will provide information on the reform process in the agriculture sector. It would be desirable to undertake

a comprehensive review of the agriculture sector reform process towards the end of 1997. The Government will evaluate the benefits of the Program according to the terms of reference and a time schedule to be agreed upon between the Government and the Bank.

D. Technical Assistance

99. The Government has requested advisory TA for: (i) a Study on Market Reform in the Agriculture Sector; and (ii) a Study on Rural Credit and Savings. The details of the two TAs are given in Appendix 2 and Appendix 3, respectively.

1. Market Reform in the Agriculture Sector

100. The ongoing transition to a market economy under the Program may not be attainable without a sound understanding of key policy issues in the sector. The TA will (i) investigate the important policy issues in the agriculture sector to obtain a comprehensive understanding of the key constraints and to recommend further reform measures or improvements; (ii) monitor the impacts of the reform measures; and (iii) strengthen the capacity of the Government in policy analysis, formulation, implementation, and monitoring.

101. A total of 27 person-months of international consulting services will be required for the TA. In addition, a total of 27 person-months of local consultants will be required for survey and translation, as well as for the training of Government officials. An international consulting firm with extensive experience in agricultural policy analysis will be recruited in accordance with the Bank's *Guidelines on the Use of Consultants*. The local consultants will be recruited by the international consulting firm in consultation with the Bank. The TA will be implemented by MOA. The detailed terms of reference of the TA are in Appendix 2.

102. The TA will be implemented over a period of approximately 11 months. The estimated cost of the TA is \$1,100,000 equivalent comprising \$832,000 in foreign exchange and \$268,000 equivalent in local currency. The entire foreign exchange cost of \$832,000 and part of the local currency cost (\$212,000 equivalent) amounting to \$1,044,000 equivalent is proposed to be provided by the Bank as a grant and charged to the Bank-funded TA program. The Government will contribute in kind the remaining local currency costs estimated at \$56,000.

2. Rural Credit and Savings

103. The objective of the TA is to assist the Government in reforming the rural credit and savings services by promoting a market-based rural credit system; mobilizing rural savings; expanding credit, including investment credit for the private sector; and addressing the financial intermediation needs of poor farm households and women.

104. A total of 12 person-months of international consulting services will be required for the TA. In addition, a total of 12 person-months of local consultants will be required to assist the international consultants in the collection of data as well as to facilitate the survey and the interviews. An international consulting firm with extensive experience in rural finance will be recruited in accordance with the Bank's *Guidelines on the Use of Consultants*. The local consultants will be recruited by the international consulting firm in consultation with the Bank.

The TA will be implemented by NBK. The detailed terms of reference of the TA are in Appendix 3.

105. The TA will be implemented over a period of approximately eight months. The estimated cost of the TA is \$500,000 equivalent comprising \$398,000 in foreign exchange and \$102,000 equivalent in local currency. The entire foreign exchange cost of \$398,000 and part of the local currency cost (\$72,000 equivalent) amounting to \$470,000 equivalent is proposed to be provided by the Bank as a grant and charged to the Bank-funded TA program. The Government will contribute in kind the remaining local currency costs estimated at \$30,000 equivalent.

VI. PROGRAM IMPACT, RISK, AND JUSTIFICATION

A. Program Impact

106. The reform measures under the Program will enable the agriculture sector to adjust to its optimal size based on its comparative advantage. This implies substantial increases in the sector's factor productivity and resource efficiency. The emergence of a market for agricultural lands resulting from greater security of land tenure and the transfer of ownership of state farms to private entities will pave the way for long-term investments in land. The further liberalization of external trade will permit world market price signals to be more clearly reflected in the domestic markets, including at the farmgate level, thereby greatly improving the efficiency of resource allocation. Combined with the trade liberalization measures, the dismantling of the monopoly holding companies, the shift to a competitive grain procurement system, and the elimination of direct controls on trade mark ups will raise grain prices received by farmers and lower fertilizer prices. Thus, farm incomes will increase and the terms of trade of agriculture will improve. The large spread between producer and consumer prices in the grain market are expected to diminish substantially as the existing misalignment between domestic and world prices is corrected and the monopoly market structure is dismantled. The elimination of price subsidies on meat, wool, and fertilizer will promote market-based resource allocation and free the scarce fiscal resources of the Government for more important uses elsewhere in the economy. The reformulation of water pricing policies for irrigation purposes will permit the true scarcity value of irrigation water, the most scarce agricultural resource, to be reflected in user charges to be paid by farmers. The Government's capacity for policy formulation and analysis and for monitoring the impact of the reform process will be strengthened through TA.

107. The Program includes measures to strengthen the legal and regulatory framework for voluntary farmer associations, which will promote the growth of grassroots farmer's associations, independent of the traditional cooperative arrangements. The measures will promote the disadvantaged private farmers' socioeconomic interests, and will also promote mutually beneficial pooling arrangements for product marketing, irrigation services, and farm equipment leasing, all of which presently constrain the rapid growth of private farming. The commercial orientation of the APB, the predominant agricultural credit institution, will be greatly strengthened and the foundations for the emergence of market-based rural credit and savings services will be established.

108. The Program also includes measures to strengthen social protection to those hardest hit by the transition process. The environmentally sustainable management of agriculture will be strengthened through new directives for the safe disposal of hazardous pesticides and new policies for range land conservation.

109. A poverty impact assessment (PIA) has been conducted of the measures under the Program. The details of the PIA are in Appendix 4. As shown in the PIA, most of the adverse impacts occur in the labor market, because open unemployment may rise as a result of the transfer of ownership of state farms, the phasing-out of agricultural input subsidies, the restructuring of APB, and the dismantling of monopolistic holding companies. However, these adverse impacts should not be overestimated. Currently a large amount of hidden unemployment in the agriculture sector already exists, and many farm workers although employed, have not been paid for several months because of the severe financial difficulties in the agriculture sector. Thus, workers, unable to rely on wages and salaries as their major source of family income, are increasingly turning to household farming for subsistence, such as raising cattle and poultry and growing vegetables and fruits on small garden plots. The opportunity for subsistence farming will, therefore, cushion the negative impact of a rise in open employment. Of greater concern, however, is the loss of access to social services that will accompany the shift from hidden to open unemployment. However, it is expected that the negative impact will only be temporary, because in the medium term, local governments will provide the social services. In addition, the rural unemployed will be absorbed in the rural service sector. The PIA also reveals that in most cases, the positive impacts resulting from enhanced market competition, strengthened farmgate prices, increased credit supply, and revived agricultural production will be large enough to offset the temporary negative impacts, resulting in a net effect that is beneficial to the poor in the medium to long term. The negative short run impacts on public transfer are also expected to be temporary and will be offset in the long run.

110. Nevertheless, mitigation measures have been included under the Program to protect those who will be adversely affected in the near term. The mitigation measures include (i) providing training programs for the unemployed in the agriculture sector; (ii) extending the Employment Fund to cover the agriculture sector; (iii) increasing the budget of the Employment Fund; and (iv) ensuring adequate budget allocation for cash compensation to meet the essential needs of vulnerable groups. Furthermore, a monitoring system will be established under the Program with TA, to monitor closely both the implementation of the reform measures and their impact on the beneficiaries in the agriculture sector.

111. The overall impact of the Program is expected to be highly positive because it will stimulate early recovery of the agriculture sector and thereby contribute substantially to the overall recovery of the economy. The reforms under the Program will increase producer incomes and stabilize agricultural production and rural employment, and hence, reverse the declining living standards in the sector.

B. Program Risk

112. The principal risks associated with the proposed Program are: (i) the inadequate institutional capacity, in the face of the country's economic crisis and the restructuring of Government ministries, departments, and agencies; (ii) the differences in outlook and

commitment to reform between the central and local authorities; and (iii) the delays in implementation of key policy measures under the Program.

113. The Executing Agency, MOF, is capable of implementing the overall Program. To ensure smooth implementation of the Program, the staff of the Cabinet of Ministers will directly supervise the implementation of key aspects of the Program. The MOA, which will have substantial responsibility for implementing specific measures, has been provided with TA ¹ by the Bank to strengthen its capabilities. The Project Implementation Unit of CUFC which will be responsible for documentation and day-to-day operation of the imprest account under the loan, has acquired substantial experience with the Bank's requirements, because it had a similar role under the Bank's Special Assistance Project. The Bank's Inception Mission and subsequent Review Missions will provide further guidance to ensure that the proper procedures for the disbursement of the loan funds are followed.

114. The ongoing reform process has required frequent restructuring of Government ministries, departments and agencies to develop the appropriate institutional structures required to support the transition. While this process of restructuring is likely to continue throughout the period covered by the Program, it is not viewed as a major risk because the main aim of the restructuring is to strengthen the reform process. The implications of the restructuring on the implementation of the Program, has been discussed at length with Government officials and the Government is aware of the Bank's concerns.

115. Substantial differences in outlook and commitment to specific reforms appear to exist among the different Government agencies and between the central and local authorities. Although it is difficult to assess the risk of a slowdown in the reform process from these differences, there appears to be broad-based support for the reform process. Accordingly a major slowdown, much less a reversal, of the overall agricultural reform process is considered highly unlikely. This view is strengthened by the speed at which fundamental reforms in the agriculture sector have been carried out in the recent past.

116. With regard to delays in the implementation of the Program, the usual risk of policy reforms applies in that unforeseen developments may impede full compliance with specified measures under the Program within the indicated target dates. To minimize such risks, the measures included in the Program have been carefully assessed and selected to enable the Government to undertake the policy actions on schedule, including those specified as second tranche conditions.

C. Program Justification

117. The substantial policy measures to be undertaken under the Agriculture Sector Program in order to sustain the reform process, the strong commitment by the Government to the Program, and the expected benefits of the Program provide adequate justification for the assistance from the Bank to meet part of the adjustment costs of the Program. The Government has incurred significant financial costs in implementing the past reforms, and substantial costs will be incurred in the future during the implementation of the Program.

¹ TAR No. 28425-KAZ: Strengthening the Implementation of Agriculture Sector Reforms, July 1995.

Strengthening the legal and regulatory framework for agricultural land rights is directly related to the Government's program of issuing of land share certificates to individual farm workers. This program alone is estimated to cost about \$90 million. The removal of the export tax will result in a loss of about \$40 million a year in revenue over the medium term. The shift to a competitive public grain procurement system will result in a net additional expenditure of about \$40 million a year over the medium term due to higher grain prices. The fiscal measures to strengthen social protection will involve \$8 million a year over the medium term. The total financial adjustment cost of the Program on account of these measures is estimated to be \$400 million in present value terms in 1996¹ which is substantially higher than the proposed loan amount for the Program.²

VII. RECOMMENDATIONS

118. I am satisfied that the proposed loan and technical assistance would comply with the Articles of Agreement of the Bank and recommend that the Board approve:

- (i) the loan of \$100 million to the Republic of Kazakhstan for the Agriculture Sector Program from the Bank's ordinary capital resources, with interest to be determined in accordance with the Bank's pool-based variable lending rate system for US dollar loans and with an amortization period of 15 years, including a grace period of 3 years, and such other terms and conditions as are substantially in accordance with those set forth in the draft Loan Agreement presented to the Board; and
- (ii) the technical assistance of \$1,044,000 equivalent, on a grant basis, to the Government of the Republic of Kazakhstan for the Study on Market Reform in the Agriculture Sector.

MITSUO SATO
President

25 October 1995

¹ A medium-term time horizon of five years and a discount rate of 20 percent, were used in estimating the discounted present value.

² The Government expects to utilize the revenues from the sale of agricultural enterprises and part of the enhanced revenues projected from the fiscal reforms, to support the adjustment of the agriculture sector. In addition, part of the proceeds of the World Bank's Structural Adjustment Loan are expected to be utilized for this purpose. The proposed loan from the Bank for \$100 million will augment these resources and meet part of the overall adjustment costs in the sector.

APPENDIXES

Number	Title	Page No.	Cited on (para.)
1.	Negative List of Imports	25	91
2.	Technical Assistance - Study on Market Reform in the Agriculture Sector	27	100
3.	Technical Assistance - Study on Rural Credit and Savings	27	103
4.	Poverty Impact Assessment	29	109

NEGATIVE LIST OF INELIGIBLE ITEMS

1. The proceeds of the loan will be utilized to finance the foreign currency expenditures in respect of the reasonable cost of imported goods (excluding any duties on taxes) required during the implementation of the Program. All imported goods financed from the loan must be produced in, and supplied from, the Bank's member countries.

2. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of:

- (i) Expenditures for goods included in the following groups or subgroups of the United Nations Standard International Trade Classification, Revision 3:

Group	Sub-Group	Description of Items
122	-	Alcoholic beverage
121	-	Tobacco, unmanufactured tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semi-precious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof, fuel elements (cartridges), non-irradiated for nuclear reactors
897	897.3	Jewelry of golds, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

- (ii) expenditures for goods intended for military or paramilitary purpose or for luxury consumption;

- (iii) expenditures for pesticides categorized as extremely hazardous or highly hazardous in Class 1a or 1b, respectively, of the World Health Organization's Classification of Pesticides by Hazard and Guidelines to Classification;

- (iv) expenditures for goods supplied or to be supplied under any contract that a national or international financing institution or any other financial agency has financed or agreed to finance, including any contract financed or to be financed under any loan from the Bank; and
- (v) expenditures incurred more than 180 days prior to the date of the effectiveness of the Program loan.

ADVISORY TECHNICAL ASSISTANCE FOR A STUDY ON MARKET REFORM IN THE AGRICULTURE SECTOR

A. Background

1. Despite the significant progress achieved under the previous agricultural reforms, including the removal of Government controls on agricultural pricing, procurement, and trade, substantial additional reforms in the agriculture sector need to be undertaken. Agricultural production continues to fall leading to deterioration in farm incomes and a rise in rural unemployment. A number of key constraints in the agriculture sector have been identified, including problems caused by external trade restrictions, a monopolistic market structure for farm products and inputs, ongoing restructuring of the rural financial system, legal and institutional constraints, a lack of a reliable information and data base to support policy analysis and formulation, and inadequate domestic capacity in policy analysis and implementation. A comprehensive understanding of the agriculture sector, particularly in critical policy areas such as agricultural pricing and subsidy, external and domestic trade, and social protection in the rural areas, is required at the present stage of the transition. It is also important to assess and monitor the impacts of measures under the Program.

B. Objectives

2. The ongoing transition to a market economy under the Agriculture Sector Program may not be attainable without a sound understanding of key policy issues in the agriculture sector. The technical assistance (TA) will (i) investigate important policy issues in the sector to obtain a comprehensive understanding of the key constraints and to recommend further reform measures or improvements; (ii) monitor the impacts of the reform measures under the Program; and (iii) strengthen the capacity of the Government in policy analysis, formulation, implementation, and monitoring.

C. Scope

3. The proposed TA will comprise a series of comprehensive policy studies in key areas such as (i) international trade of agricultural products; (ii) agricultural marketing including measures to develop a future market for agricultural products; (iii) agricultural pricing and subsidies including pricing policies for irrigation water; (iv) socioeconomic impact of agricultural policy reforms; and (v) environmental protection related to pesticide regulations and rangeland management. The TA will also propose a set of measures to strengthen the implementation of critical reform measures under the Program. In addition, under the TA, training will be provided to the Government staff involved in the Program on rapid survey methodology, data processing and presentation, and policy analysis. The output of the TA will consist of a series of reports and policy briefs to provide a comprehensive understanding of key aspects of the agricultural sector. It will also develop a computerized data base for evaluating policy impacts and monitoring benefits of the Program. The detailed terms of reference for the study are outlined on pages 3-7.

D. Consulting Services

4. The TA will provide the services of a team of consultants with expertise in agricultural marketing, agricultural information, legal and institutional reform, water resources

pricing, and environmental management. A total of 27 person-months of international consulting services will be required under the TA. In addition, a total of 27 person-months of local consultants will be required for surveys and translation, as well as for training of government officials. An international consulting firm with extensive experience in agricultural policy analysis will be recruited in accordance with the Bank's *Guidelines on the Use of Consultants*. The local consultants will be recruited by the international consulting firm in consultation with the Bank. The international consulting firm will have the flexibility to propose changes in the consulting time inputs for each consultant, if required to achieve the objective of the TA, provided the total person-months and the implementation period are not exceeded.

E. Cost Estimates and Financing Plan

5. The estimated cost of the TA is \$1,100,000 equivalent comprising \$832,000 in foreign exchange and \$268,000 equivalent in local currency (see page 8 of this Appendix). The entire foreign exchange cost of \$832,000 and part of the local currency cost (\$212,000 equivalent) amounting to \$1,044,000 is proposed to be provided by the Bank as a grant and charged to the Bank-funded TA program. The Government will contribute in kind the remaining local currency costs estimated at \$56,000 equivalent.

F. Implementation Arrangements

6. The TA will be implemented by the Ministry of Agriculture (MOA). For the analysis of pricing policies for irrigation water, the TA will involve the State Committee on Water Resources (SCWR). For the development of a data base to monitor the issuance and transfer of land share certificates, the TA will involve the State Committee on Land Relations and Land Use Planning (GOSKOMZEM), the State Property Committee (SPC) and the Ministry of Justice (MOJ) will be involved in the analysis of the rights and interest of privatized farm workers. MOJ will also be involved in the review of legislation pertaining to farmers' associations. MOA will be responsible for monitoring and supervising all TA activities as well as providing administrative and counterpart support to the consultants, including personnel, office space, utilities, furniture, documents and data. MOA will appoint a qualified TA coordinator on a full time basis to coordinate the work of the consultants and relevant central and local government agencies. MOA will also arrange with the SCWR to provide office space for the Water Resources Specialist in the premises of SCWR, as necessary. Six computers will be provided under the TA to support the TA activities, including four computers located in MOA and one each in GOZKOMSEM and SCWR. The training of Government officials will be carried out in MOA and may involve local government officials, if necessary. In addition to a brief quarterly report, the consultants will submit an inception report within one month after commencement of the TA services, an interim report in the fifth month, a draft final report in the tenth month, and the final report in the eleventh month. The TA will be implemented over a period of approximately 11 months, and is tentatively scheduled to be completed by June 1997.

TERMS OF REFERENCE

A. Agricultural Economist, Team Leader (International, 9.5 person-months)

1. Qualifications

1. The agricultural economist should have strong qualifications in agricultural economics with specialization in market analysis. Extensive experience will be required in analysis of agricultural markets, including futures markets, agricultural policies including socioeconomic impact assessment, and policy reform issues in the transitional economies, with work experience in Central Asian republics (CARs) or similar countries. The consultant should also have experience in conducting field surveys, workshops, and policy dialogue with governments, and shall be familiar in training and establishing monitoring systems. Fluency in Kazakh and/or Russian is desirable.

2. Terms of Reference

- (i) Assess the existing marketing channels (including private channels) from farm-gate to the retail level and analyze the marketing margins in processing, transport, storage and export; determine the extent of competitiveness in major agricultural product and input markets, and recommend appropriate measures to increase competition at all tiers of the market, i.e., farm-gate, wholesale and retail.
- (ii) Assess the extent of integration of domestic grain markets and the linkage between domestic and international grain prices, and identify the reasons for the large observed difference between the international and domestic prices of grains.
- (iii) Evaluate the comparative and competitive advantage of wheat and other major crops in the short and medium term; and assess the opportunity costs of using natural grazing lands (rangelands) for crop production.
- (iv) Examine the operations of the International Agro-Industrial Exchange in Almaty and assess the potential for establishing it as a fully-fledged futures market for agricultural products; also assess the prospects of broadening farmer participation in the Exchange operations at the local levels.
- (v) Assess and evaluate the financial and economic costs and benefits of the existing direct and indirect government subsidies to the agriculture sector, including input subsidies, output price support policies, consumer subsidies, and government budget support for state-owned enterprises, as well as trade policies for major crops and farming inputs (such as fertilizer) in the agriculture sector. The analysis will include the effects of the Government's minimum price policies for grain procurement and price support to wool. The analysis will also include evaluation of measures such as crop insurance to reduce excessive weather risks in crop production.
- (vi) Study the effectiveness of the newly established ASF, analyze its objective, scope and operations, and assess its impact on agricultural prices, production,

marketing, employment, as well as on farmers' income; and recommend measures to reorient ASF to support the development of a market-based agriculture sector without distorting resource allocation.

- (vii) Assess the socioeconomic impact of the agricultural policy reforms on different subgroups of the rural population, with particular emphasis on the vulnerable groups; recommend appropriate measures to mitigate the adverse impact of the reforms on the poor and near-poor in the rural areas.
- (viii) Arrange short training courses and seminars for MOA and other interested institutes to undertake analysis of policies such as trade policy, market stabilization and food security policies, to maintain continuity of the policy analysis beyond the TA implementation period.
- (ix) Document findings in working papers and a final report including the contributions by the other international consultants.

B. Agricultural Information System Specialist (international, 8 person-months)

1. Qualifications

2. The agricultural information systems specialist should have strong qualifications in statistics particularly in survey design, sampling methodologies, and establishing computerized data management systems linked to agricultural policy analysis. The consultant should have basic training in agricultural economics, and be familiar with the policy reform issues in the transitional economies, with work experience in CARs or similar countries. Fluency in Kazakh and/or Russian is desirable.

2. Terms of Reference

- (i) Assess the efficiency of the existing system of statistical data collection and processing pertaining to major agricultural products and inputs. Evaluate the quality and accuracy of key existing primary agricultural statistics, e.g., farm-level prices, crop yield and production forecasts, demand, and costs of production.
- (ii) Conduct market surveys to provide information on input and output prices, supply stocks, milling efficiency, interest rates, storage and transportation charges, exporting costs and constraints, etc. covering both state-owned and private milling/marketing/exporting intermediaries.
- (iii) Establish a user-friendly computerized data base which will enable the monitoring of crop plantings, losses, domestic supply situation, prices, stocks, exports, and agricultural demand; develop a reporting system on the grain market situation and outlook in line with the seasonality of production and draw-down of stock, to support the Government's grain policy analysis and formulation.
- (iv) Using a computerized data base, establish a system within GOSKOMZEM to regularly monitor and report the issuance of land share certificates as well as

monitor the progress of transferring state farms to private entities.

- (v) Using the computerized data base, establish a system within MOA to (a) restructure the budget of ASF to make it transparent, and to regularly monitor and report the allocation and use of ASF; and (b) make transparent and monitor regularly the allocation and use of all other agricultural subsidies, both within and outside the central Government's budget.
- (vi) Propose a system to disseminate market information to farmers, traders, and policy makers.
- (vii) Establish benefit monitoring and evaluation (BME) systems to regularly monitor and analyze the social and economic impacts of reform measures, with particular emphasis on the vulnerable groups in the rural areas.
- (viii) Train staff members of the agencies involved in survey design, statistical sampling methods and data collection processing, interpretation, analysis and reporting by ways of workshops and on-the-job exposure. Recommend measures to institutionalize the above measures and sustain the data base system and the BME beyond the TA implementation period.
- (ix) Document findings at relevant intervals in an inception report, working papers and other papers as required.

C. Legal/Institutional Specialist (international, 3 person-months)

1. Qualifications

3. The legal/institutional specialist should have legal training, and experience in institutional and farm management, and extensive experience in legal and institutional issues pertaining to agricultural cooperatives, land reform, farm privatization, provision of farm support services during the transition, and the development of voluntary farmer associations. The consultant should be familiar with the reform issues in the transitional economies. Work experience in CARs or similar countries and fluency in Kazakh and/or Russian are desirable.

2. Terms of Reference

- (i) Review existing legislation pertaining to the privatization of state farms, as well as relevant provisions of the Civil Code, Land Code, and Law on Economic Partnerships, and land share certificates issued to farm workers by GOZKOMZEM, and prepare draft decrees or other supporting legislation to clarify the legal rights and interests of farm workers in privatized farm enterprises.
- (ii) Examine the remaining institutional constraints to the farm restructuring and privatization process and recommend measures to facilitate the privatization.
- (iii) Review the existing legal and regulatory framework for agricultural cooperatives and other types of farmers' organizations, and prepare draft decrees or other supporting legislation to facilitate the formation of voluntary farmer associations

for obtaining credit, input purchase and output marketing, use of farm machinery and equipment, as well as water user associations.

- (iv) Prepare one or more draft model charters for voluntary farmer associations and propose other measures to empower farmer groups.
- (v) In coordination with the water resources economist, assess the role and status of existing organizations in relation to the use of irrigation water; and recommend measures to develop an appropriate institutional framework for grassroots level organizations of water users, which will also be responsible for cost recovery.

D. Water Resources Specialist (international, 3 person-months)

1. Qualifications

4. The water resources specialist should have experience in irrigation management, particularly in pricing policy analysis for irrigation water, operation and maintenance (O&M) of irrigation systems, and water user associations (WUAs). The consultant should be familiar with policy reform issues in the transitional economies, with work experience in CARs or similar countries. Fluency in Kazakh and/or Russian is desirable.

2. Terms of Reference

5. The water resources specialist will work in the office of the State Committee on Water Resources, and will work closely with the Committee staff and relevant MOA staff to:

- (i) Assess and evaluate the overall pricing policies for water, and estimate the long run marginal cost of water supply under alternative irrigation systems. Assess the impact of water pricing policies on the efficiency of water usage and on efficient O&M.
- (ii) Examine the role and operation of existing institutions responsible for supplying and distributing irrigation water as well as for repairing and maintaining the irrigation system, and recommend appropriate measures to improve the efficiency of these functions.
- (iii) Recommend measures to reform water pricing policies under alternative irrigation systems and to establish mechanisms and procedures for the collection of irrigation user charges.

E. Environment Specialist (International, 3.5 person-months)

1. Qualifications

6. The environment specialist should have extensive experience in environmental/natural resources regulation and policy analysis in developing countries, including transition economies. The consultant should have a background in preparation of EIAs community based resource management systems, and design of regulatory regimes. The consultant will:

2. Terms of Reference

- (i) Review regulations regarding pesticide use for agricultural purposes, and examine their consistency with international standards.
- (ii) Recommend specific measures to ensure conformity of pesticide regulations with FAO recommendations in respect of pesticide use in agriculture.
- (iii) Evaluate the extent, and plausible policy and institution related causes for degradation of range lands in the country.
- (iv) Identify feasible approaches to policy making for range land rehabilitation and conservation, in the context of transition of the sector to market systems.

F. Local Consultants

- (i) Assist international consultants in undertaking their assignments under the TA.
- (ii) Undertake independent assignments in their respective areas of expertise as allocated to them by the team of international consultants.
- (iii) Assist in data collection, field surveys, information compilation and processing.
- (iv) Assist in training Government officials and undertake interpretation and translation work.

(The detailed TORs for the local consultants will be prepared by the international consultants, and incorporated in a work plan to be included within the inception report.)

Cost Estimates and Financing Plan
(\$'000)

Item	Foreign Exchange	Local Currency	Total
A. Bank Financing			
1. Consultants			
a. Remuneration			
i. International Consultant	486.00	-	486.00
ii. Domestic Consultants	-	54.00	54.00
b. Per Diem			
i. International Consultant	121.50	-	121.50
c. Travel			
i. International (International Consultants)	30.00	-	30.00
ii. Domestic (International Consultants)	-	6.00	6.00
iii. Domestic (Domestic Consultants)	-	3.00	3.00
2. Equipment			
a. Vehicles (4 wheel-drive)	30.00	-	30.00
b. Computers and Accessories	24.00	6.00	30.00
c. Other Office Equipment	10.00	-	10.00
3. Training	-	50.00	50.00
4. Surveys and Reports			
a. Data Collection and Processing	-	43.00	43.00
b. Communications and Report Preparation	5.50	10.00	15.50
5. Miscellaneous Administration and Support Services	-	8.00	8.00
6. Contingencies	125.00	32.00	157.00
Subtotal (A)	832.00	212.00	1044.00
B. Government Financing			
1. Counterpart Support			
a. Professional Staff	-	17.00	17.00
b. Secretaries and Interpreters	-	7.00	7.00
2. Maintenance of Vehicle	-	3.00	3.00
3. Equipment and Others			
a. Office Space and Furniture	-	16.00	16.00
b. Office Support and Miscellaneous	-	8.00	8.00
c. Local Communications	-	5.00	5.00
Subtotal (B)	-	56.00	56.00
Total (A + B)	832.00	268.00	1100.00

- = magnitude zero.

Source: Staff estimates.

ADVISORY TECHNICAL ASSISTANCE FOR A STUDY ON RURAL CREDIT AND SAVINGS

A. Background

1. The ongoing restructuring of the APB, and the banking system as a whole has become an important constraint to Kazakhstan's rural sector, including the agriculture sector. The APB, the predominant bank in the rural sector with a network of 230 branches covering all regions is facing serious financial difficulties because of the Government's directed credit operations, channeled to the agriculture sector through the APB. Its non-performing assets were estimated to be at least T15 billion as of June 1995. On the other hand, farmers, especially those being separated from the state farms, have little access to alternative channels for rural credit and savings services. There is a large unserved need for rural credit and for mobilization of rural savings from agricultural households and firms.

B. Objectives

2. The objective of the TA is to assist the Government in reforming the rural credit and savings services by promoting a market-based rural credit system; mobilizing rural savings; expanding credit, including investment credit to the private sector; and addressing the financial intermediation needs of poor farm households and women.

C. Scope

3. The proposed TA will consist of two major components. The first component will include a comprehensive review of important policy issues in the rural credit and savings, including legal and institutional issues. The second component will comprise a set of policy recommendations to assist the Government to reform the rural credit and savings services, including measures to establish microfinance institutions, policies and strategies to mobilize savings, and farmgate extension services to support farmers' participation in agricultural financing. The output of the TA will consist of a series of reports and policy briefs to provide a comprehensive understanding of key aspects of the rural credit and savings services, and a set of appropriate policy recommendations to establish market based rural credit and savings services. The detailed terms of reference for the study are outlined on pages 3-5.

D. Consulting Services

4. The TA will provide the services of a team of consultants with expertise in rural credit, micro-finance, agricultural economics, and rural sociology. A total of 12 person-months of international consulting services will be required under the TA. Furthermore, a total of 12 person-months of local consultants will be required to assist the international consultants to collect data as well as facilitate surveys and interviews. An international consulting firm with extensive experience in rural finance will be recruited in accordance with the Bank's *Guidelines on the Use of Consultants*. The local consultants will be recruited by the international consulting firm in consultation with the Bank.

E. Cost Estimates and Financing Plan

5. The estimated cost of the TA is \$500,000 equivalent comprising \$398,000 equivalent in foreign exchange and \$102,000 equivalent in local currency (see page 6). The entire foreign exchange cost of \$398,000 and part of the local currency cost (\$72,000 equivalent) amounting to \$470,000 is proposed to be provided by the Bank as a grant and charged to the Bank-funded TA program. The Government will contribute in kind the remaining local currency costs estimated at \$30,000 equivalent.

F. Implementation Arrangements

6. The TA will be implemented by the National Bank of Kazakhstan (NBK), which will be responsible for monitoring and supervising all TA activities as well as providing administrative and counterpart support to the consultants, including personnel, office space, utilities, furniture, documents and data. NBK will appoint a qualified TA coordinator on a full time basis to coordinate the work of the consultants and relevant central and local government agencies. Three computers will be provided under the TA to support the TA activities, including two in NBK and one in APB. The consultants will submit an inception report within one month after commencement of the TA services, an interim report in the fourth month, a draft final report in the seventh month, and the final report in the eighth month. The TA will be implemented over a period of approximately eight calendar months, and is tentatively scheduled to be completed by April 1997.

TERMS OF REFERENCE

A. International Consultants

1. Rural Financial Specialist, Team Leader (International, 8 person-months)

1. The rural financial specialist/team leader should have strong qualifications and experience in finance/monetary economics, particularly in the fields of rural finance and banking. Experience in the analysis of rural financial policies and financial restructuring as well as work experience in Central Asian republics (CARs) or similar countries will be required. Fluency in Kazakh and/or Russian is desirable.

2. The consultant will:

- (i) Review the rural financial sector in view of financial sector reforms undertaken since 1991 (with support of the International Monetary Fund and the World Bank), including the implications of the legal and institutional reforms in the financial and commercial sectors; evaluate the impact of the reforms on the efficiency of financial intermediation in the rural sector, focusing on APB and other finance institutions operating in rural areas; identify policy issues that need to be addressed in the Bank's continuing policy dialogue with the Government in the area of rural finance.
- (ii) Examine the existing structure of rural credit and savings services and their interest rate regime, including rural real interest rates; evaluate the effects of the interest rate regime on commercial profitability; and recommend interest rate adjustments needed to strengthen the commercial viability of rural credit and savings services.
- (iii) Identify interest rate distortions in the APB and other commercial banks engaged in the rural sector. Examine the impact of subsidized lending through special Government programs outside the banking system, on commercial operations of rural finance institutions.
- (iv) Assess the existing and potential demand for short-term credit in the agriculture and rural off-farm sector, including processing, marketing, storage, transportation, export and import of major agricultural commodities and materials, including industrial crop products and livestock products.
- (v) Assess the existing and potential medium-term credit requirements of the rural sector, including the urgent need for replacing farm machinery and equipment, agricultural land development, irrigation schemes, investments for agricultural processing enterprises and marketing facilities, and recommend medium term lending terms (loan size, maturity, interest rate, loan-equity ratios, repayment plans, etc.) for implementation by APB and other commercial banks in the rural sector.

- (vi) Review the loan classification procedures and policies of APB and the other commercial banks operating in the rural sector, and recommend measures to establish internationally acceptable loan classification procedures in these rural finance institutions in order to strengthen the management of their credit programs.
- (vii) Review the loan provisioning procedures of APB and other commercial banks engaged in the rural sector and recommend detailed provisioning measures for non-performing assets and for strengthening their equity in order to maintain sound financial discipline.
- (viii) Critically review the potential for mobilization of rural savings, examine the constraints to savings mobilization and the deposit mobilization strategies of financial institutions involved in the agriculture sector, including those for medium term deposits, and recommend measures and policies for increasing savings mobilization by product, region and economic sector, as the key to sustainable financial intermediation.
- (ix) Examine the present institutional structure of APB and suggest measures for further restructuring to improve operational efficiency, including rationalization and/or APB's privatization in whole or in part.
- (x) Prepare a timebound plan for consideration by the Government and the Bank, to establish market based reform the rural credit and savings services involving APB, other banks and other potential commercial institutions that could engage in efficient credit delivery and savings utilization service in the rural sector (in collaboration with the Microfinance Specialist).

2. Microfinance Specialist (International, 4 person-months)

2. The microfinance specialist should have extensive work experience with microfinance institutions, preferably in transitional economies, relating to assessing microfinance needs, designing savings mobilization programs, and credit delivery and recovery system to poor rural households and groups, in particular, women and households headed by women.

3. The consultant will:

- (i) Examine prospects for establishing microfinance institutions (MFIs), e.g., rural shareholding banks, rural credit cooperatives, farmers' credit unions and women's credit unions, to engage in retail banking operations in rural areas; identify the constraints to the emergence of sustainable financial intermediation by these MFIs; and recommend institutional policy and legal measures to create an enabling environment for the growth of MFIs.
- (ii) Assess the effectiveness of financial policies of NBK, APB and other banks relating to savings mobilization and lending to poor rural households; assess

the impact of existing collateral policies of the NBK and the MFIs on microcredit to the poor.

- (iii) Recommend appropriate savings and loan policies and strategies to be implemented by APB and other banks operating in the rural sector to improve the poor's access to credit, while providing appropriate prudential safeguards, including institutional arrangements such as joint liability group lending, for effective management of their loan portfolios.
- (iv) Consult with actual and potential clients of MFIs to ensure their effective participation in the formulation of the policies stated above.
- (v) Based on a comprehensive review of the rural financial sector, recommend appropriate institutional mechanisms for establishing rural credit and savings related extension services to support farmers in general, and poor farmers in particular.

B. Local Consultants

1. Agricultural Economist (8 person-months)

2. Rural Sociologist (4 person-months)

- (i) Assist international consultants in undertaking their assignments under the TA.
- (ii) Undertake independent assignments in their respective areas of expertise as allocated to them by the team of international consultants.
- (iii) Assist in data collection, field surveys, information compilation and processing.

(The detailed TORs for the local consultants will be prepared by the international consultants, and incorporated in a work plan to be included within the inception report.)

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total
A. Bank Financing			
1. Consultants			
a. Remuneration			
i. International Consultant	216.00	-	216.00
ii. Domestic Consultants	-	24.00	24.00
b. Per Diem			
i. International Consultant	54.00	-	54.00
c. Travel			
i. International (International Consultants)	15.00	-	15.00
ii. Domestic (International Consultants)	-	3.00	3.00
iii. Domestic (Domestic Consultants)	-	2.20	2.20
2. Equipment			
a. Vehicles (4 wheel-drive)	30.00	-	30.00
b. Computers and Accessories	12.00	3.00	15.00
c. Other Office Equipment	8.00	-	8.00
3. Surveys and Reports			
a. Data Collection and Processing	-	15.00	15.00
b. Communications and Report Preparation	9.00	-	9.00
4. Miscellaneous Administration and Support Services	-	17.00	17.00
5. Contingencies	54.00	7.80	61.80
Subtotal (A)	398.00	72.00	470.00
B. Government Financing			
1. Counterpart Support			
a. Professional Staff	-	6.00	6.00
b. Secretaries and Interpreters	-	4.00	4.00
2. Maintenance of Vehicle	-	3.00	3.00
3. Equipment and Others			
a. Office Space and Furniture	-	10.00	10.00
b. Office Support and Miscellaneous	-	4.00	4.00
c. Local Communications	-	3.00	3.00
Subtotal (B)	-	30.00	30.00
Total (A + B)	398.00	102.00	500.00

- = magnitude zero.

Source: Staff estimates.

KAZAKHSTAN: AGRICULTURAL PROGRAM LOAN POVERTY IMPACT ASSESSMENT

A. Introduction

1. A poverty impact assessment (PIA) was conducted for each of the measures under the Program, based on a comparison of "with" and "without" the Program scenarios. Such a comparison was deemed necessary because severe adverse impacts have already been experienced in the agriculture sector in the form of sharp declines in agricultural production and income, and to a lesser extent, in declining employment. It is expected that such trends will continue in the short term, and the adverse impacts may get worse without the reform measures supported by the Program.

2. The PIA was based on four channels: (i) demand for agricultural labor; (ii) prices of goods bought and sold by the poor (both consumer and producer prices); (iii) access of the poor to public and rationed goods and services; and (iv) net public transfers (transfers minus taxes) to the poor. Although all impacts (direct, indirect, macro, and the impact on the non-poor) are examined, only those that are significant will be discussed in this Appendix. For presentation purposes, the reform measures are grouped by similarity of objectives and impacts. Table 1 provides a summary of the poverty impact assessment by group. It should be noted that the effects presented in Table 1 are the net impacts of various positive (+) and negative (-) impacts on the poor resulting from the reform measures. For example, if the positive impact on producer prices balances the negative impact on consumer prices, the reform measures are said to have a zero net impact on the poor. Thus, a (0) and/or (+) sign in Table 1 should not be interpreted as having no negative impacts on the poor, but as a net impact in which the positive impacts outweigh the negative impacts. The following section starts with a detailed analysis of PIA by group, followed by a section proposing monitoring and mitigating measures.

Table 1: Summary of PIA by Group
(Net Impact of Reform Measures on Poverty)

Group:	1	2	3	4	5	6
Objective of Measures:	Land Reform	Transfer of State Farms	Agri. Trade & Marketing	Phasing-out Agri. Input Subsidies	Restructuring Rural Credit and Savings	Environmental Protection
Labor market	0 / +	- / +	- / +	- / +	- / +	0 / +
Producer and Consumer Prices	0 / +	0 / +	0 / +	0 / +	0 / +	0 / +
Access of the poor	- / 0	- / 0	0 / 0	- / 0	0 / 0	0 / 0
Public Transfers	0 / +	- / +	- / +	+ / +	- / +	- / 0

Note: The (+) and (-) signs before the "/" sign represent the positive and negative net impacts, respectively, in the short term; whereas those after the "/" sign represent the long term net impacts. The (0) sign means no significant net impacts.

B. Poverty Impact Analysis by Group

1. Group 1: Land Reform

3. Group 1 includes measures to strengthen farm workers' land rights in farm enterprises and to strengthen security of tenure in order to encourage the growth of an agricultural land market. The anticipated impacts of these measures on the poor include the following:

a. Demand for Agricultural Labor

4. In the short run, no significant impact on the demand for agricultural labor is expected. Given the substantial contraction in almost all sectors of the economy, agricultural labor will have difficulty in finding employment in the nonfarm sectors except for the rural service sector. In the long run, however, as full recovery of agriculture and other sectors of the economy takes place, a significant positive impact on the demand for labor is expected.

b. Prices of Goods

5. These measures may not have a direct impact on the prices of goods and services used by the poor in the short term, though they may have a positive impact on price of land use rights sold by the poor and hence, on their incomes. In the long run, however, by encouraging investment in land which will lead to a rise in land productivity, these measures are expected to contribute to lower consumer prices for agricultural products consumed by the poor.

c. Access of the Poor

6. These measures per se may not cause significant changes in the access of the poor to public goods and services. However, some poor farmers may have to sell their land use rights in order to obtain urgently needed cash or food. If this happens, a category of landless farmers and agricultural workers may emerge. However, the sale of land rights need not necessarily increase poverty as long as these farm workers find employment. It should also be pointed out that the main factors that cause poverty are declining farm production and increasing unemployment, rather than the measures that facilitate the transfer of land use rights. It may be further noted that the proposed land reform measures will significantly enhance empowerment of the farmers and strengthen their ability to combat poverty. Nevertheless, efforts are needed to closely monitor the development of a landless category among the rural population, and to adopt appropriate measures as necessary (see discussions in para. 24-25).

d. Public Transfers to the Poor

7. These measures are not expected to have any direct impact on public transfers to the poor. Furthermore, since these measures have a net positive impact on the demand for labor in the long run, they also contribute positively to public resources mainly due to the reduced need for unemployment benefits.

2. Group 2: Transfer of State Farms

8. This group includes measures aimed at transferring state farms to private entities in order to encourage efficient use of agricultural land and to provide incentives for long-term investment in land development. Assuming significant changes occur in farm management after the ownership transfer, the anticipated impacts on poverty include the following:

a. Demand for Agricultural Labor

9. Open unemployment is expected to increase as privatized farms may reduce excess labor in order to improve operational efficiency. However, such an adverse impact on the poor may not be overly significant for the following reasons. First, there currently exists a large amount of hidden unemployment in the farm sector. Second, many farm workers, although employed, have not been paid for several months due to the severe financial difficulties faced by the farms. Some farms, however, have paid salaries in kind because of serious liquidity problems. It was also observed from field visits that many farm workers no longer rely on salaries as their major source of family income, but have turned to subsistence household farming for survival, such as raising cattle and small ruminants and cultivating vegetables and fruits on small garden plots. The shift from hidden to open unemployment is, therefore, not expected to significantly affect the unemployed. Furthermore, they will be entitled to unemployment benefits, albeit in small amounts. In the long run, the private farms are expected to increase production efficiency and improve scale economies. A gradual recovery of farm production will lead to a reduction in hidden unemployment in the farm sector and a rise in agricultural wage in the long run. Nevertheless, measures are provided under the Program to mitigate any negative impact on the poor that may result in the short run (see discussions in para 24-25).

b. Prices of Goods

10. No significant impact on prices is expected from the farm restructuring in the short run. However, by providing incentives for improving management and efficiency, these measures may contribute to lower consumer prices in the long run.

c. Access of the Poor

11. There is a concern that the shift from hidden to open unemployment may cause the openly unemployed farm workers to lose their access to social services. Although such services have declined sharply in recent years, they are still available to the poor. Again, such a negative impact should only be temporary due to the following reasons. First, most social services have already been transferred from farm enterprises to local governments. Second, the Government, under the assistance from the World Bank, is preparing a program to strengthen local governments' capacity in providing these services. Assuming successful implementation of these reforms, local governments will become the provider of social services. Thus, all rural residents, whether employed in farm enterprises or not, will have equal access to the social services in the long run.

d. Public Transfer to the Poor

12. The rise in unemployment may, in the short run, lead to an increased need for social assistance and more public spending on unemployment benefits. However, such an impact

should not be over estimated, as analyzed in paras. 9 and 11 above. Furthermore, measures have been included under the Program to extend the Employment Fund to cover the agriculture sector and to increase its budget. Further, provision of targeted cash compensation to the poor to mitigate adverse impacts on them has also been included. In the long run, the measures in this Group will have a positive impact on labor demand, so that the impact on public transfer may be positive because of savings in public spending on unemployment benefits.

3. Group 3: Reforms in Agricultural Trade and Marketing

13. This group includes measures aimed at (a) accelerating the liberalization of international trade in agricultural commodities, i.e., abolishing the export tax and minimum export prices for grains; (b) dismantling monopoly holding companies; (c) reducing government interventions in agricultural markets, such as establishing a market-based system for grain procurement, and eliminating direct controls on trade mark-ups for grain, bread, and fodder. Assuming successful implementation of these reform measures, the anticipated impacts on poverty will include the following:

a. Demand for Agricultural Labor

14. The dismantling of monopoly holding companies may cause a rise in open unemployment in the agro-industrial sector in the short term, as the most inefficient holding companies, having lost their monopolistic power may be forced to close down under market competition. At the same time, however, the reform measures in this Group is likely to have a large positive impact on demand for farm workers for the following reasons. Currently, the farm sector is suffering from seriously depressed farmgate prices, low-level use of inputs, and continuous decline in farm production, which is the single most critical cause of rising unemployment (especially hidden unemployment) in the farm sector. Assuming successful implementation of the reform measures under this Group, in particular successful dismantling of monopoly in farm marketing, farmgate prices are expected to be significantly strengthened, which will lead to a recovery in agricultural production and a reduction in hidden unemployment in the medium to long run. Since the reduction in the hidden unemployment in farm sector is expected to be larger than the rising open unemployment in the agro-industry sector, the net impact on demand for agricultural labor is expected to be positive, in the long run. However, the net impact is still expected to be negative in the short run.

b. Prices of Goods

15. These measures will have a positive impact on farmgate prices, or producer prices, while consumer prices are expected to decline. However, due to structural bottlenecks in the adjustment process, consumer prices may not decline as rapidly as expected in the short run. The consumer prices will remain constant, at worst. The producer prices are expected to rise significantly due to the dismantling of monopoly holding companies. However, considering the time needed for successful dismantling of monopoly enterprises, the positive impact on prices can be expected only in the long run. Currently, a few monopolistic holding companies, by controlling agricultural processing and marketing, earn monopolistic profit while both producers and consumers suffer (are implicitly taxed). With the dismantling of the monopoly companies in the medium to long run, intensified market competition will improve both production and marketing efficiencies, leading to elimination of monopoly profits, a rise in producer prices and a reduction in consumer prices at the same time. But in the short run,

consumer prices may not decline and producer prices may not rise causing a zero net impact on the poor.

c. Public Transfer to the Poor

16. In the short term, abolishing the export tax on grain will constrain overall budgetary resources available for public transfers, leading to a negative impact on public transfers to the poor. In the long run, by contrast, increased general tax revenue may be expected from the recovery of grain production, which may also lead to reduced unemployment and associated need for unemployment benefits. Assuming a time lag exists between the recovery of farm production and the rise in Government tax revenue, the positive impact on public transfer will occur only in the long run.

4. Group 4: Phasing-out Agricultural Input Subsidies

17. This group of reforms aimed at improving the efficiency of resource allocation, includes measures for phasing out agricultural product and input subsidies, as well as making all remaining subsidies transparent. Assuming successful implementation of these measures, the anticipated impacts on poverty will include the following:

a. Demand for Agricultural Labor

18. Phasing-out of agricultural input subsidies may have a negative impact on demand for farm labor in the short run because many farms in Kazakhstan have been relying on Government subsidies for survival, and have been experiencing financial difficulties. Thus, the phasing-out of agricultural input subsidies may intensify the liquidity crisis and force the most inefficient farms to exit leading to a rise in open unemployment. However, such a negative impact is not expected to be significant for the following reasons. First, the shrinking budget revenue in the past three years has already forced the Government to cut agricultural subsidies sharply. The agricultural price subsidies at present amount to only about \$8.5 million and are no more than a fraction of the subsidies in the pre-reform period, when the subsidies accounted for a significant proportion of gross domestic product (GDP). The direct budgetary subsidies now represent only symbolic support to the agriculture sector and have little impact, if any, on farm operations. Phasing out the remaining product and input subsidies is therefore, not expected to have a significant impact. Secondly, the problem of hidden unemployment in the most inefficient farms has been serious for quite sometime already. In many of these farms, farmers have not been paid for several months. They have survived by relying on subsistence household farming. The shift of hidden to open unemployment after bankruptcy may cause some problems, as analyzed in para 9 above. Nevertheless, mitigation measures have been included to assist farm workers who may be adversely affected by these measures, including the increase of the provision of unemployment benefits. The medium to long run impact of these measures is expected to be positive, as improved resource allocation will contribute to early recovery of the farm sector, with favorable impacts on farm employment.

b. Prices of Goods

19. These measures are not expected to have any impact on fertilizer prices in the short run, due to the small magnitude of the subsidy to be phased out under the Program. But, there may be marginal increases in the prices of certain meat and wool products. It may be noted, however, that the subsidy on meat is provided only to special high quality meat products

which were traditionally exported to FSU. The removal of the subsidy will therefore, adversely affect exporters and not poor consumers in the short run. The long-term impact of the removal of the subsidies on commodity prices will enable farms to operate on a comparative advantage basis thus raising efficiency and productivity. The long-term net impact should therefore be in favor of the poor.

c. Access of the Poor

20. Phasing-out of agricultural input subsidies may induce a shift from hidden to open unemployment in the farm sector in the short run. Such a shift may also cause the openly unemployed farm workers to lose their access to social services in the short run. However, this adverse impact is not expected to be large because farms that may go bankrupt after the phasing out of input subsidies are already in a very difficult financial situation and have curtailed social services to their workers. Furthermore, local governments are expected to become the provider of social services in the long run. Rural residents' access to social services will therefore be independent of their employment status.

d. Public Transfer to the Poor

21. These measures are expected to have positive impact on the poor in both the short run and long run, because the phasing out of budgetary input subsidies will lead to a saving in Government budget, which will strengthen the Government's financial ability and increase resources which may be used as public transfers to the poor.

5. Group 5: Restructuring of Rural Credit and Savings

22. This group includes measures aimed at restructuring the APB and the agricultural savings and credit system. The restructuring of APB may increase unemployment in the short run, as some currently bankrupt APB branches may be forced to close down in the financial restructuring process. Their staff may, therefore, be unemployed. On the other hand, these measures will have a positive impact on demand for labor in the long run, as a successful restructuring of APB will increase farmers' access to credit supply, and thereby contribute to the recovery of farm production and employment. The positive impact on farm employment is expected to outweigh the negative impact on the relatively small number of unemployed in the bankrupt APB branches, resulting in a positive net impact on the labor market in the long-run. Since the successful restructuring of APB will contribute positively to the recovery of agricultural production, these measures may also have positive impact on consumer prices of farm products in the long run. The net impact on public transfer will be negative in the short run but positive in the long run, mainly due to the close linkage between the impact on rural employment and the need for public transfer to provide unemployment benefits.

6. Group 6: Environmental Protection

23. This group includes measures to ensure appropriate regulations on pesticide usage and to prepare policy recommendations for the sustainable use of range lands. Assuming farm privatization will induce commercialization, there is a need to strengthen regulations on pesticide use in order to sustain a safe environment for long term economic growth of the farm sector. In the short run, these measures are not expected to have a significant impact on farmers' production decisions, since most of them lack cash and credit to buy fertilizer and other agro-chemicals. The preparation of policy recommendations on range land management

is also not expected to have any short run impact on livestock production decisions. In the long run, however, these measures will have a positive impact on the growth of an economically viable farm sector, and therefore contribute positively to the demand for labor, and the prices paid and received by the poor. The implementation of these measures may require more public spending on pesticide control and range land management in the long run and may require some public transfers to support training programs to increase environmental awareness among poor farmers.

C. Monitoring and Mitigation Measures

24. As analyzed above, most measures under the Agriculture Sector Program have neutral short run impacts on the poor. Although the impacts on labor market, access to social services and public transfer may cause negative net impacts in the short run due to some of the reform measures, the positive impacts of the measures under the Program are large enough to offset the negative impacts, resulting in an overall net impact that is beneficial to the poor in the long run. Nevertheless, close monitoring and appropriate mitigation measures are needed for the adversely affected poor, especially in the short run. The Program, therefore, includes measures to establish an information system within MOA, under the TA to closely monitor and analyze the socioeconomic effects of the Program's reform measures, including distress sales of land rights. The TA on Strengthening the Implementation of Agricultural Sector Reforms which is presently under the implementation, also includes a major component on establishing an effective system to closely monitor both the implementation of Government reform measures and the impact of reform measures on beneficiaries in the agriculture sector. Critical variables for monitoring will be developed under the TA, including (i) the number of unemployed by sector (farm sector, rural credit sector, and agro-industrial sector); and (ii) the number of landless population by location.

25. Mitigation measures provided under the Program for the poor who are adversely affected by the reform measures, include: (i) training programs to strengthen training on self-employment skills, targeting those adversely affected by the transfer of state farms, phasing-out of agricultural input subsidies, restructuring of APB, and dismantling of monopoly companies; (ii) extending the Employment Fund to cover the agriculture sector; (iii) increasing the budget of the Employment Fund; and (iv) ensuring sufficient budget allocation as targeted cash compensation to meet the essential needs of vulnerable groups.

**BOARD
OF
DIRECTORS**

ASIAN DEVELOPMENT BANK

CONFIDENTIAL

(For consideration by the Board
or about 23 November 1995)

R217-95, Attachment 1
2 November 1995

**PROPOSED LOAN AND TECHNICAL ASSISTANCE GRANTS
AGRICULTURE SECTOR PROGRAM
(KAZAKHSTAN)**

Attachments

1. The Report and Recommendation of the President (RRP:KAZ 28449) on a proposed loan and technical assistance grants to Kazakhstan for the above Program is being separately circulated to the Board.

2. Attached are the following documents:

- (i) Appendix 1: Development Policy Letter
- (ii) Appendix 2: Policy Matrix

which should be read together with the RRP.

3. The Government has requested that the document not be released to the public. Accordingly, as provided in the Board paper on Confidentiality and Disclosure of Information (DOC.R134-94), the document will therefore not be released to the public following Board consideration of the RRP.

For Enquiries: Mr. S. H. Rahman, Agriculture and Social Sectors Department (East)
(Ext. 6965)
Mr. D. Edwards, Programs Department (East)
(Ext. 6231)
Ms. E. McGill, Office of the General Counsel
(Ext. 4905)

The attached document has a restricted distribution and recipients may use it only in the performance of their official duties. Its contents may not be disclosed without the authorization of the Asian Development Bank.

CONFIDENTIAL

**PROPOSED LOAN AND TECHNICAL ASSISTANCE
AGRICULTURE SECTOR PROGRAM
(REPUBLIC OF KAZAKHSTAN)**

ATTACHMENTS

**APPENDIX 1: DEVELOPMENT POLICY LETTER
APPENDIX 2: POLICY MATRIX**

ҚАЗАҚСТАН
РЕСПУБЛИКАСЫНЫҢ
ҮКІМЕТІ



Appendix 1, page 1
ПРАВИТЕЛЬСТВО
РЕСПУБЛИКИ
КАЗАХСТАН

199__ жылғы _____

№ _____

№ _____ дінгесі

13 October 1995

№ 1510-3

ЭКЗ. №

DEVELOPMENT POLICY LETTER

Mr. Mitsuo Sato
President
Asian Development Bank
Manila, Philippines

Dear Mr. President,

1. As you will be aware, since Independence, Kazakhstan has faced severe economic and fiscal difficulties. In this situation, our people have suffered hardships as purchasing power declined sharply and the level and standard of Government services were reduced. The impact has been most serious for vulnerable groups such as elderly pensioners.

2. The cumulative decline in real output of over 50 per cent during 1990 to 1994 reflects the severity of the crisis with which my Government has had to cope. A steep fall in investment and the effect on consumption expenditures of lower real incomes depressed demand. A primary factor underlying this trend was the decline in foreign trade as the economic relationships within the former Soviet Union, particularly the trade and payments system, broke down. An unusually severe winter and problems in energy product transactions with the Russian Federation and access to the use of pipelines to export oil worsened the trend in 1994.

3. At the same time, a rapidly increased rate of inflation emerged as a serious concern during 1992 to 1994. The magnitude of inflation then experienced was destabilising to the economy, eroding both confidence in holding money and in the currency and the

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

incentive to save through holding financial assets. A restrictive fiscal stance was initiated to counter the impact of the cessation upon Independence of the previous sizable budgetary transfers from the central Union government. While direct taxation was rationalized and a value added tax introduced, the initial shock of the fiscal adjustment was borne on the expenditure side with sharp reductions in the investment budget, subsidies, operation and maintenance expenditures and real remuneration and benefits of civil servants. The external accounts situation equally was of serious concern. The deficit in the trade balance and the current account widened in 1994 even as a reorientation took place toward sources of trade alternative to the Commonwealth of Independent States.

4. Against this background, my Government has given priority to a program of macroeconomic stabilization and structural reforms aimed at containing falls in output, decelerating inflation and correcting domestic and external imbalances while moving the country towards a market economy. The macroeconomic stabilization program has been supported by the IMF, firstly, through a Systemic Transformation Facility, and secondly, through an Upper Credit Tranche Standby Arrangement approved in January 1994. The structural reform program, commenced in 1991 and 1992, was deepened with the support of the World Bank through a Rehabilitation Loan. My Government is also appreciative of the timely assistance to these efforts extended by the Asian Development Bank through the Special Assistance Loan approved in December 1994.

5. Considerable progress was attained in the structural reform program with price liberalization, aspects of trade deregulation, financial reform and privatization. Achievements until recently had been less substantive in enterprise restructuring, demonopolization and

social protection. The slower pace of enterprise restructuring in particular became a major source of macroeconomic instability. Attempts at coping with enterprise losses adversely affected policies of monetary restraint and ultimately moved the stabilization program off track from meeting budgetary targets. Additionally, it inhibited the supply response to a more liberalized market regime.

6. Efficient enterprise restructuring in an economy with appropriate price signals is recognized by my Government as a key component to both macroeconomic stabilization and continued success in the direction of a market economy. Addressing this issue comprised a key component of an Anti-Crisis Program which in July 1994 initiated a revised, accelerated structural reform package. A tightening in monetary and fiscal policies since mid-1994 has shown, furthermore, some positive impact on the economy: (i) inflation has decelerated to single digit monthly figures in 1995; and (ii) there are signs that the sharp decline in industrial production may have bottomed out in the last quarter of 1994.

7. In this context, my Government has entered into a second Standby Arrangement with the IMF in June 1995. The Government is committed to adhering to the program that we have agreed with the IMF. It is clearly understood that the Bank attaches great importance to the macroeconomic stability, that such stability is essential for successful implementation of our agricultural reform program and that release of the second tranche of the proposed loan will be dependent on the maintenance of a macroeconomic framework which is conducive to effective implementation of the Agriculture Sector Program.

8. In parallel with the IMF program, my Government has received from the World

Bank in June 1995 a Structural Adjustment Loan in support of three strategic principles we have adopted toward restructuring the economy. These are: (i) to set the framework for firms to restructure effectively through developing and deepening competitive markets and encouraging the entry and exit of firms; (ii) to strengthen the instruments of enterprise restructuring through an enhanced privatization program and stricter financial discipline on banks and enterprises; and (iii) to put in place appropriate social protection measures, in particular, for the expected increase in the numbers unemployed as well as to devise means to provide alternative methods of ensuring the continued operation to the extent possible of social services conventionally delivered by enterprises.

9. While effective action has been taken to eliminate administered pricing and remove the principal restrictions on imports, in themselves, these measures have not proved sufficient to ensure competitive market pricing. The land-locked nature of our vast country has partly acted to protect enterprises from foreign competition due to high transport and entry costs; additionally, border prices derived from our neighboring republics of the former Soviet Union may not reflect world market levels. More importantly, significant domestic monopolistic marketing structures continued to inhibit competition. A key component of the reform program will now focus on the holding companies that have proliferated in the economy. Demonopolization of their market position will be an important means to achieve this objective. A more concerted effort is also being directed at exit policies for distressed and non-viable enterprises, if necessary, through liquidation and bankruptcy procedures.

10. Notable measures taken in recent months by my Government in support of the accelerated reform program have included: ((i)) adopting initiatives to restructure the previous

specialized banks and adopting (in February 1995) a banking reform program to strengthen the banking sector; (ii) adopting various trade measures which, among others, eliminate export quotas and broadly leave exporters free to select marketing arrangements; (iii) adopting a decree to incorporate the right to use land employed in business activities as part of enterprise assets; (iv) adopting a Bankruptcy Law and procedures for dealing with distressed companies; (v) establishing a Rehabilitation Bank to deal with at least twenty of the largest net debtor enterprises outside the agriculture sector; and (vi) adopting various institutional measures to facilitate the privatization program. Additionally, a revised Tax Code was adopted and became effective in July 1995 to further rationalize the tax system.

11. Mr. President, within the context of these economy-wide measures and structural reforms, my Government attaches great importance to the transition of the agriculture sector to a competitive, market-related system moving away from the previous essentially command system. Agriculture, traditionally the second largest sector of Kazakhstan's economy, made a sizeable contribution to exports (particularly non-energy) and employed as much as 25 per cent of the labor force.

12. The sector was deeply destabilized following the breakdown of the economic relationships of the former Soviet Union. The post-Independence economic crisis had a severe impact on output and living standards in the sector. To deal with this situation, my Government initiated a series of sectoral reforms. However, the reforms reflect an incomplete agenda and their initiation was much delayed.

13. The sector has experienced significant adverse terms of trade arising from the

liberalization of input prices, while output price adjustments lagged behind considerably and remained sluggish due to residual monopolistic marketing and processing structures. This circumstance has led to serious erosion in farm incomes and profitability.

14. With the elimination of directed credit, restructuring rural credit and savings operations has become a critical constraint. A daunting liquidity squeeze now faces the sector. Inadequate agricultural infrastructure and the lack of farmer-oriented support services have also contributed to the critical state of the sector. Many large farm enterprises are in distress, with barter trade and subsistence-oriented activities forming an increasing proportion of farm members' activities.

15. Mr. President, my Government aims to promote the transition to a competitive, market-based agriculture sector. The Government of Kazakhstan is requesting the support of the Asian Development Bank in the form of an Agriculture Sector Program loan. The principal objectives of this Program are to: (i) strengthen security of tenure in order to encourage the growth of an agricultural land market; (ii) strengthen farm workers' property rights in farm enterprises; (iii) encourage efficient use of agricultural land and provide incentives for long-term investment in land development; (iv) accelerate the liberalization of international trade in agricultural commodities; (v) ensure market-based farmgate prices of agricultural products through enhanced competition in domestic agricultural markets; (vi) further reduce Government intervention in domestic agricultural markets; (vii) strengthen the Government's capacity for agricultural policy formulation and analysis; (viii) promote the growth of voluntary farmer associations; (ix) strengthen the commercial orientation of the rural credit and financial services; (x) strengthen social protection measures for vulnerable groups affected by the

transition of the agriculture sector towards a market-based system; and (xi) ensure sustainable management of agriculture.

16. The details of the proposed Program are set out in the attached policy matrix. Various of the reform measures already undertaken and the broad parameters of the Program to be supported are set out briefly in the paragraphs that follow.

17. Land reform is a basic component in the promotion of a competitive agricultural land market. Under existing laws and decrees, lifetime inheritable tenure for individual farms has been established, as well as use rights and lease rights in agricultural land. The right of individuals and entities to sell, grant, mortgage and otherwise transfer rights in agricultural lands has been confirmed. However, key issues concerning the security of land use rights need to be clarified. While various land-related laws under preparation will address these issues, supplemental decrees or regulations will be needed to effectively implement these laws at the local level. Under the Program, measures will be taken to establish transparent procedures for the: (i) resolution of disputes concerning rights in agricultural land; (ii) state repossession of agricultural land; (iii) compensation and resettlement in cases of state repossession of agricultural land; (iv) registration of rights in agricultural land; and (v) pledging of agricultural land use rights as collateral.

18. Under the Program the process of ownership transfer of state farms to private entities initiated in 1993 will be completed, except for about 100 state farms to be retained for public purposes such as applied research. In fulfillment of this aspect of the Program, the ownership of over 300 state farms has been transferred to private entities so far in 1995. In

addition, the Government will review existing legislation relating to the privatization of state farms, and will issue decrees confirming the legal status of land share certificates issued to farm workers in privatized farm enterprises.

19. The promotion of market competitiveness is essential to provide appropriate price signals and incentives to farm producers and to assist in the establishment of the long-term viability of farm production. Market competitiveness will be encouraged through: (i) trade policy reforms; (ii) reforms of domestic agricultural markets; (iii) domestic procurement and price policy reforms; (iv) institutional reforms; and (v) reform of rural financial markets. While these crucial reforms are being implemented, the Government's capacity to evaluate their impact will also be strengthened.

20. External trade policy reforms, initiated in recent years, were substantially accelerated in the early part of 1995 with all economic entities, including the private sector, permitted to participate in the import and export of agricultural commodities. Quantitative restrictions, such as quotas and licenses, on the import and export of agricultural commodities have been abolished. The import tariff regime has been substantially liberalized. Nevertheless, Government interventions persist in the export trade for grain through the imposition of an export tax and the setting of a minimum reference price. Under the Program, the export tax on grain will be abolished and the minimum price for the export price of grain will also be eliminated.

21. The domestic agricultural markets have been dominated by thirteen vertically-integrated state holding companies at the national level which have controlled

marketing, distribution and processing of agricultural products. The monopolistic operations of these holding companies have been a major constraint to the development of competition in agricultural markets. The decision of the Government at the end of 1994 to include agro-industrial enterprises under its National Privatization Program has permitted the accelerated dismantling of these holding companies and the subsequent privatization of their subsidiaries, including state-controlled holding companies exercising monopoly power at the oblast level. Under this Program the thirteen agro-industrial monopoly state holding companies will be liquidated. Of these, eight have already been liquidated. The Government will also establish under the Program, a timebound plan to liquidate state-controlled monopoly holding companies at the oblast level. Additionally, the Government will divest its remaining shares in Astyk's grain elevators through the National Privatization Program.

22. While substantial policy reforms in the Government's domestic procurement system have been undertaken in recent years, further liberalization of the system was required. Under the Program, a market-based system of grain procurement through competitive auction involving the Kazakh International Agro-Industrial Exchange was recently established and direct controls on mark-ups for grain, bread and fodder were eliminated.

23. Price controls on virtually all agricultural inputs were removed shortly after Independence. Direct budgetary subsidies on inputs had been eliminated by early 1995. However, the Agriculture Support Fund established in January 1995 reintroduced some subsidies on critical inputs and outputs on a highly selective and temporary basis. These subsidies are also very well targeted. However, to improve the efficiency of agricultural markets, under this Program the Government will: (i) make all allocations and expenditures

under the Agriculture Support Fund fully transparent and develop an expenditure reporting system; (ii) phase out price subsidies on agricultural products and inputs under the Agriculture Support Fund; (iii) review the effectiveness and expenditures under the Agriculture Support Fund and restructure the Fund as appropriate; and (iv) as an additional measure, keep agricultural products and inputs free of budgetary subsidies throughout the Program period.

24. Historically, only the cost of services for water distribution and repair and maintenance of irrigation facilities have been charged, with no charge levied for the economic cost of water. The Government, accordingly, will review its pricing policies for irrigation water and determine user charges for alternative irrigation systems as well as establish procedures for the setting and collection of irrigation user charges.

25. As the agricultural economy moves towards a market-based system, the reliance on indirect policy instruments is increasing. We recognize that the capacity of Government to formulate and analyze agricultural policies needs to be strengthened. Accordingly, the Ministry of Agriculture will establish an information system to collect and analyze market and socioeconomic data to strengthen the basis of policy formulation and analysis. Based on this system the Ministry of Agriculture will monitor and analyze the economic effects and socioeconomic impacts of the Program's reform measures.

26. Despite important institutional reforms in agriculture, the legal and regulatory framework for voluntary farmer's associations needs to be clarified and strengthened. The Ministry of Agriculture and other concerned ministries and other associations will review the existing legal and regulatory framework for agricultural cooperatives, in order to prepare a

model charter for voluntary farmer's associations and to issue appropriate decrees to facilitate formation of such associations.

27. Agroprombank (APB), which has been the predominant bank servicing the rural sector, faces serious difficulties and consequently its role in future rural financial intermediation is expected to be greatly curtailed. The Agriculture Support Fund is in the process of assuming the non-performing assets of APB resulting from Government-directed credit. Following this development, APB is expected to be able to meet NBK's prudential safeguards. Potential exists for the purchase by other banks of some branches of APB in order to initiate rural financial operations. Nevertheless, there is a large unserved need for rural credit and the mobilization of rural services, entailing the requirement for substantial restructuring of the rural financial system.

28. To address these issues under the Program: (i) T5.5 billion of APB's bad debts has been transferred to the Agriculture Support Fund; (ii) the external audit of APB's 1994 accounts will be completed in accordance with international auditing standards; (iii) the value of the Government's remaining shares in APB will be determined and the Ministry of Finance will prepare a timebound plan to substantially divest the Government's remaining shares in APB; (iv) NBK has permitted banks (other than APB) which meet its prudential requirements to operate in the agriculture sector; and (v) NBK will prepare a timebound plan to restructure the rural financial market.

29. Even though problems would have been more severe in the absence of the reform program, the transition to a market economy has been accompanied by a significant

increase in rural underemployment. Living standards have deteriorated sharply due to lagged adjustment of wages to a very high rate of inflation. Given the sharp deterioration in living standards there is an urgent need to strengthen social protection to the most vulnerable groups. The budgetary social safety net has been strengthened through improved targeting and increased allocations. However, the resources needed to respond adequately to this deteriorating socioeconomic situation are far beyond the capacity of the Government to mobilize.

30. As measures to address social protection under the Program the Government has extended the Employment Fund to the agriculture sector and furthermore will: (i) increase the 1995 budget of the Employment Fund from T3.0 billion to T3.5 billion and maintain the level of T3.5 billion in the Fund's 1996 budget; (ii) develop appropriate training programs for unemployed agricultural workers, especially women; and (iii) within the context of the Government's macroeconomic stabilization program, include the provision of at least T2.6 billion in the national budget as targeted cash compensation to meet essential needs of vulnerable groups.

31. Major environmental problems in the agriculture sector include the desiccation of the Aral Sea; control and use of pesticides; the degradation of range lands; soil salinity and erosion; and desertification. While the issues of desiccation; desertification and soil erosion are being addressed, there is a need to address problems relating to pesticide use and range land conservation. Accordingly, as measures to ensure sustainable management of agriculture, under the Program the Government will: (i) compile an inventory of the old pesticides banned under existing regulations of Kazakhstan; (ii) issue directives and/or guidelines for the disposal

of old stocks of such banned pesticides; (iii) review and amend, if necessary, its existing pesticide regulations to ensure conformity with FAO regulations; and (iv) prepare policy recommendations for the sustainable use of range lands.

32. My Government appreciates the support to be provided by the Asian Development Bank by way of an Agriculture Sector Program loan. This will support my Government's efforts to accelerate the transition to a competitive, market-oriented agriculture sector which will be a key component in establishing a market economy in Kazakhstan.



A. S. Yesimov
Deputy Prime Minister

KAZAKHSTAN: AGRICULTURE SECTOR PROGRAM

Policy Matrix

Overall Objective: To substantially strengthen the reform process with a view to establishing a competitive, market-based agriculture sector.

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
1. To strengthen the security of tenure in order to encourage the growth of an agricultural land market.	<p>A. Land Reform</p> <p>(i) Regulatory Framework for Land Use Rights</p> <p>1.1. The Government's present land policy requires that a non-state model of ownership and management be adopted with the worker's rights to land clearly established. Land tenure reform commenced with the Land Code of 1991, which established lifetime inheritable tenure for individual farms, as well as use rights and lease rights in agricultural land. The Farmer Facility Law of 1993 further defined the rights and obligations of family farms. However, it also contained significant restrictions, some of which were removed through a Presidential decree in April 1994. This decree confirmed the right of individuals and entities to sell, grant, mortgage and otherwise transfer rights in agricultural lands. The Presidential decree of 1994, however, did not adequately clarify key issues concerning the security of land use rights. Drafts of a new Land Code, Mortgage Law, and Law on Registration of Rights in Immovable Property and Related Transactions are under preparation and a new Civil Procedure Code is expected to be drafted in the near future. These new codes and laws should address many of the issues relating to rights in agricultural land. However, supplemental decrees or regulations will be needed to effectively implement these laws at the local levels.</p>	<p>1.1.1. Government to issue decrees and/or regulations establishing transparent procedures for state repossession of agricultural land.</p> <p>June 1996</p> <p>1.1.2. Government to issue decrees and/or regulations establishing transparent procedures for compensation and resettlement in cases of state repossession of agricultural land.</p> <p>September 1996</p> <p>1.1.3. Government to issue decrees and/or regulations establishing transparent procedures consistent with the Land Code and the Law on Registration of Rights in Immovable Property and Related Transactions, for registration of rights in agricultural land.</p> <p>June 1996</p> <p>1.1.4. Government to issue decrees and/or regulations establishing transparent procedures for the resolution of disputes concerning rights in agricultural land.</p> <p>December 1996</p> <p>1.1.5. Government to issue decrees and/or regulations establishing transparent procedures for pledging agricultural land use rights as collateral.</p> <p>December 1996</p>		Second tranche

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
2. To strengthen the farm workers' property rights in farm enterprises.	<p>(ii) Land Shares in Farm Enterprises</p> <p>2.1. As an intermediate step to granting farm workers rights in specific parcels of land, the Government initiated a program in March 1995 to issue land share certificates to individual farm workers of privatized state farms. However, the legal rights and interests represented by these certificates are not clearly defined.</p>	<p>2.1.1. Government to issue decrees and/or regulations confirming the legal status of land share certificates issued to farm workers in privatized farm enterprises, consistent with the Land Code, the Civil Code and the Law on Registration of Rights in Immovable Property and Related Transactions.</p>	September 1996	Second tranche
3. To encourage the efficient use of agricultural land and to provide incentives for long-term investment in land development.	<p>(iii) Transfer of State Farms</p> <p>3.1. The Government initiated the process of ownership transfer of state farms to private entities in 1994 following the Presidential decree of April that year. By the end of 1994, ownership of 1,363 state farms had been transferred.</p>	<p>3.1.1. Government to transfer to private entities 300 additional state farms.</p> <p>3.1.2. Government to transfer to private entities the remaining state farms, except for about 100 to be retained for public purposes, such as applied research.</p>	<p>June 1995 (accomplished)</p> <p>December 1996</p>	Board consideration

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
II. Promoting Market Competitiveness				
<p>4. To accelerate the liberalization of international trade in agricultural commodities.</p>	<p>A. Trade Policy Reforms</p> <p>4.1. A Presidential decree issued in February 1995 substantially liberalized external trade policies. Following this decree, quantitative restrictions (such as quotas and licenses) on imports of agricultural commodities have been abolished. The import tariff regime has also been substantially liberalized. All economic entities, including the private sector, are permitted to participate in the import of agricultural commodities. By April 1995, quantitative restrictions (such as quotas and licenses) on the export of all agricultural commodities were also abolished.</p> <p>4.2. Despite these reforms, an ad valorem export tax of 10 per cent on grain remains in place. The high present rate of export tax on grain accentuates the misalignment of domestic prices with world prices, with adverse implications for farm incomes. It also reduces incentives to export grain. Another major government intervention involves the setting of a minimum reference price for the export of grain, which undermines the transparency of price signals in domestic markets.</p> <p>4.3. All economic entities, including the private sector, are permitted to participate in the export of agricultural commodities. To strengthen market participation and increase competition, and hence improve the efficiency of agricultural markets, the Government established theb Kazakh International Agro-Industrial Exchange.</p>	<p>4.2.1. Government to abolish the export tax on grain.</p> <p>4.2.2. Government to discontinue the practice of settling minimum export price for grains.</p>	<p>September 1996</p> <p>September 1997</p>	<p>Second tranche</p>

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
<p>5. To ensure market-based farmgate prices of agricultural products through enhanced competition in domestic agricultural markets.</p>	<p>B. Reform of Agricultural Markets</p> <p>(i) Dismantling Monopoly Holding Companies</p> <p>5.1. The domestic agricultural markets have been dominated by 13 vertically-integrated state holding companies at the national level. These state-owned national apex bodies have controlled marketing, distribution and processing of agricultural products. The monopolistic operations of these state holding companies have been a major constraint to the development of competition in agricultural markets, including the market for grain. This market structure has resulted in a continued pattern of low farmgate prices adversely affecting the agricultural terms of trade and weakening production incentives. The decision of the Government at the end of 1994 to include agro-industrial enterprises under its National Privatization Program permits accelerated dismantling of these 13 holding companies and the subsequent privatization of their subsidiaries, including state-controlled holding companies exercising monopoly power at the oblast level.</p> <p>5.2 The most prominent of the state holding companies at the national level is Astyk, which initially retained 31 grain elevators in the country following its liquidation as a national monopoly. However, the capacity of these grain elevators is about 3.5 million tons, which is far in excess of the elevator capacity required by the Government to maintain adequate foodgrain supplies for the security forces and for national food security purposes.</p>	<p>5.1.1. Government to issue decrees or resolutions to liquidate 8 of the 13 agro-industrial monopoly state holding companies.</p> <p>5.1.2. Government to issue decrees or resolutions to liquidate the remaining 5 agro-industrial monopoly state holding companies.</p> <p>5.1.3. Government to prepare a program to liquidate state-controlled agro-industrial monopoly holding companies at the oblast level.</p> <p>5.2.1. Government to divest its remaining shares in Astyk's grain elevators through the National Privatization Program.</p>	<p>June 1995 (accomplished)</p> <p>September 1996</p> <p>December 1996</p> <p>December 1996</p>	<p>Board consideration</p> <p>Second tranche</p>

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
6. To further reduce Government intervention in domestic agricultural markets in order to improve the efficiency of market-based resource allocation.	<p>(ii) Domestic Procurement and Price Policy Reforms</p> <p>6.1. Substantial policy reforms have been undertaken in recent years. The Government initiated the liberalization of its procurement system for agricultural products in 1993 by replacing the state orders system by the state needs system, which involved a significant reduction in quantities procured and which was less restrictive. The state needs system was abolished in early 1995. However, the Government procurement system needs substantial further liberalization.</p> <p>6.2. On the consumption side, prices for grain, bread and fodder were liberalized in December 1994. However, controls were introduced on trade mark-ups for these products.</p> <p>6.3. Shortly after independence, price controls were removed on virtually all agricultural inputs. Direct budgetary subsidies on inputs, fertilizer and animal feed had been eliminated by early 1995. However, the Agriculture Support Fund (ASF), established in January 1995 reintroduced some price subsidies on critical agricultural inputs and products. Expenditures on these subsidies amounted to about T500 million as of June 1995. Due to the Government's resource constraints, however, the budgeted allocation to the ASF in 1995 has been reduced to T3.7 billion from T5 billion.</p>	6.1.1. Government to establish a market-based system of grain procurement through competitive auctions administered by the Kazakh International Agro-industrial Exchange.	April 1995 (accomplished)	Board consideration
		6.2.1. Government to eliminate direct controls on trade mark-ups for grain, bread and fodder.	April 1995 (accomplished)	Board consideration
		6.3.1. Government to keep meat, wool and fertilizer free of direct budgetary subsidies except through the ASF.	Program period	
		6.3.2. Government to make all allocations and expenditures under the ASF fully transparent, beginning with the national budget for 1996, and to develop an expenditure reporting system for the ASF acceptable to the Bank.	March 1996	
		6.3.3. Government to phase out direct subsidies on agricultural inputs under the ASF.	September 1996	Second tranche
		6.3.4. Government to phase out price support on meat and wool under the ASF.	September 1997	

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
<p>7. To strengthen the Government's capacity for agricultural policy formulation and analysis.</p>	<p>6.4. The use of water for irrigation is regulated through the provisions of the Water Code of 1993. Historically, only the cost of services for water distribution and repair and maintenance of irrigation facilities was charged. No charge for the economic cost of the water resource was levied.</p> <p>C. Institutional Reform</p> <p>(i) Capacity for Policy Analysis</p> <p>7.1. As the agricultural economy moves towards a market-based system, the reliance on indirect policy instruments is increasing. However, the Government's capacity to formulate and analyze agricultural policies needs considerable strengthening.</p>	<p>6.3.5. Government to review, with technical assistance, the effectiveness of expenditures under the ASF and to restructure the ASF, as appropriate.</p> <p>6.4.1. Government to review, with technical assistance, its pricing policies for irrigation water and to determine appropriate user charges for alternative irrigation systems.</p> <p>6.4.2. Government to establish procedures for setting and collecting irrigation user charges.</p>	<p>September 1996</p> <p>December 1996</p> <p>March 1997</p>	
		<p>7.1.1. Ministry of Agriculture (MOA) to establish, with technical assistance, an information system to collect and analyze market and socioeconomic data to strengthen the basis of policy formulation and analysis.</p>	<p>September 1996</p>	
		<p>7.1.2. MOA to monitor and analyze the economic effects of the Program's reform measures.</p>	<p>Remaining Program period</p>	

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
8. To promote the growth of voluntary farmer associations.	(ii) Reform of Grassroots Institutions	8.1.1. MOA and other concerned ministries to review, with technical assistance, the existing legal and regulatory framework for agricultural cooperatives and other associations; to prepare a model charter for voluntary farmer associations; and to prepare decrees and/or regulations to facilitate the formation of voluntary farmer associations.	December 1996	Board consideration
	8.1. Despite the granting of individual land use rights, most farmers have remained within the privatized state farm systems. Even those who separated to establish individual, private farms have been obliged to enter into resource-pooling arrangements to overcome capital equipment, credit and market constraints. The legal and regulatory framework for voluntary farmers' associations needs to be clarified and strengthened.	8.1.2. Government to issue decrees and/or regulations to facilitate the formation of voluntary farmer associations, especially for purposes of marketing, obtaining credit and using farm capital equipment.	March 1997	
9. To strengthen the commercial orientation of the rural credit and savings services.	D. Reform of Rural Credit and Savings Services	9.1.1. Government to transfer at least T5.5 billion of APB's non-performing assets to the ASF.	July 1995 (accomplished)	Board consideration
		9.1.2. External audit of APB's 1994 accounts to be completed in accordance with international auditing practice.	March 1996	
		9.1.3. Government to determine the value of its remaining shares in APB.	June 1996	
		9.1.4. MOF to prepare a timebound plan to substantially divest the Government's remaining shares in APB.	September 1996	

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
	9.2. There is a large unserved need for rural credit and the mobilization of rural savings. The scarcity of rural financial services has severely constrained agricultural activities, and the rural financial system needs substantial restructuring. Potential exists for the purchase by other banks of some branches of APB in order to strengthen rural financial operations.	9.2.1. NBK to permit banks (other than APB) which meet NBK's prudential requirements to operate in the agriculture sector. 9.2.2. NBK to prepare, with technical assistance, timebound plan to restructure rural credit and savings services.	April 1995 (accomplished) September 1996	Board consideration
III. Addressing Social and Environmental Concerns				
10. To strengthen social protection measures for vulnerable groups adversely affected by the transition of the agriculture sector towards a market-based system.	A. Social Protection 10.1. The transition to a market economy has been associated with a significant increase in the rural underemployment rate, estimated at 16 per cent or twice that in other sectors. The average agricultural wage, estimated at T2,300 per month in mid-1995, is less than half the national average compared to near parity in the early 1990s. Living standards deteriorated sharply due to lagged adjustment of wages to runaway inflation. This situation has been accentuated by the inability of state farms to pay wages for up to 9 months in many cases, the wage arrears being estimated at T6 billion in early 1995.	10.1.1. Government to extend the Employment Fund to include the agriculture sector. 10.1.2. Government to increase the 1995 budget of the Employment Fund from T3.0 billion to T3.5 billion and maintain the level of T3.5 billion in the 1996 budget. 10.1.3. Ministry of Labor to develop appropriate training programs for unemployed agricultural workers, especially women. 10.1.4. MOA to monitor and evaluate, through the information and analysis system established under technical assistance, the socio-economic impact of the Program's reform measures with particular emphasis on vulnerable groups in rural areas.	July 1995 (accomplished) March 1996 June 1996 Program period	Board consideration Second tranche

Policy Areas and Objectives	Measures Previously Taken	Policy Measures Under the Program	Target Date	Condition To:
<p>11. To strengthen sustainable management of the environment in the agriculture sector.</p>	<p>10.2. Given the sharp deterioration in living standards which is expected to continue in the medium term, there is an urgent need to strengthen social protection to the most vulnerable groups. The social safety net, comprising social insurance outlays and targeted cash compensation, has been strengthened through improved targeting and increased allocations. However, the resources needed to respond adequately to this deteriorating socio-economic situation are far beyond the capacity of the Government to mobilize.</p> <p>B. Environmental Protection</p>	<p>10.2.1. Government to include the provision of targeted cash compensation (to meet essential needs of vulnerable groups), in the 1996 budget an amount not less than the 1995 budget allocation of T2.6 billion.</p>	<p>March 1996</p>	<p>Second tranche</p>
	<p>11.1. Environmental management measures for land are in the early stages of preparation. Environmental management as it relates to agriculture is regulated by the Water, Land and Forest Codes, as well as the more general provisions of an Environmental Protection Law. Major environmental problems in the agriculture sector include the control and use of pesticides; the conservation of range lands; soil salinity and erosion; and desertification. Specifications for ecological zoning of the country have been nearly completed. Amendments to the Environmental Protection Law to address these serious environmental problems are expected to be drafted by the end of 1995. The country is a signatory to an international convention on desertification. While the issues of desertification and soil erosion are being addressed to a certain extent, there is a need to address problems relating to pesticide use and rangeland conservation.</p>	<p>11.1.1. Government to compile an inventory of the old stocks of pesticides banned under existing Government regulations (or not recommended for use by FAO).</p>	<p>December 1995</p>	
		<p>11.1.2. Government to issue directives and/or guidelines for disposal of old stocks of banned (or FAO non-recommended) pesticides.</p>	<p>March 1996</p>	
		<p>11.1.3. Government to review and amend, as necessary, its existing pesticide regulations to ensure conformity with FAO recommendations.</p>	<p>September 1996</p>	<p>Second tranche</p>
		<p>11.1.4. Government to prepare, with technical assistance, policy recommendations for the sustainable use of rangelands.</p>	<p>September 1996</p>	