

RRP:KGZ 28394

# **ASIAN DEVELOPMENT BANK**

**REPORT AND RECOMMENDATION**

**OF THE**

**PRESIDENT**

**TO THE -**

**BOARD OF DIRECTORS**

**ON A**

**PROPOSED LOAN**

**AND**

**TECHNICAL ASSISTANCE**

**TO THE**

**KYRGYZ REPUBLIC**

**FOR THE**

**AGRICULTURE SECTOR PROGRAM**

**October 1995**

## CURRENCY EQUIVALENTS

(as of 9 October 1995)

Currency Unit	-	Som
\$1.00	-	Som10.45
Som1.00	-	\$0.0957

The exchange rate of the Som is determined on a managed float basis through periodic foreign exchange auctions. The calculations in this Report are based on an exchange rate of Som10.45 to \$1.00.

## ABBREVIATIONS

APEAC	-	Agriculture Privatization and Enterprise Adjustment Credit
CLAR	-	Center for Land and Agrarian Reform
FSU	-	Former Soviet Union
GDP	-	Gross Domestic Product
IMF	-	International Monetary Fund
JSC	-	Joint Stock Company
KAK	-	KyrgyzAilKomok
KDA	-	KyrgyzDanAzyk
KSKK	-	KyrgyzSelkhozKhimia
KZVS	-	KyrgyzZoovetsnab
MAF	-	Ministry of Agriculture and Food
MWR	-	Ministry of Water Resources
NLF	-	National Land Fund
O&M	-	Operation and Maintenance
PESAC	-	Privatization and Enterprise Sector Adjustment Credit
PIA	-	Poverty Impact Assessment
PPTA	-	Project Preparatory Technical Assistance
RCLAR	-	Republican Center for Land and Agrarian Reform
SOE	-	State-Owned Enterprise
TA	-	Technical Assistance
WUA	-	Water Users Association

## NOTES

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

## TABLE OF CONTENTS

	Page
LOAN AND PROGRAM SUMMARY	ii
MAP	v
I. PROPOSAL	1
II. INTRODUCTION	1
III. THE AGRICULTURE SECTOR	2
A. Background and Recent Performance	2
B. The Sector's Key Development Issues	6
C. The Government's Sectoral Policies	7
D. Recent Policy Reforms	7
E. Impacts of the Past Reforms	14
F. Remaining Constraints and Issues	15
G. Medium-Term Growth Prospects	19
H. External Assistance to the Sector	19
I. The Bank's Operational Strategy	20
IV. THE PROPOSED PROGRAM	21
A. Rationale	21
B. Objective	21
C. Program Scope	21
D. Program Measures	22
E. Policy Dialogue	24
V. THE PROPOSED BANK ASSISTANCE	24
A. The Loan	24
B. Tranche Conditions	24
C. Implementation Arrangements	25
D. Technical Assistance	27
VI. PROGRAM IMPACT, RISK, AND JUSTIFICATION	29
A. Program Impact	29
B. Program Risks	31
C. Program Justification	31
VII. RECOMMENDATION	32
APPENDIXES	34

**KYRGYZ REPUBLIC  
AGRICULTURE SECTOR PROGRAM  
LOAN AND PROGRAM SUMMARY**

<b>Borrower</b>	: Kyrgyz Republic
<b>Program Description</b>	: The Program will support the Government's continuing reform process towards a market-based agriculture sector.
<b>Classification</b>	: Primary Objective: Economic Growth.
<b>Rationale</b>	: The agriculture sector is expected to lead the economy's recovery and growth through the transition process. The Kyrgyz Republic is undergoing a significant structural transformation amid deteriorating economic and social conditions. The Government continues to show strong commitment to the reform process and while substantial progress has been made, the process needs to be broadened and deepened. The proposed Program complements and supplements the Government's macroeconomic stabilization and structural adjustment reform measures supported by other external agencies, especially the International Monetary Fund and the World Bank. It will also facilitate the assistance programs of other funding sources for the agriculture sector.
<b>Objective and Scope</b>	: The overall objective of the Program is to facilitate the transition to a competitive market-based agriculture sector within a framework to (i) encourage the development of market institutions, (ii) increase the competitiveness of markets, (iii) improve social and environmental progress, and (iv) enhance public sector support. The Program focus is on further policy and institutional efforts in land reform and farm restructuring and in natural resources management, and restructuring and further improvement of the agricultural input supply system, maintenance of social protection, and capacity building of the sector's key institutions in managing the transitional process.
<b>Loan Amount and Terms</b>	: A loan equivalent to \$40 million will be provided from the Bank's Special Funds resources. The loan will have a maturity of 40 years, including a grace period of 10 years, and will carry a service charge of 1 percent per annum.
<b>Utilization of Loan Proceeds</b>	: 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

against eligible imports 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 sector to a market-based system.

- Tranching** : The proposed 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 in December 1996, subject to compliance with the conditions for its release.
- Executing Agency** : Ministry of Finance.
- Procurement** : Eligible imports financed under the Bank loan will be procured in accordance with the Bank's *Guidelines for Procurement*.
- Program Period** : Two-year period ending December 1997.
- Program Benefits** : The incentive structure for private sector development will be enhanced at the farm level and the input supply level, resulting in more efficient farm operations and increased competition in the input supply market. The reforms will also extend and strengthen the institutional framework to provide for more effective implementation of the reforms. Capacity building measures for the Ministry of Agriculture and Food will enable it to provide a more appropriate public sector management role for a market-based sector. The overall Program is expected to provide an environment that is (i) more effective and efficient in the allocation and use of available resources; (ii) more conducive to effective investment lending; and (iii) more flexible in responding to changing economic circumstances.
- Program Risks** : The principal risks are that (i) the Government's capacity to effectively implement reforms may be limited; (ii) the land reform and farm restructuring process may face some resistance at the local farm level and interference from local government officials; and (iii) the Government's commitment to the current pace of reform may not continue, particularly if economic recovery is not soon forthcoming. Under the Bank's technical assistance (TA), the reorganization of the Ministry of Agriculture and Food will provide essential capacity building to enhance the Government's implementation effectiveness. As a policy measure in the World Bank's Agriculture Privatization and Enterprise Adjustment Credit, the interference of the local

government authorities in economic decision-making is to be removed through the implementation of new Presidential decrees.

**Technical Assistance** : Two TA grants will be provided: (i) Reorganization and Strengthening of the Ministry of Agriculture and Food (\$1,324,000); and (ii) Building Capacity for the Formation and Management of Water Users Associations, in the Ministry of Water Resources (\$861,000). A consulting firm will be engaged by the Bank for each TA, in accordance with its *Guidelines on the Use of Consultants*. The TAs will contribute to ongoing policy dialogue between the Government and the Bank.

[illegible]

(Boundaries not necessarily authoritative)

## I. THE PROPOSAL

1. I submit for your approval the following Report and Recommendation on a proposed loan to the Kyrgyz Republic for the Agriculture Sector Program, and proposed technical assistance for (i) the Reorganization and Strengthening of the Ministry of Agriculture and Food; and (ii) Building Capacity for the Formation and Management of Water Users Associations, in the Ministry of Water Resources.

## II. INTRODUCTION

2. The Kyrgyz Republic became independent in December 1991, following the breakup of the former Soviet Union (FSU). It immediately faced a deteriorating economic situation as the break-up resulted in the loss of transfers from its central Government, the loss of traditional markets, the breakdown of the payments mechanism for cross-border transactions, deteriorating terms of trade, and hyperinflation. Gross domestic product (GDP) has declined 53 percent between 1990 and 1994.

3. The Government responded immediately with a reform program to pursue its transition to a market-based economy. These reforms have been guided by the "Programme of Economic Reforms" approved by Parliament in 1992. The Programme outlined macroeconomic stabilization and sectoral and structural reform measures. The macroeconomic measures were aimed at reducing inflation and enabling economic growth and development. The broad sectoral and structural reform measures covered (i) enterprise reform and privatization; (ii) industrial and trade policy reform; (iii) promotion of private sector development, including encouragement of direct foreign investment and eradication of monopolistic markets; (iv) financial sector reform; and (v) social safety net reform. These reforms were vigorously pursued, with the Kyrgyz Republic being the first Commonwealth of Independent States country to adopt its own currency and to institute monetary and fiscal policies to combat the severe inflation. Also it was the first country to receive access to the International Monetary Fund's (IMF's) Systemic Transformation Facility (in 1993) and to receive a three-year enhanced structural adjustment facility in July 1994. As a result of the Government's macrostabilization efforts, inflation has dropped from over 1,000 percent in 1992 and 1993 to less than 100 percent in 1994 and is expected to be less than 50 percent in 1995.<sup>1</sup> At the June 1995 Consultative Group Meeting, the funding community concluded that the macroeconomic stabilization and structural reform program in the Kyrgyz Republic was perhaps the most advanced among the Central Asian republics, and merited further strong support from the funding community.

4. The agriculture sector has been seriously affected by the deteriorating economic circumstances, but has been more resilient than the industry sector. Agriculture accounted for 35 percent of GDP in 1990 and has declined 38 percent through 1994. Industry, which also accounted for 35 percent of GDP in 1990, has declined by more than 60 percent over the same period. As a consequence, agriculture is now of greater importance to the economy, accounting for 42 percent of GDP in 1994 and 43 percent of employment. While the Government has been pursuing reforms, the supply-side responses in the agriculture sector

<sup>1</sup>

For more detailed information on recent economic developments, see Economic Review and Bank Operations, Kyrgyz Republic, EBO KGZ 95013: *Kyrgyz Republic*, October 1995.



have been less than expected. This limited response is due to the extent of the reform measures relative to the immensity of the challenges facing the Government, the length of time required for the recent reforms to diffuse through the sector, and the relatively ineffective implementation of some reforms at the local level.

5. The Government has continued its commitment to the reform process despite deteriorating economic and social conditions. The Government has recognized that agriculture will be the basis for the economy's recovery and development through the transition process and accordingly has given priority in 1995 to accelerating the reform program for the sector. Both the IMF and World Bank have been supporting the Government's stabilization and structural adjustment program. The Government has urgently requested Bank support to further the transformation of the agriculture sector to a competitive market-based system.<sup>1</sup> A Bank-funded project preparatory technical assistance (PPTA) assisted the Government in formulating the Agriculture Sector Program this year. The PPTA intensified the policy dialogue with the Government, particularly with regard to building up a common understanding of the key constraints and issues remaining and the further policy measures required for the transition to a competitive market-based agriculture sector.

6. A Bank Reconnaissance Mission for the Agriculture Program Loan was undertaken in March 1995, a Loan Fact-finding Mission in May 1995, and an Appraisal Mission from 31 July-21 August 1995.<sup>2</sup> This Report is based on the findings of the Bank missions, the report of the PPTA, review of various studies, and discussions with staff of national and local government agencies, privatized enterprises, and farms. Loan negotiations were held in Manila from 18-19 October 1995 with the authorized representatives of the Borrower. If the proposed loan is approved, it will be the Bank's second loan to the Kyrgyz Republic.

### III. THE AGRICULTURE SECTOR

#### A. Background and Recent Performance<sup>3</sup>

7. A land-locked country at the northern extremity of the Himalayan range, the Kyrgyz Republic has a population of 4.5 million and is among the poorest republics of the FSU, with a per capita income of \$830 in 1993.<sup>4</sup> Agriculture land accounts for more than half of the country's territory (19.9 million hectares[ha]), with intensively irrigated farms in the lowlands and valleys, and large areas of extensive grazing in the mountains. About 63 percent of the population lives in rural areas. One third of the labor force is employed directly in primary

<sup>1</sup> In July 1995, the President, Mr. Akaev and senior officials, of the Government of the Kyrgyz Republic visited the Bank's headquarters and reiterated the Government's support for the agriculture reform program and their request for the Agriculture Program Loan to be considered for approval in 1995.

<sup>2</sup> The Loan Appraisal Mission comprised J. Whittle (Project Economist/Mission Leader), A. Bauer (Program Economist (Social Sector), P. Daltrop (Sr. Counsel), D. Green (Sr. Program Economist), and R. Siy (Sr. Program Officer).

<sup>3</sup> A detailed historical review of the sector's development is contained in the Board Information Paper entitled, *Economic Report on the Kyrgyz Republic*, 21 November 1994.

<sup>4</sup> *The World Bank Atlas 1995*. The GDP estimate of the World Bank uses a rolling average of the exchange rates to fashion an international comparison. Estimates that use contemporary exchange rates would be considerably lower. Future estimates will undoubtedly reflect the fall in GDP in 1994.

agriculture, and an additional 10 percent of employees work in industries processing fiber, food, and agricultural by-products. Primary agriculture and agro-processing together account for over one third of GDP (Table 1). The country is known within the FSU as a supplier of high quality yarn and woolen products, red meat, cotton, silk, tobacco, fruits and vegetables, and honey. The exports from agriculture and agriculture-related industries accounted for over one third of the total value of exports in 1993.

8. During the Soviet era, the sector had been organized under a highly centralized system on the basis of extensive resource use. Agricultural production took place predominantly on state and collective farms.<sup>1</sup> Input supply and output marketing and processing were handled by state-owned agro-industrial conglomerates. Different components of the sector and their linkages with the rest of the economy were integrated into the broader FSU's economy; virtually all fertilizer supply and a large amount of animal feed, particularly for winter, were provided by other republics of the FSU, just as the Kyrgyz Republic was a major supplier of farm machinery to other republics.

Table 1: Agriculture's Role in the Kyrgyz Economy

	1990	1991	1992	1993	1994
Share of GDP (in percent)	35	32	34	37	42
Share of Employment (in percent)	33	36	38	39	43
Share of Total Exports (in percent)	50	52	33	38	n/a

Source: Goskomstats, Kyrgyz Republic, and staff estimates.

9. Livestock-raising has been the mainstay of agricultural activity, but its importance is declining relative to the crop subsector. The livestock subsector's value of agricultural output has declined from almost two thirds to about one half of total agricultural output. Pasture land and supporting forage areas together account for about 90 percent of the agriculture land. The country would have significant comparative advantages in livestock production if it (i) had an appropriate policy environment, and (ii) developed competitive market-based production and distribution systems.

10. During the Soviet period, the livestock subsector grew to an unsustainable size. Under pressure by Central Government planners to increase herd sizes without regard to the long-term economic costs of the resources, the number of animals increased sharply. For example, between 1960 and 1987 the number of cattle increased by over 50 percent, sheep and goats by 66 percent, pigs by 100 percent, horses by 25 percent, and poultry by 300 percent. These sharp increases put severe pressure on pasture grazing, leading to an overall productivity decline of the pasture land. The summer pasture's productivity had declined from 640 kilograms (kg)/ha in the early 1960s to 415 kg/ha in 1990, and the winter pasture from 300 kg/ha to 100 kg/ha. The increase in herd size was accompanied by a reduction in overall livestock production efficiency. Even in the absence of the shocks accompanying the breakup

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The household sector was active with about 4 percent of arable land and a high proportion of marketed fruit and vegetables. Prior to 1990, the household sector owned about one third of the cattle, one fifth of the sheep and goats, half the poultry and one quarter of the horses.

of the FSU it would have been difficult for the herd size and composition in 1990 to have been maintained.

11. The crop subsector consists of four principal commodity groups: food grains (mostly winter wheat, spring barley, and corn); industrial crops (such as cotton, tobacco, and sugar beet); potatoes and vegetables; and fodder crops (perennial hay and annual silage). In the early 1990s, the cropped area totaled about 1.3 million ha which had changed little since the 1970s. Over the period, the mix of products changed, favoring grain, particularly wheat, at the expense of industrial crops.

12. The crop subsector utilizes only 7 percent of total agricultural land, but a high proportion of this – nearly 80 percent – is irrigated. Given this kind of resource endowment, the subsector's comparative advantage appears to be in high value industrial crops, fruits, and vegetables. The recent expansion of food grain areas reflects the country's growing concern over domestic food security as a consequence of the sharp decline in grain imports following the break-up of the FSU. However, domestic grain production in the Kyrgyz Republic is dependent on imported inputs. Recent production data indicate that 87 percent of grain costs in 1993 were accounted for by materials inputs, the majority of which were imported. Greater domestic production of food grain may therefore not reduce overall import dependency.

13. In the process of economic transition, the agriculture sector is expected to lead the economy's recovery and growth. Since independence, the sector's performance has deteriorated markedly (Table 2). Agricultural output has consistently declined since 1990 in parallel to the general economic contraction, and the output decline appears to have accelerated between 1993 and 1994. The reduction in agricultural production is mainly due to falling productivity in the crop and livestock subsectors. In the crop subsector, falling yields reflect insufficient use of farm inputs, which are in general shortage because of market disruptions, a fall off in interrepublican trade, and a lack of agricultural credit. As a result, grain yields fell by over 30 percent between 1993 and 1994. The decline in livestock productivity in turn is due also, in the first instance, to a shortage of inputs, particularly feed. Cattle and pig live weight at slaughter decreased by over 20 percent between 1990 and 1993. In the same period, wool per sheep fell 12 percent. An increasing proportion of annual wool production is of low quality. The low productivity and quality of the wool industry is particularly worrisome. The Kyrgyz Republic, producing about 10 percent of the total wool production in the FSU, is traditionally a producer of relatively fine fiber, and the wool products alone accounted for over 40 percent of total agriculture-related exports in the early 1990s.

14. As a result of falling agricultural output, a large number of agro-processing, storage, and distribution facilities are operating significantly below capacity. The meat processing industry, for example, is running at about 20 percent of its capacity. This substantially reduced capacity utilization is a result of a failure of enterprises to respond to the reduction in the state procurement of primary farm products, operational inefficiency stemming from inadequate and obsolete equipment, a general lack of technological improvement, and limited market-based managerial skills.

Table 2: Recent Performance of the Agriculture Sector

	1990	1991	1992	1993	1994
Real GDP Growth (in percent)	3.2	-5.0	-15.8	-15.6	-26.5
<b>Agriculture Sector</b>					
Sector-wide Growth (in percent)	1.3	-15.6	-3.5	-8.7	-17.0
(i) Crops Output Growth (in percent)	-1.0	-16.7	0.9	-13.5	-18.0
(ii) Livestock Output Growth (in percent)	3.2	-6.1	-8.7	-7.7	-14.2
Share of Sectoral Output (in percent)					
(i) Crops Subsector	40	39	57	40	51
(ii) Livestock Subsector	60	61	43	60	49
Output of Major Products (in thousand tons)					
Grain	1,573	1,446	1,602	1,596	1,044
Seed Cotton	81	62	52	49	54
Vegetables	487	399	404	259	266
Meat	254	230	228	214	194
Wool	39	37	34	31	21
Grain Availability					
Food Grain (wheat in thousand tons)	1,112	934	884	1,170	n/a
– Share of Imports (in percent)	57.1	53.5	28.3	47.0	n/a
Feed grain (corn in thousand tons)	1,461	1,340	1,132	910	n/a
– Share of Imports (in percent)	30.1	30.0	22.1	25.3	n/a
<b>Memo Items</b>					
Farm Wage as Share of Average Wage (in percent)	90	95	102	72	45
Agric.'s Share of Capital Investment (in percent)	34	32	25	22	7

Source: Goskomstats, Kyrgyz Republic, and staff estimates.

15. As a result of the overall decline in agricultural production, farm income has fallen, both absolutely and in relation to other sectors. In 1990, agricultural wages were approximately 90 percent of average wages for the economy. In 1994, agricultural wages had fallen to only 45 percent of average wages for the economy, and by May 1995 had declined further to 41 percent. The reduced earnings, which reflect the collapse in agriculture trade, discourage farm producers from engaging in commercial production and instead encourage a retreat into subsistence operations. Also, with the erosion of social service provisions and transfers, the income in rural areas has deteriorated seriously in the last two years, resulting in increased outmigration of the younger population.

16. Furthermore, and partly as a result of the fiscal crisis, public resources allocated for agricultural research, extension services, and the maintenance of the sector's capital stock have been substantially reduced. For example, in 1990 the capital investment in the agriculture sector was about one third of the country's total. By 1994, the agriculture's share had dropped to only 7 percent of the much smaller total. As a result of this lack of public sector support, the country risks losing vital infrastructure facilities built up over decades. For example, of 1.4 million ha of arable land about 1 million ha is irrigated, but the area actually irrigated has declined about 15 percent over the last few years.

## B. The Sector's Key Development Issues

17. The key development issues challenging the Government are the policy and institutional inefficiencies remaining from the inherited structure of production and organization; the extent of poverty, particularly in the rural areas; and the unsustainable use of natural resources.

18. The sector, under the centralized structure combined with the highly controlled quantitative-based planning instruments, such as the state order and quota system, suffered from enormous inefficiency. The state order and quota system obligated farms and other economic entities alike to fulfill the quantitative targets with little regard to operational efficiency. In the absence of market forces and prices, there was no assurance economic resources would be appropriately allocated. There were clear signs of allocative inefficiencies such as the overexpansion of livestock herds. The rigid structure of production lacked the flexibility to respond to changing economic conditions.

19. In addition to the legacy of inefficient operations of the agriculture sector, the rural society in general is beset with widespread poverty. The Kyrgyz Republic emerged from the FSU as one of the poorest newly independent states; over one third of the population in 1991 was estimated to have a "socially unacceptable standard of living," and most of the poor were in rural areas.<sup>1</sup> The rural poor tend to be regionally concentrated – the south of the country has a higher incidence of rural poverty than does the north principally because of the poor natural resource base in the mountainous south; the rural poor also tend to be socially distinct – a large number of them are pensioners of state and collective farms.

20. The breakdown of the command system has severely aggravated economic circumstances in the Kyrgyz Republic during the transition period. In addition, the deteriorating terms of trade and the elimination of fiscal transfers from the FSU have also eroded the purchasing power and living standards of the population. Until late 1993, the state orders system, trade restrictions, and prevalent price controls and nonpayment by state procurement agencies had eroded real incomes in the agriculture sector and aggravated the adverse impact of the shocks on rural households. The precipitous decline in economic activity and ensuing erosion of real incomes have, in turn, exacerbated the poverty situation. Recent survey results show that poverty among rural households (48 percent) was estimated to be higher than urban households (29 percent).<sup>2</sup> The higher incidence of rural poverty also reflects the effects of distortionary policies that remain despite significant changes in the overall economic context.

21. The development issues of the agriculture sector in terms of its inefficiency and widespread rural poverty are compounded by a number of natural resource and environmental concerns. Among the most crucial problems in this regard are (i) severe land degradation mainly caused by overgrazing, (ii) inefficient utilization and management of water resources, and (iii) overexploitation of fragile forest resources. The problems of this nature have resulted from past sectoral and economy-wide policies that paid little attention to the central issue of sustainability of the natural resource base for economic development.

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<sup>1</sup> World Bank. 1995. "Poverty Assessment and Strategy." March. Washington, D.C..

<sup>2</sup> Ibid.

### **C. The Government's Sectoral Policies**

22. The three-fold development issues of inefficiency, poverty, and unsustainable use of natural resources now challenge the Government in formulating strategies and policies for the future development of the agriculture sector. The Government is fully aware that these problems are deep-seated in the existing economic and institutional framework for the sector, and in order for the sector to recover and grow in a more sustainable manner, the profound restructuring and transformation of the existing framework, which has been initiated, should be accelerated.

23. In the agriculture sector, the Government is pursuing an overall reform agenda to (i) create basic market institutions through establishment of clearly defined and enforceable property rights and other legal framework governing the market; (ii) promote development of competitive markets through privatization and restructuring of agricultural entities, and improve the incentive structure through elimination of undue price distortions and administrative controls on marketing and trade; and (iii) ensure the reform program proceeds with minimum social and environmental costs, and further develop strategies and policies on reduction of rural poverty and sustainable use and management of natural resources. To manage this important policy and institutional reform process and provide continued support for the sound development of a market-based agriculture sector, the Government has recognized the need to reorient and strengthen the public sector's support capability.

### **D. Recent Policy Reforms**

24. In 1991, the Government embarked upon one of the most ambitious reform programs among the FSU countries. The pace of the reform process and the support of the international community are continuing, with more focus on the agriculture sector. The overall reform agenda for agriculture is comprised of the following four areas: (i) promoting the development of market institutions; (ii) encouraging competitive forces in the newly created markets; (iii) mitigating against adverse impacts of the transformation by providing social protection, particularly for the most vulnerable groups in society, and preserving the environmental resource base; and (iv) reorienting and strengthening key public sector agencies. The key reform measures, the progress to date, and the reforms taken and pending are discussed within this framework.

#### **1. Developing Agricultural Markets**

25. The Government's reform program for developing agricultural markets has identified the following requirements: (i) clearly defined property rights, (ii) voluntary transactions as the basis of trade, (iii) prices that are free to adjust to changing market conditions, and (iv) relatively unrestricted entry into and exit from markets.

26. Establishing clearly defined and enforceable property rights is an essential base for asset markets in any sector. The absence of the appropriate forms of ownership and user rights of important resources such as land, water, and other agricultural property was a crucial deficiency for the agriculture and rural sector, a deficiency that had to be addressed during the transitional process. The Government has approached this issue primarily through its land and agrarian reform program.

27. Land reform and farm restructuring commenced with the February 1991 Law on Peasant Farms, which allowed the establishment of small, single family, private peasant farms as legal entities. Subsequent legislation and decrees outlined the 1991-1993 program for restructuring unprofitable state and collective farms, forming rural committees to implement farm restructuring, establishing the National Land Fund (NLF),<sup>1</sup> and determining land shares and property shares for all members of state and collective farms. Because of the lack of clarity in asset distribution and lease-hold rights as well as the lack of support services for private farmers, little progress in land reform and farm restructuring was achieved by the end of 1993.

28. In 1994, the reform program gained momentum commencing with the Presidential Decree in February 1994. This decree clarified the problems of the earlier policies and established further measures that included granting all rural residents the right to use a share of arable land for agricultural purposes for 49 years and a right to exchange, lease, buy, sell, and mortgage such land shares. The decree also reduced the NLF to 25 percent of arable land, excluding pastures, in each *raion* (administrative district under *oblast* level); retained the NLF and pastures as the property of the State; established maximum sizes for family holdings; and transferred responsibility for farm restructuring from the State Property Fund to the Ministry of Agriculture and Food (MAF). In addition, the decree provided for shares of nonland assets (livestock, buildings, machinery, stores of seed, and fuel) to be allocated to all workers of former state and collective farms.

29. To implement the new policies, the Republican Center for Land and Agrarian Reform (RCLAR) was established in 1994 in MAF. Through its branches in the *oblasts* (administrative regions) and *raions* the Centers for Land and Agrarian Reform (CLARs), are responsible for coordinating and monitoring the reform effort<sup>2</sup> being implemented by the *raion* administrations and rural committees. *Raion* administrations and rural committees have primary responsibility for implementing the reform program. An order from MAF of 23 January 1995 provided another administrative level, the Commissions on Land and Agrarian Reform, to help the rural committees, *raion* administrations, and CLARs in implementing reforms.

30. By the end of 1995, the Government, supported by the World Bank's Agriculture Privatization and Enterprise Adjustment Credit (APEAC) will have implemented the following measures in support of their land and farm restructuring program:

- (i) To provide more secure access to land, the Government will either amend the Constitution to institute private ownership of land or will pass legislation to ensure (a) automatic renewal of the right to use land after 49 years, (b) clear and limited grounds for terminating land-use rights, and (c) that existing legislation does not introduce any undue restrictions on transferability of land and its use as collateral.

<sup>1</sup> NLF land is reserved for renting to state joint-stock breed, seed, experimental farms; for land shares for citizens working and living beyond the farm limits and persons moving into the area to take up permanent residence on a farm; and for agricultural producers that will use the land temporarily on the basis of rental agreements.

<sup>2</sup> CLARs at the *raion* and *oblast* levels were previously administered by *raion* and *oblast* Akims (administrative heads). A recent Presidential decree has placed the CLARs under the RCLAR to give implementation of the reform program more consistency and transparency.

(ii) To consolidate existing legislation and regulations, and enact new ones if needed, to clarify and strengthen the agrarian reform program the Government will

- (a) facilitate the exit strategy and functioning of land markets through eliminating the minimum and maximum private farm size requirements for various categories of agricultural land, abolish the power of rural committees to approve land transactions, limit the period during which agricultural enterprises can lease land from individuals to five years, and provide for full marketability of shares inside or outside the enterprise in the case of corporate farms;
- (b) clarify the objectives of NLF lands regarding the quality of land to be selected for the NLF; criteria, procedures, and timetable through which land will be allocated to individual farmers; and the institution to decide on the allocation; and
- (c) establish transparent implementation procedures by providing separate procedures for adjudication of disputes, issuing a uniform land title or certificate, streamlining land registration procedures, and vesting responsibility in a single authority for land registration.

31. The farm restructuring program has resulted in a significant reduction in state and collective farms. By the end of 1994, some 167 state and collective farms (totaling 442) were estimated to have been reorganized, although the nature of the reorganization differs significantly from case to case. Whereas about 95 percent of land in agricultural enterprises in 1990 was under state and collective ownership, this had been reduced to 43 percent, or about 6.5 million ha by the end of 1994. The proportion of arable land is higher, with 48 percent still being held by state and collective farms at the end of 1994. An estimated 24,000 individual private farms or farm cooperatives have been formed, with an average land area of 350 ha. Since November 1994, the Government has been aiming to restructure all state and collective farms before the end of 1996. More farms have reportedly been restructured since January 1995, but reliable data are not available.

32. Although farmers are obtaining access to individual landholdings, their access to major inputs such as seed, livestock feed, fertilizer and chemicals, spare parts, and general support services has been considerably reduced. This situation is in part caused by the reduced availability of inputs but also by the absence of credit for farmers to make essential purchases. As a result, the volume and quality of farm production has declined rapidly. The absence of definable markets and market information has seen increased barter trading and on-farm storage.

33. Water resources share a similar importance to land resources for the agriculture sector, with approximately 80 percent of arable land under irrigation. A critical issue relates to water rights and responsibilities for the operation and maintenance (O&M) of the irrigation system. The Government has adopted a general policy that water users should assume responsibility for their irrigation services. A law in January 1994 and subsequent decrees have provided for transferring the ownership of irrigation systems and equipment from former state and collective farms and for licensing individual irrigation water-use rights. In June 1995, a further decree was issued authorizing the establishment of water users associations (WUAs) to be responsible for O&M of the irrigation systems at farm level.



34. For markets to function, administrative controls must be removed and a basis established for voluntary transactions. The state quota and purchase orders, which used to be the primary mechanism for procuring agricultural products, were eliminated in early 1994 and replaced by the so-called state needs system for a range of commodities, including grain, cotton, tobacco, seeds, livestock, and wool. The state needs purchase system is to operate under the new competitive procurement procedure, which is being designed and will be translated into law.<sup>1</sup> For all other agricultural commodities, market-based voluntary transactions now prevail. The Government also has liberalized foreign trade of farm inputs and outputs by lifting the quantitative restrictions on imports and exports and abolishing trade licensing.

35. Prices must also be free to equilibrate demand and supply in functioning markets. Initially a wide range of direct and indirect price controls had been imposed on the agriculture sector through the use of prescriptive prices and wholesale/retail margins for agricultural trade. By early 1994, however, price controls and trade margins on farm products and consumer goods had been phased out. Prices are now being determined by the market, typically as negotiated between producers and marketing and processing enterprises.

36. The impact of the liberalization efforts at the national level have, however, not been diffused through the economy as the local government authorities have continued to interfere with the pricing, marketing, and production decisions of farms and industrial enterprises. Although the Government has taken steps under APEAC to forbid local Governments from controlling procurement, distribution, and pricing decisions of privatized and corporatized<sup>2</sup> productive enterprises, this is likely to be a long-term problem. Continual monitoring by the central Government and capacity building at the local level will be required.

37. To increase the competitiveness of markets, enterprises must be free to enter and exit the market. Legal barriers to the private sector's entry into the agricultural input supply and the output marketing system have been eliminated. The private sector's participation is increasing and is particularly prevalent at the retail end of the commodity distribution chain. To facilitate the sound development of the private sector's involvement in other stages of the agricultural marketing and processing system, the Government has established a national business administration body – the State Central Registry – to issue business licenses to private entrepreneurs. In addition, the overall privatization program has been modified to convert the closed form joint stock companies into open form to encourage the private investment and management of newly privatized state-owned enterprises (SOEs). The Government has made further efforts to introduce other relevant legislative measures, such as the Company Law and Bankruptcy Law, both of which have been prepared and are being reviewed. Moreover, legal provisions are now in place to encourage foreign direct investment and joint venture operations.

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<sup>1</sup> The design of the competitive procurement procedure is being prepared under a technical assistance grant funded by the World Bank and will comprise the following elements: A tendering system will be introduced in which commercial agents will invite priced bids from producers and trading firms for the supply of commodities to the state. Contracts for delivery will be awarded to the lowest priced bidders, and the government will guarantee prompt payment to the suppliers. No preferences in allocation of input or credit will be given to those who supply state needs. Competition will be allowed in all products where the state is involved in supplying inputs or marketing products.

<sup>2</sup> Corporatization is the process of forming a joint stock company.

## 2. Encouraging Competitive Markets

38. The development of agricultural markets is necessary, but not sufficient, for a functioning market system. For newly established markets to be efficient, competition must be encouraged. The Government has recognized that for competitive market conditions, the following are needed: (i) state assets should be privatized and demonopolized, (ii) taxes and tariffs must be nondistortionary, and (iii) financial markets must be developed.

39. One of the first and major steps in encouraging competitive markets is the restructuring, privatizing and demonopolizing of the SOEs. Improvements in the efficiency of input and output markets cannot be fully realized only through abolishing administrative controls or liberalizing prices. A concerted effort has to be made to restructure, privatize and demonopolize the state-owned agro-conglomerates that control the input supply and output processing and marketing system.

40. At independence, the input supply, marketing, and processing of agricultural commodities was dominated by several large conglomerates. Input supply was controlled by KyrgyzAilKomok (KAK), which handles machinery and spare parts; KyrgyzSelkhozKhimia (KSKK), which handles import and distribution of fertilizers and agro-chemicals; and KyrgyzZoovetsnab (KZVS), which handles veterinary supplies. Petroleum products, storage, and recycling of used products continue to be provided by AgroMunaiz under MAF, but a financially self-supporting subsidiary of Munaizat, the national fuel and oil importer and distributor. Output marketing and processing was dominated by KyrgyzDanAzyk (KDA, the Bread Complex), KyrgyzTamak'Ash (handling processing and distribution of livestock and industrial crop products), and PetrebSoyuz (the Union of Consumer Cooperatives). Together with KSKK these conglomerates controlled about 90 percent of all purchases of agricultural outputs and inputs.

41. Accordingly, the Government commenced its privatization program in 1991, focusing largely on the industry sector. This early program resulted in the formation of "closed" joint stock companies (JSCs), with all shares being held by the labor collective and the state. A Presidential decree issued in August 1992 initiated the 1992-1993 privatization program wherein the privatization of agricultural enterprises was to be carried out by MAF, local state committees, and the State Property Fund. However, little real progress was made. While some operating units of the SOEs were converted to "closed" JSCs, the State still retained a major share. Furthermore, the newly created corporations and the local government administrations created holding companies that recreated the previous state-owned monopolistic structure. In many instances, the formal change in ownership did not result in an institutional or behavioral change.

42. In early 1994, the Government started a new "mass privatization program" designed to be more competitive and permit wider public participation. This new approach provides for all remaining small-scale enterprises to be sold off competitively at cash auctions. The remaining state shares in enterprises already privatized are to be sold through voucher ("coupon") or cash auctions at which individual voucher holders and investment funds can bid. For large enterprises (over 1,000 employees) and medium enterprises (over 100 employees), privatization will be under competitive bidding procedures. Five percent of the enterprise will be distributed free to managers and workers of the enterprise. Assuming the State share is 25 percent or more, at least 25 percent of the shares will be offered for sale at public voucher

auctions. The remaining 70 percent will be sold by inviting competing privatization bids or by direct sale to a strategic investor. From February 1995, the mass privatization program was to be on the basis of "open" JSCs with 70 percent of the shares being sold competitively and transparently. Companies privatized before January 1994 were, however, not covered by the new rules.

43. The demonopolization and final privatization of the major SOEs in agriculture is a priority issue for the Government. The six major enterprises are presently in various stages of demonopolization and privatization. Of the input supply enterprises, KZVS is mainly responsible for procuring and distributing veterinary supplies, and also undertakes regulatory and disease control functions. KZVS tests and registers drugs and vaccines, retains monopoly control for the procurement of drugs, manages stocks of vaccines and drugs for the control of epidemic diseases, and implements disease control measures. KZVS now consists of a headquarters and five *oblast* units as previous *raion* drugs stores and small shops in each village have been closed. KZVS remains 100 percent state owned and attached to MAF. KSKK was the monopoly importer and distributor of fertilizer and agro-chemicals. It also provided regulatory functions for plant protection services and operated agro-chemical stations for monitoring the incidence of pests and disease.<sup>1</sup> Its structure consisted of a headquarters, 6 *oblast* units, and 69 *raion* units. Restructuring commenced in 1992 but proceeded slowly. By December 1994, the *oblast* units and 32 *raion* units had been corporatized. By July 1995, shares in 20 of the JSCs had been offered at regional coupon auctions. KAK was one of the first wholesale monopolies to undertake the full privatization program. It now comprises a headquarters, 2 central storage depots, and about 100 units at *oblast* and *raion* level engaged in the repair of farm and other machinery and equipment. Eleven of KAK's larger local depots and workshop JSCs have been through coupon auctions, and a further 25 are expected to be auctioned by the end of 1995. KAK remains the principal procurement agency, importer, and distributor of machinery and parts.

44. Of the agro-processing conglomerates, KyrgyzTamak'Ash comprised over 100 food processing units of varying size. These had been corporatized by the end of 1994, with a majority of shares held by the state. Over half of the JSCs are controlled by local administrations through local holding companies. KDA has also been privatized and is operating as a holding company for 13 milling enterprises operating 14 flour and feed mills, 28 bread factories, and 110 smaller bakeries. It is also engaged in the purchase and distribution of cereal seed. PotrebSoyuz previously dominated rural retail trade but, as a result of financial and other difficulties, its market share is reported to have fallen markedly. It is an association of 6 *oblast* cooperatives with 250 primary cooperative societies. PotrebSoyuz operates 14 national, *oblast* or *raion* level wholesale bases and 3,500 retail stores. It purchases farm products and distributes them through its retail network.

45. Under the World Bank's APEAC, measures are to be taken to abolish existing and forbid new holding companies at national and regional level. The Government issued decrees on 25 May 1995 returning responsibility for the state shares in KyrgyzTamak'Ash and KDA to the State Property Fund, with a view to completing privatization in both cases by December 1995. The KyrgyzTamak'Ash national holding company will be corporatized, privatized, and converted to a consulting service company with the administrative services it

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As part of the MAF reorganization, the Ministry is establishing a crop protection administration and the KSKK plant protection service will be transferred to it, including the 80 headquarters, *oblast* and *raion* staff.

provided centrally being transferred to the individual enterprises. All enterprises will be converted to JSCs and offered for sale by December 1995. Similarly, KDA will no longer act as a holding company. It will be reorganized, downsized, and corporatized prior to privatization, with its administrative functions being transferred to the trading enterprises. It will ultimately withdraw from milling, bread production, and distribution activities. All enterprises will be converted into JSCs, divested, and privatized. KDA will continue to provide, on behalf of the Government, storage and management of an emergency wheat reserve, possibly retaining up to three regional storage complexes for this purpose. In the case of PetrebSoyuz, the State Property Fund is developing an approach to decentralizing ownership and creating more responsive local cooperatives. A cooperative law is to be introduced to (i) transform existing cooperatives into market responsive entities, (ii) enhance members' rights, (iii) break the obligatory link between regional cooperatives and the Union, and (iv) allow primary cooperatives to dispose of assets without approval of the Union. A restructuring strategy is to be prepared with World Bank funded technical assistance.

46. An outward looking agricultural trade policy will help ensure international competitiveness. Considering the smallness of the country and the limited capacity and potential of the domestic agricultural input supply industry, it is essential for the Kyrgyz Republic to maintain an open and competitive trade regime in agriculture-related imports and exports. To this end, the Government has reduced the scope and scale of the excessive agriculture-related import tariffs and export taxes. The import tariff now is at 10 percent on all import items. Under APEAC, a decree in June 1995 eliminated export taxes on cotton, wool, and silk cocoons. The single remaining export tax on hides and skins is scheduled for removal before the end of 1995, thus removing all export taxes.

47. The supply side response to market reforms cannot be expected without access to the required finance for investment in the new opportunities presented. The transition from central planning to a market economy requires the establishment of a banking sector capable of providing savings and credit services to financially autonomous enterprises and households. In the Kyrgyz Republic, the agricultural reform program has not been effectively supported by the rural finance and banking sector. Commercial banks are burdened with a significant amount of nonperforming loans in their portfolio, and are unable to make any new loans or to mobilize rural savings. The Government continues to provide directed credit to farms and enterprises, but it has ceased lending to nonviable enterprises. At the same time, alternative pilot schemes on village banking are being implemented, and other rural financial schemes are in preparation. Revamping the rural financial sector has now become a major policy issue. Initial steps are being taken in terms of (i) conducting detailed diagnostic studies and external audits of commercial banks, and (ii) writing off the portion of the bad debts that are due to the Government's directed lending in the past. Further measures on rural finance and banking are to be initiated as part of the overall financial sector adjustment program expected to take place in 1995 and 1996 with assistance from the World Bank. In addition, the Bank is proposing a PPTA, for implementation in 1996, to formulate an agricultural credit pilot project.

### **3. Improving Social and Environmental Progress**

48. In the course of its program to encourage the development of market institutions, the Government is cognizant of the social and environmental implications and the need to guard against potential market failures. The Government has initiated activities on (i) social service maintenance, (ii) retraining of the unemployed, (iii) employment services, and (iv)

a poverty monitoring program. A new law on social insurance and medical insurance has been prepared. A law on pension and social protection has been approved by Parliament. The Government also has implemented with budgetary support the compensation measures (including income support) to minimize the negative impact of price liberalization on the vulnerable groups. The Government is also working on a wheat reserve program as a temporary measure against undue fluctuations in the wheat market in the advent of a fully developed marketing system; the transactions of the state wheat reserve will take place at market prices through competitive tenders or contracts on commodity exchanges.

49. Similar efforts have been undertaken in formulating and implementing legislative measures and related policies on natural resources management and environmental protection. Specifically, a State Committee for Environmental Protection has been established. Laws on environmental protection and programs for monitoring potential damage to natural resources by various farming techniques and use of inputs have been introduced. A law on forestry protection and development has been approved. The National Environmental Action Plan also has been adopted. The Committee is working with MAF to implement the legal framework concerning various environmental clauses relevant to the agriculture sector.

#### **4. Enhanced Public Sector Support**

50. The public sector needs to play a supporting role in developing markets on a sustainable basis. The Government has started to reorient the public sector's support services to manage the reform process and to provide continued support to the development of a market-based agriculture sector. As a major initiative in this regard, an agriculture sector strategy study, completed in March 1995, provides detailed analyses and recommendations as to the future direction of the sector's development. A master plan for the development of the agriculture sector will be completed by the end of 1995. Moreover, the Government, with World Bank assistance, completed a detailed study on restructuring the existing setup of MAF, the key sectoral institution. In July 1995, a Government draft decree substantially redefined the role of MAF, and a working group within MAF was established to commence implementation. A reorganization plan, based on modified recommendations of the study, is being implemented.

51. Other public sector agencies are also being reoriented towards support for the market economy. The Government has issued a decree authorizing the establishment of WUAs to be responsible for O&M of the irrigation system at the farm level. This is part of the Ministry of Water Resource's (MWRs) overall program to change its strategy and functions from direct involvement in irrigation O&M towards devolution of responsibility for financing and managing irrigation facilities below the level of major canals to WUAs.

#### **E. Impacts of the Past Reforms**

52. The policy reforms carried out by the Government to date have made a significant stride in laying the foundations for a market-based agriculture sector in the Kyrgyz Republic. However, the sector's performance in the midst of the policy changes has been poor. One obvious indicator is that the sector has been on a continuous decline. Several factors explain the sector's weak supply response. First, given the immensity of the policy and institutional reform challenges facing the sector, the reforms carried out to date, although significant, are not enough to have a positive impact on the sector. A number of fundamental

and deep-seated policy and structural constraints remain, and need to be removed. Second, insufficient time has passed for the recently adopted policies to diffuse through the sector and for market mechanisms to begin functioning. A longer period of stabilization is necessary for credibility in the program to build up and for lasting changes in patterns of economic activity to become visible. In addition, liberalization measures decided and announced at the national level have not been fully implemented at the local level. Furthermore, the liberalization of prices and trade does not automatically translate into more productive and efficient activities. It does, however, create incentives and signals for reallocation of resources to better uses, a process that again takes time. Furthermore, the agriculture sector's response to the reforms may result in a smaller, but more efficient, sector than that at independence.

53. Despite its overall weak response, the sector has shown a number of healthy developments. Producers have become more responsive to market signals and more decisive in pursuing their own commercial interests. A most notable sign is a clear shift in the sector's product mix towards high value crops in response to their better market prospects. In 1994, for example, the production of major export items such as seed cotton, vegetables, fruits, and berries registered a positive growth over 1993 in contrast to the sector's overall decline. Furthermore, informal distribution channels are developing as some farmers have either held onto their harvest for future barter for their needs or started marketing directly to consumers, as in the case of meat and milk. Moreover, the vacuum created by the collapse of the state procurement system is being filled by small-scale local traders and foreign traders from the People's Republic of China, Turkey, and FSU countries that have become very active in exports of wool, cotton, live animals, leathers, and skins. Because of these encouraging developments, it appears that selected agricultural producers are somewhat better off in terms of real earnings despite large overall sectoral losses, although data are not available to support this observation.

54. Another major development as a result of the past reforms is that the proportion of the agricultural output produced by the nonstate sector has been increasing. For example, the nonstate sector production of grain accounted for 40 percent of the total in 1994 in contrast to 23 percent in 1992. The nonstate sector's share of vegetable production increased from 58 percent to 74 percent during the same period. By 1994, more than 80 percent of the output of major livestock products was from the nonstate sector.

## **F. Remaining Constraints and Issues**

55. The broad policy framework for the sector is now in place as a result of the reforms carried out to date. To induce a strong and lasting supply response in the sector requires further efforts to move the reform process into the next stage by broadening and deepening the policy and institutional reforms. Most of the simple or standard policy reform measures, especially those that can be accomplished by central authorities through legislation changes, have been taken. The next phase of the reform program will be the most challenging for the Government as the measures required will need to address further the deep seated structural constraints on future growth and development. The ensuing paragraphs highlight the key remaining constraints and issues to be addressed during the next stage of the sector's reform program.<sup>1</sup>

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These issues are also addressed in the Development Policy Letter and Development Policy Matrix (Appendixes 1 and 2).

## **1. Developing Agricultural Markets**

56. The principal policy measures for the land reform and farm restructuring are largely in place. However, as the implementation of the reforms gains momentum it is essential the process be consolidated with a clear legal and institutional framework and transparent procedures for effective implementation. While some further policy measures are needed, a major requirement will be the strengthening of institutional capacity to support the programming and implementation of further reforms.

57. The Centers for Land and Agrarian Reform (CLARs) in association with the rural committees at farm level, play a significant role both in land reform and farm restructuring. They are responsible for inventories, valuation, and determining shares of land, including NLF land; shares of other nonland assets; and farm reorganization. There is concern that the procedures and mechanism for the distribution of land, handling of land disputes, use/distribution of NLF lands, and distribution of nonland assets have not been transparent to all concerned. Moreover, the distribution of farm assets has lagged behind the distribution of land, resulting in farmers having little or no access to farm machinery. Many assets cannot be divided, posing serious problems for their distribution and for their future management and use. Measures are required to make the procedures more transparent, devise mechanisms for allocating nonland assets, and completing the distribution, and develop arrangements for operating nonland assets.

58. Under the land and farm restructuring program, farm restructuring is proceeding with insufficient consideration of the issues of water rights and distribution of water to small farmers. While legislation exists for the transfer of ownership of irrigation systems and for individual irrigation water-user rights, effective implementation is being inhibited by inconsistencies in the legislation and the absence of clear implementation procedures. Furthermore, laws and decrees have been issued requiring users to pay for water and for the establishment of WUAs, but the WUAs have not been given rights to collect charges and allocate the revenue within their irrigation system area. The rights to irrigation water as well as the proper O&M of the system are fundamental to increasing agricultural production. Measures are required to make clear (i) the legislation governing water-use rights, (ii) procedures for the transfer of ownership of the irrigation infrastructure, and (iii) rights of WUAs.

## **2. Encouraging Competitive Markets**

59. The agricultural output marketing/processing structure is undergoing accelerated restructuring and privatization with support of the World Bank's APEAC, a process that will require close monitoring. The agricultural input supply conglomerates are a growing policy concern. Two specific policy issues require immediate attention. First, since authority for the former input supply monopolies was delegated to MAF, it has taken no serious initiative to accelerate the process of privatizing them. MAF has left the initiative to the former monopolies. Some have turned themselves into holding companies that remain in administrative and managerial control of their subsidiary factories and enterprises, many of which are already privatized. This type of organization has three major negative effects on the evolution of a competitive input marketing system: (i) it impedes the already privatized enterprises from becoming fully independent economic entities, (ii) it impedes private initiatives to enter the market, and (iii) it behaves monopolistically in dealing with agricultural producers. Second,

these input supply enterprises, even though they are in the process of privatization, have retained many public sector functions, such as regulation, national procurement, and disease control. The retention of these public sector functions inhibits the privatization and demonopolization process as it retains an attached association to MAF, which requires these functions to be carried out. Measures are required to accelerate the demonopolization and privatization of the input supply enterprises, including the clear separation of Government and commercial functions, such as the privatization or liquidation of seed breeding, cattle breeding, and experimental farms not required by the Government for strategic purposes. The successful increased competitiveness of the input supply system will contribute significantly to the overall competitiveness of the agriculture sector.

60. While the process of privatizing input supply should be pursued, the existing local distribution network should remain largely in operation to ensure the continued distribution of essential input supplies. Moreover, the Government will continue in agricultural input supplies in the immediate future, particularly for supplies obtained through external assistance or from its own budgetary resources. Nevertheless, the private sector must be encouraged to participate in procuring and distributing these supplies.

61. A successful supply response by the emerging private farms is being constrained in part by the lack of seasonal credit. Problems of rural finance in general are becoming more acute: the rural banking institutions burdened with bad debts are unable to make any new loans; they are also troubled with a number of institutional and managerial weaknesses. Major revamping of the rural financial institutions is imperative but will take time. In the interim, the Government is exploring ways to ensure provision of seasonal credit with a focus on the emerging private farm sector and in a way consistent with the thrust of planned financial sector reforms. Diagnostic studies and external audits of commercial banks are continuing and consideration is being given to writing off the remaining bad debts resulting from directed credit to the collective and state farms. With the assistance of the World Bank, the Government is preparing a financial sector program aimed at addressing the major issues confronting the sector.

### **3. Improving Social and Environmental Progress**

62. The transition to a market-based economy has been associated with significant unemployment, particularly in rural areas. Agricultural wages have dropped to 45 percent of the national average in 1994, from near parity in 1992. In addition, poverty in rural areas is increasing, from 30 percent of rural households in 1991 to 48 percent in 1994. Labor force migration has resulted in an increasing proportion of nonworking population in rural areas. While the social fund and the social assistance<sup>1</sup> schemes provide cash transfers to the more vulnerable groups, both schemes are heavily in arrears with serious delays in paying benefits, particularly to the rural population. It is important in view of the rural population's high dependence on cash transfers that payments are made equitably on the basis of entitlements and that the rural population is not disadvantaged.

63. As a result of the transition process, most rural enterprises, both farms and industrial, are unable to provide the social services that have traditionally been available to

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The social fund is responsible for the pension fund, the employment fund, and the social insurance fund and is funded by employers and employees. Social assistance comprises mainly allowance for families with children under 16 years of age.



employees free of charge. The most essential of these are kindergartens and medical facilities. In the first half of 1995, about 50 percent of the kindergartens had been closed, with the remaining 50 percent in various stages of transfer to the local governments. Kindergartens provide child care and education and improve direct and indirect employment opportunities for women.

64. The situation of the population in remote rural areas is deteriorating rapidly. In addition, previous dependable supplies of food and essential commodities have declined. Even food shortages are already reported in remote areas.

65. While the Government has commenced environmental action to protect the environment, pressure remains on pasture lands despite the reduced numbers of livestock. The break-up of the state and collective farms has meant grazing land has been transferred to the *oblast* agriculture departments that issue annual grazing leases. There are no incentives provided to manage the pastures on a sustainable yield basis. Similarly the small forested areas of the country are suffering from continued grazing, which inhibits natural regeneration. Sound grazing and other land-use practices are necessary to ensure the sustainable use of the natural pastures and forested areas for grazing purposes.

66. In the past, the extensive use of fertilizers and chemicals, especially in cotton production, resulted in environmental degradation and caused health problems for the population. The use of chemicals had been largely replaced by biological control of cotton pests but the system has collapsed since independence because of insufficient funding. The restoration of biological control for cotton pests is seen as providing a basis for sound environmental action in other fields, with obvious long-term economic and environmental benefits. Alternative financing sources for the restoration of the biological control of cotton pests is warranted on these grounds.

#### **4. Enhanced Public Sector Support**

67. Managing the design and implementation of the sector reform program and eventually providing the needed public support services requires major restructuring and strengthening of MAF and MWR. MAF reorganization has commenced; however, to undertake its new functions in implementing the reform process and supporting a market-based agriculture sector, the reorganization needs to be completed in the shortest possible time. In addition to the reorganization of the headquarters the MAF's 36 dependent organizations require review and programs prepared for privatizing/liquidating some, while other organizations, principally training and research institutes, will be retained.

68. The formation and operation of WUAs is critical to the management of irrigation at the local level, including the collection of charges. There is no local expertise on the formation of WUAs. While a decree has been issued authorizing the establishment of WUAs, no single agency has been given the responsibility for promoting and facilitating their formation and no resources have been allocated. The MWR has taken on this responsibility and it will need assistance to establish appropriate structures and staffing to strengthen its capacity to undertake this function.

## **G. Medium-Term Growth Prospects**

69. The medium-term macroeconomic framework of the IMF-supported program for 1994-1997 aims at (i) achieving a recovery through positive GDP growth by the end of the program in 1997, (ii) cutting consumer price inflation to under 10 percent per year by 1997, (iii) reducing the balance of payments, current account deficit (excluding official transfers) from about 16 percent of GDP in 1993 to under 10 percent by 1997, and (iv) reducing the fiscal deficit from about 8 percent of GDP in 1993 to under 5 percent by 1997. The program envisages (i) steady increases in domestic savings and investment, (ii) economic growth based on a healthy private sector, and (iii) continued fiscal discipline.

70. The medium-term macroeconomic framework attaches a critical importance on the agriculture sector to lead the overall economic recovery and growth. IMF and World Bank projections indicate a base case growth scenario, that the agriculture sector will start its recovery at a rate of 1.5 percent in 1995 and reach a growth rate of 4 percent per year by 1997.<sup>1</sup> The projected recovery and growth will be mainly in efficiency gains through resource reallocation within the sector in response to market prospects. The new investment opportunities in the more conducive policy and institutional environment will also be expected to raise the sector's total productivity. These economic projections are accepted as the basis for this Program, which is fully integrated with their adjustment assistance. Nevertheless, for the economic projections to be realized, it is imperative to continue carrying out the sector's reform programs, which aim at removing a number of structural constraints facing the sector and further developing and improving the market-based policy and institutional framework.

## **H. External Assistance to the Sector**

71. The IMF and the World Bank are playing a lead role in supporting the transition of the Kyrgyz Republic to a market economy. These institutions are providing substantial support to the Government through resource transfers and policy advice related to macroeconomic stabilization and structural adjustment programs. The Government has received support from the IMF Systemic Transformation Facility and an extended program adopted under the Enhanced Structural Adjustment Facility. The International Development Association approved (i) the \$60-million Privatization and Enterprise Sector Adjustment Credit (PESAC) and the \$12-million Social Safety Net Project in June 1994; and (ii) a credit of \$45 million for APEAC in June 1995. In 1994, the United States provided \$35 million for a technical assistance (TA) program, much of it in support of national privatization and economic restructuring.

72. In addition to structural adjustment loans, the Kyrgyz Republic is receiving grants and credits for inputs, TA, and investment projects for the agriculture sector. The assistance under implementation or expected includes input supplies from Japan (\$24 million for agrochemicals, veterinary drugs, farm machinery, and diesel fuel); the European Union's Technical Assistance to the Commonwealth of Independent States (TACIS) program (\$10 million for general inputs); the Netherlands (\$5 million for agrochemicals and veterinary drugs); Germany (\$2.3 million for machinery spare parts); and Turkey and Denmark with smaller

<sup>1</sup> World Bank's country economic report on Kyrgyz Republic, prepared for Consultative Group meeting in May 1995.

contributions. In addition, the European Bank for Reconstruction and Development is to provide \$22 million to support a private sector operation to supply inputs and machinery for wheat production and finance procurement of the crop. TA is being provided by TACIS, equivalent to about \$12 million for mainly pilot activities, and Switzerland is providing \$5.4 million for piloting advisory services to private farmers and forest planning. Other smaller TA totaling about \$2 million comes from Germany, the United Kingdom and the World Bank. Investment projects are mostly at a preliminary stage of preparation. The World Bank is to finance a sheep development project for about \$50 million and an agricultural support services project for \$25 million. A rural financial services project is also expected in 1996.

73. The Bank approved the Special Assistance Loan of \$40 million in December 1995.<sup>1</sup> In addition, the Bank has provided a credit advisor to assist the Government's working group on rural finance to provide more effective emergency credit.

## I. The Bank's Operational Strategy

74. The Bank's interim operational strategy<sup>2</sup> for the Kyrgyz Republic, 1994-1996, was endorsed by the Board of Directors in January 1994. Facilitating the transition to a market economy is the principal objective of the interim operational strategy. In the near term, this objective will entail (i) support to macroeconomic and sectoral policy reforms in close cooperation with the World Bank and the IMF, (ii) institutional strengthening and human resource development, and (iii) selected sectoral infrastructure interventions in support of general economic growth and private sector development. For the medium term, the Bank's operational program will include quick-disbursing loans designed to support the macroeconomic stabilization and structural reform programs through extensive policy dialogue at the sectoral level.

75. The proposed Program is consistent with the Bank's interim operational strategy in contributing directly to sectoral policy reform in the agriculture sector and facilitating the transition to a market economy.

76. The Bank has coordinated with other major external agencies, particularly the IMF and the World Bank, in discussions and preparation of support to the agriculture sector. The Bank Reconnaissance Mission in March held discussions and arranged joint meetings with the World Bank Appraisal Mission for APEAC. The Fact-finding and Appraisal Missions had full discussions with the IMF and the World Bank, and exchanged information on the programs to ensure full coordination.

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<sup>1</sup> Loan No. 1342-KGZ: *Special Assistance Project*, for \$40 million, approved on 8 December 1994.

<sup>2</sup> See the informal Board Paper on "The Bank's Interim Country Operational Strategies in Kazakhstan and the Kyrgyz Republic," circulated on 23 December 1993.

#### IV. THE PROPOSED PROGRAM

##### A. Rationale

77. The agriculture sector is expected to lead the economy's recovery and growth through the transition to a market-based economy. Agriculture is presently undergoing a significant structural transformation amid deteriorating economic and social conditions. The Government continues to show strong commitment to the reform process. Support to the Government's continued reform initiatives is essential in view of the deteriorating circumstances and the limited domestic resources available on the one hand and the potential role of the sector to lead the economic recovery and growth on the other. Other agencies, particularly the World Bank through the APEAC, are providing support to the Government's reform program in the agriculture sector. The proposed Program complements and supplements the reform measures supported by the other agencies. While substantial progress has been made in reforming the sector the momentum of the reform process needs to be maintained, broadened, and deepened particularly in the following areas: (i) support for effective implementation of the reform program already adopted (e.g., land reform and farm restructuring), its reevaluation and appropriate modification, (ii) further reforms in restructuring and privatizing the major input supply conglomerates that continue exerting monopolistic influence; (iii) extension of the reform program to cover policy issues on management of natural resources, and further policies and mechanisms to address social and environmental concerns; and (iv) reorientation of the public sector to manage the reform process and support a market-based agriculture sector.

##### B. Objective

78. The objective of the Program is to facilitate the transition to a competitive market-based agriculture sector within a framework to (i) encourage the development of market institutions, (ii) increase the competitiveness of markets, (iii) improve social and environmental progress, and (iv) enhance public sector support. The Bank's Program is an integral part of the Government's broad reform agenda for the sector, which other agencies, notably the World Bank, are supporting.

##### C. Program Scope

79. The details of the policy and institutional measures to be supported by the Bank are contained in the Development Policy Letter and the Development Policy Matrix (Appendixes 1 and 2). The scope of the Program is comprehensive in coverage and significant in furthering the agriculture reform program of the Government. The Program will (i) support the continuing land reform and farm restructuring process with additional policy measures and strengthen the institutional capacity to support the programming and effective implementation of the reforms; (ii) improve the use of irrigation water; (iii) increase the competitiveness of the input supply system, mainly through further corporatization and privatization; (iv) enhance social protection through support to the social fund, maintenance of social assistance, and related monitoring activities; (v) further environmental protection by focusing on managed grazing of natural pastures and forested areas and reintroducing biological control measures

for cotton pests; and (vi) enhance the capacity of selected Government agencies to implement the reform process and provide the required support for a market-based agriculture sector.

## **D. Program Measures**

### **1. Developing Agricultural Markets**

80. Effective land reform and farm restructuring are central to the promotion of an agriculture sector based on functioning market institutions. The measures to be adopted will facilitate the Government's endeavors to complete the process with more effective implementation at the local level. The Government will develop permanent land dispute resolution procedures to handle land allocation conflicts, boundary disputes, and similar problems. To make the restructured farms more operational, the Government will (i) complete the distribution of shares in nonland assets, which currently lags behind the farm restructuring process; (ii) develop modes of ownership, organization, and management for the efficient operation of nonland assets to meet the needs of the emerging farms; and (iii) submit to the Parliament a draft law for a simplified land and immovable property registration system. As the responsibility for the implementation of the land reform and farm restructuring rests with the CLARs in association with the rural committees, their operations will be made more transparent by adopting the implementation guidelines and procedures to be prepared by the Government under the Program.

81. As agriculture in the Kyrgyz Republic relies upon an extensive irrigation system, the Government has recognized the importance of water rights and its efficient utilization and the need for users to assume the responsibility for sustaining their irrigation services, including financing. The establishment of WUAs is fundamental to this policy. Under the Program, the WUAs will be significantly strengthened as the Government will (i) review existing legislation and clarify and publish the policies and procedures governing irrigation water-user rights; (ii) issue a decree extending the rights and responsibilities of the WUAs to collect water charges, retain revenues, and make decisions regarding the allocation of operational and capital costs within their respective jurisdictions; and (iii) establish and publish clear procedures governing the transfer of ownership of irrigation infrastructure within particular service areas to their WUAs.

### **2. Encouraging Competitive Markets**

82. Maintaining the momentum of reform in input supply markets will increase the competitiveness in these markets and complement the continuing process of reform in the output markets. Under the Program, the Government will implement substantial measures to remove regulatory and central procurement functions from the former SOEs supplying agriculture inputs, further corporatize and privatize these enterprises, and reduce the noncompetitive aspects of public sector trading in input supplies.

83. In relation to the regulatory and central procurement functions, the Government will (i) transfer the regulatory functions for veterinary products and agrochemicals from KZVS and KSKK to MAF, (ii) establish a seed regulatory function and capability in MAF, and (iii) determine whether the central procurement function for agriculture-related commodities should

be absorbed into MAF or in some central independent procurement agency. In furthering the corporatization and privatization of these enterprises, the Government will (i) prepare a plan to transfer the responsibility for disease control services from KZVS to MAF and to corporatize and then privatize the KZVS network; (ii) corporatize the KSKK headquarters and all local units; and (iii) determine the minimum number of seed and cattle breeding farms to be retained for strategic purposes, and privatize or liquidate at least 12 of the remaining farms. The Government will increase the competitiveness in the public sector trading of input supplies by (i) establishing a market-based mechanism for the distribution of agricultural inputs that are provided under external assistance (as permitted under external agreements) or financed from its own budget resources; and (ii) having the Anti-Monopoly Committee continue to monitor the operations of the successor organizations to KSKK to ensure that fair trade practices prevail.

### **3. Improving Social and Environmental Progress**

84. Providing for social protection is an increasingly important need and difficult problem, and should be closely monitored and supported. Under the Program, the Government will (i) monitor, evaluate, and report to the Bank on the impact of the reform measures, particularly on vulnerable groups in rural areas; (ii) provide additional financial support to the social fund of at least Som15 million (\$1.44 million) per year in 1996 and 1997; (iii) maintain social assistance expenditure in 1996 and 1997 at least at the 1995 level; (iv) monitor the social fund and social assistance expenditures to ensure payments are in accordance with beneficiary entitlements; (v) ensure that the majority of rural public sector kindergartens operational in 1995 remain operational in 1996 and 1997; and (vi) assess food supply and needs in remote rural areas and develop a strategy for meeting these needs.

85. The Program will also address the need to protect the environmental resource base of the country by focusing on policies to protect and restore natural pastures and forested areas and minimize/rationalize the use of pesticides. The Government will (i) prepare policy recommendations and laws and regulations on the long-term leasing or ownership and the management and sustainable use of natural pastures to promote sound grazing and other sustainable land-use practices, (ii) issue a decree controlling grazing in the forest areas, and (iii) introduce a mechanism for industry funding of biological control of cotton pests.

### **4. Enhancing Public Sector Support**

86. The building of institutional capacity and restructuring of public sector institutions to provide the necessary support to a market-based agriculture sector will be significantly increased under the Program, with Bank-funded TA. This will involve continuing the restructuring and strengthening of MAF headquarters, restructuring MAF's dependent entities, and strengthening MWR's capacity to organize and provide sound management for WUAs.

87. In relation to MAF and its attached entities, the Government will (i) complete the reorganization of MAF; (ii) with TA, strengthen the capacity of the Directorate of Economics, Directorate of Investment and Agroprocessing, and Directorate General Republican Center of Land and Agrarian Reform; (iii) issue a decree placing the CLARs under the direct supervision and management control of MAF; (iv) privatize or liquidate at least 10 of the attached organizations; and (v) prepare a time-bound program for restructuring the research institutes and the agricultural education and training institutes. The Program measures for MWR involve

establishing within MWR units to support the promotion, formation, and operations of WUAs; the provision of technical advice on water management and system administration; and the strengthening of MWR, with TA, to facilitate the formation and sound management of WUAs.

## **E. Policy Dialogue**

88. The Bank, together with IMF and the World Bank, has been engaged in policy dialogue with the Government on general stabilization matters and agriculture sector reforms since the Bank's first economic mission to the Kyrgyz Republic in June 1994, two months after it became a member of the Bank. Many of the measures discussed during policy dialogue with the Government have been implemented in line with the coordinated efforts of the Bank, IMF, and the World Bank.

89. In preparing the Agriculture Sector Program, the policy dialogue has been intensified, particularly with regard to building up a common understanding of the key constraints and issues remaining and the further policy measures required for the sector to move towards a competitive market-based system. A significant policy and institutional agenda has been agreed for implementation under the Program. The policy dialogue will continue during the implementation of the Program, and particularly through the proposed TA for the reorganization of MAF. The focus of this policy dialogue will be on the overall policy reform framework and agenda, including the measures specified in the Program as well as those outside. Further policy dialogue with the Government will be undertaken during the course of preparing and implementing the Bank's proposed agricultural credit study and the irrigation sector study.

## **V. PROPOSED BANK ASSISTANCE**

### **A. The Loan**

90. It is proposed that the Bank support the Government's agriculture sector reforms by providing a loan of \$40 million equivalent, denominated in Special Drawing Rights. The Borrower will be the Kyrgyz Republic. Funds will be made available from the Bank's Special Funds resources with a service charge of 1 percent per annum, a maturity of 40 years, and a 10-year grace period.

91. The loan will be disbursed in two equal tranches against eligible imports. The first tranche will be made available upon loan effectiveness. The second tranche is targeted to be released in December 1996, or about 12 months after the first tranche. Prior to the release of the second tranche, the Government will be required to meet the conditions specified in the Development Policy Matrix (Appendix 2) and to make satisfactory progress in the implementation of the overall Program.

### **B. Tranche Conditions**

92. Nine measures have been specified as conditions for the release of the second tranche of the loan: (i) the completion of the distribution of shares in nonland assets of former

state and collective farms, except for specific cases affecting individual farms where legal or public use issues remain; (ii) the submission to Parliament of a draft law for a simplified land and immovable property registration system; (iii) the review, clarification, and publication of the policies and procedures governing irrigation water-user rights; (iv) the transfer of regulatory functions for veterinary products and agro-chemicals, respectively, from KZVS and KSKK to MAF; (v) the corporatization of all local units of KSKK; (vi) the determination of the minimum number of seed and cattle breeding farms to be retained for strategic purposes and the privatization or liquidation of at least 12 of the remaining farms; (vii) the submission of a budget provision for 1997 for additional financial support to the social fund of at least Som15 million (\$1.44 million) above the 1995 planned budget level, and for the maintenance of total social assistance expenditures in 1997 at least at the 1995 planned budget level; (viii) the issuance of a decree on the management and sustainable use of natural pastures; and (ix) the privatization or liquidation of at least ten of MAF's attached organizations.

## **C. Implementation Arrangements**

### **1. Executing and Implementing Agencies**

93. The Ministry of Finance will be the Executing Agency for the Program, and will be responsible for coordinating and overseeing the implementation of the Program, which will involve MAF, the Ministry of Economy, the National Bank of Kyrgyzstan, MWR, the Ministry of Labor and Social Protection, and the State Committee for Environmental Protection. The Ministry of Finance will have overall responsibility for (i) ensuring that the policies adopted and the actions taken 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, as specified in the Development Policy Letter and the Development Policy Matrix; and (iii) consulting with, and periodically reporting to, the Bank on the progress of the Program.

94. To ensure coordination of the Program on a continuous basis, a high-level Program Coordination Committee will be formed under the chairmanship of the Deputy Prime Minister responsible for agriculture.<sup>1</sup> The Committee will comprise representatives from all the ministries and agencies involved in implementing the Program, and will meet at least twice a year.

### **2. Eligible Items**

95. The loan proceeds will be disbursed against imports to the extent that these items are produced in and procured from the Bank's member countries and are not included in the negative list attached as Appendix 3.

### **3. Procurement**

96. For the procurement of eligible commodities that are commonly traded in the international markets, the supply contract may be awarded on the basis of normal commercial

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An equivalent PCC under the chairmanship of the Deputy Prime minister responsible for agriculture has been established for the World Bank's APEAC. This PCC with modified representation to accommodate the additional agencies could serve as the PCC for this Program.



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 procedures, as described in the Bank's *Guidelines for Procurement*. Each supply contract for eligible items estimated to cost the equivalent of \$5 million or less must be awarded (i) on the basis of normal commercial procurement practices acceptable to the Bank, in the case of procurement by the private sector; or (ii) or in accordance with the Government-prescribed procurement procedures, in the case of procurement by the public sector.

97. The award of contracts for eligible items requiring international competitive bidding and commodity contracts valued at more than \$5 million equivalent will be subject to Bank review prior to disbursement from the loan proceeds. For such review, the Government must provide to the Bank two copies of each relevant 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 (see para. 99 below), the Government must provide, together with the relevant statement 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**

98. Except as described in this paragraph and in para. 99, 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, provided that such items have been procured in accordance with the procedures described in paragraph 96 above.

99. An imprest account will be established at the National Bank of Kyrgyzstan 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 of any import contracts for eligible items not exceeding \$5 million equivalent. The account will be operated and maintained in accordance with the Bank's *Guidelines on Imprest Fund and Statement of Expenditure Procedures*.

#### **5. Use of Counterpart Funds**

100. The Government will use the counterpart funds to be generated from the proceeds of the loan to support the transition of the agriculture sector to a market-based system.

#### **6. Audits and Reports**

101. 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 financial year during the Program period, 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, during the Program period, the Government will submit to the Bank six-monthly reports on the progress of the Program and, more specifically, about the attainment of targets and the carrying out of measures included in the Development Policy Letter and Development Policy Matrix. Within three months of the closing date of the loan, the Government will provide a written report to the Bank on the execution of the Program, including its cost and the accomplishment of its purposes.

## **7. Program Monitoring**

102. Bank missions will review progress regularly and continue the policy dialogue. The Government and the Bank will continue to discuss agriculture policy and related legal, institutional, and other developments. The progress of reforms, and the commitments stated in the Development Policy Letter and Development Policy Matrix, will be reviewed by the Bank in consultation with the Government prior to release of the second tranche.

## **D. Technical Assistance**

103. Bank TA is proposed together with the loan to support (i) the Reorganization and Strengthening of the Ministry of Agriculture and Food, and (ii) Building Capacity for the Formation and Management of Water Users Associations. The objectives, scope, cost estimates, and the draft terms of reference for the two TAs are described in Appendixes 4 and 5.

### **1. Reorganization and Strengthening of the Ministry of Agriculture and Food**

104. Action is being taken to reorganize and strengthen the role of MAF for the management of the reform process and to support a market-based agriculture sector. In July 1995, a Government decree substantially redefined MAF's role. Accordingly, MAF has prepared its own reorganization plan, based on modified recommendation of a World Bank funded study. The first phase, the reorganization of MAF headquarters, is under implementation. The second phase, the reorganization and/or privatization of 36 dependent institutes and enterprises, is under preparation. The process of reorganization and rebuilding will restructure and strengthen functions that are still valid, divest MAF of activities and services that are no longer required or can be provided better by the private sector, and establish a capacity to undertake important new functions.

105. The objective of the TA is to strengthen MAF's capability to formulate strategy and policies and to design, finance, and implement a program to complete the process of reform in the agriculture sector and to provide continuing support to and strengthen the three key directorates responsible for these tasks. The scope of the TA includes (i) strengthening the Directorate of Economics, the Directorate of Investment and Agroprocessing, and the Republican Center for Land and Agrarian Reform to undertake their responsibilities in implementing the reforms and supporting the market-based agriculture sector; and (ii) facilitating the implementation of the headquarters reorganization plan, the reorganization and privatization of agencies attached to MAF, and the preparation of a program for the development of agricultural training institutions.

106. The TA will be implemented over a period of 18 months. A total of 34 person-months of international consulting services will be required from a consulting firm, with expertise in agricultural policy, institutional development, privatization, and education and training. The consultants will be engaged by the Bank in accordance with its *Guidelines on the Use of Consultants*. In addition, domestic consulting services of about 12 person-months will be required and will be recruited by the firm through the team leader in consultation with the Bank. The TA will be implemented by MAF. The total cost of the TA is estimated at \$1,364,000 equivalent, including \$1,196,000 in foreign exchange and \$168,000 in equivalent local currency. The entire foreign exchange cost and \$128,000 equivalent in local currency, for a total cost of \$1,324,000, will be charged to the Bank-funded TA program. The Government will fund the remaining \$40,000 equivalent of local currency costs.

## **2. Building Capacity for the Formation and Management of Water Users Associations**

107. The Kyrgyz Republic has 1.4 million ha of arable land with a total irrigated area of about 1 million ha. Irrigated agriculture is responsible for most of national production. However, the area actually irrigated has declined about 15 percent over the last few years, largely because of the reduced funding for O&M of the irrigation system. In view of the difficulty with continuing the O&M of the system, the Government is establishing WUAs to assume full responsibility for system operations at the farm level. In the long term, the sustainability of irrigation systems in the Kyrgyz Republic will depend on the willingness and ability of water users to finance and maintain irrigation operations. Based on the experience of other countries with similar problems, this can be best achieved when (i) the water users themselves are involved in planning water distribution and in setting the level of water charges, (ii) irrigation system staff are responsible and accountable to the water users, and (iii) water charge revenues collected from water users are used exclusively on their irrigation system rather than remitted to a central irrigation authority. Such lessons can be adopted in the approach to be taken by MWR for developing a decentralized irrigation management system through involvement of WUAs.

108. The immediate objective of the TA is to strengthen the capacity of MWR to facilitate the formation and sound management of WUAs. The scope of the TA will include (i) reviewing the legislation, particularly Presidential Decree No. 226 of 6 June 1995, with a view to developing clear, complete, and consistent implementation procedures for exercising the functions and responsibilities of WUAs, and establishing and levying appropriate water charges; (ii) providing advice on the most appropriate unit structure and staffing within MWR to service the *oblast* and *raion*-level irrigation departments; (iii) providing advice on the policies, processes, and procedures for organizing WUAs, irrigation fee collection, and farm level system management; (iv) training key staff at MWR and selected *oblast* and *raion* levels to facilitate the formation and monitoring of WUAs; and (v) assisting MWR in field testing and refining new intervention approaches for the formation and sound management of WUAs in selected pilot irrigation systems.

109. The TA will be implemented over a period of 18 months. A total of 24 person-months of international consulting services will be required from a consulting firm with expertise in farmer organization processes, institutional development, and financial management. The consultants will be engaged by the Bank in accordance with its *Guidelines on the Use of Consultants*. In addition, domestic consulting services of 12 person-months will be required and will be recruited by the firm through the team leader in consultation with the

Bank. MWR will be the Executing Agency for the TA. The total cost of the TA is estimated at \$901,000 equivalent including \$744,000 in foreign exchange and \$157,000 in equivalent local currency. The entire foreign exchange cost and \$117,000 equivalent in local currency cost for a total of \$861,000 will be charged to the Bank-funded TA program. The Government will fund the remaining \$40,000 equivalent of local currency costs.

## VI. PROGRAM IMPACT, RISK, AND JUSTIFICATION

### A. Program Impact

108. The Government's structural reform program is aimed at transforming the sector to a market-based system while simultaneously addressing the major development issues: the policy and institutional inefficiencies remaining from the inherited structure of production and organization; the extent of poverty, particularly in the rural areas; and the unsustainable use of natural resources. The Bank's Program is an integral component of the Government's overall reform agenda and will provide significant support for (i) more effective implementation of the Government's reform program; (ii) further privatization, particularly of former SOEs in input supply; (iii) extension of the program into management of natural resources and support for social protection; and (iv) reorientation of public sector agencies to support a market-based agriculture sector. The measures under the Program will provide an improved incentive structure for the private sector; develop an appropriate institutional framework for further reforms and investment; and enhance the capacity of the public sector agencies to support the market-based sector.

109. The incentive structure for private sector development will be enhanced at both the farm level and the input supply level. At the farm level, the land reform and farm restructuring measures and the improved water-user rights will improve security of land tenure, release nonland assets for more efficient farm operations, and extend control over irrigation systems and water use to farmers. This is expected to lead to investments in farm land, facilitate more efficient farm operations, and support the development of a market for land. The privatization of the SOEs dominating the input supply system and the transfer of regulatory functions to MAF will reduce the monopolistic behavior of these firms, encourage the entry of smaller private traders, and thus increase the competition in the input supply market. The farmer should benefit from improved accessibility to input supplies at reasonable prices. These measures at both the farm and input supply level are expected to considerably improve the incentive structure for increased private sector development and enhance the impact of the previous reforms, particularly price and trade liberalization.

110. The institutional framework for a market-based agriculture sector will be extended and strengthened through several measures under land reform and farm restructuring, irrigation water use, and restructuring of public sector agencies that provides for transparent guidelines and procedures in the implementation of previous and current reforms. Through this increased transparency, farmers and private enterprise will become more confident of their rights, undertake investment, and gradually rebuild the productive capacity of the agriculture sector.

111. The capacity enhancing measures for MAF and MWR will enable these major Government agencies to undertake their public sector management role more appropriate to a

market-based sector. These agencies will be better placed to meet the continuing challenges of transition and development through better management of the policy and institutional framework and the further development of the institutional structure of the sector.

112. The combination of an improved incentive structure, an expanded and strengthened institutional framework, and the enhanced capacity of public sector agencies is expected to provide an appropriate environment for a more effective and efficient allocation and use of available resources; be more conducive to effective investment lending, unconstrained by inappropriate policies and public sector institutions; and provide more flexibility to respond to changing economic circumstances.

113. The Program, as an integral part of the Government's overall reform process, will contribute to the medium-term growth prospects for the sector and the economy. However, the attainment of the projected sectoral performance would not be possible without the Bank's Program and the achievement of these sector and economy-wide growth prospects is contingent on the continuation of the Government's reforms without major disruption.

114. The social impact of the Program has been assessed primarily through conducting a poverty impact assessment for the six areas of Program measures according to the expected impact on the labor market and changes in the income of the poor, prices, access of the poor to goods and social services, and public transfers (See Appendix 6).

115. The most adverse impacts are assessed to be in the short term and are expected to occur primarily in the labor market and to a lesser extent in reduced access to social services. However, these negative impacts are marginal in the context of the overall impacts of the Government's total reform program. The effects on the labor market could be some further unemployment resulting from the farm restructuring, privatization of SOEs, and restructuring of the MAF, especially the privatization of the attached enterprises. However, the increased unemployment may be marginal as there is already a significant level of hidden unemployment, with many workers having wages unpaid for several months. The loss of access to social services will stem from the farm restructuring and privatization of SOEs as the services are transferred to the local governments. This will also be limited as the Program includes a measure for a majority of kindergartens to be kept in operation. The extent of service provision will depend on the capacity and resources available to local governments.

116. Overall, the Program is expected to have a positive impact, resulting particularly from the improved land reform and farm restructuring implementation and the improved market development and increased competitiveness. To provide some protection, the Program has included (i) increased funding of the social fund, and (ii) maintenance of social assistance expenditures. In addition, other measures will ensure the monitoring of the socioeconomic impact of the reforms, expenditure from both the social fund and social assistance to ensure particular groups are not being disadvantaged, and assessment and development of a strategy for meeting food needs in remote areas

117. The environmental impact of the Program measures is significantly positive. Increased efficiency of water use is expected from the measures for water-user rights, ownership of irrigation systems, and formation of WUAs. More direct impacts evidenced through reduced erosion will eventuate from the promotion of sound grazing practices on pasture and forested land. The introduction of a mechanism for industry funding for the

reintroduction of biological control of cotton pests will benefit the environment through reduced use of pesticides on cotton and will demonstrate more widely the broader benefits of biological control.

## **B. Program Risks**

118. The next stage of the Government's reform program addresses many deep-seated and politically sensitive constraints and issues, and there is a question of whether it can be kept on track and progress on time without possible disruptions to the ongoing reform program. The principal risks associated with the proposed Program are as follows. First, the Government's capacity to effectively implement reforms may be limited. There has been considerable variation in the complete and effective implementation of different reforms to date. Much of this variation is attributed to the lack of capacity to implement the reforms through the development of appropriate administrative procedures and guidelines on implementation. Under the Program, several measures will strengthen these procedures and guidelines, and the TAs for reorganizing and strengthening MAF and building capacity in MWR to support the establishment of WUAs, will also help redress this problem. Second, the land reform and farm restructuring process may face some resistance at the local farm level and interference from local government officials. However, under the World Bank APEAC, the interference of the local government authorities in economic decision-making is to be removed through the implementation of new Presidential decrees. Third, the Government's commitment to the current pace of reform may not continue, particularly if economic recovery is not soon forthcoming. The Kyrgyz Republic started the reform process with very unfavorable economic conditions and has continued despite the deteriorating economic and social situation. While social discontent is not evident, the increased unemployment likely from the whole privatization process in the economy could increase social reaction and therefore effect the implementation of the reform Program. Potential disruptions to the reform program may result in further deterioration of the sector's performance and possibly delay its recovery and growth by another two to three years. In this regard, the Government's capacity to manage implementation of the reform programs is just as important and crucial as the content of the reform programs, for an early recovery and growth of the sector.

## **C. Program Justification**

119. The Government continues to pursue substantial reform programs in several sectors. In the agriculture sector, the Government's reform program has made significant progress in creating an incentive structure in the sector, particularly through (i) liberalization of farm commodity and input prices, which has now been completed; (ii) abolition of the state-mandated procurement scheme for farm products; (iii) removal of quantitative restrictions on agricultural foreign trade; and (iv) reduction in the scope and scale of export taxes and import tariffs. Land reform and farm restructuring continue to gain momentum, restructuring and demonopolization of the state-owned agro-industrial conglomerates is proceeding, and the Government is commencing the reorientation of public sector agencies to support the development of a market-based agriculture sector.

120. The resolution to implement further reforms under the Program demonstrates the Government's firm commitment, also expressed in the Development Policy Letter, to

achieving a market-based economy. Already the economy is reaching a stable macroeconomic environment and the structural reforms are being pursued despite the deteriorating economic and social conditions.

121. The agriculture sector is seen as providing the basis for economic recovery and subsequent development. The Program will deepen and extend the reform process and the TAs will strengthen the capacity of MAF and MWR to provide a service and facilitating role to the sector rather, than continuing their involvement in the production and distribution of goods and services. The reforms coupled with the TAs will help provide the policy and institutional framework for investment lending to be more effective and for efficient growth and development in the agriculture sector.

122. The Government has incurred substantial costs in implementing its reform program, and further costs will be incurred in implementing the Bank's Program. The costs of adjustment of the Program cannot be clearly separated from the Government's overall costs of transition. The following costs are indicative levels of administrative expenditure associated with particular reform measures where direct costs are expected to be incurred by the Government. The development of land dispute resolution procedures, distribution of nonland assets, and development of WUAs is estimated to cost about \$40 million. The further corporatization and privatization of the input supply SOEs and the transfer and establishment of various regulatory functions in MAF will cost about \$15 million. The fiscal costs associated with the social protection measures will involve about \$30 million. The environment protection measures are expected to cost about \$2 million per year, while a further \$2 million per year will be required for the institutional capacity building and restructuring measures. The total financial adjustment cost of the Program is estimated at about \$95 million in 1996 present value terms.<sup>1</sup> The overall costs of adjustment are significantly higher than the proposed loan for the Program.

## VII. RECOMMENDATION

123. 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 in various currencies equivalent to Special Drawing Rights 26,764,000 to the Kyrgyz Republic for the Agriculture Sector Program, with a service charge at the rate of 1 percent per annum and with an amortization of 40 years, including grace period of 10 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;
- (ii) the technical assistance of \$1,324,000 equivalent to the Government of the Kyrgyz Republic for the Reorganization and Strengthening of the Ministry of Agriculture and Food, to be made available as a grant; and

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

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## APPENDIXES

Number	Title	Page	Cited On (page, para.)
1.	Development Policy Letter	35	21,79
2.	Development Policy Matrix	41	21,79
3.	Items Ineligible for Import	49	25,95
4.	Technical Assistance: Reorganization and Strengthening of the Ministry of Agriculture and Food	50	27,104
5.	Technical Assistance: Building Capacity for the Formation and Management of Water User Associations	55	28,107
6.	Poverty Impact Assessment	59	30,116

19 October, 1995

Mr. Mitsuo Sato  
President  
Asian Development Bank  
Manila, Philippines

Dear Mr. President:

1. Since Independence, the Kyrgyz Republic has faced a harsh challenge: to transform its economy from a command to a market-based system while minimizing the social costs of this transformation. The Government has faced this challenge at a time of great difficulties. Exacerbated by weak demand in the markets of its traditional trading partners and by failures in the interrepublican payments systems, the Kyrgyz Republic has experienced a serious depression with gross national output declining by nearly 53 percent since 1990. The loss of income has had a particularly severe impact on certain groups of people including the elderly and poor families, especially in remote rural areas and among the new immigrants to the Republic's towns and cities.

2. The Government recognized at an early stage that long-term sustainable development necessitated a change to a market-based economic environment. The Kyrgyz Republic was among the first of the former Soviet Union countries to adopt its own currency and to institute monetary and fiscal policies to combat the severe inflation then present in the *ruble zone*. The Republic received early support from multilateral agencies including the International Monetary Fund (IMF). The Kyrgyz Republic was the first country to receive access to the IMF's Systemic Transformation Facility and, in July 1994, the first former Soviet Union country to receive an Enhanced Structural Adjustment Facility (ESAF).

3. The Government is committed to maintaining this program of macroeconomic stabilization. The current program is broadly designed to create an enabling environment for economic growth and development, and specifically targets a continued reduction in inflation. As a result of the Government's efforts, inflation has moved down from over 1,000 percent in 1992 and 1993, to less than 100 percent in 1994. In the first half of 1995, inflation fell further, to less than 50 percent on an annual basis. Unfortunately, largely due to difficulties in revenue collection there have been some problems in maintaining the ESAF program. My Government is making every effort to ensure that the ESAF program will be successful. It is recognized that the approval of the proposed Agriculture Program Loan and subsequent tranche release will be dependent upon the maintenance of a macroeconomic framework conducive to the effective implementation of the ESAF.

4. Complementary to the stabilization efforts is the Government's structural reforms program. This program is tailored to move the country to a market-based economy while minimizing social and environmental costs. A large number of actions have been initiated:

- (i) Broad-based and comprehensive legislative and regulatory reforms have been enacted providing for market creation and market liberalization.
- (ii) Privatization activities have been vigorously pursued. The Government by March 1995 transferred approximately 53 percent of assets previously owned by the state to the private sector. The current program has a goal of transferring fully 70 percent of state assets by the end of 1997.
- (iii) Land reform has begun the task of creating a strong private sector in agriculture. The program has created 24,000 privately owned farms and 187 large farms owned on a cooperative or shareholder basis.
- (iv) Public enterprise reform has targeted both (a) the development of a legal and regulatory environment supportive of private sector activity; and (b) addressing the specific problems of large, loss-making public sector firms.
- (v) Financial sector reform has included the creation of an independent central bank and a commercial banking sector. The current program will (a) strengthen the policy environment, (b) reform commercial banking operations, and (c) develop specialized institutions especially in the rural sector.
- (vi) Fiscal reform is being addressed through improved expenditure control and steps to increase revenue generation.
- (vii) The establishment of a social safety net has involved rationalizing the social assistance and social insurance programs and moving to separate social service provision from the workplace.

5. My Government is appreciative of the timely assistance to these efforts provided by the Asian Development Bank's Special Assistance Loan provided in 1994. The structural adjustment program has also received support from the World Bank in the form of a Rehabilitation Credit extended in 1993, accompanied by matching cofinancing by the Japanese Overseas Economic Cooperation Fund (OECF). The World Bank has also provided support to enterprise reforms through the Privatization and Enterprise Sector Adjustment Credit (PESAC) and the Agricultural Privatization and Enterprise Adjustment Credit (APEAC). The APEAC concentrates on further liberalization of the agricultural economy by (i) abolishing the few remaining export taxes, (ii) demonopolization and reorganization of certain agroindustries, the bread and wheat conglomerate Kyrgyz Dan Azyk, the food-processing conglomerate Kyrgyz Tamak'ash, the input supplier KyrgyzSelkhozKhimia, and the retail trader Kyrgyz Potrebsoyuz; and (iii) contributing to a consolidation of the process of agrarian reforms and enterprise restructuring. The APEAC program falls within the broader Government program for the sector, and is complementary to the specific program for which the Government is requesting assistance from the Asian Development Bank.

6. Within the context of these economy-wide stabilization measures and structural reforms, the Government of the Kyrgyz Republic attaches great importance to an improved policy environment in the agriculture sector. Agriculture currently accounts for more than 40 percent of gross domestic product and provides for roughly one-third of total employment. The broad rural economy provides livelihood for 2.7 million people or 62 percent of the population.

The relative importance of the sector is likely to increase with the continued reform of activities in industry, particularly the heavy industrial sector.

7. In view of the importance of the agriculture sector, my Government is requesting assistance from the Asian Development Bank for a comprehensive program that will (i) encourage the development of market institutions, (ii) enhance competitive forces in the newly created markets, and (iii) provide safeguards against adverse social and environmental effects. The first element in the transformation of the Kyrgyz economy, away from a command system, is the *creation of basic market institutions*. Much progress has been made, however, further work must be undertaken especially in establishing clearly defined and enforceable property and use rights for both land and water.

8. *Land reform* is central to the promotion of an agriculture sector based on functioning market institutions. Although the Constitution does not allow private ownership of land, under our legal system, allowance is made for the ownership of land-use rights. User-rights for land can be extended for 49 years, and these rights can be freely traded. Land reform in any country is potentially a politically sensitive activity, but my Government is determined to press ahead with a comprehensive and broad-based land reform program. One element will be to develop permanent land dispute resolution procedures to handle land allocation conflicts, boundary disputes, and similar problems. Currently these problems are handled by temporary, locally-based Rural Committees. In addition, to further encourage investment in the agriculture sector and the development of markets for land-use rights, the distribution of property shares will be vigorously pursued until it is completed, arrangements for the efficient operation of non-land assets are being developed, simplified procedures for land and property registration will be designed, and the activities of the Commissions on Land and Agrarian Reform and the Rural Committees will be made more transparent.

9. Water rights are also important to the Kyrgyz economy: sustainable recovery and growth in the agricultural sector will depend upon rehabilitation of irrigated agriculture. Kyrgyz agriculture relies upon an extensive irrigation system: of roughly 1.4 million hectares of arable land, approximately 60 percent is irrigated. Total irrigation operating and maintenance costs are estimated to be roughly Som 566 million annually. There is, however, currently little cost recovery from users. Given the limited fiscal resources of the Government, roughly 80 percent of this year's estimated irrigation costs remain unfinanced. The Government intends to work towards an equitable and efficient resolution of the financial crisis by shifting, to the extent possible, the responsibility for irrigation financing to the water users associations themselves. A general policy that water users should assume responsibility for sustaining their irrigation services and procedures for the transfer of ownership of irrigation infrastructure within particular service areas will be established.

10. Our Government is encouraging the establishment of water users associations (WUAs) in order to implement this policy. Although Rural Committees are expected to take the initiative in setting up WUAs they have no clear brief and little capability in this area. No single agency has been given responsibility for promoting and facilitating the formation of WUAs and no resources have been allocated for assistance. At present the financing and management of irrigation systems is controlled by the Central Government. As a first step to strengthen the WUAs, the Government will act to clarify their responsibilities and powers. Clear policies will be established, governing irrigation water user rights. In order to give farmers the maximum incentive to contribute to system operation and maintenance, the Government will ensure that

water charges collected within an irrigation section should be locally retained. To support the WUAs, raion Irrigation Departments will be allowed to levy fees to support intermediate level systems. The support for primary irrigation systems will be retained in the Ministry of Water Resources (MWR). Finally, the MWR will establish administrative units responsible for providing technical support for the establishment and operation and management of water users associations.

11. The development of market institutions must be accompanied by steps to encourage these markets to develop in a *competitive fashion*. This is necessary both to ensure that the markets function in an efficient fashion and to ensure that the benefits of the new system are distributed in as wide a fashion as possible. In agriculture this includes (i) maintaining the momentum of privatization and demonopolization of state enterprises, (ii) building institutional capacity and restructuring public sector institutions, particularly the Ministry of Agriculture and the Ministry of Water Resources.

12. There has been considerable progress in enhancing the degree of competition found in the nascent commodity markets in the Republic. Many major policy issues of *demonopolization, privatization, and ensuring free entry* have already been or are now being addressed. The marketing of agricultural commodities, for example, is no longer dominated by the former state concerns as was the case in the first few years after Independence. The remaining enterprises are being broken up and privatized. These enterprises now account for 20 percent or less of the total trade in these markets. Equally important, reforms such as the abolition of the State Order system have been completed, while reforms such as the phasing out of the state needs system, the break up of the state trading and input monopolies, are well under way. Serious remaining issues include the implementation and enforcement of the new reforms.

13. Maintaining the momentum of reform in *input supply markets* will include: the divestment of regulatory functions from agricultural enterprises; corporatizing and privatizing these restructured enterprises; and reducing noncompetitive aspects of any residual public sector trading in input supplies. The key enterprises to be affected are the KyrgyzAilKomok (involved in the supply of machinery and spare parts), the KyrgyzSelkhozKhimia (involved in fertilizer and agrochemicals), and the KyrgyzZoovetsnab (providing veterinary supplies through oblast units). These enterprises are in various stages of privatization. They still retain a number of public-sector regulatory functions, and these functions, such as the regulation of veterinary products, agrochemicals, and seeds, will be transferred to the Ministry of Agriculture and Food (MAF). As one aspect of this transfer, the Government will act to remove the central procurement functions from these enterprises and determine whether Government procurement will be absorbed in MAF or by a central independent procurement agency.

14. With the regulatory functions removed from these enterprises, the corporatization and privatization activity can proceed. The Government intends to prepare a plan for the transfer of responsibility for the disease control services of KyrgyzZoovetsnab to MAF and the corporatization and subsequent privatization of its oblast units. Further, the Government intends to complete the corporatization of KyrgyzSelkhozKhimia. In addition, after determining the minimal number of seed and pedigree cattle farms to be retained for strategic purposes the remaining farms will be privatized or liquidated.

15. In addition to these privatization activities there will be an active program to reduce noncompetitive aspects of remaining public sector trading in input supplies. The Government intends to establish a market-based mechanism for the distribution of agricultural inputs that are provided under external assistance (as permitted under the agreements governing the assistance) or financed out of government resources.

16. The preceding policy actions are designed to encourage the development of market institutions. However, the Government remains cognizant of its *need to guard against adverse social and environmental effects*. Two activities will be most important; (i) the need to provide social protection, and (ii) the need to protect the environmental resource base.

17. Providing for *social protection* is an increasingly important problem. Since independence, as a result of the depressed economic conditions and the attendant fiscal crisis of the Government, the incidence of poverty in the rural sector has increased from approximately 30 percent to 48 percent. Underemployment in the rural sector is estimated to be as high as 70 percent and open unemployment is growing. In many cases, especially for vulnerable groups, pensions and allowances are the only source of cash income. To address social problems in the agriculture and rural sector and to stimulate the demand for products and markets, the Government will provide additional financial support to the Social Insurance Fund of at least Som 15 million, above the 1995 planned budget level, during each of the next two years. At the same time, social assistance expenditures in 1996 and 1997 will not fall below the 1995 planned budget level. Careful monitoring of the regional balance of social insurance and social assistance payments will ensure that an equitable distribution of support is extended, particularly with respect to the distribution of payments between rural and urban beneficiaries. As part of our program, extra efforts will be made to maintain crucial social services, such as kindergartens, which address many of the needs of the women in our country, both for child care and for employment. In addition special attention will be paid to the needs of people living in remote areas where the institutional dislocation of this transitional period has meant a breakdown in the normal supply patterns for even basic necessities such as food. The Government will also continue to monitor the social impact of the reforms being implemented.


18. The current program will address the need to protect the environmental resource base of the country by focusing on policies to protect and restore natural pastures and forested areas. Approximately 45 percent of the country's land is *pasture land*, however, there has been considerable over-grazing in the recent past. With the break-up of the state farm structure, grazing land has been transferred to the oblast agriculture departments, but there have been few incentives provided to manage the pastures from the point of view of long-term sustained yield. The Government intends to prepare policy recommendations and laws and regulations on the long-term leasing or ownership and the management and sustainable use of natural pastures, and on controlled grazing in forest areas. A further environmental pursuit will be to reintroduce the biological control of pests for a major crop, cotton. Biological control previously collapsed due to lack of funding and the Government will determine an appropriate mechanism for industry funding for biological control.

19. Fundamental to a properly functioning agriculture sector, are public agencies that can provide the proper institutional and regulatory support. At the current time, seven separate high level agencies, in addition to MAF are involved in the management of the sector. Their individual roles and responsibilities are not well defined and often in conflict. One crucial

element in the Government's plan to resolve this situation is a thorough reorganization of the Ministry of Agriculture. In this reorganization, MAF will divest itself of those institutions which function as private sector entities. Conversely MAF is expected to absorb public sector responsibilities from those organizations slated for privatization. It is expected that at least 10 organizations attached to MAF will be privatized. As one element of the overall reorganization, it is expected that MAF will assume responsibility through the Republican Center for Land and Agrarian Reform (RCLAR) for the network of Centers on Land and Agrarian (CLAR) now under local control.

20. The above program to support reform and development in agriculture is described in more detail in the accompanying development policy matrix. Given the magnitude of the challenge facing the country, by itself the program will not solve all the problems of the nation. This program is, however, an important part of the overall program of reform and will move the country significantly closer to its goal of developing fully functioning market institutions while minimizing the social and economic burdens of the transition.

21. Mr. President, the Government of the Kyrgyz Republic appreciates the support to be given by the Asian Development Bank in implementing this vital program to strengthen and accelerate agriculture sector reforms.



Hon. B. Talgarbekov  
Minister of Agriculture and Food  
Kyrgyz Republic

# DEVELOPMENT POLICY MATRIX

Overall Objective: To facilitate the transition to a competitive market-based agriculture sector

No.	Policy Areas and Objectives	Previous Reform Measures and Concerns	Policy Measures under the Program	Target Date	Condition to
A	CREATING MARKETS				
1.	Land Reform and Farm Restructuring	<p>The Presidential Decree on Land Reform (February 1994) granted all farm residents the right to a share of arable land for use for agricultural purposes for 49 years and a right to exchange, lease, buy, sell, and mortgage such land shares.</p> <p>Centers for Land and Agrarian Reform (CLAR) in association with the Rural Committees (RC) are responsible for inventories, valuation and determining shares of land, including National Land Fund land, shares of other property and farm reorganization, etc. Land allocation disputes are currently adjudicated by the RCs and, if unresolved, by the judicial system (<i>raion</i> tribunals).</p> <p>The Presidential Decree also provides for shares of non land assets (livestock, buildings, machinery, etc.) to be allocated to all employees of former state and collective farms. The RCs are responsible for valuing property and determining property shares with the assistance of CLAR staff. The status of property distribution is difficult to assess and lags behind land distribution. Many assets are "lumpy" posing serious problems for subdivision and for future management and use. Mechanisms for determining and allocating property shares are inadequate and transparency is lacking.</p>	<p>1.1.1 Government to develop permanent land dispute resolution procedures to handle land allocation conflicts, boundary disputes, and similar problems.</p> <p>1.1.2 Government to complete the distribution of shares in non land assets of former state and collective farms, except for specific cases affecting individual farms where legal or public use issues remain.</p> <p>1.1.3 Government to develop modes of ownership, organization and management for the efficient operation of non land assets to meet the needs of emerging farms.</p> <p>1.1.4 Government to submit to the Parliament a draft law for a simplified land and immovable property registration system.</p>	<p>December 1996</p> <p>December 1996</p> <p>Program Period</p> <p>December 1996</p>	<p>Second Tranche</p> <p>Second Tranche</p>



No.	Policy Areas and Objectives	Previous Reform Measures and Issues and Concerns	Policy Measures under the Program	Target Date	Condition to
		There is concern regarding the transparency of land reform activities, especially in the use/distribution of National Land Fund and non land assets.	1.1.5 Government to prepare and implement guidelines and procedures for CLAR and RC activities	June 1996	
2.	Water Rights, Management and User Contributions				
2.1	Clarifying Irrigation Water Rights	A law and several Government Decrees have been issued for licensing individual irrigation water use rights. However, implementing procedures have not been adequately clarified.	2.1.1 Government to review, make consistent, and publish the policies and procedures, governing irrigation water-user rights.	December 1996	Second Tranche
2.2	Establishing Collection of Irrigation Water-Use Contributions	At present, the Government through the Ministry of Water Resources (MWR) is responsible for the financing and management of the national irrigation system. Total irrigation operating and maintenance costs are estimated by MWR to be Som 566 million annually. While laws and decrees require users to pay, currently there is no mechanism or user capacity to pay. Consequently there is currently negligible cost recovery. Given the limited fiscal resources of the Government, approximately 80 percent of the estimated irrigation costs remain unfinanced. The decree of 5 June 1995 authorizes the establishment of private WUAs and these can be used to begin collecting user contributions for irrigation water use.  Legislation provides for the transfer of ownership of irrigation systems and equipment from former state and collective farms to WUAs. However, the legislation needs to be simplified, clarified, and made available to the public.	2.2.1 Government to issue a decree extending the rights and responsibilities of WUAs to set and collect water charges, to retain revenues, and to make decisions regarding operational and capital costs, within their area of jurisdiction.  2.2.2 Government to establish and publish clear procedures governing the transfer of ownership of irrigation infrastructure within particular service areas to their respective WUAs.	November 1995  April 1997	Board Consideration

No.	Policy Areas and Objectives	Previous Reform Measures and Issues and Concerns	Policy Measures under the Program	Target Date	Condition to
B	PROMOTE MARKET COMPETITIVENESS				
3.	Input Marketing				
3.1	Transferring Regulatory Functions from the former State Owned Enterprises to MAF	<p>Previous State-Owned Enterprises supplying agricultural inputs are in various stages of privatization. KyrgyzAiIkomok (KAK, machinery and spare parts) has been privatized; KyrgyzSelkhozKhimia (KSKK, fertilizer and agrochemicals) is partly privatized; and privatization of KyrgyzZoovetsnab (KZVS, veterinary supplies) has recently commenced. These enterprises still retain some public-sector functions including regulatory and procurement responsibilities. These public service functions should be transferred to the MAF.</p>	<p>3.1.1 Government to transfer regulatory functions for veterinary products and agro-chemicals from KZVS and KSKK to MAF</p> <p>3.1.2 Government to establish seed regulatory functions and inspection capability in MAF</p> <p>3.1.3 Government to determine whether Government procurement should be absorbed in MAF or some central independent procurement agency.</p>	<p>December 1996</p> <p>December 1995</p> <p>June 1996</p>	Second Tranche
3.2	Corporatizing and Privatizing Agricultural Enterprises	<p>KZVS has made little progress in privatizing distributive activities.</p> <p>The process of corporatizing KSKK is ongoing. It is necessary that the existing local distribution network remains in operation. to ensure continued distribution of essential input supplies</p> <p>By Decree (No. 745 of 04.08.94) the 74 seed breeding, pedigree cattle breeding, and experimental farms are required to be restructured with some listed as being of strategic importance to the state.</p>	<p>3.2.1. Government to prepare a plan for the transfer of responsibility for the disease control services to MAF and the corporatization and subsequent privatization of the KZVS distribution network.</p> <p>3.2.2 Government to corporatize the KSKK headquarters and 50 percent of all local units.</p> <p>3.2.3 Government to corporatize the remaining local units.</p> <p>3.2.4 Government to determine the minimum number of seed and cattle breeding farms to be retained for strategic purposes and to privatize or liquidate at least 12 of the remaining farms.</p>	<p>Program Period</p> <p>November 1995</p> <p>December 1996</p> <p>December 1996</p>	<p>Board Consideration</p> <p>Second Tranche</p> <p>Second Tranche</p>

No.	Policy Areas and Objectives	Previous Reform Measures and Issues and Concerns	Policy Measures under the Program	Target Date	Condition to
3.3	Government Supplied Commodities	The Government will still remain active for some time in agricultural input supplies obtained through external assistance or from its own resources. However, the private sector must be encouraged to participate in the procurement and distribution of these supplies.	<p>3.3.1 Government to establish a market-based mechanism for the distribution of agricultural inputs that are provided under external assistance (as permitted under external agreements) or financed from its own budget resources.</p> <p>3.3.2 Anti-Monopoly Department to continue to monitor operations of successor organizations to KSKK to ensure that fair trade practices prevail.</p>	<p>Program Period</p> <p>Program Period</p>	
C	SOCIAL AND ENVIRONMENTAL CONCERNS				
4.	Social Protection				
4.1	Monitoring Social Impact of the Reforms	The transition to a market based economy has been associated with significant unemployment particularly in rural areas. Agricultural wages have dropped to 45 percent of the national average in 1994, from near parity in 1992.	4.1.1 Government to monitor and evaluate, through the information and analysis system established within Goskomstat, and report to the Bank on the socio-economic impact of the reform measures, with particular emphasis on vulnerable groups in rural areas.	Program Period	

No.	Policy Areas and Objectives	Previous Reform Measures and Issues and Concerns	Policy Measures under the Program	Target Date	Condition to
4.2	Supporting the Social Safety Net	<p>Poverty in the rural areas is increasing; from approximately 30 percent of rural households in 1991 to 48 percent in 1994. Labor force migration has resulted in an increasing proportion of non-working population in rural areas.</p> <p>The public sector provides two different means of cash transfers to vulnerable groups. The Social Fund (consisting of pension, employment and health insurance) is designed to be funded by employer and employee contributions. Social Assistance, mainly family allowances, is funded by payroll taxes and general government funds. Both schemes are heavily in arrears with serious delays in payment of benefits, particularly to the rural population.</p> <p>Due to the high dependence of the rural population on transfers there is a need to ensure that payments under the current social protection system are made equitably on the basis of entitlements and that rural beneficiaries are not disadvantaged.</p>	<p>4.2.1 Government to submit a budget provision for 1996 and 1997 for additional financial support to the Social Fund of at least Som 15 million above the 1995 planned budget level and for the maintenance of total social assistance expenditures in 1996 and 1997 at least at the 1995 planned budget level.</p> <p>4.2.2 Government to monitor that Social Fund and Social Assistance payments are in accordance with beneficiary entitlements.</p>	<p>November 1995</p> <p>December 1996</p>	<p>Board Consideration</p> <p>Second Tranche</p>
4.3	Maintaining Essential Social Services	<p>The majority of rural enterprises, both farms and industrial, are unable to provide the social services which have traditionally been available to employees free of charge. The most essential of these are kindergartens and medical facilities. Kindergartens provide child care and education and also improve employment opportunities for women. Medical service provision is being assisted by external donors.</p> <p>The situation of the population in remote rural areas is deteriorating rapidly resulting in large out-migration and high dependent population ratios. In addition previous dependable supplies of food and essential commodities have declined.</p>	<p>4.3.1 Government to ensure that the majority of rural public sector kindergartens operational in 1995 will be kept operational in 1996 and 1997.</p> <p>4.3.2 Government to assess food supply and needs in remote areas.</p> <p>4.3.3 Government to develop a strategy for meeting identified food needs in remote areas.</p>	<p>Program period</p> <p>December 1995</p> <p>June 1996</p>	

No.	Policy Areas and Objectives	Previous Reform Measures and Issues and Concerns	Policy Measures under the Program	Target Date	Condition to
5.	Environment				
5.1	Sustainable Management of Forests and Upland Pastures	About 45 percent of the country's land is pasture land. There was considerable over-grazing in the past. This has been reduced on summer (high altitude) pastures due to the halving of sheep numbers and the ending of subsidized support of shepherds in remote areas. However pressure remains on spring and autumn pastures around valley fringes. With the break-up of the state and collective farm structure, grazing land has been transferred to the <i>oblast</i> agriculture departments who issue annual grazing leases. There have been few incentives provided to manage the pastures from the point of view of long-term sustained yield.	<p>5.1.1 Government to prepare policy on the long term leasing or ownership of natural pastures to promote sound grazing and other sustainable land use practices.</p> <p>5.1.2 Government to issue a decree to promote the management and sustainable use of natural pastures.</p>	<p>June 1996</p> <p>December 1996</p>	Second Tranche
		Approximately 4 percent of the country's land is under forests. Grazing of cattle in these area is generally inhibiting natural regeneration.	5.1.3 Government to issue a Decree controlling grazing in the forest areas.	June 1996	
5.2	Biological Control of Cotton Pests	Previously extensive use of fertilizers and chemicals, especially in cotton production resulted in ecological degradation and caused health problems to the population. Use of chemicals had been largely replaced by biological control of cotton pests but the system has collapsed due to the lack of funding.	5.2.1 Government to introduce a mechanism for industry funding of biological control of cotton pests.	Program Period	

No.	Policy Areas and Objectives	Previous Reform Measures and Issues and Concerns	Policy Measures under the Program	Target Date	Condition to
6.	Institutional Capacity Building and Restructuring				
6.1	Strengthening MAF Headquarters (HQ) and Republic Center for Land and Agrarian Reform (RCLAR)	MAF is responsible for agriculture policy but seven other high level agencies are also involved in setting policy. Their individual roles and responsibilities are not well defined. The Government has published a draft decree (July 1995) for the reorganization of agricultural services which strengthens MAF's role. A MAF Decree (July 1995) provides for the reorganization of MAF HQ and dependent institutes and enterprises.	<p>6.1.1 Government to complete the reorganization plan of MAF HQ.</p> <p>6.1.2 Government to complete the reorganization of MAF HQ.</p> <p>6.1.3 Government with technical assistance to strengthen the capacity of the Directorate of Economics, Directorate of Investment and the Directorate General Republican Center of Land and Agrarian reform (RCLAR).</p> <p>6.1.4 Government to issue a decree placing CLARs under the direct supervision and management control of MAF.</p>	<p>November 1995</p> <p>December 1997</p> <p>December 1997</p> <p>November 1995</p>	<p>Board Consideration</p> <p>Board Consideration</p>
6.2	Restructuring MAF's Dependent Entities	As of July 1995 MAF was responsible for 36 attached enterprises and institutes, with approximately 1500 staff. The reorganization plans for MAF call for the privatization or liquidation of approximately one-half of these organizations; while others, principally training or research institutes will be retained.	<p>6.2.1 Government to privatize or liquidate at least 10 of MAF's attached organizations.</p> <p>6.2.2 Government to prepare a time-bound program for restructuring research institutes.</p> <p>6.2.3 Government to prepare a time-bound program for restructuring agricultural education and training agencies.</p>	<p>December 1996</p> <p>December 1997</p> <p>Program Period</p>	Second Tranche



### ITEMS INELIGIBLE FOR IMPORT

1. The proceeds of the Loan will be utilized to finance the foreign currency expenditures for 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 para. 1, no withdrawals shall be made for:

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

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
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), nonirradiated for nuclear reactors
897	897.3	Jewelry of gold, silver, or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, nonmonetary (excluding gold ores and concentrates)

(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 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.



## TECHNICAL ASSISTANCE: REORGANIZATION AND STRENGTHENING OF THE MINISTRY OF AGRICULTURE AND FOOD

### A. Introduction

1. During the visit by the Appraisal Mission for the Agriculture Sector Program Loan to the Kyrgyz Republic from 31 July to 21 August, 1995 the Government requested technical assistance (TA) from the Bank for capacity building and advisory services for the Ministry of Agriculture and Food (MAF) to help MAF strengthen its capacity to implement the reform process and support a market-based agriculture sector. This paper sets out the objectives, scope, cost estimates, and implementation arrangements for the TA.

### B. Background and Rationale

2. Since the collapse of the command economy, a framework for agriculture sector reform has been largely established and most major policy measures and many minor measures have been put in place, by decree and through legislation. The Agriculture Sector Program Loan will support a number of further measures that are required.

3. As a consequence of the changes, many of MAF's former functions have disappeared and new needs have emerged. MAF has been given overall responsibility for the reform of the agriculture sector and the development of a market-oriented agriculture sector. However, MAF has not been effective in its new role. As a result, although policy measures are in place there is no coherent program for implementing sector reform, management is often poor, and implementation of reform measures is delayed. This has resulted in other Government agencies intruding in an ad hoc manner upon MAF responsibilities.

4. Action is being taken to strengthen the role and capacity of MAF for the management of the reform process and to support a market-based agriculture sector. In July 1995, a Government draft decree substantially redefined the role of MAF, enhancing its position relative to that of other public institutions. The duties of *oblast* and *raion* agricultural administrations were reduced and redefined, responsibility for local Centers for Land and Agrarian Reform was transferred to MAF, and MAF was given overall responsibility for agricultural education, including the Agricultural University. At the same time, MAF started to prepare a reorganization plan. The first phase, the reorganization of MAF Headquarters, is under implementation. The second phase, the reorganization and/or privatization of 36 dependent institutes and enterprises is being prepared. The process of reorganization and rebuilding will restructure and strengthen functions that are still valid, divest MAF of activities and services that are no longer required or can be provided better by the private sector, and establish a capability to undertake important new functions. The process will involve the reorganizing and strengthening all main directorates and dependent services. The activities to be developed and strengthened include policy formulation and economic analysis, the budgetary process, investment programming and aid coordination, land and agrarian reform, marketing, field advisory services, research, regulatory services, education and training, and the revision and preparation of legislation. In view of the extent of the reorganization the process is likely to extend over several years and will require substantial carefully targeted external support.

5. The first phase of the MAF plan provides for the reorganization of all Headquarters directorates, including two key directorates – the Directorate of Economics (DOE) and the Directorate of Investment and Agroprocessing (DOI). Following the breakdown of central planning, these Directorates faced entirely new tasks that were neither well understood nor properly defined. Defining these tasks and strengthening the capacity of DOE and DOI is central to the strengthening of all MAF activities. The reorganization plan has confirmed and strengthened the position of the MAF Republican Center for Land and Agrarian Reform (RCLAR), which has General Directorate status and has overall responsibility for land and agrarian reform (including privatization of a number of key enterprises). The strengthening of the capacity of the DOE, DOI, and the RCLAR is critical to the effective functioning of MAF and management of sector reform.

6. MAF recognizes the need for technical advice operating within its departmental structures to strengthen its capacity for guiding, programming, and managing sector reform and for the development of services to support private agriculture. MAF is seeking Bank assistance in the following priority areas:

- (i) the implementation of overall reorganization plans for MAF and dependent entities and services;
- (ii) the privatisation of dependent enterprises, especially KyrgyzZoovetsnab and KyrgyzSelkhozkhimia, and parts of some public services;
- (iii) the institutionalization within DOE and DOI of policy making and programming capability (including investment programming and program financing) with the development of a MAF-owned sector strategy, policies, implementation, and investment/financing plan;
- (iv) the coordination of external assistance;
- (v) the preparation of prioritized and timebound ministry and departmental work programs, including establishing systems and procedures and staff training;
- (vi) advice on immediate economic and institutional development problems; and
- (vii) staff development including staffing requirements and training needs and a staff development plan.

## **C. The Technical Assistance**

### **1. Objectives**

7. The objective of the TA is to strengthen MAF's capability to formulate strategy and policies and to design, finance, and implement a program to complete the process of reform in the agriculture sector and to provide continuing support for market-based agriculture. Within this broad objective, the TA will provide support and strengthen the three key directorates responsible for these tasks.

## 2. Scope

8. Within the framework of strengthening MAF's capacity for programming and managing sector reform and developing services for private agriculture, the scope of the TA will include:

- (i) MAF reorganization through:
  - (a) review and implementation of MAF headquarters reorganization plan;
  - (b) review and implementation of MAF plans to reorganize and privatize dependent enterprises and institutes; and
  - (c) preparation of a program for developing agricultural training institutions, including the Agricultural University, technicums and agricultural vocational training schools.
- (ii) specific support to RCLAR for the privatization of dependent enterprises, especially KyrgyzZoovetsnab and KyrgyzSelkhozkhimia, and to other directorates for the privatization of some public services;
- (iii) strengthening DOE, DOI, and the RCLAR through:
  - (a) clarifying and establishing the responsibilities of the directorates, departments and sections and of staff members;
  - (b) finalizing sector strategy, policies, and a prioritized implementation plan;
  - (c) on the basis of (b) preparing and implementing annual work programs (AWPs) within the context of an overall Ministry AWP, introducing and implementing AWP programming methods and procedures;
  - (d) developing investment programming capability, an updated public investment program and a mechanism for aid coordination;
  - (e) training staff in technical, language, and computer skills; and
  - (f) advising on immediate economic and institutional development problems; and
- (iv) Staff development and training for DOE, DOI, and RCLAR and in the context of overall MAF needs: assess staff, staffing needs, and staff training needs, and prepare a staff development plan.

### 3. Cost Estimates and Financing Plan

9. The total cost of the TA is estimated at \$1,364,000 equivalent, including \$1,196,000 in foreign exchange and \$168,000 in equivalent local currency. The entire foreign exchange cost and \$128,000 equivalent in local currency for a total cost of \$1,324,000 will be charged to the Bank-funded TA program. The Government will fund the remaining \$40,000 equivalent in local currency costs. The cost estimates and financing plan are given in Table 1.

### 4. Implementation Arrangements

10. The MAF will be the Executing Agency for the TA. The TA will be implemented over a period of 18 months.

11. The TA team will be led by an international consultant with experience in the former Soviet Union or Eastern Europe in reorganizing and strengthening a ministry of agriculture and related public services and, in particular, developing ministry economic and financial services, including investment programming and aid coordination. The team leader, who will be a policy/development economist with extensive institutional experience specializing in agriculture, will be engaged for a period of 18 months. The team leader will be supported by an institutional/operations and maintenance specialist (4 months), a privatization specialist (6 months) and an education and training specialist (6 months). The team will include four domestic specialist consultants, with specialist knowledge and related skills; they will work closely with the international consultants and be engaged for 12 months. The team leader will be responsible for recruiting and selecting the domestic consultants.

12. The team leader will report to and work in close collaboration with MAF's Deputy Minister for Economics and Investment, and the team will work within the directorates for which the Deputy Minister is responsible and in the RCLAR.

13. The consultants will be recruited in accordance with the *Bank's Guidelines on the Use of Consultants*.

14. At the start of the consultancy the team leader will focus on establishing the team in the directorates, recruiting domestic consultants, orienting of the consultant team and counterpart staff from MAF, and preparation of DOE and DOI work programs that will form the framework for the consultants' work program.

15. The TA will also finance overseas and local training for MAF staff, seminars and workshops, local and international travel of the consultants, one vehicle, office equipment, and training materials

16. An inception report will be provided by the consultants to the Executing Agency and the Bank 1 month after the fielding of the team leader. A progress report will be submitted 10 months after the submission of the inception report. A draft final report will be submitted for review by MAF and the Bank after 17 months. A final report incorporating comments received will be submitted at the end of the consultancy period.

**Table 1: Cost Estimates and Financing Plan (\$)**

	Foreign Exchange	Local Currency	Total Costs
<b>A. Bank Financing</b>			
1. Consultants (Remuneration and Out-of-Pocket Expenses)			
(a) International Consultants	809,000		809,000
(b) Domestic Consultants		29,000	29,000
2. Equipment	40,000	5,000	45,000
3. Seminars, Workshops, and Training	160,000	20,000	180,000
4. Studies, Surveys, and Documents	7,000	20,000	27,000
5. Contract Negotiations	6,000		6,000
6. Miscellaneous TA Administration and Support Costs	18,000	37,000	55,000
7. Contingency	156,000	17,000	173,000
<b>Subtotal A</b>	<b>1,196,000</b>	<b>128,000</b>	<b>1,324,000</b>
<b>B. Government Financing</b>			
1. Counterpart Staff		20,000	20,000
2. Support Services		15,000	15,000
3. Contingency		5,000	5,000
<b>Subtotal B</b>		<b>40,000</b>	<b>40,000</b>
<b>TOTAL (A+B)</b>	<b>1,196,000</b>	<b>168,000</b>	<b>1,364,000</b>

Source: Staff estimates

## **TECHNICAL ASSISTANCE: BUILDING CAPACITY FOR THE FORMATION AND MANAGEMENT OF WATER USERS ASSOCIATIONS**

### **A. Introduction**

1. During the Appraisal Mission for the Agricultural Program Loan, the Government requested technical assistance (TA) from the Bank for capacity building and advisory services for the Ministry of Water Resources (MWR) to facilitate the formation and sound management of Water Users Associations (WUAs). This paper sets out the objectives, scope, cost estimates, and implementation arrangements for the TA.

### **B. Background and Rationale**

2. The Kyrgyz Republic has 1.4 million hectares (ha) of arable land with a total irrigated area of about 1 million ha. Irrigated agriculture is responsible for most of national production. However, the area actually irrigated has declined about 15 per cent over the last few years, largely due to the reduced funding for operation and maintenance (O&M) of the irrigation system. In view of difficulty in the O&M of the system, the Government is establishing WUAs to assume full responsibility for system operations at the farm level. Previously this was undertaken by the state/collective farm, including the financing of recurrent costs within their service area. The service area of a WUA is normally a part of a former state/collective farm served by one outlet.

3. Continuing financial and staffing constraints are forcing MWR to shift its strategy and functions from direct involvement in irrigation O&M towards the devolution of responsibility for financing and management of irrigation facilities below the level of major canals to WUAs. However these are in the early stages of establishment. The water charges being levied are minimal (however there is a land tax on irrigated land used for other purposes), and the size of the WUAs being established makes them difficult to manage.

4. In the long term, the sustainability of irrigation systems in the Kyrgyz Republic will depend on the willingness and ability of water users to assume responsibility for financing irrigation operations. Based on the experience of other countries with similar problems, this can be best achieved when the water users themselves are involved in planning water distribution and in setting the level of water charges, when irrigation system staff are responsible and accountable to the water users, and when water charge revenues collected from water users are used exclusively on their irrigation system rather than remitted to a central irrigation authority. It is proposed that such lessons be incorporated in the approach taken by the MWR for assisting WUAs.

5. This reorientation of the MWR will require:

- (i) advice on supporting policies, legislation, and regulations;
- (ii) staff training and exposure to best practices of similar irrigation agencies in other countries, including assistance with the establishment of an appropriate unit within MWR to facilitate and monitor the establishment of WUAs; and

- (iii) pilot testing the processes for forming and strengthening WUAs and introducing water users' unions to become financially responsible for the O&M of irrigation systems.

6. Methods and processes that prove to be effective in building local-level capacities for system management can then be replicated in other irrigation systems

## C. The Technical Assistance

### 1. Objectives

7. The broad objective of the TA is to provide more effective O&M of the farm-level irrigation system. The immediate objective is to strengthen MWR's capacity to facilitate the formation and sound management of the WUAs.

### 2. Scope

8. The scope of the TA will include:

- (i) review of the legislation, particularly Presidential Decree No. 226 of 6 June 1995, with a view to developing clear, complete, and consistent implementation procedures for exercise of the functions and responsibilities of WUAs and the establishment and levying of appropriate water charges;
- (ii) provision of advice on the most appropriate unit structure and staffing within the MWR to service the *oblast* and *raion* level irrigation departments;
- (iii) provision of advice on the policies, processes, and procedures for organizing WUAs, irrigation fee collection, and farm-level system management;
- (iv) training of key staff at the MWR and selected *oblast* and *raion* levels to facilitate the formation and monitoring of WUAs; and
- (v) assistance to MWR in field testing and refining new intervention approaches for the formation and sound management of WUAs in selected pilot irrigation systems.

### 3. Cost Estimates and Financing Plan

9. The total cost of the TA is estimated at \$901,000, including \$744,000 in foreign exchange and \$157,000 equivalent in local currency. The entire foreign exchange cost and \$117,000 equivalent in local currency cost for a total cost of \$861,000 will be charged to the Bank-funded TA program. The Government will fund the remaining \$40,000 equivalent of local currency costs. The cost estimates and financing plan are given in Table 1.

### 4. Implementation Arrangements

10. MWR will be the Executing Agency for the TA. The TA will be implemented over a period of 18 months.

11. There will be 24 months of international consultant inputs and 12 months of domestic consultant inputs. The consultant team will be led by an international consultant with experience in the former Soviet Union or Eastern Europe in farmer organization processes, cost recovery, and management of farm level irrigation systems. In addition there will be six months of short-term consultant inputs in the areas of legislation, institutional, financial management and cost recovery. The team leader will be responsible for recruiting and selecting the domestic consultants. The consultants will be recruited in accordance with the Bank's Guidelines on the Use of Consultants.

12. At the start of the consultancy the team leader would focus on recruiting the domestic consultants, orienting the consultant team and the counterpart staff from MWR, and planning and starting the three pilot projects.

13. An inception report will be provided by the consultants to the Executing Agency and the Bank one month after commencement. A progress report will be submitted ten months after the submission of the inception report. A draft final report will be submitted for review by MWR and the Bank after 17 months. A final report incorporating comments received will be submitted at the end of the consultancy period.



**Table 1: Cost Estimates and Financing Plan (\$)**

	<b>Foreign Exchange</b>	<b>Local Currency</b>	<b>Total Costs</b>
<b>A. Bank Financing</b>			
1. Consultants (Remuneration and Out-of-Pocket Expenses)			
(a) International Consultants	581,000		581,000
(b) Domestic Consultants		29,000	29,000
2. Equipment	35,000	5,000	40,000
3. Seminars, Workshops and Training		20,000	20,000
4. Studies, Surveys and Documents	7,000	20,000	27,000
5. Contract Negotiations	6,000		6,000
6. Miscellaneous TA Administration and Support Costs	18,000	28,000	46,000
7. Contingency	97,000	15,000	112,000
<b>Sub Total A</b>	<b>744,000</b>	<b>117,000</b>	<b>861,000</b>
<b>B. Government Financing</b>			
1. Counterpart Staff		20,000	20,000
2. Support Services		15,000	15,000
3. Contingency		5,000	5,000
<b>Sub Total B</b>		<b>40,000</b>	<b>40,000</b>
<b>Total (A+B)</b>	<b>744,000</b>	<b>157,000</b>	<b>901,000</b>

Source: Staff estimates

## POVERTY IMPACT ASSESSMENT

### A. Introduction

1. A poverty impact assessment (PIA) was conducted for each of the Program measures, based on a comparison of "with" and "without" Program measures. The PIA on the poor was analyzed through four channels: (i) demand for agricultural labor; (ii) the prices of goods bought and sold by the poor; (iii) access of the poor to public (education, health) and rationed (agricultural inputs, credit) goods and services; and (iv) net public transfers (transfers minus taxes) to the poor.

2. The results of the PIA are presented by categories of reform measures with similar objectives. A summary of the assessment by category of reform measures is presented in Table 1. The various positive (+) and negative (-) signs indicate the net impact of the reform measures in each category.

**Table 1: Summary of PIA by Category of Reform Measures  
(Net Impact of Reform Measures on the Poor)**

	<b>Policy Measure Category</b>	<b>Labor market</b>	<b>Prices</b>	<b>Access of the poor</b>	<b>Net transfers</b>
A	Land Reform and Farm Restructuring	+ +	0 +	+ +	0 +
B	Water Management	+ +	- 0	- 0	- 0
C	Input Marketing	- -	- +	0 +	- -
D	Social Protection	+ +	0 +	+ +	+ +
E	Environmental Protection	0 +	- +	- +	0 0
F	Institutional Capacity Building and Restructuring	- 0	0 +	+ +	0 0

Notes:

- (i) Ranking: from - (negative impact), through 0 (no impact), to + (positive impact)
- (ii) The first line in each category represent the short-term and the second line the long-term impacts.

### B. Poverty Impact Analysis by Category

#### 1. Land Reform and Farm Restructuring

3. The measures in this category include (i) developing permanent land dispute resolution procedures, (ii) completing the distribution of shares of non-land assets, (iii) developing modes of ownership organization and management for the efficient operation of

non-land assets, (iv) submitting to Parliament a draft law for a simplified land and immovable property registration system, and (v) providing guidelines and procedures for the Centers for Land and Agrarian Reform and rural committee activities. The general social impacts of these measures will be the improvement of asset and land distribution and more democratic control of land and access to nonland assets.

**a. Labor Market**

4. In the short term, little change is anticipated. The distribution of indivisible assets, such as large machines, will not create significant employment and, with unemployment high, there is little alternative for small landholders than staying on the land. In the medium and long term land, consolidation is expected. Assuming a functioning land market, and that inheritance practices do not lead to fragmentation of holdings, this may reduce on-farm employment but should also increase more rural specialist service and supply jobs. The net long-term effect may be an increase in overall rural employment.

**b. Prices of Goods**

5. Clearer legislative foundations and procedures will result in more reliable and sustainable planning and investments in land use. This will increase agricultural production and efficiency. Also, an increase in land prices can be expected. In the long run, assuming that supply and marketing chains are developed, the land reform and farm restructuring should reduce prices for both producers and consumers.

**c. Access of the Poor**

6. In the short term, the larger producers are likely to have better access to scarce resources and markets since they may have their own transport. As transport services develop, this advantage should diminish. Access to other social services is not affected by the policy measures.

**d. Public Transfers to the Poor**

7. The net public transfers to the poor will not be affected by the policy measures in the short term. In the longer perspective, a greater disparity between richer and poorer should lead to more sharply-defined targeting, while overall increases in living standards should reduce the need.

**2. Water Rights and Water Management**

8. Policy measures under the Program include (i) making the policies and procedures governing water user rights more consistent and publishing them; (ii) extending the rights and responsibilities of water-users associations (WUAs), including the collection of water charges and allocation of the revenue; and (iii) implementing procedures for transferring ownership of irrigation infrastructure to WUAs. The overall social effect of these measures is to place the ownership and control of irrigation resources (excluding major works) in the hands of the water users and for the government to commence relinquishing control and funding. Since WUAs have only officially existed since June 1995 there is little practical local experience on which to base an analysis. Much will depend upon the extent to which WUAs genuinely

represent their full membership and how effective they are in integrating their interests and undertaking their new responsibilities.

**a. Labor Market**

9. With a five-year backlog of maintenance to be undertaken, the transfer of water management into the hands of the farmers might provide increased employment. In some circumstances this could include public works programs that would target the employment benefits to the poor, though care is needed to ensure that this does not undermine the development of a local labor market. In many cases, for example, owners of irrigated land might prefer to pay their dues to the WUA in the form of labor.

**b. Prices of Goods**

10. WUAs will gradually have to introduce much higher water charges than apply now. This will initially lead to increased costs of production and some reduction in farm income. Eventually, increased yields from the better operation of the system should lead to increased incomes. However, these may not be sufficient to offset the removal of subsidies and the increased production costs. The effect would thus be an increase in prices (to the detriment of nonproducers), or a squeeze on margins (problematic for producers); the most likely result is a combination of the two. In time, and preferably with the guidance of an extension program, farmers would learn to optimize their water use and hence to reduce their expenses.

**c. Access of the Poor**

11. Irrigated land is a scarce resource. Some irrigation schemes are so expensive to operate and maintain as to be economically nonviable. Closure would cause hardship among the farmers and community in general and would reduce agricultural production. Consequently, the poor farmer's access to irrigated land will be reduced. In the long run, increased agricultural productivity on probably smaller land plots might also allow the poorer farmers to have better access to irrigated land.

**d. Public Transfers to the Poor**

12. Yield increases from improved practices may not be sufficient to offset increased costs of production. The effect would thus be an increase in prices (to the detriment of nonproducers) or a squeeze on margins (problematic for producers); the most likely result is a combination of the two.

**3. Input Marketing**

13. Input marketing reforms under the program aim at (i) transferring regulatory functions from the former state-owned enterprises to the Ministry of Agriculture and Food (MAF), (ii) corporatizing and privatizing agricultural enterprises, and (iii) strengthening the competition for Government supplied commodities. The long-term aim of these measures is to give society as a whole the benefits of an efficient, market-oriented economy. The reform measures, by supporting the general transformation trend, will have some negative labor market effects on the rural poor in the short run.

**a. Labor Market**

14. In the process of the reforms staff will be laid off, many of whom have already experienced declining living standards as a result of wage erosion, late wage payments, short time work, and extended leave. The restructured and privatized enterprises and their successors will, in response to market pressures, seek to reduce staffing and in the economic recovery process some further staff reductions may result in the medium run. There is therefore likely to be a long period of adjustment with little prospect of reemployment for many of those made redundant. The basic statutory redundancy pay is one month's salary. The social fund's employment fund and the social assistance program both offer financial assistance to the unemployed.

**b. Prices of Goods**

15. The privatization process will not result in increased wages in the short run. However, in the long run the price for labor will go up, once the privatized enterprises become more competitive. This will favor the poor because they are normally well trained and educated. Furthermore, increased market competition should lead to a rise in producer prices and a fall in consumer prices in the medium to long term.

**c. Access of the Poor**

16. Agricultural inputs have become scarce commodities, to the serious detriment of the agriculture sector. The regeneration of the supply and services sector in private hands will, in the medium and long term, considerably improve access for all. In the immediate future, shortages are likely to continue as the new system is created.

**d. Public Transfers to the Poor**

17. Being state employees, the poor have had access to social facilities, transfers, and other benefits provided by the enterprises (albeit on a decreasing scale) and additionally funded by the national budget. These have been a part of the employment package and as such supplements to the wage, but will cease. Social facilities associated with unprofitable concerns are being transferred to local government to be funded by tax revenue (local and central), which might not be able to budget sufficient transfers to the poor. The net impact of the rural poor formerly receiving transfers will be negative both in the short as well as in the long run.

**4. Social Protection**

18. The proposed policy measures under the Program focus on (i) monitoring the social impacts of the reforms; (ii) supporting the social safety net with increased contributions to the social fund (used especially for paying pensions to the rural areas) and monitoring the social fund and social assistance payments; (iii) maintaining essential social services such as rural kindergartens; and (iv) assessing the needs to further support remote rural areas, e.g., through public food supplies. The net social impacts of these policy measures are positive.

**a. Labor Market**

19. In view of the inevitable decline in rural employment in the short and probably medium term there will be increasing reliance on social benefits and needs for social facilities previously provided by state-owned enterprises. Social protection policy measures under the Program have little effect on general employment, because they are mainly designed to mitigate the problems associated with unemployment and poverty. However, maintaining rural kindergartens will have a major contribution to women's further employment opportunities. The reform measures under the Program will directly improve the cash income of the poor through cash transfers and contribute to women's employment in the social sector.

**b. Prices of Goods**

20. Remote rural communities have suffered both from general price rises and from the worst problems of the breakdown of retailing and transportation. Supplies formerly subsidized for remote areas are now very expensive for the poor or not available at all. The monitoring component of the policy measures in the MAF, in close cooperation with NatComStat, and other ministries, will develop a strategy for meeting identified social needs rooted in among other things, the sharp rise of consumer prices with its negative impacts both for the urban and rural poor as well as for special target groups like pensioners.

**c. Access of the Poor**

21. Additional costs to access social services that were formerly provided by the State limit the accessibility of the poor to such services and places particular pressure on women. In this context, kindergartens in rural areas are especially important. They (i) provide pre-school education, (ii) reduce the domestic workload on women, (iii) enable them to participate or continue employment in and outside the social sectors, (iv) and so provide for additional income. Whereas most of the still relatively intact health facilities have been transferred from the rural enterprises and farms to the local governments, in the first half of 1995 about 50 percent of the kindergartens have been closed due to lack of funds. This will mainly effect the children of the rural poor, because their parents do not have sufficient income to pay the very high private contributions that sometimes equal as much as two thirds of the agricultural average wage to send their children to such preschool facilities. Since kindergartens in the Kyrgyz Republic serve more preschool than child care purposes, there are already serious concerns that the nonavailability of kindergarten, especially in the rural areas, will exacerbate the limited opportunities of the poor.

**d. Public Transfers to the Poor**

22. Apart from the reduced accessibility to social services and the nonpayment of wages, the erosion of pensions and allowances is causing one of the major problems for the poor's income. Whereas previously pensions and allowances have kept many households out of poverty, their erosion and delayed payment is causing severe poverty, especially in the rural areas. Pensions constitute more than 20 percent of the family incomes; about 23 percent of the total population get pensions and other allowances. In rural areas and among special target groups these figures are even much higher. Additionally, private transfers contribute up to one third of poor household's income.

23. Due to the relatively low rate of open registered unemployment, the unemployment fund, though in trouble, is able to manage. The situation is different with the pension fund, which is running at a 20 percent deficit, (in rural areas this is much higher, and from agriculture, nearly 90 percent). The rural sector is likely to remain a net recipient of the insurance funds (especially the pension fund). At the present contribution level, it requires nine active farmers to pay for the pension of one retired person. Moreover, there is a need to inject more cash into the rural economy. Hence, the maintenance of pensions, with a humanitarian and poverty alleviation purpose, contributes also to demand-led growth.

## **5. Environment**

24. Proposed measures to protect the environment focus on the sustainable management of forest and upland pastures for grazing and the biological control of cotton pests. The net impact on the poor is positive.

### **a. Labor Market**

25. Policies on the long-term leasing or ownership and on the sustainable use of natural pasture land will result in (i) a change in the composition of herds, and (ii) more controlled grazing of natural pastures and forested areas. Some additional labor may be required for controlling grazing in forest and pasture areas. Though restrictions on grazing may, in the short run, reduce direct income opportunities of shepherds and other livestock employment, the net effect in the short run is expected to be small. In the long run a positive labor and income effect is expected.

### **b. Prices of Goods**

26. A reduced availability of grazing land and a change in the composition of the herds will also lead to a reduced holding, especially of sheep and goats. The increased slaughtering will in the short run disfavor the rural and favor the urban poor. In the long run, prices for meat are expected to go up again, which help the poorer farmers through higher prices.

### **c. Access of the Poor**

27. One of the reasons for the under-use of high pastures and the overgrazing of lower land is the decline in service provision. Food supplies, formerly benefiting from subsidized transport to remote areas, have become scarce as well as expensive. The same applies to social services, especially health and education, which are no longer provided to remote rural areas. Restricting access to pasture and forest lands will lead to further out-migration from remote to better accessible regions. This, in turn, will improve the poor's access to social services in the long run.

### **d. Public Transfers to the Poor**

28. Out-migration of the younger population and the change in demographic structure could create, as in hill communities elsewhere in the world, an increased dependency of the elderly people on the provisions of public transfers, especially pensions in the long run. Currently due to the shortage of the social fund and transport problems, pension payments to

the remote areas are already heavily delayed. A higher consideration of these regions for environmental purposes might increase the public interest and therefore improve the provision of benefits to the poor.

29. Mechanisms for industry funding of biological control of cotton pests do not have significant impact on the poor.

## **6. Institutional Restructuring of Ministry of Agriculture and Food**

30. Measures under the Program aimed at providing institutional support to: (i) strengthen in MAF; (ii) support MAF in the divestiture of some of its attached organizations and dependent entities; and (iii) strengthen the Ministry of Water Resources to organize WUAs. The improvement in land and agrarian reform should have similar benefits to those described in paras. 3-7 above. The establishment of WUAs and a more responsive MAF to the needs of private farmers should have a positive impact on farming activities by strengthening the position of farmers in the supply and marketing chains. Hence, the net short- and long-term impacts of these policy measures on the poor will be positive.

### **a. Labor Market**

31. However, the process of privatization of attached agencies will directly affect staff, resulting possibly in some unemployment as well as loss of entitlements to access social services and benefits, etc.; reduced net-income; and a higher incidence of poverty. However, through better advisory services to the farmers, some positive long-term effects on labor market reforms are also expected in the long-run indirectly.

### **b. Prices of Goods**

32. The institutional capacity building and restructuring component of the Program will improve the efficiency of agriculture. The effect on prices to the poor is neutral.

### **c. Access of the Poor**

33. The WUAs can make an important contribution to providing access for all farmers to inputs and markets. The wide publicity of their constitution and the focus on strengthening their role should enable poorer farmers to ensure that their interests are properly represented.

### **d. Public Transfers to the Poor**

34. Those laid off will depend more heavily on transfers. Those retained as employees and others benefiting from the other measures will contribute more in taxes and premiums, so that in the long run a neutralizing effect on the budget is expected. Additionally, the reduced costs of the MAFs' attached organizations will reduce costs and the tax burden. Any savings can then be used to finance transfers to the needy in the short run.



### **C. Mitigating measures**

35. The net effects of the Program on the poor are negative in the short run and positive in the long run. In the short run, the negative impacts on the labor market and on access to social services, inherited mainly from the transformation process in general, but supported by the Program, are reduced by the Program through mitigating measures. These are intended to (i) promote the labor market, especially for the rural women, by injecting the rural economy with cash, thus supporting targeted rural poor in need; (ii) maintain special social services in the rural areas; and (iii) provide for monitoring measures especially on the food situation in remote areas.