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REPUBLIC OF KAZAKHSTAN

FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

MARCH 29, 1995

**Agriculture, Industry and Finance Division
Country Department III
Europe and Central Asia Region**

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

CURRENCY EQUIVALENTS

Currency Unit = Tenge (T)
1 Tenge = 100 Tiyns

EXCHANGE RATE
(Tenges per US\$)

December 31, 1993	:	6.3
March 31, 1994	:	19.9
June 30, 1994	:	42.9
September 30, 1994	:	48.0
December 31, 1994	:	54.1

WEIGHTS AND MEASURES
Metric System

ABBREVIATIONS AND ACRONYMS

BSD	Bank Supervision Department (in NBK)
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
EU	European Union
FSU	Former Soviet Union
GDP	Gross Domestic Product
GOK	Government of Kazakhstan
ICB	International Competitive Bidding
IS	International Shopping
LDE	Large Distressed Enterprise
LIB	Limited International Bidding
LS	Local Shopping
MEBR	Ministry of Ecology and Bio-Resources
MOE	Ministry of Economy
MOF	Ministry of Finance
NAFI	National Agency for Foreign Investment
NBK	National Bank of the Republic of Kazakhstan
PIU	Project Implementation Unit
PPF	Project Preparation Facility
RAU	Restructuring Advisory Unit
RT	Rehabilitation Trust
SPC	State Property Committee
TA	Technical Assistance
TOR	Terms of Reference
TPS	Tour Program Secretariat
USAID	United States Agency for International Development

FISCAL YEAR

January 1 - December 31

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This report is based on the findings of an appraisal mission that took place in May 1994. The project team included: Messrs./Mmes. Lorch (task manager); Ikramullah, Knaut, Ledoux (financial sector); Dutz, Grudzinska, Haggerty, Ivanov, Lieberman, Saba (enterprise sector); Krzyzanowski (environment); and Saccheri and Pilch (implementation and legal issues). Secretarial support was provided by Ms. Bebli. Peer reviewers were Ms. Lee and Messrs. Duvivier, Pohl and Rocha. Mr. Michael A. Gould and Mr. Yukon Huang are the managing Division Chief and Department Director, respectively, for the operation.

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**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

LOAN AND PROJECT SUMMARY

- Borrower:** Republic of Kazakhstan
- Beneficiaries:** National Bank of the Republic of Kazakhstan; State Property Committee; Ministry of Economy; Ministry of Finance; participating commercial banks
- Amount:** US\$62 million equivalent
- Terms:** 17 years, including five years of grace period, at the Bank's standard variable interest rate
- On-Lending:** Part of the Loan funds would be on-lent to the National Bank of the Republic of Kazakhstan under a Subsidiary Loan Agreement between the Government and the National Bank, at terms and conditions that will be substantially equivalent to those of the Bank Loan and will be approved by the Bank. Under the Project's commercial bank development component, proceeds of the Loan up to a total of US\$12 million equivalent would be on-lent to participating commercial banks in US dollars at an interest rate equivalent to that of 10-year U.S. Treasury Notes plus two percent. These subsidiary loans would have a repayment period of ten years including four years of grace. The National Bank would bear the cross currency and default risks.
- Objectives:** The Government of Kazakhstan is committed to stabilizing and transforming the economy. It expressed this commitment in the context of a Standby Agreement with the IMF and an Economic Rehabilitation Loan of the World Bank. The success of this economic reform program critically depends on fundamental restructuring in the enterprise and the financial sectors. The Project would help to accelerate and deepen this restructuring. The Project would support the private sector and Government institutions in continuing privatization; preparing enterprise turnaround and liquidation; resolving bad debts; and developing sound commercial banks which would then also be able to finance enterprise-level restructuring and new investment. The Project would also aim at ensuring efficient, rapid, and secure payments within Kazakhstan, through creation of a new payment system infrastructure. The Project is considered of high priority because of the local shortage of relevant experience and resources, and because grant funding alone is not expected to be available in sufficient volume and timeliness to provide the necessary external support.
- Description:** The Loan would help finance information and communication technology, training, and technical assistance. In the enterprise sector, the Project would: (i) continue the Bank's assistance for the implementation of the Government's privatization program; (ii) provide advisory services for the defensive restructuring and privatization of distressed large enterprises, or for their liquidation; and (iii) transfer modern market economic know-how to enterprise managers through a program of highly structured study tours. In the financial sector, the Project would support: (i) advice for the start-up and operation of a debt resolution institution ("Rehabilitation Trust") to force the restructuring and resolve the debts of up to forty insolvent enterprises that burden the banks, state budget, and other creditors most severely; (ii) institutional development programs for two promising medium-size banks and restructuring programs for two large, formerly specialized banks, consisting of intensive three-year assistance by foreign banks and of equipment and software for bank automation;

(iii) strengthening of prudential bank supervision through on-the-job training of bank examiners, with increasing specialization on problem banks; and (iv) the long-term investments for a new domestic payment system aimed at, *inter alia*, same-day finality of settlements and real time processing of high value transactions. In addition, the Loan would fund assistance for the implementation of this Project.

Benefits: The Project would reinforce enterprise-level adjustment in the real sector. In the process, it would also relieve the burden of the most indebted insolvent enterprises on banks and suppliers; set precedents for liquidation and for tying bad debt resolution to rigorous restructuring of enterprises; build local consulting capacity for enterprise restructuring; enhance the know-how of local company managers; improve corporate governance through privatization; and enable banks to play an important role in enterprise restructuring. Moreover, the Project would enhance the quality and quantity of banking services, the prudence and financial discipline in banking, and the efficient allocation of credit (including bank lending funded by external donors) to viable activities. The payment system component would facilitate financial risk management, reduce the float in the domestic payments system, raise the efficiency and accuracy of payments, and thereby stimulate commercial relations between enterprises.

The Project would follow up, without loss in momentum, on the Bank's Technical Assistance Project, by helping implement policies and institution-building programs that were assessed and designed under that earlier Project. Enhancing local institutional capacity will still be important in the coming years because Kazakhstan's profound economic transition requires technical capacity of extraordinary nature and extent.

Risks: In a newly created country undergoing fundamental economic transformation there is an inevitable risk of policy changes and implementation delays, but in Kazakhstan these risks are worth taking in view of the Project's important role for the implementation of critical structural reforms. (i) The risk of policy changes is common in transition economies. However, the current direction and speed of reform in the financial and enterprise sectors are very encouraging, the country's leadership appears firmly committed to it, and proper external support will be essential for the success of the reforms. (ii) Delays could occur in project implementation due to limited administrative capacity, unforeseen technical complexities in the information systems, or slowness in preparing, deciding, and implementing economic reforms closely related to this Project. This risk shall be reduced through substantial assistance for Project implementation; close supervision to assure that inefficiencies are addressed promptly; and some contractor payments being tied to critical performance milestones.

Co-financing: The United States Agency for International Development (USAID) will provide parallel financing of about US\$200,000 equivalent to the training of bank supervisors. Host country institutions participating in the manager study tour program are expected to fund their costs of about US\$200,000 on their own or with donor assistance. The direct bank-to-bank assistance for strengthening four local commercial banks is expected to receive co-financing of about US\$4.0 million in grant funds; these arrangements need still to be confirmed. The EBRD envisages funding the institutional development of four further commercial banks, following the same concept but with some months delay.

Project Cost:

Project Component	Local	Foreign	Total	Percent of Total
	(US\$ million equivalent)			
Enterprise Sector Components	3.6	14.8	18.4	25%
Financial Sector Components	4.0	43.7	47.7	66%
Project Implementation	0.3	1.3	1.6	2%
Subtotal: Base Costs	8.0	59.7	67.7	93%
Contingencies	0.6	4.6	5.2	7%
Total Costs	8.5	64.4	72.9	100%

Financing Plan:

Financing Source	Local	Foreign	Total	Percent of Total
	(US\$ million equivalent)			
IBRD	3.9	58.1	62.0	85%
Grant Co-Financing	0.7	3.3	4.0	5%
Grant Parallel Financing	0.0	0.4	0.4	1%
Participating Banks and Enterprises	1.9	-	1.9	3%
Government / National Bank	2.1	2.5	4.6	6%
Total	8.5	64.4	72.9	100%

Disbursement:

	FY95	FY96	FY97	FY98
	(US\$ million equivalent)			
Annual	1.0	28.8	24.5	7.6
Cumulative	1.0	29.8	54.4	62.0

Economic Rate of Return: Not applicable.

Map: IBRD No. 26872

REPUBLIC OF KAZAKHSTAN

FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

I. INTRODUCTION

1.1 The Government of Kazakhstan is committed to stabilizing and restructuring the national economy. These commitments are reflected in the Standby Agreement that has been signed with the International Monetary Fund (IMF) and the Economic Rehabilitation Loan (Loan No. L-36490) agreed on with the World Bank. The success of these programs critically depends on fundamental restructuring in the enterprise and financial sectors.

1.2 In the enterprise sector, the Government is committed to privatizing enterprises quickly and in a manner that is transparent, equitable, and conducive for improved corporate governance. It does so through a program of small-scale privatization, coupon-based mass privatization, sale of the largest enterprises on a case-by-case basis, and special methods of agricultural privatization. It is also committed to upgrading the capabilities of enterprises managers; ensuring the provision of technical advice to enterprises that need to restructure; and bringing the largest loss-making enterprises under the control of a central debt resolution institution that would force them to restructure and get privatized, or be liquidated.

1.3 In the financial sector, the Government is committed to improving the efficiency of critical infrastructure such as the payments system; strengthening prudential bank supervision; encouraging the rapid development of private sector banks aimed at their meeting international standards; restructuring the large formerly specialized banks; and **relieving commercial banks of the heavy burden placed on them by the largest loss-making enterprises, by transferring the respective loans to the above-mentioned debt resolution institution.**

1.4 While the Government has adopted appropriate reform policies, it lacks the institutions necessary to implement these policies effectively. In recognition of this problem, the Bank made a Technical Assistance Loan (Loan No. L-3642) in August 1993 to help strengthen key government agencies and conduct various diagnostic and feasibility studies. The proposed Loan would follow up on this process by providing key institutions with the support that they will need to implement the next phase of the reform effort.

A. Economic Background

1.5 Kazakhstan's 17 million people are spread over the second largest territory of the Former Soviet Union (FSU) republics. Kazakhstan's per capita GNP in 1992 was estimated at US\$1,690, at the official exchange rate. Rich endowments of oil, minerals, and arable land give the country good growth prospects in the longer run.

1.6 In the short term, however, GDP has decreased by about 15 percent for two years in a row, in 1992 and 1993. Data for 1994 indicate a continuation of that trend, with industrial production declining by about 30 percent during first 6 months of 1994 as compared to the same period of 1993, following a 16 percent drop in 1993. Demand suffered from a steep fall in investment expenditures, depressed consumption levels reflecting the decline in real wages and wealth, and cutbacks in defense spending throughout the FSU. The losses of the state enterprise sector, and the difficulties of the authorities and the financial sector to tighten financial discipline and to force defaulting debtors to start restructuring or liquidation, were the main

sources of macroeconomic imbalance in 1992 and 1993. The aggregated losses reported by non-financial enterprises grew rapidly by about 10 percentage points of GDP between 1992 and 1993 to reach 24 percent of GDP.

1.7 Inflation averaged about 25 percent a month until final break-up of the ruble zone and introduction of the national currency. Thereafter, the inflation accelerated to about 35 percent a month until July 1994, bringing the annual inflation rate up to 3,200 percent by that date. The abrupt attempt in late 1993 - early 1994 to restrict credit to enterprises in order to contain monetary expansion had little impact on inflation but triggered a payment crisis: by March 1994, inter-enterprise arrears had accumulated to a net level comparable to total outstanding bank credit to enterprises. The Government stepped in to refinance the said arrears. These events have impressed on the Government the urgent need for widespread enterprise-level adjustment, and for further policy reform and institution building to encourage and enable enterprises to carry out such restructuring. This involves also efforts to enable the financial sector to play an increasingly important role in the restructuring effort.

B. Status and Reform of the Enterprise Sector

1.8 Compared with other Central Asian transition economies, Kazakhstan's enterprise sector is characterized by heavy primary industry and large-scale agriculture. Its enterprises tend to be large and capital intensive. When the Soviet Union broke up, fixed assets per capita (in 1991 prices) in Kazakhstan exceeded those in the rest of Central Asia's FSU republics by some 50 percent. 200 enterprises have more than 5,000 employees, and more than 6,000 enterprises (including farms) employ 200 to 5,000 persons; together they account for approximately three-quarters of enterprise employment. The total number of enterprises is estimated at about 60,000. Many enterprises are combined in large groups that emerged from former branch ministries, or departments thereof. Many markets, including distribution and trucking on the local level, are dominated by such groups or individual state enterprises.

1.9 Kazakhstan's most prominent production sectors, and main exporters, are mining and metallurgy, oil and gas, and large-scale farming and ranching. In terms of broader sectors, Kazakhstan employs 1.2 million people in industry including energy; 1.1 million in agriculture; 0.6 million in transport and communication; 0.5 million in construction; and 0.3 million in trade and related services. Within the industry sector, mining and metallurgy account for 27 percent of employment, and the related metal processing and machine building sub-sectors for further 18 percent; together, they are reported to account for 53 percent of fixed assets in industry. The oil and gas industry accounts for 7 percent of employment and 14 percent of fixed assets. (Annex I presents a statistical overview of the enterprise sector, especially industry.)

1.10 By mid-1993, about 7,000 establishments had been formally privatized. This was approximately 20 percent of all state-owned business units, but it was still less than 10 percent of the state enterprise sector's fixed assets because most transformed units were small retail and service outlets. Under a much improved new privatization program, whose implementation unfolded in early 1994, further 2,300 non-agricultural enterprises were privatized until October 1994. In addition, more than 15,000 individual and family farms and some 1,000 other private enterprises have been formed on the basis of state farms or parts thereof. Official statistics reported about 6,000 additional non-farm private enterprises by early 1994, most of them newly created, with an average of 11 employees, and there are most likely additional businesses that remain unrecorded.

1.11 **The main institution to plan and implement the privatization of state enterprises is the State Property Committee (SPC).** SPC shares authority over the territorial property committees with the heads of the oblast administrations. SPC and its territorial committees together have some 800 staff. SPC has also

been responsible for exercising the state's ownership role in enterprises, but this function might now be transferred into a new, separate entity. The branch ministries, including the Ministry of Industry and Trade and the Ministry of Agriculture, still have an inclination to interfere with firms on their operational level, but they are gradually recognizing the need to adopt new roles as arm's length regulators and promoters of their sectors. The Ministries of Finance and of Economy play an important role for the state enterprise sector. They have largely been controlling the allocation of central credit resources except those that are subject to auction. They also took a lead role in clearing inter-enterprise arrears, the last time in early 1994, and have been preparing measures for the Government to use its resulting claims on defaulting enterprises as a lever to force restructuring or liquidation. The Ministry of Economy is also the main Government agency directly responsible for analyzing, developing, and monitoring policies and programs to support small and medium enterprises. An important role is also envisaged for the Anti-Monopoly Committee. A revised legal framework and improved operating procedures should put the Committee in a position to break up monopolies and prevent the emergence of new ones; control dominant suppliers; prevent collusion, restrictive vertical agreements, and other unfair trade practices; and protect consumers.

1.12 For the training of managers, several institutions are rapidly adjusting to the market environment or have newly emerged. The Kazakh State Academy of Management and the Kazakh Institute for Management and Economic Prognosis stand out among them. Several non-governmental institutions support the private sector through representation of its interests and support services for their members. So-called enterprise unions were created in 1990 to represent and assist small enterprises, non-agricultural cooperatives, and small and cooperative agricultural enterprises, respectively. These unions are members of the Congress of Entrepreneurs. Most large state enterprises are members of a Union of Industrialists and Entrepreneurs.

1.13 In stark contrast to the socialist period, Kazakhstan's enterprises face today a competitive environment, entirely different relative prices, drastic changes in demand, new markets and competitors, and new kinds of Government policies and policy instruments. Yet, the largest part of their adjustment to this new environment has yet to take place. As a result, enterprises have been suffering increasing distress, burdening their creditors, and undermining the Government's economic stabilization efforts. In 1993, one out of every three enterprises reported losses, despite the low energy prices and negative real interest rates at the time. When credit policy was tightened in late 1993, enterprises rapidly accumulated arrears, with the net arrears after clearing still equal to total bank credit. By now, the financial constraints have hardened. At least 130 major enterprises have been closed, and many more have been operating only intermittently. Their workers commonly remain formally employed and retain their access to the firms' social facilities, but receive wages only for the days worked and often with long payment delays. Hidden unemployment has been estimated at well over seven percent already in mid-1994, although only 0.7 percent were registered as unemployed. Nonetheless the Government is committed to proceed with plans to force the severe restructuring or liquidation of enterprises, starting with those which default on the short-term state credit that refinanced their above-mentioned net inter-enterprise arrears.

1.14 Fundamental restructuring is now indeed needed in the enterprise sector for Kazakhstan's economic reform program to succeed. Without such restructuring, the enterprise sector would continue burdening the economy with losses, arrears, and requests for subsidies and price distortions. Efficient restructuring will require: (i) a market environment that sends relatively undistorted price signals, exerts competitive pressures, and provides a conducive legal framework; (ii) effective enterprise governance exercised by owners and creditors who aim at appropriate returns on investment and debt service, and therefore force enterprises to restructure and to operate efficiently; and (iii) human and financial resources to carry out the restructuring.

1. Creating a Market Environment

1.15 **Price Controls.** The removal of price distortion in the form of state price controls has made rapid progress, disrupted only by a brief period of temporary price and margin controls upon the introduction of the national currency in late 1993: (i) The prices of all but a few goods have been liberalized. Price administration applies still to electricity and heating, water and sewerage, natural gas, rents, railway and telecommunication, and a few food and feed products. Price controls on petroleum and coal were removed in April/May 1994. Procurement for "state needs" is by now largely confined to parts of the agricultural sector, and increasingly uses negotiated prices. (ii) In foreign trade, the Government has reduced export taxes to about 8 percent (unweighted) and import taxes to less than that; reduced the number of items subject to export and import licensing to 35 and 10, respectively; and cut the number of items requiring export quotas, with a part of these quotas being auctioned off. The remaining export quotas cover still much of the mining, metallurgy, oil and gas sub-sectors, which are Kazakhstan's principal exporters, but the Government envisages phasing them out in 1995. (iii) Lease fees for state-owned urban land and premises are still negligent at least for state enterprises, while the prices for acquiring such lease rights are fixed. Moreover, competitive procedures in the award of lease rights are not widely used. (iv) Interest rates are largely free. Even the former state savings bank and other state banks are free to set their lending and deposit rates. The interest rates resulting from auctions of central credit resources have reached positive levels in real terms. Interest rates on those central credit resources that are still allocated rather than auctioned are set close to the auction interest rate; they peaked at 37 percent per month, and became positive in real terms in July 1994. Moreover, the auction mechanism is used for a rapidly rising percentage of new central credit resources, with directed credit largely limited to agriculture. (v) Wages and salaries are influenced by strong fiscal incentives for wages not to exceed a fixed multiple of the minimum wage. The latter has dropped steeply in real terms in 1993, and more slowly in 1994. The Government also decided to penalize any firm, private or public, whose wage bill exceeds the target rate of inflation. Some firms seem to find ways, however, to compensate employees well beyond the reported wages, although those practices clout cost accounting and often amount to asset stripping. Other firms have not been paying wages for months.

1.16 **Competition.** The main market distortions stem today from monopolistic structures and unfair trade practices. Even price and margin controls are now applied largely as a means of anti-monopoly policy, to the point that the Price Committee has been merged with the Anti-Monopoly Committee.

- (i) Due to the historically large scale-oriented industrial organization (and in part due to the definitions used by the Anti-Monopoly Committee), well over thousand enterprises are registered as "dominant". Since forced segmentation is costly and time-consuming, and anti-competitive practices are hard to prove in the current environment, the Committee has resorted to price controls as its main policy instrument. Donor assistance is helping to strengthen the Committee's capacity and legal basis for more market-oriented means of competition policy.
- (ii) Competition has been enhanced in transport and distribution structures, with the assistance of USAID and the Bank. Most non-agricultural trucking companies have seen twenty percent of their truck fleet auctioned off. Small retail and service enterprises are being auctioned off at a rate of 300 per month. Wholesale concerns are being split up and privatized.
- (iii) State structures that currently dominate many export and import areas, especially in agriculture and metals, need to have their privileges revoked or be broken up. In 1994, about two thirds of the quotas for metals, coal, oil and gas were reserved for seven designated trading companies. Inter-republican trade continues to suffer from payment problems, lack of trust in contract enforcement, and price setting under bilateral trade agreements.

- (iv) In addition to these foreign trade areas, non-competitive situations prevail today mainly in the realm of state holding companies and similar entities. There are more than eighty such structures, controlling some 1,600 enterprises. Since the Government pursued not just better governance, but also scale economies and venues for industrial policy, it has created most of these holdings on a horizontal, sub-sectoral basis, and has even in some cases given them regulatory powers. This has been undermining competition. Recognizing these problems, the Government has in late 1994 started dismantling several holding companies and privatizing their individual subsidiaries, and transferring regulatory powers back to ministries and the Anti-Monopoly Committee.

1.17 **Legal Framework.** Much attention has been paid to creating a conducive legal framework. While this work continues, a further challenge is the creation of capacity to enforce the new legislation.

- (i) A large number of new economic laws have been promulgated since 1991. They provide a first broad basis for market transactions and property rights. However, this new legislation is often inconsistent and incomplete. Various amendments or replacements of these early laws, including the Laws on Foreign Investment, Collateral, and Bankruptcy, are now awaiting parliament approval. Additional new legislation, including a new Civil Code that also covers contract law, has been prepared as well.
- (ii) Law enforcement suffers from a severe shortage of legal professionals and effective settlement and enforcement structures. Legal technical assistance from the Bank and USAID supports, therefore, not only the law-making process but also improvements in jurisdiction and arbitration. A particular challenge for the Government is the combat of organized crime that jeopardizes the rule of law as well as market competition in the economy.
- (iii) Critical legal infrastructure such as appropriate company, mortgage, share, and land registers is also only beginning to emerge, but is receiving increasing donor assistance. For example, a central share depository is being established, and the company register will henceforth be overseen by the newly recreated National Securities Commission. A new accounting system for commercial enterprises is being finalized, with its timetable for implementation determined by the vast training needs. The accounting and audit profession is being organized with USAID and EU assistance.

2. Strengthening Enterprise Governance, especially through Privatization

1.18 Fundamental restructuring will only take place if enterprises are subject to effective governance. Like governments elsewhere, the Government of Kazakhstan has proven to be an ineffective owner of enterprises. Rapid privatization, and the emergence of new private firms, continues hence to be among the Government's highest priorities. Creditors can also exercise governance of enterprises, and indeed need to take a lead role in the case of many insolvent firms. Since the local banks are unaccustomed to this role, and are either still small or themselves state-owned, they may play this role initially only for small and medium-size firms. Special central institutions for debt resolution are needed for the largest and most highly indebted defaulters.

1.19 **Privatization.** By early 1993, over 7,000 enterprises had been regarded as privatized. However, few were substantial in size; commonly only a minority share was transferred; very few sales were competitive, and most carried highly beneficial terms; and the recipients were almost exclusively the employee collectives and managers. This was due in part to slow case-by-case procedures, lack of privatization coupons and international tenders, and unclear property rights and institutional authority. An

entirely new National Privatization Program¹, drafted with Bank assistance, was therefore approved in March 1993, and the Privatization Law amended accordingly. SPC's status within the Government, and its authority vis-a-vis oblast-level property committees, were enhanced. During the remainder of 1993, extensive implementation legislation was drafted; the staff of property committees trained; information processing and communication infrastructure installed; the public educated; privatization coupons distributed; private investment funds licensed; and pilot efforts launched. By April 1994, one year after approval of the new program, all components of the program (as explained below) had been rolled out nationwide. The key is now the further strengthening of local implementation capacity; the flexible adjustment of the program in view of the initial experience and changing circumstances, yet without jeopardizing the program's integrity and consistency; improvements in agricultural privatization; and persistent rapid implementation of the program despite opposition from traditional stakeholders and the reluctance of local administrations to submit enterprises to the privatization program.

- (i) Small establishments with less than two hundred employees are being auctioned off on the oblast and municipal level against a mix of cash and unutilized housing vouchers. SPC aims at transferring objects with a minimum of restrictions, if any, on their future business activities, and at providing some technical advice to the new owners immediately after sale. By October 1994, some 2,000 objects had been disposed of under this program, with USAID and Bank assistance, and at least further 4,000 objects are earmarked for auction by end-1995. Further expansion of the program hinges on local authorities disclosing state properties. To ensure a competitive environment especially for these small enterprises, trucking and wholesale structures are also privatized on a priority basis. By October 1994, SPC had auctioned off some 3,000 trucks. It plans to quickly sell the trucking firms with their remaining fleets under the mass privatization program. SPC has been less successful to date auctioning off warehouse space or, after segmentation, wholesale companies, in part due to opposition by the state distribution sector.
- (ii) Most non-agricultural firms with 200 to 5,000 employees are to be sold in 1994-96 through mass privatization. More than ninety percent of the population have registered their privatization coupons, which are denominated in "points" rather than currency and are not securitized. Step by step, the citizens have been investing their coupons in one or several of the 169 licensed private investment funds. SPC sells through auction the majority of shares of about one hundred firms per month. It sells them to the investment funds against the coupons that they have been able to mobilize. Only further ten percent of the shares have been given for free to the employees upon corporatization of their firms. The remaining shares are earmarked for sale to investors against money.

In the first three months starting late April 1994, SPC sold 230 firms totalling about 100,000 employees in five auctions. This speed would suffice to complete the sale of 2,000-2,500 firms by early 1996, as planned. Moreover, the first auctions succeeded in covering firms from all regions (albeit with lower participation of northern regions); selling also many subsidiaries of state holding companies and similar structures; selling, in 60 percent of the cases, all shares offered; and receiving bids from most of the 169 investment funds. Due to changes in SPC's leadership, the auctions slowed down after July 1994, but resumed since November 1994 with four further auctions. Some weaknesses, including the following, need still to be rectified. First, excessive restrictions on the share packages that an investment fund can buy or own hinder it unduly in exercising governance or reselling shares, and

^{1/} The Government has also started privatizing other assets that are not covered by the National Privatization Program, and not regarded as a primary responsibility of SPC. For example, the Ministry of Geology has started an international tender program for more than thirty mineral deposits. The Ministry of Oil and Gas is awarding exploitation rights for oil and gas fields to foreign investors. The Ministry of Energy has recruited advisors for attracting private investment into the power sector. The municipalities are selling various kinds of use rights for urban land.

hence also in generating cash income to be used for its fund management, dividends, and the restructuring of firms in its portfolio. Resale of shares by the investment funds should also be a major venue for foreign investors. Second, flaws in the earlier corporatization, the desire to segment dominant firms prior to sale, and the need to clarify financial, environmental and social liabilities call for more intensive preparation of firms for sale. Third, capital markets are being developed with expediency to facilitate post-privatization trading. Fourth, about a third of the mass privatized enterprises to date were actually small-scale objects with less than 200 employees. Given SPC's limited processing capacity, this slowed down the sale of medium and large scale enterprises that are supposed to be mass privatized. Elaboration of these policy adjustments, as well as the continued implementation of the mass privatization program, are supported by several donor agencies.

- (iii) State farms are currently transformed through a process that gives each farm worker a long-term transferable use right for a part of the farm's land. The farm without its land is usually transferred into the ownership of its employee collective, except for some assets that are sold, leased out, or given as incentives to the farm directors. Individual members of the collective have the right to opt out of the farm by receiving a concrete piece of land corresponding to their share of the collective's total land, and establish a farm on their own. By early 1994, some 15,000 individual and family farms were established. Shares of agro-processing enterprises are usually transferred to their worker collectives, as well as to agricultural suppliers against long-term supply contracts. These procedures for agro-processors largely predate the National Privatization Program; since they tend to reduce competition and raise questions about equity they are now under review, aimed at adding them into the above-mentioned mass privatization program.
- (iv) Very large enterprises (with more than 5,000 employees), and "special" enterprises requiring extensive regulatory provisions (e.g., natural monopolies, exploiters of non-renewable natural resources, and firms fulfilling mainly social functions) shall be privatized in a case-by-case process through international tender and similar competitive procedures. Bank-funded consultants have helped refine the policy and legal framework, and a Japanese grant is available to help SPC manage the case-by-case program. Presently, about 130 firms are earmarked for case-by-case sale, many of them from the mining/metallurgy and oil/gas sectors. The Government intends to also privatize power companies and some further public service enterprises. It is estimated that SPC will be able to sell about fifteen to twenty firms per year on a case-by-case basis. The Government, motivated largely by expected divestiture revenue for the state budget, aims for a higher figure. So far, SPC has sold three large firms to foreign investors through tender, and awarded one management contract to a foreign firm. SPC is in the process of recruiting financial advisors for the sale of more than thirty further enterprises. A constraint is the funding for fixed fees demanded by advisors for the preparation and sale of objects whose chances of successful sale do not appear certain. The EU and the French Government have indicated their readiness to help finance such costs for a total of some ten to twelve cases over two years. The Bank would provide assistance under this Project (see paras. 3.6-3.7).

1.20 **State Enterprise Governance.** Although the Government is still the owner of most large and medium-size enterprises, it lacks some basic instruments to exercise effective governance. SPC has been able to formally corporatize almost 2,000 state enterprises, and thus to delineate their property rights and liabilities, clarify their legal status, determine the rights and responsibilities of managers and owners, and provide for supervisory boards. But there is no uniform system of financial reporting, monitoring, audit, performance targets, and incentives that would be appropriate in a market economy. Moreover, the Government decided not to collect any dividends, thus reinvesting profits into their sources irrespective of expected returns. In 1993, the Government has then created about eighty state holding companies and similar structures, combining some 1,600 enterprises. The Government hoped that this intermediate institutional layer would exercise governance more effectively, in a more business-oriented manner, and with

less operational interference from line ministries. However, as mentioned earlier, the Government's concurrent objectives of increasing scale economies and conducting industrial policy, as well as pressures from stakeholders in the administration and in important enterprises, undermined this objective. The holding companies were formed on a sub-sector basis, thereby often restricting competition; their executives are mostly former ministry officials; and various ministries are using their Board membership and other influences to interfere ad hoc into enterprise operations. Moreover, the holding companies themselves are not subject to effective governance by the state who owns them, resulting in a lack of accountability. The Government is now dismantling a number of these holding companies, and considers establishing a new entity to exercise the state's ownership rights, other than the right of their disposal which would remain at SPC. Assistance to improve such governance of still unprivatized enterprises is available under the Bank's existing Technical Assistance Loan.

1.21 **Governance Exercised by Creditors.** Governance can also be exercised, and restructuring forced upon management, by the creditors of enterprises. In insolvent enterprises in market economies, the creditors' powers prevail commonly over those of the owners. Some control of enterprises by their creditors, aimed at forcing their restructuring or liquidation, can also be desirable where enterprises are economically viable but too heavily burdened with overdue debt to be privatizable without major financial restructuring.

1.22 **In Kazakhstan, the number of insolvent enterprises is rapidly growing under the increasingly restrained monetary policy pursued under the IMF Standby Arrangement.** Among their creditors are suppliers, banks, and the fiscal and social security authorities. Moreover, the Government assumed net claims on enterprises resulting from an inter-enterprise arrears clearing exercise in the first quarter of 1994. The banks have still limited capacity for forcing and overseeing the restructuring of their clients. Widespread exercise of governance by suppliers appears undesirable for structural reasons. Therefore, commercial banks and suppliers alone can not be relied upon to exercise governance over all defaulting debtors. Special central institutions are being established by the Government and by commercial entities to assume other creditors' claims on defaulting enterprises, and to force and oversee the restructuring of the latter.

- (i) Since the clearing exercise in early 1994, supplier enterprises have again accumulated substantial overdue receivables. However, these suppliers are commonly still state-owned and suffer hence themselves from weak governance, or they are foreign entities. Moreover, widespread control of firms by their suppliers may not be a desirable industrial organization, especially since it could hamper competition. The creditor role of enterprise could be reduced in future if the banks took greater responsibilities in the payments system, by guaranteeing payment orders as a condition for their settlement.
- (ii) Commercial banks carry a large number of non-performing loans in their portfolios. With the help of EBRD, five banks (Turan-, Kredsoc-, Kramds-, Center-, and Kazkommerzbank) are now establishing internal work-out units to force defaulting debtors to restructure or liquidate. NBK considers making the introduction of such units mandatory for all banks. Bank twinning arrangements envisaged under this Project, and an EU-sponsored advisory service for smaller banks, would support this process. Even with special work-out units, however, the ability of the local banks to exercise effective governance over distressed clients will remain limited. They are still inexperienced in this activity, and they are either relatively small or suffer from various governance and management problems themselves. **Large enterprises with the largest non-performing debts, as well as public service enterprises who can not easily be downsized or liquidated, need therefore be handled by special structures.**

- (iii) Several central institutions are being established with the purpose to force major insolvent enterprises to restructure, or to liquidate them. To deal with up to forty distressed non-agricultural enterprises with the largest outstanding net debts, the Government is establishing a so-called Rehabilitation Trust that will assume the claims on these firms; this institution would be further supported in its operation under this Project (see paras. 3.18-3.25). In the agricultural sector, many non-performing loans are being moved from Agroprombank to a special Agricultural Support Fund. In addition, the Government encourages the establishment of profit-oriented turnaround funds that would buy the debt of a few illiquid but highly promising enterprises with the objective to convert debt into equity, restructure the firms, and sell them; the EBRD is preparing the establishment and financing of such a fund.

3. Human and Financial Resources for Enterprise Restructuring

1.23 Skilled human resources are needed to plan enterprise restructuring or liquidation; carry it out; and operate the firm profitably thereafter. Similarly, financial resources are needed to keep the respective firms liquid while the restructuring is being planned and implemented; undertake the various restructuring measures, including debt restructuring; and operate and expand the firm once the main sources of losses have been eradicated.

1.24 **Human Resources for Restructuring.** Qualified human resources are needed to undertake basic viability assessments, elaborate restructuring plans or liquidation concepts, and implement the adjustment measures, including debt restructuring, staff lay-offs, and disposal of businesses or assets. In Kazakhstan, these skills and experience are still in very short supply, yet the need to restructure a large part of the country's more than 6,000 significant enterprises is urgent. With the help of various donors, a wide range of management training courses is being offered in Kazakhstan. This Project would help support an intensive tour program for managers to study management practices in Western companies, including their experience with restructuring (see paras. 3.12-3.17). Small and medium private enterprises can also obtain advice on restructuring from a network of oblast-level business development centers that are assisted by American business people recruited by the Peace Corps, and by a Business Communication Center that is assisted by the EU. For very large and complex enterprises, more specialized skills will be required. The Government is establishing a Restructuring Advisory Unit, affiliated to the Ministry of Economy, to help companies prepare viability assessments and restructuring plans. This Unit, with Bank assistance, will draw largely on local and foreign consultants to train the local consultants and Unit staff, and supplement them with specialized expertise (see paras. 3.8-3.11). The Unit will first focus on the enterprises whose debts will have been transferred to the above-mentioned Rehabilitation Trust, since these are very urgent and sizable cases, and since being highly insolvent makes it difficult for these firms to employ advisors otherwise. The Government envisages creating, in addition, special units for the rapid liquidation of clearly non-viable state enterprises, and for the restructuring of strategic public service enterprises.

1.25 **Financial Resources for Restructuring.** Firms that seek funding for restructuring have in principle access to an ECU 100 million credit line of EBRD for medium-size export-oriented enterprises, an additional upcoming EBRD facility for enterprise restructuring, a Central Asian American Enterprise Fund, and a U.S.-funded defense conversion facility. The Bank has started preparing a Project to provide a credit (and potentially equity) facility for private enterprises. For local cost funding, the main financing sources are still central credit resources extended or guaranteed by the authorities within the framework of the IMF standby agreement. Local banks and other local creditors will have to bear part of the burden from restructuring bad debts. Moreover, the development of commercial banks, which will be discussed below, shall enhance banks' ability to lend to promising enterprises emerging from work-outs. The main sources for investment in new assets need to be foreign and local private investors, however. For this reason, and because the state has proven to be an ineffective owner, every restructuring of a state enterprise,

ENVIRONMENTAL PROBLEMS IN THE ENTERPRISE SECTOR

Kazakhstan faces severe problems of environmental degradation. Water resources are scarce in the country, and this problem is compounded by localized pollution of water sources. Soil degradation is an equally important problem. Industrialization and rapid population growth have contributed both to air and water pollution. Among stationary sources, major polluters are power plants and metallurgical facilities. Mining contributes especially to ground water pollution and, in some cases, to radioactive contamination. The deterioration of environmental conditions has reached disaster levels in nine geographical areas, and is imposing immense economic and social costs in many others as well. Moreover, the country's energy consumption is as high as that of countries with a much higher industrial output. Air pollution of industrial and automotive origin (smog, heavy metals, CO, benzopyrene, and particulates) is highly localized and affects even important urban areas like Almaty, Karaganda, Chimkent, and Pavlodar. Seven large municipalities with a population of nearly 1 million do not have waste water treatment plants, and some others have some plants under construction but not completed. The authorities report that less than half of some 1,200 major industrial plants are equipped with functioning pre-treatment facilities. As a result, the contamination of surface waters by heavy metals and chlorinated hydrocarbons is a major problem. In 1990, for example, nearly 4,800 of 5,500 inspected plants were found in violation of environmental standards, and 43 thereof in such serious violation that a production stop was ordered.

The degradation of the environment in the Republic can be attributed in large part to the following factors: past economic policies that promoted quantitative targets without regard to sustainability; ineffective enforcement of environmental laws and standards; overall, an inefficient system of environmental management; and lack of public participation in environmental protection. The economic transition has added problems caused by delays in adjusting the legal and regulatory framework, as well as enforcement practices, to the market economic environment.

The Law on Environmental Protection in the Kazakh SSR (June 18, 1991) appears on the whole to be an appropriate instrument upon which to construct an effective regulatory program. It covers the protection of land, air, water, forestry, wildlife, and natural resource deposits. In addition to permits and environmental reviews and impact assessments, the legislation features principles which are based on a "polluter pays" principle through the use of pollution charges. The operation of the charge system, and the capacities for managing the related Environmental Fund, need to be strengthened, however. Although principles and intentions expressed in Kazakhstan's environmental law are often at par with international standards, the legislation seems to lack mechanisms to ensure that delays in implementation will be reviewed and rectified. The responsibilities for monitoring and enforcement are not clearly delineated. The environmental monitoring system involves several institutions (Kazhydromet, Academy of Sciences, State Sanitary Services, etc.) and is based on a complex and cumbersome approach; a more streamlined and better coordinated system is warranted. The State Committee on Environmental Protection, created in 1988, was reorganized in 1990 and again in early 1992, becoming the Ministry of Ecology and Bio-Resources (MEBR). The ministry is entrusted with setting the Republic's environmental policy; coordinating environmental activities of other public and private entities; and monitoring and enforcing compliance. Significant progress is being made in developing the institutional capacity of the ministry and related institutions, and is supported through training and advice under the Bank's Technical Assistance Loan, but it will take considerable time and effort to build the capacity needed to address the immense environmental challenges of Kazakhstan. As market liberalization, privatization and restructuring proceed in industry and agriculture, MEBR needs to ensure that environmental issues related to both past and future activities are given adequate consideration.

Enterprise privatization and restructuring are a challenge, but also a window of opportunity, for environmental protection. Environmental problems could worsen, for example, where distressed enterprises cease operating pollution control or treatment facilities, new facilities and products are brought on stream, or private ownership requires changes in regulatory enforcement practices. But environmental issues are also gaining attention: Potential buyers of enterprises are concerned about environmental liabilities, investors ask for predictability in environmental regulations, and enterprise managers use restructuring as an opportunity to address their plants' environmental problems. Given the status of equipment and production management in Kazakhstan today, efficiency-enhancing measures and new technologies will in many cases reduce pollution.

including those forced by the Rehabilitation Trust, should aim at privatizing the firms before they start to invest in major new assets. Some viable enterprises are too highly indebted or burdened with non-viable activities, though, to be privatized without any prior "passive" restructuring.

1.26 Extensive resources will also be needed to bear and alleviate the social costs of enterprise-level adjustment. The social situation has already become more fragile. An estimated 550,000 people were without work by September 1994. Fewer than 50,000 people received unemployment compensation, however. The minimum pensions and other benefits have been adjusted only sporadically to the increases in cost of living, and yet the financial viability of the pension system is in jeopardy. The Government has introduced several measures to shield the most vulnerable groups like disabled people, single mothers, and large families. It has also encouraged the rapid growth of private vegetable, garden and dacha plots, now numbering 5 million. It is now working with the Bank on a program to divest and safeguard vital social facilities that hitherto belonged to state enterprises. A Social Protection Project that has been appraised recently would help strengthen the network of employment offices and the system of unemployment benefits, and divest and rationalize social assets in some districts.

C. Status and Reform of the Financial Sector

1.27 The banking sector consists of the National Bank of the Republic of Kazakhstan (NBK); the former State Savings Bank, which has since then been transformed into a common joint stock commercial bank (People's Bank); three recently created specialized state banks (export/import, housing, and development bank); and about 160 commercial banks. Most of these commercial banks are very small institutions that were set up in 1991-93 by public enterprises in order to get direct access to highly subsidized centralized credit resources allocated by NBK. About 50 of the commercial banks were privately owned from their start, and 15 further ones are joint ventures, subsidiaries and branches of foreign banks that are mainly active in external trade finance and services. The sector is largely dominated by the ten largest institutions (more than 75 percent of total assets, by mid-1994). They consist of the five former specialized banks (People's, Agroprom-, Turan-, Kredsoc- and Alembank, which focused historically on households, agriculture, industry, small enterprises, and foreign trade, respectively) and a nucleus of rapidly growing new private banks that strive towards international standards.

1.28 The NBK, which became fully independent from the Government in 1994, is increasingly concentrating on genuine central bank functions. It has been adopting market-economic monetary and financial sector policies, and adjusting its organizational structure and skills mix to it. In addition to its 386 headquarter positions it has also some 8,000 employees in the local branches, many of whom are still involved in keeping the customer and general ledger accounts of commercial banks and state enterprises.

1.29 A particular bottleneck in the financial sector, with direct implications also for the enterprise sector, is the payments system. Nineteen regional clearing centers are presently supporting a daily average of approximately 200,000 intra-bank and 70,000 inter-bank financial obligations. In 1994, inter-oblast transactions took up to fourteen workdays to settle, resulting in a high negative float, a net reduction in banks' monetary assets, and reduced availability of working capital to enterprises. Due to deficient data processing capacities and linkages between regional centers, the settlement balances were "netted out" only once a month, forcing banks to maintain unnecessarily high levels of reserves, and resulting in ineffective liquidity management. With these weaknesses, the payments system also has not allowed NBK to adequately oversee credit and liquidity risks and to regulate the financial conduct and viability of the banks.

1.30 The 1992-93 period² was characterized, for the banking sector, by four major features: (i) a rapid shrinking of its deposit base, that declined from 96 percent of GDP at the end of 1991 to 28 percent at the end of 1993, mainly due to the impact of highly negative real interest rates; (ii) a stabilization of its credit portfolio at around 100 percent of GDP, reflecting the impact of an accommodating monetary policy that translated into an extensive allocation of refinancing facilities by NBK, mainly in the form of directed credit programs. As a consequence, the percentage of bank credit refinanced by NBK resources more than doubled to about 60 percent, and the deposit to credit ratio declined from nearly 100 percent to about 28 percent during this two year period; (iii) a very large proportion of insider lending to bank shareholders, given the connection between the potential amount of NBK refinancing facilities available for each bank and the level of its paid-in capital; and (iv) a very low repayment rate of both the borrowers vis-a-vis their banks and the banks vis-a-vis NBK, which translated into a quasi-automatic rolling over of both these credits and their refinancing. Although only a small proportion of loans refinanced by centralized credit resources was *de jure* guaranteed by the Government, these programs were to be approved by the Council of Ministers, and the intermediation margin of banks on such loans was limited to 3 percentage points. As a consequence, the banking sector continued to behave mainly as a simple administrative intermediary and was, de facto, the main conduit for channeling subsidies, in particular the important inflation subsidy, to loss-making public enterprises and the agricultural sector. This passive role of the banking sector was also illustrated by its automatic forwarding of payment orders issued by enterprises in the interbank payment system, regardless of their financial condition, and by repeated clearings of arrears accumulated in the system by injections of liquidity from NBK.

1.31 Following the introduction of the national currency, the Tenge, in November 1993, the monetary environment of the banking sector, as well as its role, started to change markedly. The authorities tightened substantially the monetary policy with the objectives to reduce inflation and to instill financial discipline in the sector. Measures implemented include mainly: (i) a substantial reduction in the growth rate of liquidities provided by NBK, together with a sharp increase in reserve requirements; (ii) the enhancement of the role of the auction system for the allocation of NBK credits, through which about 50 percent of NBK facilities were channeled during the first half of 1994, and about 75 percent during the last quarter of the year, compared to around 10 percent in 1993; (iii) the alignment of NBK refinancing rates to the level market-determined by the auction scheme, which is positive in real terms since mid-1994 with the exception of an agricultural credit program, and the complete liberalization of lending and deposit rates; and (iv) a large increase in deposit rates offered by the savings bank, that was made possible by the completion of the financial compensation for its assets that were frozen following the breakdown of the Soviet Union. In parallel, the authorities have accelerated the preparation and initiated the implementation of structural measures required to strengthen the financial and institutional condition of the sector over the medium term. In this context, NBK is finalizing the preparation of a comprehensive reform program which aims at enabling and inciting the banking sector to play an active role in the enforcement of a hard budget constraint on the enterprise sector, and in the efficient mobilization and allocation of financial resources³.

1.32 Due to the difficult macroeconomic environment in which it operates, in particular the poor condition of the enterprise sector, as well as its own institutional and financial weaknesses, the adjustment process of the banking sector to this new environment is difficult. The tightening of monetary policy and the increased financial discipline imposed by NBK on the banking sector has been translating, in the first stage, into its further shrinking and a rapid deterioration in both its solvency and its liquidity. This reflects

^{2/} The Bank's "Kazakhstan Economic Report" (Report No. 12856-KZ), dated July 7, 1994, gives a further description of developments in the financial sector during this period.

^{3/} Many structural issues faced by the sector were presented, with detailed reform proposals, in the Bank report entitled "The Banking Sector at a Crossroads: A Blueprint for Reform", issued in August 1993.

mainly, as experienced in other transitional economies, delays in the adjustment of the banking sector itself, and the difficulties it faces to enforce financial discipline in the enterprise sector. The anticipated deterioration in its liquidity situation is confirmed by the increase in the number of "problem banks" during 1994, and by the amplitude of the systemic liquidity crisis that emerged in the payment system in early 1994. In order to avoid a collapse of the economy at that time, NBK and the Government intervened massively through the provision of state guaranteed credit to net debtors emerging from a debt clearing operation, and the issuance of bonds to creditors, respectively. Portfolio reviews of ten large banks performed in late 1994 indicate also that the sector can be considered, in principle, as largely technically insolvent, even if all loans refinanced by non-auctioned centralized credit resources were to be considered guaranteed by the Government.

1.33 The main elements of the medium-term reform strategy envisaged by the authorities, for which action has already been initiated, include: the overhauling of the inter-bank payments system; the development of a conducive environment for banking, especially a sound and efficient legal, regulatory and supervisory framework; and the governance and restructuring of formerly specialized banks.

1. Payment System Reform

1.34 Measures introduced to initiate the reform of the inter-bank payments system aim at restoring its integrity and at making it the first source of financial discipline in the enterprise and banking sectors. In order to avoid further large accumulations of inter-enterprise arrears through the system, the use of appropriate procedures and payment instruments has been initiated. The remuneration of banks' compulsory reserves, at half the refinance rate, has been introduced together with the progressive consolidation of banks' branches reserve and correspondent accounts with NBK into a single account, with the objective to enhance, and facilitate the management of, banks' liquidity. The use of irrevocable letters of credit as payment instruments is being facilitated and encouraged. NBK further plans to require banks to fully guarantee the clearing of payment orders that they forward in the system. Treasury bills auctions have also been introduced with the objective for the banks to be in a position to acquire collateral required to borrow from a lombard window to cover their liquidity needs. In parallel, NBK has started studying the legal, regulatory, institutional, and technological aspects of reforming the payments system for the longer term.

1.35 As a short-term measure, NBK is enhancing some critical elements of the existing, old computer and communication technology within the confines of the existing accounting system, payment instruments, and general system architecture. This "interim system" is to be in place by mid-1995. It will mainly accelerate data transmission by computerizing NBK's 270 district-level cash centers and enhancing communication facilities at the oblast-level centers, thus reducing the float in the payment system. It will in the process also facilitate the nationwide consolidation of correspondent accounts with NBK, and help maintain a more up-to-date inter-bank indebtedness matrix, thus allowing better liquidity management by banks and monetary management by NBK. At the same time, NBK with Bank assistance is designing a new "long-term system". This modern system will accommodate a wider variety of payment instruments, a new accounting system, broader information requirements, and rapid growth in transaction volumes. Moreover, it should be able to process, when desired, transactions on a real-time basis, and with higher security. NBK's system is expected to process high-value transactions, the settlement of already netted amounts that result from inter-bank clearing, and -- while such inter-bank clearing is yet limited in scope -- part of the low-value transactions on a gross basis (see also paras. 3.36-3.41). For inter-bank clearing, some early efforts are under way.

2. Reform of the Banking Environment

1.36 Action is being taken to improve the environment of banking activities. Revisions of the National Bank Law and Banking Law that were enacted in 1993 have been prepared for Parliament decision before mid-1995. They are expected, among other things, to enhance NBK's intervention capacities towards delinquent banks, and facilitate the protection of banks' interests against defaulting borrowers. Also at an advanced stage of preparation are new laws on collateral, non-bank financial institutions, and some financial instruments. A new Securities Law has been passed recently.

1.37 New bank accounting and auditing standards based on international ones have been prepared by NBK. The new chart of accounts is currently being tested in several banks, and will be mandatory for all banks by January 1, 1996. Moreover, intensive training programs for bank staff, and an advisory unit located in the Bankers' Association, have started with the assistance of bilateral and multilateral donor agencies.

1.38 Bank licensing and prudential regulations are being strengthened and their enforcement is progressively implemented. The minimum capital requirements have been denominated in US dollar and raised to US\$1.5 million for new banks which intend to open branches, collect households deposits or make foreign exchange transactions, and to US\$0.5 million for other banks. Existing banks have to comply with these requirements before the end of 1995. The minimum capital adequacy ratio on risk weighted assets has been set at 8 percent; the reserve and liquidity ratios have been raised to 30 percent; and ceilings on single exposures, insider lending and foreign exchange positions have been introduced. A compulsory loan classification system is being prepared. The stricter enforcement of these prudential regulations has already translated into a marked reduction in the licensing of new banks and an increase in bank closures, and is expected to lead to a drastic reduction in the number of banking institutions over the next quarters through mergers and closures. Access to NBK's credit auction system has also been limited to banks that meet minimum capital, capital adequacy, liquidity and reserve requirements, and is updated on a monthly basis. At times, during 1994, only one out of every three banks was allowed to participate in the auctions. These access requirements are being progressively tightened to come in line with regulatory standards. In parallel, NBK's Banking Supervision Department is being reinforced with substantial technical assistance and training (see also paras. 3.34-3.35).

1.39 NBK has also commissioned, with Bank funding, comprehensive in-depth studies of the ten largest banks; the last of these reports should be completed in final form by April 1995. These studies cover institutional and financial aspects, and are not only diagnostic but also strategic in nature. They will provide a basis for the further development, or restructuring, of these banks. To help implement such commercial bank strengthening, the Bank and the EBRD would help fund intensive multi-year assistance arrangements with foreign banks or consultants for several local banks (see paras. 3.26-3.33).

3. Governance and Restructuring of Specialized Banks

1.40 The above-mentioned actions are being complemented by measures aimed at enhancing the governance of public sector banks and at restructuring formerly specialized banks. The voting rights of all public enterprises in banking institutions have been taken over by the State Property Committee, and are exercised by the Ministry of Finance.

1.41 Banks have also been requested to set up work-out units to manage their non-performing loans and play a more active role in the restructuring of loss-making enterprises. Two former specialized banks, Turanbank and Kredsochbank, have already started to implement such units with the assistance of the EBRD and the United Kingdom Know How Fund. The isolation of up to forty non-agricultural enterprises

with the largest outstanding arrears from the rest of the banking sector through the creation of a Rehabilitation Trust, and the subsequent liquidation or passive restructuring and privatization of the debtors, will help the commercial banks to recover financially and better manage their portfolios (see paras. 3.18-3.25). In parallel, Agroprombank is being relieved of a large part of its non-performing loan portfolio, through the transfer to a special Agricultural Support Fund that will try to collect those loans. Plans for a governmental liquidation unit for clearly non-viable state enterprises of medium to large size, and profit-oriented restructuring funds (which were also mentioned above in paras. 1.24-1.25), are further measures to relieve the banking sector from highly distressed debtor enterprises.

1.42 The progressive privatization of their shareholders, and the capital increases called for by the stricter minimum capital requirements, are leading to a progressive privatization of the large public sector banks. In parallel, more narrowly defined specialized banking functions are transferred to new, fully state-owned banks. Sberbank has been transformed into a commercial bank (People's Bank), and is expected no longer to enjoy a state deposit guarantee or other major privileges. The bank shall be privatized after some prior restructuring, including rationalization of its branch network. The fledgling housing finance business of Sberbank was transferred to a new state-owned Housing Construction Bank. Alembank, the bank formerly specialized in foreign financing, has been split into a common, private owned, commercial bank and a state-owned Eximbank. Kredsocbank, which was in charge of the construction and small enterprise sectors, has largely privatized itself through the issuances of new shares. At the same time, the Government has created a development bank and a first leasing company.

1.43 What might emerge, after some years of intensive shake-out, restructuring, and institutional strengthening, is a banking sector characterized by: (i) a few first-tier "international standard" commercial banks, with and without foreign ownership and little, if any, residual state ownership; this could also include some older but by then profoundly restructured banks like the People's Bank and Turanbank; (ii) a few specialized republican banks with major state ownership, for example, banks for trade finance and related guarantees, development finance, housing loans, and perhaps large agricultural credits; and (iii) some smaller banks, including rural and cooperative entities, concentrating on market niches and investment banking.

II. BANK GROUP'S ASSISTANCE AND STRATEGY

A. Past Bank Lending and Strategy in the Financial and Enterprise Sectors

2.1 The Government of Kazakhstan is undergoing a fundamental transformation towards a market economy with predominantly private ownership. A core element of the transition is a course of rapid structural reform in the financial and enterprise sectors. The Bank has been helping identify and prepare many of the key action programs of this reform. The proposed Financial and Enterprises Development Project would play a vital role in supporting the actual implementation of these measures in the two sectors.

2.2 This Project would come in stage III of a four-stage sequence of Bank operations in the enterprise and financial sectors, as outlined below.

- (i) Stage I: Formulation of, and Agreement on, Reform Strategy. In FY 93, the Bank prepared a first Country Economic Memorandum, as well as a series of sector reports and technical cooperation studies on privatization, foreign investment policy, financial sector reform, energy sector re-organization, and the social safety net. Their policy recommendations were then reflected in the Government's agreement with the IMF on support under the Structural Transformation Facility and, subsequently, a stand-by arrangement, and formed the basis of the Bank's Economic Rehabilitation Loan. In June 1994, a second Country Economic Memorandum was issued, with a focus on the costs of restructuring. The

policy dialogue with the authorities has then proceeded in the context of preparing a Structural Adjustment Loan (FY 95), which concentrates on further market development and intensified enterprise restructuring in the agriculture and industry sectors. A Financial Sector Adjustment Loan is envisaged for FY 96.

- (ii) Stage II: Preparation of Detailed Programs, and Initial Institution Building. A large part of the Bank's Technical Assistance Loan of US\$38 million, approved by the Board in August 1993, addresses enterprise and financial sector reforms. The Project has been helping to prepare in-depth diagnostic studies (such as on the ten largest commercial banks) and detailed action programs (for instance, for the long-term payment system, the privatization of very large firms, and the establishment of the Rehabilitation Trust). That Project aims also at strengthening institutional capacity in areas like privatization, anti-monopoly policy, foreign investment, and on-site bank supervision. The Project also removes bottlenecks in the old payments system through some rapid interim measures. In addition, the Bank assisted the country's privatization of small-scale enterprises, trucks, and warehouses with the help of a USAID grant, and tested a study tour program for enterprise managers through two initial tours on a pilot basis in June 1994 under an IDF grant.
- (iii) Stage III: Implementation Support for Detailed Action Programs and Institutional Infrastructure. This Financial and Enterprises Development Project would help to implement the results of the phase II studies, plans, and pilot tests. It would do so with regard to the modernization and restructuring of banks, installation of a long-term payment system, resolution of bad debt, restructuring or liquidation of large insolvent firms, and study tours for managers. In addition, the Project would continue the Bank's support for bank supervision and enterprise privatization. This Project would be complemented by a recently appraised Social Protection Project to strengthen the network of employment offices and help implement the divestiture of critical social assets.
- (iv) Stage IV: Credit Lines for Enterprise-Level Adjustment and Growth. The next stage of the Bank's support in the enterprise and financial sectors could consist of the provision of term credit, equity capital, and some technical assistance for post-privatization restructuring and new private investments. A Private Enterprise Support Project along these lines is being identified. It would complement an EBRD-funded credit line for export-oriented small and medium enterprises, a planned IFC credit line and credit guarantee for trade finance, and a U.S.-funded Central Asian American Enterprise Fund. This Financial and Enterprises Development Project would play a critical role in developing sound and capable commercial banks that could on-lend such working capital and investment credit. It would also improve corporate governance through privatization; build local consulting expertise for restructuring; and familiarize 160 dynamic enterprise managers to modern business practices.

2.3 The IFC approved investments in a joint venture bank with ABN AMRO and in the oil sector (Kazgermunai). The IFC is now preparing, among other things, a credit line for trade financing and a related credit guarantee facility, as well as an equity fund; several investments in gold mining; and advisory services to a large privatization case. The Foreign Investment Advisory Service (FIAS) has been reviewing the environment and legislation for foreign investment in Kazakhstan.

2.4 The Bank has been coordinating its activities closely on the management and task level with other donors. The EBRD, EU, and USAID, in particular, are providing support to the financial and enterprise sectors, but the magnitude and urgency of the reform effort requires the additional support by the Bank. The above-mentioned donor agencies are expected to support privatization, bank twinning arrangements, and bank supervision in parallel to this Bank Loan, or at least closely coordinated with it.

B. Lessons from Experience

2.5 Bank experience shows that fundamental policy reforms such as those aimed at the restructuring of financial and enterprise sectors for the transition to a market economy require substantial capacity building, implementation advice, and market infrastructure investments in order to be effectively and sustainably implemented. Experience further suggests that it is important to maintain the momentum, consistency, quality, and volume of the external support. Finally, the close inter-linkages between the reforms in the financial and the enterprise sectors need to be taken into account in the Bank's lending program and project design. The Bank is supporting these reforms in Kazakhstan through a rapid sequence of projects focused on (i) fast-disbursing policy support, (ii) initial institution-building, (iii) program implementation support and market infrastructure investments, and (iv) enterprise-level investments.

2.6 Technical assistance and training to underpin financial and enterprise sector reforms have been part of many Bank and IDA projects, and the experience has generally been encouraging. So has been the experience with information technology investments in payment systems and bank automation. The proposed Project has benefitted from this experience in its preparation, and will continue to do so in supervision. Some Project components stand out as less common:

- (i) The experience of the Bank with study tours has been mixed, with the main risk being the selection of inappropriate tour participants and insufficient rigor in tour programs. The study tour program for enterprise managers proposed under this Project would attempt to minimize these risks. The selection of participants would follow pre-determined weighted criteria, be carried out with the involvement of external consultants and trainers, and be supervised by a Steering Committee. The study tours would be rigorously structured, with each tour member responsible for analyzing particular issues, contributing to the tour team's technical reports, and participating in post-tour dissemination activities. In many ways, the tour program is built on the basis of the highly positive experience of the vast study tour program under the Marshall Plan after World War II.
- (ii) The resolution of bad debt in the banking sector, and the related restructuring or liquidation of debtor enterprises, has been the subject of Bank projects in Poland and Slovenia, among others. Recently, the Bank approved a Privatization and Enterprise Sector Adjustment Credit to Kyrgyzstan which, among other things, will help establish an institution to liquidate or restructure about thirty insolvent enterprises. The preparation of this Project for Kazakhstan has benefitted from reviewing the approach and experience of these operations and further similar initiatives in Eastern Europe.
- (iii) Intensive bank-to-bank assistance arrangements, often called 'twinning' if promising local banks thus enter into close partnerships with foreign banks, have been funded by the Bank on an extensive scale in Poland. So far, the experience in implementation has been encouraging in most of these Polish cases. Similar arrangements for thirty to forty banks are the core of the FY 94 Financial Institutions Development Project for Russia. In the Ukraine, the Bank is supporting bank-to-bank assistance for the Savingsbank.
- (iv) The Bank has started funding the modernization of the national payments systems in transition economies like China and Hungary (both Loans effective in FY 93). The latter system, in particular, bears many similarities with the system to be installed under this Project. Similar endeavors are being prepared for Russia and the Ukraine, and have been requested by the Governments of Uzbekistan and Azerbaijan. In Kazakhstan, some interim improvements to the old payments system are being implemented under the Bank's Technical Assistance Loan, and have been benefitting from excellent cooperation and sound capabilities of NBK.

2.7 Through its Technical Assistance Loan and sundry other activities, the Bank has learned lessons about the implementation of technical assistance executed by the Government of Kazakhstan. This experience suggests that (i) multi-component projects be implemented directly by the counterpart agencies of the respective components rather than by one central agency, in order to avoid difficulties of communication, inter-agency coordination, and conflicting priorities; (ii) substantial external implementation advice and assistance are indispensable since local Government staff are still largely unfamiliar with international legal customs, financial instruments, consultant industry practices, and complex equipment procurement; and (iii) project implementation units need a sufficient number of capable local staff; and (iv) the Bank needs to provide for intensive supervision.

III. THE FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

A. Project Objectives and Concept

3.1 The Government of Kazakhstan is committed to stabilizing and restructuring the economy. These commitments are reflected in the Standby Agreement that has been signed with the International Monetary Fund, and the Economic Rehabilitation Loan signed with the World Bank. The success of these programs critically depends on fundamental restructuring of the enterprise and financial sectors. This Project would build important institutional capacity for such restructuring, and directly support its implementation in core areas.

3.2 In the enterprise sector, the monitorable objectives of the proposed Project would be to:

- (i) support the rapid and effective implementation of the country's privatization program through continued assistance to SPC. The effectiveness of this assistance would be measured by the success of SPC in carrying out the program consistent with the objectives spelled out in understandings with the IMF and under the Rehabilitation Loan financed by the Bank. This would concern the speed of privatization as well as the principles of equitable, transparent, and competitive processes conducive for improving enterprise governance;
- (ii) help major distressed enterprises prepare for their restructuring and privatization, or their liquidation. In terms of monitorable results, a quick preliminary viability analysis would be carried out for up to forty highly indebted illiquid firms, and about twenty of these firms would formulate, with consultant assistance, detailed plans for restructuring and privatization or liquidation. Moreover, at least fifty local individuals would upgrade their skills in enterprise turnaround or liquidation by working jointly with foreign experts on the advisory teams that help to produce those assessments and plans; and
- (iii) carry out a highly structured study tour program to familiarize enterprise managers with modern business and management practices. About 160 managers would spend at least three weeks each studying enterprises on-site in market economies. Moreover, approximately 320 managers would receive classroom training in business planning and enterprise restructuring; ten sub-sector reports reflecting the tour teams' findings would be distributed locally; and a model for effective manager study tours would be established for replication in Kazakhstan and other CIS republics.

3.3 In the financial sector, the objectives of the proposed Project would be to:

- (i) create a Rehabilitation Trust that would provide an institutional framework for taking the most highly indebted loss-making enterprises off the balance sheets of the commercial banks and forcing their

restructuring and privatization, or else their liquidation. Up to forty major insolvent enterprises would be allocated to this institution, and after four years each of them would either have been liquidated or it would have carried out major "passive" restructuring, vastly improved its cash flow, and initiated or completed its privatization. This would be achieved in a manner that is financially supportable by the banks and the state, and does not create major adverse expectations of general bail-out of banks or enterprises;

- (ii) comprehensively develop or restructure four commercial banks through intensive longer-term assistance by foreign banks and through the enhancement of their information technology. At the end of the assistance period, the two new banks among the four banks would meet international standards institutionally and financially. The two formerly specialized banks would have carried out comprehensive operational restructuring relieving them of non-viable operations and enabling them to conduct their core operations efficiently and in a way that enhances sound competition in the banking sector;
- (iii) deepen NBK's capacity for the on-site supervision of commercial banks, in continuation of similar assistance started earlier under the Bank's Technical Assistance Loan. At the end of the two-phase assistance program, NBK would have about forty trained and experienced bank examiners, including ten specially qualified examination team leaders, and would have conducted at least twenty partial and twenty full examinations of banks with consultant assistance; and
- (iv) build the infrastructure of a national payment system for the longer term. The system would accelerate domestic payments in an orderly way, enhance banks' liquidity management, and permit the use of a range of payment instruments. The system would accomplish, starting in 1997, same-day finality of settlements and real-time processing of high-value transactions. Moreover, general commercial banking software would have been provided to at least ten commercial banks, facilitating their interface with the payment system.

3.4 Several components would directly follow up on the Bank's Technical Assistance Loan by implementing the results of its diagnostic and feasibility studies, and by deepening its institution-building efforts. The Loan would supplement grant funding that will be provided by other donors for some of the reform measures but that is expected to warrant additional funding to bring about the necessary results. Accordingly, the Project components are closely coordinated with other donor agencies, and some components would be parallel financed or co-financed by such other sources.

B. Project Components

3.5 The proposed Project would include the provision of institutional infrastructure, technical assistance, and training for enterprise sector reform (US\$18.4 million) and financial sector reform (US\$47.7 million), as well as for project implementation (US\$1.6 million). Of the total estimated project cost of US\$72.9 million, the Loan would finance about 85%, with the remainder funded by other donors, the Government, and beneficiary banks and enterprises. Details of the Project components are presented in Annexes II - IV.

1. Enterprise Sector Reform

a. Privatization Assistance Phase II

(US\$5.2 million, of which IBRD US\$5.0 million)

3.6 The Project would continue the World Bank's support to SPC in carrying out its comprehensive privatization program. To the extent needed in view of the progress achieved in phase I, the Project would extend the current assistance for mass privatization, starting in the fourth quarter of 1995, albeit based on a new consultant contract. Issues requiring foreign specialists would likely include, *inter alia*, questions of segmentation and clarification of environmental liabilities in the course of preparing firms for sale; training of investment fund staff in corporate governance, restructuring, and capital market participation; ad hoc advice ('trouble shooting') to SPC's leadership; continuous adjustments of procedures to rapidly changing circumstances; and the "repackaging", through segmentation, spin-off of social assets, or restructuring of liabilities, of firms whose shares had been rejected in earlier auctions.

3.7 Potentially, this Project component could also support the so-called case-by-case privatization under Kazakhstan's privatization program, depending on the assistance that other donors would provide and on the capacity of SPC to handle a large number of consultant contracts. Case-by-case privatization applies to firms that are very large (more than 5,000 employees) or special (in the sense of requiring a sound regulatory framework before privatization or complex contractual provisions upon privatization, for example, natural monopolies, exploiters of non-renewable natural resources, and public service firms). The funding of fixed fees demanded by advisors for the preparation and sale of such objects, particularly where the chances of successful company sale do not appear certain, has emerged as a critical constraint. Where such funding has not been available, SPC has started accepting consultant proposals for direct non-competitive sale to investors if these were the only consultant proposals not involving fixed fees. To support implementation of the case-by-case privatization program without suffering the drawbacks of non-competitive divestiture, the Government could use Loan funds to help cover fixed advisor fees. However, this would only be done if it were part of a joint financial effort of the donor community and the Government, and if SPC established adequate capacity to execute such an assistance program. The Bank has meanwhile mobilized Japanese trust funds which allow SPC to engage a team of financial advisors to support the overall management of its case-by-case privatization program. The total funding under the Loan available for the Privatization Assistance Phase II would amount to US\$5.0 million.

b. Restructuring Advisory Unit (including Environmental Sub-Component)

(US\$10.9 million, of which IBRD US\$10.0 million)

3.8 **Distressed enterprises are placing an enormous burden on their banks, suppliers, the state budget, and other creditors, and require urgent restructuring.** The enterprises are short, however, of in-house expertise or local expert advice for the assessment of their viability and the development of market-oriented restructuring programs. There is a similar shortage of local capacity for preparing and carrying out liquidations. These deficiency have particular economic consequences in the case of those firms that have the largest arrears towards various categories of creditors. **The debts of these up to forty most heavily indebted insolvent firms would be transferred to the earlier mentioned Rehabilitation Trust, which would make any further financing to these enterprises conditional on the their submitting proper assessments of their viability, and satisfactory restructuring plans or liquidation proposals.** The size and complexity of the enterprises, however, require particular skills, experience, and international market knowledge for such analysis and planning.

3.9 The Government is therefore establishing a special Restructuring Advisory Unit (RAU) to help enterprises, upon their request, undertake viability assessments and prepare restructuring and

privatization plans, or liquidation proposals. This unit would focus its work first with priority on the firms submitted to the Rehabilitation Trust. Over time, it could dedicate an increasing portion of its capacity to consulting private enterprises on their restructuring. The Restructuring Advisory Unit is being established as an independent unit attached to the Ministry of Economy, with autonomous status and its own budget. Its head would be appointed, and subject to dismissal, by Government decision.

3.10 The Restructuring Advisory Unit would have a small core staff. For each enterprise, or group of enterprises, it would employ external or local consultants for most of the analysis and planning. The Restructuring Advisory Unit could also invite, for an enterprise or group of enterprises, technical experts of the Ministry of Economy and other agencies and territorial authorities to join ad hoc working groups under the Unit's leadership to lend support to, but not to instruct, the Unit's enterprise-specific project team. The nature of the Unit's work would be that of an advisory service to the enterprise. The restructuring plan or liquidation proposal elaborated with the Unit's help would be submitted by the enterprise management to the Rehabilitation Trust, which would then approve or disapprove the plan and accordingly decide on further financial support subject to implementation of the plan. In other words, the Rehabilitation Trust in its role as dominant creditor would require enterprises to restructure, whereas the Restructuring Advisory Unit would advise these enterprises in actually elaborating the restructuring plans for submission to the Rehabilitation Trust's approval and financial support. Environmental considerations would be brought into the viability assessments and restructuring plans, with a view to identifying opportunities for efficiency enhancements that reduce pollution simultaneously, and to facilitating eventual privatization through early environmental audits. The key organizational and operating principles of the Restructuring Advisory Unit, based on the concept note shown in Annex II.1, have been agreed upon during Loan Negotiations.

3.11 The Project would support the institution-building and operation of the Restructuring Advisory Unit through a core team of three full-time and two part-time consultants for a period of up to three years, thus totalling about nine person-years. One of the full-time advisors would be an environmental specialist, and one of the part-time advisors a legal expert; the other three persons would be business consultants with substantial restructuring experience. This core team would initially be supplemented by additional experts to help rapidly undertake a rough review ("quick-scan") of the viability of all the firms submitted to the Rehabilitation Trust. For the subsequent elaboration of restructuring plans or liquidation proposals of individual enterprises, or possibly for several enterprises in the same sub-sector, the Restructuring Advisory Unit would engage teams of short-term experts to work with the individual project teams. The use of local experts as consultant team members or subcontractors would be strongly encouraged, with a view to building a local private consultant industry. The terms of reference for the short-term teams would be written, their performance monitored, and their outputs reviewed by the Restructuring Advisory Unit with help by the core team. Assuming that the advisors would work almost exclusively on enterprises under control of the Rehabilitation Trust, and assuming a certain mix of enterprise size, viability, and sub-sectors, it is estimated that about 20 - 25 firms would be assisted by the short-term teams. Other donors are already providing restructuring advice to some enterprises, and further donors are expected to provide additional assistance, especially once the Unit is established and working effectively. The total funding provided to the Restructuring Advisory Unit under the Loan would amount to US\$10.0 million.

c. Study Tour Program for Enterprise Managers
(US\$2.3 million, of which IBRD US\$1.8 million)

3.12 In Kazakhstan today, modern management and marketing capabilities needed in a competitive market economy are still scarce. Study tours of enterprise managers from an economic sub-sector, if very rigorously organized and accompanied with pre- and post-tour training activities, have proven to be highly

effective tools for transferring modern management know-how in a short time. They open eyes, and have the managers see for themselves what works, and how.

3.13 Two pilot tours have taken groups of managers from Kazakhstan to the United States and the Far East in June 1994, supported by a grant from the Institutional Development Fund (IDF). These pilot activities helped build local experience and capacity to implement such a tour program, and provided valuable insights for strengthening the program. This Loan would fund ten further tours between July 1995 and April 1996. It is expected that other donors continue and further expand the program thereafter.

3.14 The tour program would consist of a set of inter-related activities: (i) pre-tour seminars of 7 - 10 days; (ii) highly structured study tours of 3 - 5 weeks for 16 enterprise managers per tour, to visit 10 - 12 enterprises in a sub-sector, and relevant support institutions, in one or several countries; and (iii) post-tour activities like seminars, dissemination of tour teams' reports, follow-up assistance, and tour impact evaluation.

3.15 The selection of participants would aim at identifying managers of medium and large enterprises, and some rapidly growing new enterprises, that have proven capabilities and decision-making authority to introduce important changes in their enterprises. Firms would generally send two participants. The selection process would consist of two stages. First, enterprises would be selected for the pre-tour seminars according to objective criteria relating to the firms, resumes of proposed individuals, their job descriptions, and other application materials, as well as according to their willingness to pay fees that cover most or all of the local costs of conducting the seminars. Second, from among the seminar participants, about half of the teams would be chosen to participate in the study tours, according to their capabilities and motivation demonstrated during the seminars. The actual evaluations would be carried out by the external consultants/trainers, employed by the Ministry of Economy with funding from this Loan, in collaboration with the local training institutions involved in the program. Agreement in principle has been reached upon Loan Negotiations about the main organizational and operational features of the program as described in the concept note shown in Annex II.2, and in particular on the criteria, mechanisms, and responsibilities for selecting seminar and tour participants. The participant selection criteria would be formally approved, and the subsector selection criteria completed, by the Tour Program Steering Committee in agreement with the participating training institution, the host country partner institution, and the Bank.

3.16 The program would be overseen by a Steering Committee comprised of representatives of government agencies and business associations, and some participants of the two pilot tours of June 1994. A tour program unit under the Ministry of Economy's Personnel Training Department is acting as secretariat to the Steering Committee, and will be responsible for coordination, logistical arrangements, procurement of consultants and trainers, and ensuring organization of post-tour activities. The Ministry of Economy had already carried out the two above-mentioned pilot tours in mid-1994. A local training institution, most likely the State Academy of Management, would organize and carry out the seminars, and in this context play a key role in the selection of seminar and tour participants. External trainers/consultants would teach at the seminars, assist with the selection of participants, and accompany the tours. One or several foreign host country institutions would help arrange the company visits and logistics, and provide experts to also accompany the tours and conduct post-tour activities in Kazakhstan. The World Bank's Economic Development Institute (EDI) would provide training materials and guidance to the seminars.

3.17 The costs of the ten tours with their related activities are estimated at US\$2.3 million, of which this Loan would fund US\$1.8 million, the host country institution some US\$200,000, and the participating enterprises some US\$1,500 - 2,000 equivalent each in local currency. For further details on the tour program see Annex II.2.

2. Financial Sector Reform

a. Debt Resolution Institution (Rehabilitation Trust)

(US\$2.5 million, of which IBRD US\$2.4 million)

3.18 As the economy's monetary constraints are being hardened and inflation is being reigned in, the banks and the state budget are increasingly suffering from arrears on claims on enterprises. The commercial banks are still too weak in governance and capabilities to deal with all their large distressed borrowers. To contain the burden created by up to forty enterprises with very high arrears, and to force their restructuring and privatization if they are viable, or their liquidation if they are non-viable, a temporary debt resolution institution called Rehabilitation Trust is being established.

3.19 The enterprises are being selected mainly according to their total non-performing net debt⁴, which consists mainly of arrears to suppliers and to the tax and social security authorities, non-performing bank loans, and debt that resulted from the inter-enterprise arrears clearing exercise in early 1994. The Government is completing the compilation of this data. Agricultural firms, whose non-performing debts would be treated separately, would not be included. Public service firms such as utilities would not be included either because their financial problems stem largely from state pricing policies rather than operating inefficiencies, and because liquidation would not be a realistic option. Due to the objective and nature of the Rehabilitation Trust, enterprise are expected to try to avoid allocation to the bank. The enterprises are therefore being selected by the Government, following the above criteria, instead of applying on their own.

3.20 The outstanding bank debts of the enterprises, and some of their arrears to the Government, would be transferred to the Rehabilitation Trust, together with their refinancing by central credit resources and the bank deposits of the enterprises. To force restructuring and privatization, or liquidation, the Rehabilitation Trust will cut a firm off from any inflow of new funds except through the Rehabilitation Trust itself. The Rehabilitation Trust would make any provision of funds to a firm, or relief from debt, conditional on agreement on a rigorous restructuring plan and its timely implementation. The plans would focus on "passive" restructuring, i.e., turnaround without major new investment; new investments would instead be funded by commercial banks or private investors after the passive restructuring and privatization. Restructuring would need to be completed within three years, and liquidation within a shorter time. The Trust itself will exist for only about four years, as stipulated in a termination clause in its constituent documents.

3.21 To the extent possible, the creditor and owner roles would be kept separated, and the creditor's role is expected to prevail over the owner's role given the insolvency and illiquidity of the debtor enterprises. The process would be as follows: (i) The Rehabilitation Trust would request a viability assessment and comprehensive restructuring plan from an enterprise assigned to it. (ii) The enterprise would undertake this analysis and write its plan. To do this, it would have access to expert advice from the consultant-assisted Restructuring Advisory Unit described earlier (Section III.B.1.b). (iii) The Rehabilitation Trust alone would then decide on whether the plan would likely succeed in making the enterprise economically and financially viable, and whether the costs of the restructuring are warranted and remain within the financial envelope available to the Rehabilitation Trust. (iv) The Rehabilitation Trust would closely supervise the firm to minimize further losses, prevent asset dissipation, preclude further arrears to third parties, and monitor the implementation of the plan. The Rehabilitation Trust's satisfaction with the

⁴ Since until mid-1994 inflation was still very high and real interest rates negative, much of the non-performing outstanding debt consists of debt newly accumulated in 1993-94. In many cases, it served to finance a negative operating cash flow of the enterprise. Losses recorded by the enterprises in the existing, old accounting system are not very meaningful indicators of enterprises' financial performance, especially in the inflationary environment.

implementation progress would be condition for its on-going financial support. If the firm has no prospect for viability, or if no satisfactory restructuring plan is submitted, or if the implementation progress is unsatisfactory, the Rehabilitation Trust will trigger liquidation procedures for the firm (or, in the case of minor non-compliance with its demands, replace the management).

3.22 It is essential that this debt resolution institution be able to exercise total control over all financial transactions of a firm. They would transit through one single account, and would be a priori controlled and authorized by a loan officer of the Rehabilitation Trust. This is easiest to achieve if the institution is established in the form of a bank rather than a fund. The establishment and operation, as well as the future termination, of the Rehabilitation Trust would be facilitated if it used premises, information systems, and technical facilities of an existing bank (e.g., Turanbank) under a fee-based contractual arrangement.

3.23 It is envisaged that the Rehabilitation Trust be a fully state-owned joint stock bank with special status. Due to the state's role as creditor of many enterprises, the Ministry of Finance has taken a lead role in establishing the Trust. The Supervisory Board of the Rehabilitation Trust will be chaired by an official of at least Deputy Prime Minister rank, and include representatives of the Ministries of Finance and Economy, SPC, NBK, and other entities. In addition to the functions normally exercised by the supervisory board of a joint stock bank, the Supervisory Board of the Rehabilitation Trust would need to approve every restructuring or liquidation plan, and decide on the volume of financial support to the enterprises. The equity capital of the Rehabilitation Trust will be funded from the Budget, and its annual operating losses from the Budget, Government-guaranteed NBK credit, and/or Government-guaranteed bonds. A concept note on the Rehabilitation Trust is attached as Annex III.1(a).

3.24 The key operating principles of the Rehabilitation Trust, based on the concept note shown in Annex III.1(a), as well as the criteria for selecting enterprises to be subordinated to the Rehabilitation Trust, have been agreed upon during Loan Negotiations. The adoption of the founding Presidential Decree and a satisfactory draft charter of the Rehabilitation Trust were conditions for Board presentation. So were be satisfactory provisions in the national budget for the Rehabilitation Trust's first year of operation. Disbursement under this Loan component would be contingent on the establishment of the Trust in a manner satisfactory to the Bank, which would include, in addition to the Presidential Decree and a Government Resolution, the registration of the Trust's charter and the issuance of appropriate banking licenses by NBK. Disbursement under this Loan component would further be contingent on the existence of legal and regulatory provisions, satisfactory to the Bank, governing out-of-court settlement of debt claims and necessary for the successful functioning of the Rehabilitation Trust, such as appropriate legal provisions for foreclosure and debt transfer. (Agreements reached, conditions met, and conditions to be met for disbursements are shown in Section IV.)

3.25 It is planned that the Rehabilitation Trust be fully operational by June 1995. The World Bank is currently providing, through its Technical Assistance Loan, a short-term advisor team to help elaborate in further detail the organizational structure, operating procedures, staff needs, training plan, company documents, and so forth. The Finance and Enterprises Development Loan would subsequently fund a small core team of senior external advisors for more than two years, starting in about June 1995, and some short-term advisors as would be needed to resolve special problems. This advisor team would train local staff, provide policy and legal advice, and supplement local capacity where special expertise is needed in financial analysis, financial control, liquidations, and other fields. Draft summary terms of reference for the consultants are shown in Annex III.1(b). This Loan component would amount to US\$2.4 million.

b. Commercial Banking Development
(US\$17.0 million, of which IBRD US\$12.0 million)

3.26 This component would help strengthen commercial banking activities of local banks. It would focus on (i) the development of a core of new but rapidly growing private banks that aim at reaching, in a few years, commonly accepted international standards of bank management, services and financial condition, and (ii) the restructuring and consolidation of large banks that are expected to undergo major restructuring and continue playing an important role in the provision of banking services in Kazakhstan. It will principally rely on the implementation of "twinning" arrangements with reputable foreign banks, a scheme already tested in other countries and considered one of the most efficient and cost-effective way to provide comprehensive assistance to banks in transition economies. This component would support the implementation of institutional as well as technological development programs of the participating banks. The Loan would help fund the development programs of two medium-size private and two large banks. The European Bank (EBRD) envisages supporting similar programs of two further medium-size banks and two further large banks, most likely Turanbank and Kredsocbank. Together with wholly or partly foreign owned banks in Kazakhstan like those of ABN Amro/IFC and Chase Manhattan, and further locally owned banks that might be encouraged by the example of twinning arrangements to seek closer cooperation with foreign banks, these banks are expected to meet international standards soon, and to constitute the core of Kazakhstan's future banking system.

3.27 The two large banks tentatively pre-selected for restructuring support under this Loan are Agroprombank and the People's Bank. Both suffer from severe institutional weaknesses and, in the case of Agroprombank, a particularly poor financial condition, and need to undergo intensive restructuring. Agroprombank, which is mainly owned by the Government and state enterprises, is specialized in the financing of the agricultural and agro-processing sectors. The bank with its 235 branches employs more than 5,600 employees, and has until recently accounted for almost one third of total assets in the commercial banking sector. More than other large banks, it has been relying on central credit resources to finance its lending, which to large extent is directed credit. The bank's loan collection rates and profitability have been very weak, reflecting in part the financial distress in the agricultural sector in 1993-94, prior to the removal of important price controls, the phase-out of most "state needs", and the introduction of domestic competition in grain marketing. Liberalization in agriculture, and the provision of directed credit henceforth only with explicit Government guarantees, will improve the operating environment of the bank. Moreover, the Government has recently established a special fund that is assuming most of Agroprombank's non-performing loans accumulated in the past. Agroprombank has recently been subject to an in-depth diagnostic and strategic study under the Bank's Technical Assistance Loan, laying the basis for a comprehensive restructuring plan. One option, for example, is to spin part of the bank's branch network off to become rural credit cooperatives, with the remaining bank operating as a general commercial bank with a certain focus on large-scale agro-business clients. If satisfactory, the bank's restructuring plan would be implemented with the assistance of a foreign bank or consultants under this Project.

3.28 The People's Bank is the former Savingsbank that has recently been transformed into a common joint-stock universal bank. The bank's vast network of 4,060 branches and counters is being cut back through the termination of leases on many premises. Overall, the Savingsbank deposit base had shrunk drastically in real terms in the last years when it offered highly negative real interest rates and fell behind the newer banks and non-bank collectors of household savings in upgrading its service quality and variety. Since its transformation, the bank no longer needs to pass on its deposits to the state; is free in setting its interest rates; is engaged in a wider variety of consumer financial services; and is supposed to be relieved from, or compensated for, services provided on Government request. In return, it is envisaged that the bank no longer enjoy a state guarantee for its deposits. An in-depth diagnostic and strategic study has been undertaken under the Technical Assistance Loan for this bank as well. It would result in a restructuring plan

that a foreign bank would help implement. The restructuring program would also facilitate the further privatization of the bank in an orderly manner. Like Agroprombank, the People's Bank would only be eligible to the program if it presents a restructuring plan that is satisfactory to the World Bank and is agreed on by the Government and NBK.

3.29 The two private, medium-sized banks are being selected through a three-step process. (i) Potential candidates are pre-selected based on a series of quantitative criteria (the diversification of their shareholding, the level of their equity base, their solvency and liquidity situation, their effort to mobilize deposit resources and the level of their dependence on NBK refinancing facilities, their ownership, and their focus on private sector clients), and on their desire to rapidly develop close links with reputable foreign banks (but their difficulty to achieve this goal on their own). On this basis, four banks have been tentatively pre-selected. (ii) The pre-selected banks have been subject to comprehensive financial and institutional diagnostic studies by international audit firms in late 1994, aimed at confirming that they effectively meet the selection criteria and at designing the main components of their required institutional development and automation programs. (iii) Finally, the banks will have to commit themselves, under Subsidiary Financing Agreements, to pursue sound and prudent banking practices and to strive and meet generally accepted international financial standards in three years time. The principles of the eligibility criteria for local commercial banks to participate in the program under the Project have been agreed upon during Loan Negotiations.

3.30 A number of foreign banks have already expressed an interest in "twinning" arrangements with Kazakh banks. Initial contacts will be organized when the diagnostic studies will be available in final form. The selection of these foreign banks would be made according to the usual World Bank procedures for the use of consultants.

3.31 Each institutional strengthening program would be tailored to the needs of the individual bank. It would be based on its absorption capacity, its present situation, and its development strategy established with the help of the in-depth studies. Such a program would typically consist of the elaboration of a detailed and time-bound business plan; a rationalization of the bank's organization and procedures; and the upgrading of key banking functions and skills in the areas of organization and procedures, credit policy and management, marketing, risk assessment and financial management, planning and budgeting systems, internal control, information and performance measurement systems, personnel and training policy, and technology policy and automation planning. The main aim would be to rapidly become an international standards bank.

3.32 The technological development program of each bank would be based on the automation component of the bank's strategic plan, and would be closely integrated into its institutional strengthening program. As a consequence, these automation programs would usually start six to twelve months after the start of the institutional strengthening. The design of the automation programs would also depend on: (i) the technical features of the future payment system; (ii) the potential emergence of computer service bureaus; and (iii) the budget constraint of each bank. A typical program would include financing for information technology experts to write specifications, the provision of computer and communication hardware and software, and training.

3.33 The total cost of this Component is currently estimated at US\$17 million, of which the World Bank Loan would fund US\$12 million. Co-financing sources would provide US\$4 million on a grant basis, and the banks themselves (for additional automation needs) would cover about US\$1 million equivalent. The external financing of each bank's institutional development sub-component is expected to come in half from the Bank Loan and in half from grants by other donor agencies, whereas the external funding of the automation sub-component would be fully provided by the Bank Loan. As a result, each subloan to selected

banks would be limited to US\$3 million or (with the exception of Agroprombank) to the level of each bank's equity base, whichever is the lower of the two. As mentioned earlier, the EBRD intends to support in parallel the institutional development of four additional banks following the same concept outlined above. The conditions for the participation of banks, and draft terms of reference for foreign banks, are presented in Annex III.2.

c. Training for On-Site Bank Supervision, Phase II
(US\$1.3 million, of which IBRD US\$1.0 million)

3.34 This component aims at deepening the training provided to NBK's Bank Supervision Department for the development of its on-site examination activities. The first phase of this program is financed under the on-going Technical Assistance Loan. At the end of this two-phase program, the Bank Supervision Department would have forty qualified and experienced bank examiners, including ten highly trained examination team leaders, and would have conducted 24 partial and 24 full examinations of commercial banks. This program has been designed and is being implemented in coordination with the IMF and USAID, which would provide assistance on supervision regulations, bank licensing, and off-site supervision. Particularly close collaboration under this Project is envisaged with USAID and EU funded program for classroom teaching of new supervision staff, which would prepare them for the on-the-job training in actual examinations under guidance of the trainers funded by this Loan.

3.35 The World Bank support focuses on the on-the-job training of bank examiners. Activities undertaken in the second phase, supported by this Project, would comprise: (i) the enhancement of staff skills and experience in the full-scope examination of banks' financial situation, risk and credit management, and internal control procedures; (ii) the implementation of effective intervention mechanisms for problem banks; and (iii) the further development of follow-up procedures and examination manual and guidelines. These activities would be undertaken with the assistance of two highly qualified long-term advisors for a period of two years starting in early 1996. The Loan component would amount to US\$1.0 million. USAID is expected to fund classroom training, which would supplement the Bank's assistance, with a total of about US\$200,000. The draft terms of reference for the two long-term advisors constitute Annex III.3.

d. Long-Term Payments System
(US\$26.9 million, of which IBRD US\$23.8 million)

3.36 An effective payment system is important for channeling credit transfers to producers and consumers of goods and services, improving the availability of working capital to enterprises to meet their trade obligations, facilitating foreign investments, expediting the circulation of money between economic players, regulating the financial conduct and viability of the participants, facilitating proper oversight of credit and liquidity risks in financial sector operations, reducing the float in the system, improving liquidity management, and protecting the rights of financial intermediaries and customers. This proposed Project component would support these objectives through the establishment of a long-term payment system.

3.37 Kazakhstan's payment system suffers currently from: (i) severe deficiencies in its rules and procedures; (ii) the obsolete equipment and software that operates the existent payment system; and (iii) the poor overall system architecture, which is suitable neither for sound, market-oriented banking nor for fast and secure transactions that rapidly grow in number. The National Bank is therefore working on all these three issues in parallel: (i) The improvement of the rules and procedures has been discussed since 1992 with support by the IMF and Bank of Japan. (ii) Some hardware and software for short-term improvements in the security and efficiency of the current payment system, and in the ability to apply some new payment system rules, is being installed also under that Technical Assistance Loan. (iii) A new payment system for the long term would be established under this Finance and Enterprises Development Project.

3.38 Some of the key objectives of the long-term system would be to: (i) perform finality of settlements on a daily basis, and consolidation of cash in vault, reserve accounts, and settlement balances; (ii) accept both gross and netted values (the latter after prior bilateral or multi-lateral clearing among banks); (iii) provide a "real time" system for high value transactions; and (iv) accommodate a wide range of payment instruments. The system would maintain one settlement account per institution. Private sector representatives would be included in the decision-making process to facilitate banks' linking into the system, foster cooperation, and encourage private sector initiatives for bi- or multi-lateral clearings between financial institutions. A National Payments Council consisting of representatives of NBK, MOF, commercial banks, and the Union of Entrepreneurs has been created in January 1995. The National Payments Council is starting to play a major role in decisions on matters of payment system strategy, regulations, standards, and overall system architecture, among others.

3.39 The architecture for the long-term system would be centered on three major regional sites (South, North/East, and West), reflecting geographical factors. The southern center will be Almaty, and the northeastern center probably Akmola, which is envisaged as Kazakhstan's new capital in the longer run. All three centers would support clearing functions but only the Almaty center would accomplish settlements and maintain the settlement (correspondent) accounts. The three centers would each have duplexed machines for back-up, while the Almaty database, which comprises two thirds of the national workload, would be replicated in the Northeast region, using an optic fiber cable that is being constructed between Almaty and Akmola. In addition to computer equipment, the Project would also finance payment system application software, telecommunication links (to ensure that the clearing centers and financial intermediaries are networked), training, and initial operation assistance by the contractor. The feasibility and design study for the long-term payment system has started in June 1994; the draft final outputs were completed in February 1995 for discussion by the authorities, the National Payments Council, and the World Bank. Agreement on the main features of the long-term payment system has been a condition for Board presentation (see Section IV).

3.40 Also included in this Project component would be a comprehensive customized banking application software package to support NBK's central banking functions such as general ledger accounting, statistical analysis, foreign exchange, etc. Moreover, NBK would make the same software available to commercial banks for mini and micro computer use, under licensing agreement and together with some information technology advice and training. Especially small and medium banks could benefit from this offer to facilitate their participation in the payment system and to modernize their customer accounting. Moreover, the micro computers and communication equipment bought in 1994 for 270 cash centers for the interim payment system improvement would further facilitate the commercial banks' interface with the long-term payment system.

3.41 The long-term payment system should be operational by July 1997. The investment costs of this Project component are estimated at US\$24 million. This includes about US\$5 million equivalent for the banking application software sub-component (of which about US\$2.4 million equivalent are incremental costs for making the software also available to a number of commercial banks, not only NBK). The investment costs of the payment system network itself, i.e. without this banking application software, are expected to total approximately US\$19 million equivalent. (For more detail see the concept note in Annex III.4; detailed cost estimates are included in the Project File.)

3. Project Implementation Assistance

(US\$1.6 million, of which IBRD US\$1.5 million)

3.42 To assist project implementation, an experienced consultant firm would provide advice on procurement, contract monitoring, disbursement, project reporting, and project coordination. In the first

year, the firm would place one full-time procurement advisor with particular information technology expertise at NBK; a part-time procurement advisor at SPC; and a third procurement advisor, with special expertise in disbursements, for about half of his time on the project at MOE but also assisting NBK and SPC in disbursement matters as may be necessary. In the subsequent one and a half years, implementation assistance would continue to be provided but with fewer person-years per year, partly on a short-term basis. Draft terms of reference for the consultant firm are shown in Annex IV.

3.43 The Project would also fund the participation of Project Implementation Units staff in procurement and disbursement training abroad, as well as some office equipment for the units. The total costs of implementation assistance are estimated at US\$1.6 million, of which the Loan would finance US\$1.5 million.

C. Project Costs and Financing

3.44 The total project cost is estimated at US\$72.9 million equivalent, of which US\$64.4 million would be in foreign currency. About US\$38.6 million of the total cost are costs of equipment, software, and related services. For the equipment elements under the payment system component, the estimates are preliminary, pending refinement after the last report of the consultant study on the long-term payment system will have been received. The various cost elements of consultancy and training have been estimated based on the experience with similar activities under the Technical Assistance Loan to Kazakhstan and other operations in Eastern and Central Europe. Contingencies of 5 percent (including a 2.3 percent price contingency) would be included in each consultant contract and are shown in the cost estimates below as integral parts of the cost of the respective Project components.⁵ The unallocated contingencies are shown separately, and refer to all other cost elements, which are mainly goods. These unallocated contingencies consist of a 2.3 percent price contingency reflecting projected international inflation, and a 9.7 percent physical contingency. Project costs are summarized in Table 1 below, and shown in Annex VI. Detailed cost estimates for each Project component have been transmitted to the Borrower and are included in the Project File.

⁵/ Exceptions are consultancy and training that will be part of the equipment contract for the payment system component, and short-term consultancies to the Restructuring Advisory Unit. For these costs elements, price and physical contingencies are covered by the unallocated contingencies.

Table 1
Estimated Project Costs

Component	Local	Foreign	Total
	(US\$'000 equivalent)		
1. Enterprise Sector			
a. Privatization Assistance Phase II	1,143	4,061	5,204
b. Restructuring Advisory Unit	2,147	8,770	10,917
c. Manager Study Tours	342	1,912	2,254
Subtotal	3,632	14,743	18,375
2. Financial Sector			
a. Rehabilitation Trust	310	2,190	2,500
b. Commercial Banking Development	2,290	14,703	16,993
c. Bank Supervision Phase II	260	1,050	1,310
d. Long-term Payment System	1,172	25,801	26,953
Subtotal	4,032	43,725	47,756
3. Project Implementation Assistance	344	1,281	1,625
Subtotal: Base Cost	8,008	59,750	67,756
4. Contingencies /a			
a. Price Contingency	146	1,261	1,407
b. Physical Contingency	397	3,355	3,752
Subtotal	543	4,616	5,159
Total Costs	8,551	64,363	72,914

/a Under all Project components 1.-3. (except consultancy under 2.d and short-term consultancy under 1.b; see footnote below), consultant contracts include contingencies of 5 percent that are integral parts of the estimated costs of the individual components and are not included in the unallocated contingencies.

3.45 The Project Financing Plan is summarized in Table 2 below, and shown in more detail in Annex VII. The foreign exchange cost requirements are estimated at US\$64,363,000, and local currency requirements are estimated at US\$8,551,000 equivalent. The World Bank would finance 90.3 percent of the foreign exchange costs, and 45.4 percent of the local currency costs. The financing by the Government and NBK would increase over time, which would be in line with an expected improvement in the currently very tight budget situation.

Table 2
Financing Plan /a

Component	GOK, NBK	Local Firms, Banks	IBRD	Other Donors	Total	IBRD as Percent of Total
	(US\$'000 equivalent)					
1. Enterprise Sector						
a. Privatization Phase II	200	0	5,003	0	5,203	96%
b. Restructuring Advisory Unit	435	485	9,997	0	10,917	92%
c. Manager Study Tours	14	230	1,810	200 /c	2,254	80%
Subtotal	649	715	16,810	200	18,374	93%
2. Financial Sector						
a. Rehabilitation Trust	100	0	2,400	0	2,500	96%
b. Commercial Bank Develop.	0	994	12,000	3,999 /c	16,993	71%
c. Bank Supervision Phase II	101	0	999	210 /d	1,310	76%
d. Payment System	3,105	0	23,848	0	26,953	88%
Subtotal	1,126	994	39,247	4,209	47,756	86%
3. Implementation Assistance	132	0	1,493	0	1,625	92%
Subtotal: Base Cost	4,087	1,709	57,550	4,409	67,755	85%
4. Contingencies /b						
a. Price Contingency	152	48	1,202	5	1,407	86%
b. Physical Contingency	358	130	3,248	16	3,752	87%
Subtotal	510	178	4,450	21	5,179	86%
Total Costs	4,597	1,887	62,000	4,430	72,914	85%

/a PPF refinancing is included in the individual components. It concerns the Rehabilitation Trust, Restructuring Advisory Unit, manager study tours, and implementation assistance.

/b See note under table 1.

/c Donor to be confirmed.

/d USAID.

3.46 The Loan would be borrowed by the Republic of Kazakhstan. The Ministry of Finance would allocate part of the funds to other Government agencies (SPC and MOE), and on-lend to NBK, which is not formally included in the Government. For the commercial bank development component, NBK would on-lend to commercial banks under Subsidiary Financing Agreements. The financing by donors other than IBRD would be parallel financing; only the grant funding for the commercial bank development component would be on a co-financing basis. Local banks and enterprises that benefit directly from the bank development component, study tour program, or restructuring advisory services would cover substantial parts of the local costs themselves. The financing required from the Government would be reflected in appropriate budget provisions.

D. The Borrower and Implementation Agencies

3.47 The Borrower of the Loan would be the Republic of Kazakhstan. There would be four counterpart agencies under the Project: National Bank of the Republic of Kazakhstan (NBK), State Property Committee (SPC), Ministry of Economy (MOE), and Ministry of Finance (MOF). NBK will be the counterpart agency for the payment system, commercial bank development, and bank supervision components; MOF for the Rehabilitation Trust component; SPC for the privatization assistance; and MOE for the study tour program and restructuring advisory components. NBK, SPC, and MOE would also implement their respective portions of the implementation assistance components, but the procurement and disbursements under this component would be handled by NBK in consultation with SPC and MOE. Deputy Chairmen or Deputy Ministers of the four agencies would oversee the individual Project components.

3.48 Three of the four counterpart agencies (NBK, MOE, and SPC) would also be implementing agencies. MOF, the fourth counterpart agency, would entrust implementation of its single project component, which involves only one consultant contract, to MOE. NBK, SPC, and MOE (at present through the National Agency for Foreign Investment, NAFI) already have existing donor relations divisions or project implementation units with some initial experience in consultant and equipment procurement. To ensure sufficient capacity dedicated to the implementation of this Project, NBK and SPC have established Project Implementation Units (PIUs), with at least three staff assigned to NBK's unit and two staff to SPC's unit. The establishment of these PIUs at NBK and SPC has been condition for Board presentation (see Section IV). Coordination with other external aid and loans provided to the Republic of Kazakhstan would be provided by an institution yet to be appointed by the Government, as part of that institution's broader aid coordination mandate. (An overview of the implementation arrangements is depicted in Annex V.)

3.49 In each of their respective areas of responsibility, the NBK, SPC and MOE would be responsible for overall implementation and required coordination, within the Government (or with the Government, in the case of NBK) as well as with the Bank, procurement agencies, suppliers, and others, to ensure a consistent approach in the implementation of their respective Project elements. This would include the timely and efficient monitoring and control of the proposed use of Bank funds in the procurement of needed goods and services, the administration of a Special Account, the bookkeeping and auditing of project accounts, and the preparation of progress and Project Completion Reports on their respective activities. In addition, NBK, SPC and MOE would be responsible for: the development of terms of reference and short lists; the evaluation of proposals/bids; the management of the bidding process; negotiations; obtaining Bank no-objections and other clearances; the signing and execution of contracts; the administration of executed contracts; the approval and execution of timely disbursements; and audits.

3.50 For two of the Project's components, the counterpart agencies would act as secretariats to broader steering committees. First, the payment system reform, in particular the policy and regulatory questions, would be overseen by the National Payments Council. The Council comprises representatives from commercial banks, enterprises, and NBK. NBK provides the Chairman of the Council, and its Payment System Division acts as secretariat to the Council. Second, the study tour program for managers will be supervised by a Steering Committee comprising industry and Government representatives as well as former study tour participants. It is chaired by a representative of the Administration of the Council of Ministers. A special unit within MOE's Personnel Training Department acts as the secretariat to this Steering Committee.

3.51 Various measures aim at strengthening the still weak local capacity for project implementation:

- (i) NBK would engage, through a competitive selection process in compliance with the World Bank's guidelines, the services of a firm with appropriate experience and capability to provide the full range of project implementation advisory services to the three PIUs. These services would initially be provided for a period of one year. Based on loan implementation requirements, the extension of this contract would be subject to the prior review and approval of the NBK and the World Bank, in consultation with SPC and MOE. In the first year, the firm (Consultant) would provide three experts to assist the three agencies responsible for the implementation of their respective sections of the Project, as follows: (i) one procurement advisor, with special expertise in information technology procurement, would be assigned to work full-time with NBK's PIU; (ii) a second expert would be assigned to work part-time with SPC's PIU; and (iii) a third advisor, with special experience in disbursement, would be assigned to work part-time with the PIU at MOE (presently located at NAFI) and would, in addition, assist the PIUs at NBK and SPC in disbursement matters as will be necessary. A senior member of the consultant team would be the Consultant's team leader and would act as the project coordination advisor. The contract with the Consultant would also provide for short-term assistance from their headquarters, especially to help finalize the specifications of specialized computer and telecommunications items. The tender for the project implementation advisors, for the first year of the assistance, would be issued in March 1995, and part of the Consultant contract would be funded under the Project Preparation Facility (PPF). Draft terms of reference are presented in Annex IV.
- (ii) To strengthen the capabilities of local implementation unit staff, Loan funds would be used for short-term training overseas, supplementing training provided on-the-job and through informal seminars by the Implementation Consultant.
- (iii) To ensure effective project implementation, the Bank would conduct a project launch mission after Loan approval, a mid-term review and a final review, as well as additional interim reviews as needed. These reviews would be based on comprehensive Project Progress Reports and a Project Completion Report, written by the three implementation agencies (for their respective components) with support of the Implementation Consultant. Frequent project supervision at limited costs to the Bank would be possible through the simultaneous supervision of related elements of the Technical Assistance Loan and preparation of a planned Financial Sector Adjustment Loan. Moreover, the participating agencies and the Bank would jointly review the findings of any studies and training programs under the Project. (The Supervision Plan in Annex XII provides further detail.)

3.52 In order to prepare project implementation, engage the above mentioned Implementation Consultant, and begin work on a few critical and urgent components, some Project costs could be financed under a Project Preparation Facility (PPF). This concerns the Project components regarding the Rehabilitation Trust, Restructuring Advisory Unit, manager study tours, and implementation assistance. Moreover, there is the option of retroactive financing, as described below.

E. Cost Sharing and On-Lending Arrangements

3.53 The Loan to the Republic of Kazakhstan would be at standard Bank terms for Kazakhstan of a 17-year maturity with a five-year grace period. The Loan would be denominated in the Bank's currency pool and bear interest at the Bank's standard variable interest rate.

3.54 Part of the Loan funds would be on-lent to NBK pursuant to the terms of a Subsidiary Loan Agreement between the Government and NBK, which will contain, inter alia, the terms and conditions of repayment of the funds on-lent. It is envisaged that the subsidiary loan would have a maturity, interest rate, and grace period substantially equivalent to those of the Bank Loan. The on-lending terms will need to be approved by the Bank.

3.55 Under one Project component, the commercial bank development program, Loan funds would be on-lent to commercial entities. The on-lending to participating commercial banks would be done at the terms and conditions specified in Annex III.2(b). These subsidiary loans would be denominated in US dollars, and extend over ten years with a four-year grace period. During Loan Negotiations, it was agreed that any funds accruing to the NBK as a result of the mismatch of maturities would be used either to service the debt on the World Bank Loan or to finance further measures for the development of commercial banks. The interest rate would be equivalent to those on 10-year U.S. Treasury Notes plus 2 percent, adjusted semi-annually. The banks shall bear a commitment fee at a rate equivalent to that paid by the Borrower to the Bank, payable on the undisbursed amount of the Loan and beginning to accrue 60 days after the date of the signature of the respective Subsidiary Financing Agreement. The cross-currency risk associated with NBK's sub-borrowing the currency pool and on-lending in dollars would be covered by NBK. The institutional strengthening sub-component for each bank (i.e., not the automation sub-component) would be funded through a combination of grant funds (for fifty percent of these cost, up to a maximum US\$1.5 million) and proceeds of the proposed Loan.⁶

3.56 Participating local commercial banks would be selected according to a set of pre-determined criteria concentrated on the size of the banks' capital and asset size, their private ownership, their compliance with prudential standards, their commitment to implement agreed institutional and automation development plans, their demonstrating acceptable standards of efficiency, accounting, and managerial autonomy, and their strong interest in the proposed twinning arrangements. Two large, formerly specialized banks would be selected mainly according to their importance to the domestic economy, and to their need and willingness to undergo intensive restructuring programs to address their weaknesses in organization, procedures, and other aspects. An important basis for the selection would be the in-depth diagnostic studies that were undertaken in the ten largest commercial banks in late 1994. The final decision would be taken by the respective bank and NBK, subject to approval by the World Bank. (See Annex III.2(b) for detail.)

3.57 Under several other Project components, commercial banks or enterprises would be beneficiaries but not sub-borrowers. Generally, these beneficiary entities would cover a large part of the local costs. (i) Banks would pay fees for the use of the future payment system, aimed at covering the operating and maintenance costs, and part of the amortization cost. (ii) Enterprises receiving restructuring advice would need to bear part of the local costs. However, these contributions need to be

^{6/} The percentage and ceiling of grant financing will be firmed up on the basis of commitments by donors as they are received. The Government and participating banks are committed to borrow from the World Bank in case the grants do not materialize.

modest and constitute mainly an expression of commitment, since the firms would already be in financial distress. The firms would provide the respective teams of the Restructuring Advisory Unit free of charge with adequate offices, secretarial support, use of communication facilities, and intra-oblast transportation. The enterprises would also be charged modest fees, in local currency, for follow-up advisory services subsequent to the initial viability assessments and in-depth restructuring studies, i.e., for implementation support and follow-up studies. (iii) Enterprises whose managers participate in the study tour program and prior seminars would bear the costs of domestic transport and subsistence of their managers during pre-tour seminars, pay fees covering part of the local costs of training, and bear the local costs of follow-up activities.

3.58 The principles of the financial arrangements (subloan agreements and cost recovery) between state agencies and commercial beneficiaries in the cases of commercial bank development, enterprise restructuring advice, manager study tours, and the payments system have been agreed upon at Loan Negotiations.

F. Procurement

3.59 As briefly outlined below, and as set forth in the Loan Agreement, all goods and consulting services for technical assistance to be financed with Bank Loan funds would be procured in accordance with Bank *Guidelines on the Use of Consultants (1981)* and on *Procurement Under IBRD Loans and IDA Credits (1992)*. A substantial portion of the procurement under this Loan deals with consulting assignments, and a larger portion deals with goods, including hardware and software, chiefly for the Project's payments system and commercial bank development components. The participation of local suppliers of goods and contractors of services is expected to be very limited, since the information technology required as well as providers of the needed consultant services are generally not available locally; contractors are encouraged, however, to make active use of local employees and subcontractors. More details of the main procurement packages and consulting assignments are provided in Annex VIII. The procurement capacity of the NBK, SPC and MOE would be strengthened through on-the-job assistance provided by the Implementation Consultant mentioned above. Reporting on procurement shall be undertaken by the three PIUs with assistance of the Implementation Consultant. Procurement information on the progress of packages relating to the schedule and cost shall be provided to the Bank through quarterly reports (see para. 3.70), and the Bank shall discuss the progress during the supervision missions. Table 3 below provides a summary of proposed procurement arrangements.

Table 3
Summary of Proposed Procurement Arrangements

Project Element	Procurement Method			TOTAL COSTS
	ICB	OTHER	N.B.F.	
(US\$ million equivalent)				
Computer Systems	32.5 ^{/a} (32.5)	2.1 ^{/b} (2.1)	3.6 (-)	38.2 (34.6)
Office and Misc. Equipment	-	0.4 ^{/c} (0.2)	-	0.4 (0.2)
Consultancies	-	27.6 ^{/d} (23.3)	2.4 ^{/e} (-)	30.0 (23.3)
Training	-	2.4 ^{/f} (2.4)	0.3 (-)	2.7 (2.4)
Refinancing of PPF	-	1.5 ^{/g} (1.5)	-	1.5 (1.5)
TOTAL	32.5 (32.5)	34.1 (29.5)	6.3 (-)	72.9 (62.0)

Note: Numbers in parentheses are amounts to be financed by the Bank Loan.
NBF: Not Bank-Financed.

- ^{/a} US\$17.3 million thereof would be a turnkey contract for the payment system computer system that includes also the provision of operation assistance and local training (US\$1.8 million) and external training (US\$0.3 million) by the supplier.
- ^{/b} Includes DC for proprietary computer, peripherals, and software upgrades (US\$0.9 million); LIB for limited-source computer/network equipment and special software (US\$0.4 million); and IS and LS for off-the-shelf items (US\$0.6 million and US\$0.1 million, respectively).
- ^{/c} Includes IS (US\$0.2 million).
- ^{/d} Services shall be procured in accordance with the Bank's *Guidelines: Use of Consultants, 1991*.
- ^{/e} Includes, among other things, local costs of counterpart staff, office space, communication facilities, etc. directly related to consultancies.
- ^{/f} Includes reimbursement of flight tickets and other costs for the manager study tours and other study tours (US\$1.4 million), and trainer services to be procured in accordance with the Bank's *Guidelines: Use of Consultants, 1991*.
- ^{/g} A Project Preparation Facility (PPF) is intended to be used to finance initial consulting activities, training, and minor office equipment.

3.60 **Equipment and Goods.** The procurement of equipment and goods concerns principally the purchase of information processing and telecommunications equipment and software for the payments system and commercial banks development components. (i) All contracts over US\$200,000 would be awarded through International Competitive Bidding (ICB) following the Bank's *Guidelines for Procurement under IBRD Loans and IDA Credits*, dated May 1992, and using the Bank's *Standard Bidding Documents*. It is expected that six contracts be awarded through ICB. For bid evaluation and comparison purposes in ICB procurement, Kazakhstan manufacturers and suppliers may be granted a preference margin of fifteen percent or the existing customs duty that a non-exempt importer would have to pay, whichever is lower, over the competing price of imports, providing domestic value added is at least 20 percent. (ii) Limited International Bidding (LIB) procedures as outlined in Section 3.2 of the Bank's *Guidelines*, and using the Bank's *Standard Bidding Documents*, would be used for an aggregate value of not more than US\$400,000, where automation improvements, such as banking and local area

network (LAN) software, are offered by only a few suppliers and do not justify full advertisement procedures. (iii) For the procurement of specialized information technology equipment, e.g., proprietary operating systems to expand existing bank networks, and computing and telecommunications hardware to continue participating banks' standardization and service/spare parts programs, Direct Contracting (DC) can be done. DC is estimated to involve approximately US\$0.9 million, and shall not exceed a total aggregate value of US\$1 million. Such solicitations would be justified and procedures and prices reviewed and cleared beforehand as required by the Bank's *Guidelines*. All DC documentation, awards, and contracts would be subject to prior Bank review and clearance. (iv) Goods or group of goods with a contract value less than US\$200,000 equivalent, up to an aggregate of US\$0.8 million, may be purchased through International Shopping (IS), by obtaining at least three quotations from suppliers in three eligible countries. (v) Goods or group of goods with a total contract value less than US\$50,000 equivalent, up to an aggregate of US\$0.1 million may be purchased through Local Shopping (LS), based on a minimum of three quotations from three suppliers.

3.61 To ensure compliance with the World Bank Procurement Guidelines, all contracts awarded through ICB, LIB, and DC, as well as the first two contracts under IS, would be subject to prior World Bank review and "no-objection". This will result in Bank reviews for approximately eighty-nine percent of Bank-financed contracts for goods. General Procurement Notice will be issued after Loan Negotiations.

3.62 **Consultant Services.** The selection of consulting firms for the provision of services would be carried out following the *Guidelines for the Use of Consultants by World Bank Borrowers and by the World Bank as Executing Agency*, published by the Bank in August 1981. Contracts will follow the Bank's *Standard Contract Form for Consultant Services*. Contracts and documentation for the employment of consulting firms, estimated to cost less than US\$100,000 equivalent each, and contracts and documentation for the employment of individual consultants, estimated to cost less than US\$50,000 equivalent each, as well as solicitation methods and terms of reference for all consultant assignments, would be subject to the prior Bank review and approval. Other contracts would be subject to the Bank's ex-post review including, where appropriate, ex-post review on a selective basis.

G. DISBURSEMENT

3.63 The Loan would finance: (i) up to 100 percent of the foreign expenditures for imported goods; (ii) up to 100 percent of the local expenditures (ex-factory costs) for locally manufactured eligible goods; (iii) up to 75 percent of the expenditures for other goods procured locally; (iv) up to 100 percent of expenditures (- all expenditures to be financed are net of taxes -) of consultant services and training; and (v) the PPF. It is projected that US\$1.0 million would be disbursed in the Bank's fiscal year (FY) 1995, in part through retroactive financing for urgent activities launched prior to Loan effectiveness. Subsequent disbursements are estimated at US\$28.8 million in FY 96, US\$24.5 million in FY 97, and US\$7.6 million in FY 98. The Project is expected to be completed by March 31, 1998, and the Loan closing date would be September 30, 1998. (A disbursement schedule is found in Annex IX, and an Implementation Plan in Annex X).

3.64 Withdrawal applications would be fully documented, except for expenditures against contracts valued at less than US\$10,000 equivalent, which would be made on the basis of certified statements of expenditures detailing the individual transactions. The documentation to support these expenditures would be retained by NBK, SPC and MOE for their respective Project activities for at least

one year, after receipt by the World Bank of the audit report for the year in which the last disbursement is made. This documentation would be made available for review by the auditors (see section H below) and the World Bank upon request. The minimum amount of application for direct payment and issuance of the Special Commitment will be US\$50,000.

3.65 To facilitate and expedite the disbursement of funds, NBK, SPC and MOE would each establish a Special Account in a commercial bank acceptable to the Bank. The authorized allocation to the Special Accounts would be US\$300,000 for NBK, US\$100,000 for SPC, and US\$200,000 for MOE, representing about four months of average expenditures, respectively, under the Loan. The accounts would be opened in the name of the Borrower and would be administered by the respective authorized representatives of NBK, SPC and MOE on behalf of the Borrower. At the request of the Borrower, and based on the Project needs, the Bank would make an initial deposit or deposits into the Special Accounts up to the amount of the respective authorized allocation. NBK, SPC and MOE would send, on a monthly basis, to the World Bank requests for replenishment of the Special Accounts for the amounts to be transferred. In addition, monthly bank statements of the special accounts which have been reconciled by the Borrower should accompany all replenishment requests. The Loan provides for retroactive financing up to 10% of the Loan amount in respect of expenditures incurred since June 30, 1994, for goods and services procured in accordance with the Bank's practice. Retroactive financing is needed for early project start-up and effective implementation.

3.66 Each Special Account (SA) would be maintained in a commercial bank selected by the implementing agencies and acceptable to the World Bank. Selection criteria for participation are: (i) the bank should be financially sound as demonstrated by its latest accounts, as audited by an internationally recognized accounting firm; (ii) the bank should have a significant foreign correspondence network covering all major currencies; (iii) the bank should have a reasonable capacity and experience for issuing letters of credit, making direct foreign payments, and other international transactions, with appropriate arrangements for the training and development of its staff; (iv) the bank should be capable of performing a wide range of local banking services, including cash payments, transfers to other domestic banks, issuance of debit notes, application of conversion rates from foreign currencies, and maintenance of adequate accounts for the Special Account; (v) the bank should preferably be a member of Swift (Society for Worldwide Interbank Financial Telecommunications) and should routinely use or plan to use this facility to expedite payment transfers; (vi) the bank should be willing to issue a Comfort Letter to assure that amounts deposited in a Special Account would not be set off or otherwise seized or attached to satisfy amounts due to the commercial bank by the Borrower; (vii) the bank should be willing to maintain adequate accounts as required by the World Bank, provide monthly bank statements to the World Bank and the implementing agencies, and any other information considered necessary; copies of all transactions would be routinely submitted to the implementing agencies; and (viii) the bank should be willing to charge reasonable rates for its services and provide reasonable interest on balances held from time to time. The commercial banks to manage the Special Account must be selected prior to loan effectiveness.

H. PROJECT ACCOUNTING, FINANCIAL REPORTING, AND AUDITING

3.67 Accounting. The Borrower would be responsible for the appropriate accounting of the funds provided by the Bank under the Loan, for reporting on the use of these funds, and for ensuring that audits of the financial statements or reports are submitted to the World Bank.

3.68 NBK, SPC and MOE (each on behalf of the Borrower) would establish an appropriate accounting system to process and record information on the proper receipt and use of funds provided in accordance with the Loan Agreement. The system should ensure timely and accurate accounting of all transactions under the Loan and clear presentation of the financial information. NBK, SPC and MOE have established capabilities in project accounting and reporting. However, if deemed necessary by these agencies, an external disbursement adviser can be procured on a part-time basis to support these agencies in order to ensure that all Project accounts are maintained in accordance with internationally accepted accounting procedures.

3.69 The Special Accounts which would be established under the Loan for NBK, SPC and MOE are intended to assist the Borrower with cash flow and to enable early and more effective project implementation and disbursements. The Borrower would ensure that all the necessary arrangements for proper accounting of receipts and payments (and replenishment) are completed before the three Special Accounts start operating.

3.70 Financial Reporting. Financial reporting for the Loan would closely reflect the specific requirements of the Loan. It would be comprised of a statement of receipts and payments for the reporting period since the beginning of the program. The reporting would be in accordance with the disbursements classified and reported by the expenditure categories agreed with the Borrower and spelled out in the legal documents. The suggested format of the report has been supplied at Negotiations. Brief quarterly progress reports would be submitted by NBK, SPC and MOE on their respective Loan component activities. A separate report for the Special Accounts would need to be provided by NBK, SPC and MOE, respectively. NBK, SPC and MOE would submit a Project Completion Report to the Bank promptly after the completion of their program of activities under the Loan, and, in any event, not later than six months after the Loan closing date.

3.71 Auditing. A condition of the Loan would be that the financial statements and reports on the Loan (including the Special Accounts) are audited in accordance with generally accepted auditing standards by independent auditors acceptable to the World Bank. The NBK in consultation with SPC and MOE would procure an experienced and qualified auditing firm through a competitive selection process acceptable to the Bank, and in accordance with the selection criteria indicated below. The auditor would perform the audits required by the Bank on NBK, SPC and MOE, and would promptly submit its reports to the Bank according to the timetable indicated below.

3.72 The criteria for selecting auditors would be as follows: (i) impartiality and independence from the entity to be audited; (ii) being well established and reputable; (iii) experience in the type of assignment to be undertaken; and (iv) ability to fulfill the terms of reference within the specified timetable.

3.73 The audit report is to be submitted to the Bank by the Government within six months of the end of the reporting period, i.e., the fiscal year end. The audit would cover a review of the supporting documentation made available by NBK, SPC and MOE, including appropriate customs documentation.

I. Environmental Assessment

3.74 Since this Project involves the financing only of computer equipment for the financial sector, and of consultancy and training, this is a category "C" Project. The Project would be consistent with Bank policy and would follow accepted Bank procedures. In developing procurement procedures for financing imports, specific provision would be made to ensure that the inclusion of any toxic or hazardous substances would be under conditions acceptable to the Bank.

3.75 Kazakhstan's industry is heavily engaged in mining, metallurgy, and primary chemicals processing. Some of these facilities are major sources of pollution, as was explained in section I.B. above. The critical importance of such large enterprises for entire towns or even oblasts tends to weaken pollution control efforts. At present, this problem is exacerbated by the strains of economic adjustment on enterprise performance and employment, and the weak accountability of enterprise managers. At the same time, concerns about environmental liabilities and uncertainty about future environmental standards and regulations are significant barriers to privatization and restructuring. Therefore, consultancy provided under this Project to the Restructuring Advisory Unit for the restructuring or liquidation of distressed large enterprises would include a sub-component to address environmental issues in this context, as mentioned above in section III.B.1.b and further specified in Annex II.1. The Rehabilitation Trust would, as part of its operating procedures, take the environmental issues thus identified into account in its decisions on funding of restructuring or liquidation, and in the conditions that it imposes in this context on the enterprises. Moreover, commercial banks would be introduced, under their institutional development programs, to environmental due-diligence procedures used in developed market economies.

3.76 This assistance would complement specific assistance already provided to the Ministry of Ecology and Bio-Resources under the Technical Assistance Loan, which supports in particular the ministry's legislative, monitoring and enforcement capabilities. Cooperation with other donor agencies would be sought by the Bank in the further support to the ministry in matters like the review of environmental standards and the strengthening of the management of the Republic's Environmental Fund. This latter Fund could play an increasing role in the financing of environmental pollution control, clean-up, and damages.

J. Benefits and Risks

3.77 Benefits. The Project would support the private sector and Government institutions in accelerating and deepening restructuring in the enterprise and financial sectors that is critical for the success of the Government's policies of economic stabilization and transformation. First, the Project would reinforce enterprise-level adjustment in the real sector. In the process, it would also relieve the burden of the most indebted insolvent enterprises on banks and suppliers; set precedents for liquidation and for tying bad debt resolution to rigorous restructuring of enterprises; build local consulting capacity for enterprise restructuring; enhance the know-how of local company managers; improve corporate governance through privatization; and enable banks to play an important role in enterprise restructuring. Second, the Project would enhance the quality and quantity of banking services, the prudence and financial discipline in banking, and the efficient allocation of credit (including bank lending funded in future by external donors) to viable activities. The payments system component would facilitate financial risk management, reduce the float in the domestic payments system, raise the efficiency and accuracy of payments, and thereby stimulate commercial relations between enterprises.

3.78 The Project would follow up, without loss in momentum, on the Bank's Technical Assistance Project, by helping implement policies and institution-building programs that were assessed and designed under that earlier Project. Enhancing local institutional capacity will still be important in the coming years because Kazakhstan's profound economic transition requires technical capacity of extraordinary nature and extent.

3.79 Risks. In a newly created country undergoing fundamental economic transformation there is an inevitable risk of policy changes and implementation delays, but in Kazakhstan these risks are worth taking in view of the Project's important role for the implementation of critical structural reform.

- (i) The risk of policy changes is common in transition economies. However, the current direction and speed of reform in the financial and enterprise sectors are very encouraging, the country's leadership appears strongly supportive to it, and expressed its commitment under an IMF Standby Agreement and the Bank's Rehabilitation Loan.
- (ii) Potentially, other donors could fund the same or similar assistance on a grant basis and thus replace the Bank funding, resulting in undisbursed Loan funds. However, the grant funding available to Kazakhstan falls well short of the total assistance needs, and close donor coordination during project preparation aimed at identifying those areas which are not envisaged to enjoy adequate grant support, especially due to their nature or scale.
- (iii) Local groups unfamiliar with the international market levels of fees for consultant services in areas like enterprise turnaround, corporate law and banking might regard the proposed use of consultants and trainers as too expensive, compared with local public sector salaries. To the extent possible without compromising the quality of the consultant services, tenders should therefore include firms not only from high-income countries, and encourage the use of local employees and subcontractors. It would also be important to communicate effectively the benefits of the assistance.
- (iv) Delays could occur in project implementation due to limited administrative capacity, unforeseen technical complexities in the information systems being procured, or slowness in preparing, deciding, and implementing particular reform measures closely related to this Project. This risk would be reduced through the establishment of implementation units within the main counterpart agencies; substantial assistance for Project implementation; close supervision to assure that inefficiencies are addressed promptly; and some contractor payments being tied to critical performance milestones.

IV. AGREEMENTS REACHED AND RECOMMENDATION

4.1 Agreements reached at Negotiations include:

- (i) the program of equipment and software purchases, consultancy, and training to be financed under the Loan;
- (ii) the Project costs and the financing plan;
- (iii) the Project arrangements, in particular as regards the role of the project implementation units, their staffing and external support, and the accounting and reporting systems;

- (iv) the arrangements for the appointment of auditors for the Loan; and
- (v) prior agreement with the Bank on the criteria for the selection of trainees, and the composition and procedures of the selection commission, and on the terms of reference of technical assistance.

4.2 Further achieved at Negotiations were:

- (i) agreement on key organizational and operating principles of the Rehabilitation Trust and the Restructuring Advisory Unit, as well as on the criteria for the selection of enterprises to be subordinated to the Rehabilitation Trust, based on the attached concept notes (Annexes II.1 and III.1(a));
- (ii) agreement in principle on the eligibility criteria for local commercial banks to participate in the commercial bank development program under the Project, and on the fact that Agroprombank and People's Bank will only be included in the program if they present restructuring plans that will be satisfactory to the World Bank and will be agreed on by the Government and NBK (see Section III.B.2.b and Annex II.2(b));
- (iii) confirmation of the role and composition of the National Payments Council (see para. 3.50);
- (iv) agreement in principle on the criteria, mechanism, and responsibilities for selecting seminar and tour participants under the manager study tour program (see Annex II.1); and
- (v) agreement on the principles of the financial arrangements (subloan agreements and cost recovery) between state agencies and commercial beneficiaries in the cases of commercial bank development, enterprise restructuring advice, manager tour program, and the payments system (see Section III.E).

4.3 In addition, the Government has:

- (i) adopted satisfactory provisions in the national budget for the first year of operation of the Rehabilitation Trust (see Section III.B.2.a);
- (ii) adopted a Presidential Decree referring to the purpose, nature and scope of activities of the Rehabilitation Trust, and prepared a satisfactory draft charter for the Rehabilitation Trust (see Section III.B.2.a);
- (iii) agreed on the main features of the long-term payment system (see Annex III.4); and
- (iv) created the Project Implementation Units in NBK and SPC, with at least three staff assigned to the Unit in NBK and two staff assigned to the Unit in SPC (see para. 3.48).

4.4 Condition for loan effectiveness is:

- (i) execution of a satisfactory Subsidiary Loan Agreement between the Government and NBK.

4.5 Conditions for disbursement of the Rehabilitation Trust component (see Section III.B.2.a) are:

- (i) The establishment of the Rehabilitation Trust in a manner satisfactory to the Bank, which would include, in addition to a Presidential Decree and a Government Resolution, the registration of its charter and the issuance of appropriate banking licenses by NBK; and
- (ii) the existence of legal and regulatory provisions, satisfactory to the Bank, governing out-of-court settlement of debt claims and necessary for the successful functioning of the Rehabilitation Trust, such as appropriate legal provisions for foreclosure and debt transfer.

4.6 Condition for disbursements under the commercial banking development component (see Section III.B.2.b) is:

- (i) the fulfillment, with respect to a commercial bank, of the requirements regarding the procedures and accreditation criteria, and the terms and conditions of a subsidiary financing agreement between NBK and the respective bank, as set forth in Schedule 1 to the Project Agreement between NBK and the Bank.

4.7 The findings of any studies funded under the Loan will be made available to and discussed with the Bank.

Recommendation

4.8 Having reached satisfactory agreement on the above, the Project is considered suitable for a Bank Loan of US\$62 million equivalent for a period of 17 years, including a five year grace period, at the Bank's standard variable interest rate.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT
STRUCTURE OF THE FINANCIAL AND ENTERPRISE SECTORS

Tab. 1: Employment Structure of the Enterprise Sector 1991-93
(end of year)

Sector	Establishments ^{/a}			Employees		
	1991	1992	1993	1991	1992	1993
	('000)					
Agriculture	4,011	3,948	5,317	1,194	1,158	1,108
Industry and Energy	17,038	15,956	14,999	1,385	1,351	1,195
Construction	2,246	2,294	2,162	674	650	492
Transportation	500	500	500	604	566	497
Communication	5,450	5,219	4,867	89	82	79
Trade, Distribution, Catering	62,391	53,770	50,334	424	409	294
Total ^{/b}	89,636	81,687	78,179	4,370	4,216	3,665

^{/a} Most of these units do not have their own, independent accounting.

^{/b} Not including municipal services, geology, and sundry other services. Moreover, newly created private enterprises are not well covered by these Goskomstat statistics.

Source: Goskomstat

Tab. 2: Structure of the Enterprise Sector, end 1993

Sector ^{/a}	Establish-ments	Employees	Working Capital	Fixed Assets	Fixed Assets per Employee	Persons per Establish.	Share of Total Employees	Share of Total Establish.
	('000)		(T million)		(T '000)			
Agriculture	5,317	1,108	4,033	3,917	3.5	208	30.2%	6.8%
Industry	14,999	1,195	17,575	6,469	5.4	80	32.6%	19.2%
Construction	2,162	492	2,599	725	1.5	228	13.4%	2.8%
Transportation	500	497	2,468	2,126	4.3	994	13.6%	0.6%
Communication	4,867	79	256	199	2.5	16	2.1%	6.2%
Trade, Distribution, Catering	50,334	294	2,499	949	3.2	6	8.0%	64.4%
Total or Average	78,179	3,665	29,430	14,385	3.9	47	100.0%	100.0%

^{/a} Not including municipal services, geology, and sundry other services, as well as many newly created private enterprises.

Source: Goskomstat

Tab. 3: Employment Structure of the Industry Sector 1991-93
(end of year)

Sector	Enterprises ^{/a}			Employees		
	1991	1992	1993	1991	1992	1993
				('000)		
Food Processing	531	533	545	147	146	147
Fuel	53	54	55	101	107	105
Mining	n.a.	289	290	224	232	223
Metal Processing	69	63	68	168	183	183
Machine Building	435	387	357	343	312	272
Chemicals	65	55	132	103	101	91
Wood Processing	233	217	219	51	49	43
Building Materials	270	237	223	1117	114	106
Glass, Ceramics, etc.	12	11	11	5	4	4
Textiles and Footwear	571	311	274	206	144	124
Printing	33	30	32	8	8	8
Power	88	90	89	73	78	85
Subsector n.a. ^{/b}	96	2,534	3,533	31	118	116
Total	2,456	4,811	5,848	1,576	1,596	1,507

^{/a} Units with independent accounting; one enterprise can comprise several establishments.

^{/b} Includes most of the newly created enterprises that are captured by these statistics.

Source: Goskomstat

Tab. 4: Structure of the Industry Sector, end 1993

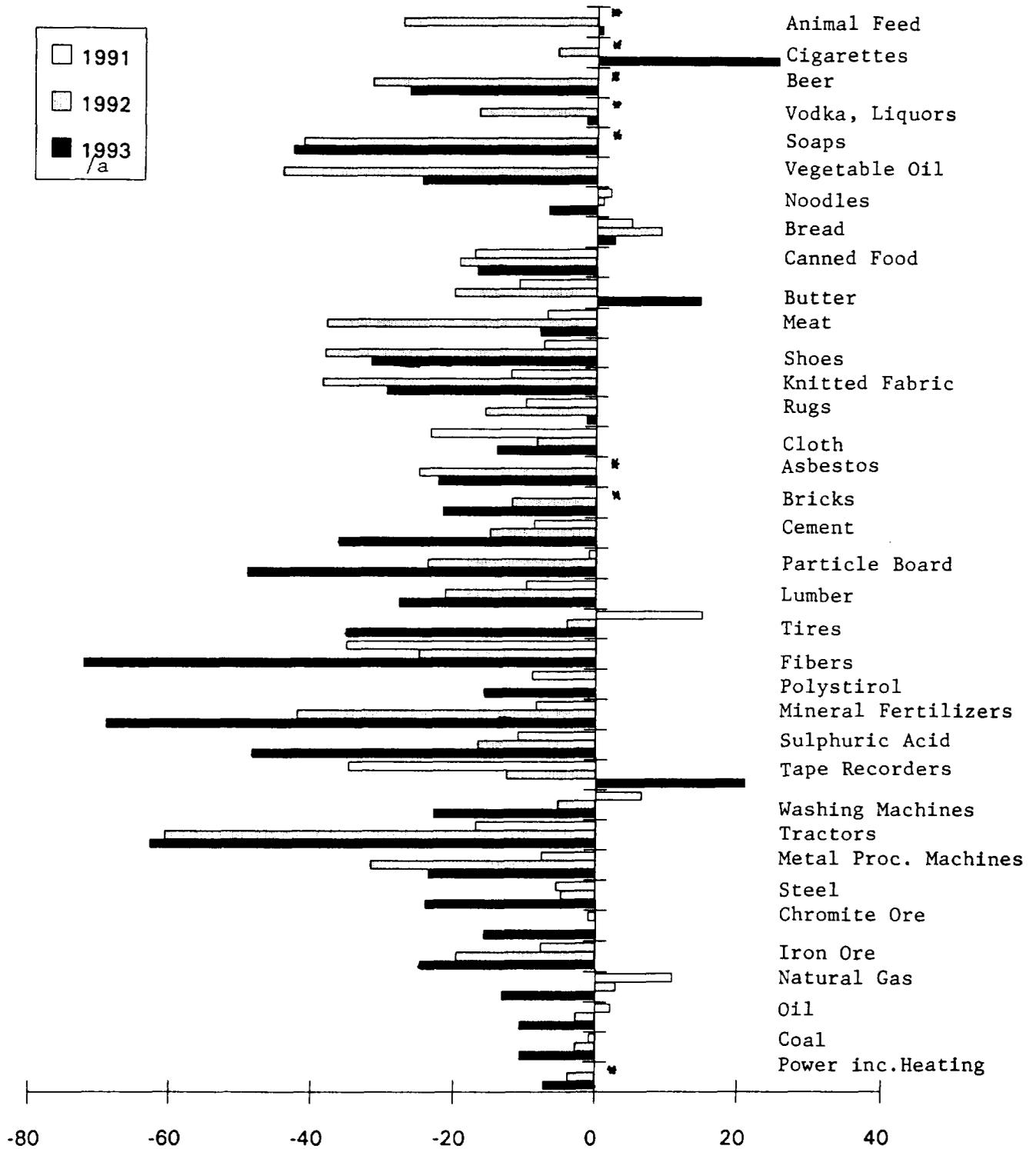
Sector ^{/a}	Enter-prises	Persons	Working Capital	Fixed Assets	Fixed Assets per Employee	Employees per Enterprise	Share of Total Employees	Share of Total Enterprises
Food Processing	545	147	1,721	407	2.8	270	9.7%	9.3%
Fuel	55	105	4,538	1,370	13.0	1,909	7.0%	0.9%
Mining	290	223	n.a.	3,068	13.8	769	14.8%	5.0%
Metal Processing	68	183	4,179	2,136	11.7	2,691	12.1%	1.2%
Machine Building	357	272	1,211	484	1.8	762	18.0%	6.1%
Chemicals	132	91	960	854	9.4	689	6.0%	2.3%
Wood Processing	219	43	129	60	1.4	196	2.8%	3.7%
Building Materials	223	106	492	354	3.3	475	7.0%	3.8%
Glass, Ceramics	11	4	6	6	1.5	364	0.3%	0.2%
Textiles, Footwear	274	124	735	152	1.2	453	8.2%	4.7%
Printing	32	8	19	7	0.9	250	0.5%	0.5%
Power	89	85	2,557	885	10.4	955	5.6%	1.5%
Subsector n.a. ^{/b}	3,553	116	515	54	0.5	33	7.7%	60.7%
Total or Average	5,848	1,507	17,063	9,837	6.5	657	100.0%	100.0%

^{/a} Units with independent accounting; one enterprise can comprise several establishments.

^{/b} Includes most of the newly created enterprises that are captured by these statistics.

Source: Goskomstat

Fig. 1: Changes in the Production Volume of Selected Goods, 1990-93
(in Percent, Change over Previous Year)



* Not available.

/a Figures for 1993 denotes output of January-September, 1993, compared with output in January-September, 1992.

Source: Goskomstat

Tab. 5: Ten of the Largest Banks, June 1994

Commercial Bank	Total Assets <u>/a</u>	Share Capital Issued	Branches	Employees
	6/30/1994 (Tenge million)		6/30/1994	
Agroprombank	20,900	42	235	5,600
Turanbank	16,500	80	85	3,500
Alembank	n.a.	n.a.	24	n.a.
Kredsocbank	4,000	31	33	1,650
People's Bank <u>/b</u>	2,100	125	4,060	16,200
Kramdsbank	2,000	92	36	1,050
Kazcommerzbank	1,850	n.a.	13	550
Igilikbank	1,550	24	110	1,700
Kazdorbank	n.a.	n.a.	20	n.a.
Centerbank	500	10	27	550

/a As per the balance sheets of the banks, without adjustments.

/b Sberbank was transformed into the People's Bank in early 1994.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

RESTRUCTURING ADVISORY UNIT

CONCEPT NOTE

A. BACKGROUND

1. Rapidly accumulating enterprise arrears have been placing extreme burdens on the Budget and impeding the transition to a market economy. An increasing number of enterprises are insolvent, but continue to incur debts without sanction. However, there are few mechanisms to impose financial discipline on the enterprises, differentiate commercially viable and non-viable enterprises, and liquidate the latter. At the same time, faced with rapidly changing, adverse circumstances, enterprises lack expert advice to help them assess their viability and advise them on the means to either adjust and privatize, or liquidate.
2. Recognizing the particularly urgent need for professional advisory services to assist with the drastic restructuring and liquidation effort aimed at the clients of the central debt resolution institution called Rehabilitation Trust, the Ministry of Economy (MOE) is establishing a Restructuring Advisory Unit (RAU). Over time, RAU could engage increasingly also in advisory services for other enterprises.

B. OBJECTIVES

3. Primary objective. The first objective is the provision of professional advisory services to enterprises for the preparation of viability assessments, restructuring plans, and liquidation proposals, consistent with the demands of competitive markets and taking into account environmental considerations.
4. Secondary objective. The second objective is to build local capability for market-oriented advisory services by: (i) training RAU staff, and including local professionals in the RAU's work; (ii) creating and testing replicable approaches for viability assessment and restructuring plans; and (iii) developing local consulting capabilities by issuing consulting contracts that require considerable participation of local experts. By adjusting international best practices to local circumstances and enabling local professionals to use them, the RAU will help build private consulting firms, and can itself at some time be commercialized and privatized.

C. ENTERPRISE SELECTION

5. First priority. All the debts of up to 40 large, distressed enterprises (LDEs) that constitute the largest financial burden for banks, suppliers, and the Budget will be assigned to a debt resolution institution ("Rehabilitation Trust", RT) established by the Ministry of Finance (MOF). The RT will have full financial control of the assigned LDEs, including their settlement accounts. The RT will make any financial support conditional on the submission, by each LDE, of a viability assessment and then a satisfactory restructuring or liquidation plan, and on progress in implementing the plan. The plan needs the advance approval of the RT. (See concept note about the RT in Annex III.1 of this Report)
6. LDEs selected for assignment to the RT will be referred by the RT to the RAU for assistance in developing their viability assessments and restructuring or liquidation plans. RAU will initially conduct brief diagnostic studies (hereafter referred to as "Quick Scan") of these LDEs. The results of the quick scan, combined with other analyses that might be available, will enable the RT to categorize the LDEs, set approximate performance targets and budget ceilings for the firms for the coming years, and prepare terms of references for in-depth restructuring analysis and plans. That in-depth analytical and planning work will

be assisted by the RAU in the case of some 25-30 LDEs (out of the up to 40 submitted to the RT) for which the cause of distress is not mainly state pricing or trade policies, and which may have a turnaround potential.

7. Second priority. The RAU would eventually also help establish viability assessments, restructuring plans, and liquidation recommendations for very large and "special" enterprises subject to case-by-case privatization but not likely to be sellable without some prior "passive" restructuring, and for medium and large enterprises whose shares have not been taken in mass privatization and warrant some "passive restructuring before a renewed privatization effort. The enterprises of this second priority would be referred to the RAU by the State Property Committee (SPC). The number referred would ultimately depend on available resources; it is expected that the RAU would during its first year deal with no more than 4-5 privatization candidates. In later years, RAU may gradually shift its resources towards post-privatization restructuring assistance.

D. OPERATING PRINCIPLES

8. LDEs assigned to the RT. The RT (or, before its existence, MOF) would indicate to the RAU the overall budget "envelope" available for one year to support the total number of LDEs referred. After receipt of the viability assessments, the RT would further indicate a ceiling of its annual financial support for the next three years for each LDE individually. The LDEs would be instructed to keep their restructuring recommendations, to be developed with RAU assistance, within these ceilings. Non-viable enterprises would receive only resources to see them through liquidation.

9. The enterprise assessments and restructuring recommendations must be approved by the RT, and their implementation supervised also by the RT. If the RT does not approve a plan, because it exceeds the respective ceiling or is deemed unrealistic, or if the implementation schedule is not followed, the RT would initiate liquidation. In case of minor deviations, the RT might decide to take other remedial measures instead, like replacement of LDE managers.

10. Restructuring plans would be limited to "passive" restructuring actions, such as establishment of commercial objectives and strategy; corresponding changes in organization, staffing, incentives, financial control, products, and marketing; segmentation and spin-off of non-core activities including most social assets; and debt restructuring. Investment in substantial new assets would be left to private investors and commercial banks. Each restructuring plan should aim at privatization of all or large parts of an LDE as part of the timetable.

11. Plans for partial or total liquidation will include necessary procedures, guidelines, methods, timing, and financial requirements for liquidation. Attempts would be made to agree on voluntary liquidation plans, but the RT could also make formal application to SPC for owner-initiated liquidation, or to the courts for a "proxy" or liquidator to replace existing management under the new Bankruptcy Law.

12. As a general rule, formulation of each restructuring plan shall take not more than 6 months, with the enterprise to be given not more than 24 months to implement it.

13. Case-by-Case and Mass Privatization Candidates. RAU can assist a few such firms in preparing viability assessments and restructuring plans for a minimum amount of "passive" restructuring necessary to facilitate sale (see above). Continued failure to privatize would trigger SPC initiated and supervised liquidation.

14. Post-Privatization Assistance. With time, RAU may direct the acquired expertise and resources to provide advisory services to privatized or private companies, to advise them on improving their operating efficiency, enter new markets, and modernize their plant and equipment.

E. ORGANIZATION

15. Structure. The RAU is being established as an independent unit attached to MOE. The RAU will have autonomous status and its own budget. Its head will be appointed, and subject to dismissal, by Government decision. The RAU will be headquartered in Almaty. The RAU's divisions would probably include: (a) enterprise strategy, organization, and operations; (b) enterprise finance, including cost controls and financial modelling; (c) social assets and labor; (d) environment; (e) legal; and (f) administration. RAU staff would not exceed ten persons, whose main task will be the issuance and supervision of consultant contracts.

16. Project Teams. The quick scans will be carried out by at least two teams working simultaneously on 15-20 enterprises, respectively. Each team will be headed by one of the resident external consultants, and will include two or more short-term consultants, including relevant industry experts, if necessary. The quick scan teams will each include at least two RAU permanent staff, who will be trained on-the-job in the process.

17. After the quick scans, RAU in coordination with enterprise management will form Project Teams for the individual enterprises, or for several enterprises within one subsector. Each Project Team will be headed by RAU permanent staff, and include also RAU's resident external consultants. Each Project Team will organize, support, and monitor the in-depth analytical and planning work regarding the respective enterprise. It will also prepare terms of reference for short-term external consultants to work under the Project Team; these consultants will be procured by MOE.

18. Working Groups. For each firm, the SPC will organize a Working Group consisting of technical experts from the Ministries of Economy and Labor, the relevant branch ministry, and the regional or municipal administrations. The Working Group shall be kept informed of the activities of the Project Team and shall be invited to work directly with it in their respective fields of expertise. The purpose of the Working Group is to provide specific expertise to the Project Team and maintain open lines of communication with the communities and institutions most concerned. However, the Working Group shall not have a right to approve or disapprove any particular viability assessment or restructuring plan.

19. Reporting & Approval. The two quick scan teams will report their findings and recommendations to the RT. Each of the Project Teams will work closely with enterprise management and report to the head of the RAU. Upon completion of a viability assessment or restructuring plan, the head of RAU will approve it and forward it to the LDE for presentation to the RT. The RT will independently approve the plan and supervise its implementation. The RAU may provide advice to the LDE also in the implementation phase. If the RT does not approve the plan, then it may initiate liquidation or take any other remedial action available. The volume of financial support for the LDEs would be the independent decision of the RT, but in any case will be limited to the Budget envelope and enterprise specific limits.

20. For enterprises not under the RT but referred to the RAU by SPC, implementation of plans would be supervised by the SPC unless otherwise agreed with creditors or other owners.

21. Staffing. The RAU headquarters would have few permanent staff, namely, about 10 local professionals. They would be permanently assisted by a core team of about 6 long and short-term foreign consultants. They would be joined in the initial months by 8-10 short-term consultants to assist only the quick scans, and then increasingly by project-specific expert teams; RAU would contract out most of its in-depth analytical and planning work to teams of short term consultants. Arrangements for participation of regional MOE offices in the work of the RAU would be determined as the scope and location of work becomes apparent. They would be engaged primarily in administrative matters such as assisting in contracts and logistics for individual Project Teams working in their region. They would work always under the authority of the RAU head and would need to be trained by the RAU's permanent central staff and consultants.

22. Technical Assistance.

- (i) Initial short-term consultants would help RAU for about 4 months to establish its internal organization and staffing, normative documents, operational and contracting procedures, and information systems requirements; identify legal, administrative, and other barriers to the RAU's work and recommend remedial action; train RAU staff; define core information requirements; develop procedures for the enterprise reviews and plans; and review methods and procedures for voluntary and involuntary liquidations. These initial consultants would be funded under the Bank's Technical Assistance Loan.
- (ii) Long-term consultants would be needed for at least 26 months. They would lead the quick scan exercise; prepare terms of references for the in-depth strategic assessments of selected LDEs; help strengthen RAU's organization and establish its information systems; establish procedures and criteria for viability assessments, restructuring and liquidation plans; train staff; assist in preparing enterprise management for the work; assist in organizing and monitoring expert teams for specific tasks; assist in the preparation, and advise on the implementation, of plans; and advise on the development of liquidation measures.
- (iii) Short-term consultant teams would, jointly with RAU's core staff and advisors, carry out the viability "quick scans" of several enterprises, respectively.
- (iv) Further short-term specialized consultants would undertake most of the work on specific enterprises, in collaboration with the project teams. Costs could be reduced if one group of consultants provided advice to several enterprises in one sub-sector.

F. RESTRUCTURING PLANS

23. Project tasks will be somewhat different in each case. Clearly defined priorities will be established early on in each assignment with enterprise management in order to achieve practical results. The main elements of the work are likely to include: (i) work preparation, (ii) "quick scans", (iii) in-depth viability and strategic assessments; (iv) restructuring or liquidation options; and (v) implementation support.

- (i) Work Preparation. This consists of establishing a working relationship with enterprise management, informing key people (through the management) about the project, and organizing logistics, work timetables and data gathering.
- (ii) Quick Scan. The RT will need to obtain quickly a rough, tentative viability screening of the firms referred to it. Such a check will provide the basis for the preparation of the budget ceilings, and will help draft the terms of reference for in-depth viability and strategic assessments, if deemed necessary. The quick scan should not take more than one or two weeks per firms, depending on size and complexity. The quick scans will be carried out by RAU on behalf of the RT.
- (iii) In-Depth Viability and Strategic Assessment. Such studies typically consider, among other things:
 - * Outputs: Quality and prices of products and services; customer profiles and market forecasts; transport and distribution networks; relative market positions and comparative advantages (locally, within the FSU, and beyond the FSU); state policies that impact on marketing (such as price, export, tax, and currency exchange regulations, trade agreements, and state orders); and risks and opportunities for growth;
 - * Inputs: The quantity, quality, reliability, and relative cost of material inputs; state policies that impact on their availability, price, and use; and purchasing procedures and management;

- * **Organization:** The enterprise structure; management responsibilities, incentives, and accountability; reporting patterns and information systems; and so forth;
- * **Operations Efficiency and Productivity:** Physical production and directly related service facilities; equipment and processes; energy efficiency; level of technology; maintenance; and current and projected capacity;
- * **Social Assets:** Operating costs and problems, investment needs, financing etc. of social assets (such as schools, clinics, vacation facilities, canteens, and various other service facilities unrelated to the enterprise's production activities);
- * **Human Resources:** Labor productivity and incentive systems; labor turnover; redundancies and likely severance liabilities; skills mix and training needs; task allocation; and so forth;
- * **Finance:** Costs (including marginal cost) and profitability by product or service, and overall; patterns of cross-subsidization; return on assets and investments (after adjusting enterprise accounts and reports to more closely approximate international standard); methods of financial controls and reporting; cash management systems; arrears towards suppliers, banks, and other creditors; and receivables and their collection;
- * **Environment and Safety:** Historical and current environmental problems, with a focus on discharges and disposal; costs of clean-up and other remedial measures; allocation of liabilities in case of enterprise segmentation, liquidation or privatization; review of safety standards and related remedial measures; and
- * **Summary Assessment:** Current economic and financial performance; plans of the enterprise for solvency and sustainability; strengths and weaknesses, and risks and opportunities; forecast of profitability and solvency (under different scenarios).

(iv) Restructuring/Liquidation Options. In tandem with the in-depth assessment, restructuring and liquidation recommendations are formed and typically include the following, among other things:

- * **Strategy Definition:** This exercise redefines the commercial objectives of the enterprise in light of the viability assessment. Different scenarios are considered for devising a strategy to achieve the commercial goals, taking into account possible, realistic, near term adjustments such as discontinuation of certain production, changes in inputs, reduction of the work force, termination of cross-subsidies, charging of market prices for social services and government-directed provision of goods and services. Necessary modest improvements are taken into account. Also considered is the impact of the regulatory regime governing the enterprise, particularly where a degree of monopoly power exists.

The strategy definition aims at defining conditions for solvency and financial sustainability. It therefore includes corporate finance modelling taking into account financial ratios necessary for solvency, and cash based analyses of operations and business plans. Based on this modelling, the strategy sets potentially achievable financial performance targets, taking into consideration interest and dividend cover, return on capital, and investments.

- * **Restructuring Actions and Liquidation Recommendations:** Taking into consideration the viability assessment and the strategy definition, recommendations are made for stabilization measures, including the segmentation and privatization, or liquidation, of assets, lines of business or the entire enterprise.

To support these fundamental recommendations, related advice is provided for the following:

- optimum timing, financial requirements and methods of liquidations;
- organizational, technical and financial restructuring;
- measures to increase labor productivity and reduce overstaffing;
- improved information management systems; and
- improvements for marketing, production and productivity improvements that do not require significant investments.

Options will also be provided, with comparative costs, for divestment of social assets or contracting out of their management, and remedies for environmental problems. Where liquidation of assets or business lines is recommended, the timing and method of the treatment of social assets, financial liabilities, and environment problems will indicated in detailed.

- (v) Implementation Support. The RAU could potentially also offer to the enterprises on-going advice on the implementation of particular restructuring or liquidation measures.

G. ENVIRONMENTAL ISSUES

24. Quick Review. Part of the preliminary viability review should be a rough review of: past pollution and the resulting impact and risks to environment and health; current pollution levels compared with standards and considering the location; main sources and reasons of this pollution, including effectiveness of environmental management organization, monitoring systems, state of equipment, material use, spill control, emergency response procedures, etc.; the main possibilities of improved pollution monitoring and reduction, and of eventual clean-up; and the order of magnitude of associated costs.

25. Detailed Analysis and Restructuring Plan. The in-depth strategy analysis of the firm will include a more detailed review or audit of the above environmental factors, with its scope depending on the case (e.g., including preparation of a materials balance for key facilities). It will include also a detailed estimate of the current and investment costs of measures aimed at enhancing pollution monitoring and control at the enterprise (to reach existing or expected standards within a time frame), and the costs and benefits of potential future clean-up, especially in case of liquidation. Priority attention will be given to measures that enhance general efficiency and profitability of the firm (e.g., energy efficiency, material yields, etc.) while at the same time reducing pollution. Timetables and scope for pollution reduction, and especially clean-up, need to consider financial constraints.

26. Privatization. Environmental advisors to the RAU will advise on environmental liabilities and clean-up in the course of privatization of firms assisted by the RAU. It is assumed that GOK will principally assume liabilities arising from past pollution, but may negotiate with investors obligations on his part (as part of the privatization agreement) to undertake specific clean-up measures.

27. Environment Expertise. One member of the core external advisor team to the RAU will be an environmental specialist who will advise on related policy and contractual issues, train RAU staff, lead the environmental part of the quick scans, and help arrange short-term environmental expert teams. The environmental work (including environmental reviews or audits) as part of the in-depth strategy analysis and restructuring planning will be supported by short-term consultant visits.

H. OTHER SPECIAL ISSUES IN RESTRUCTURING

28. Financial Restructuring. The RAU will propose in its plans a menu of debt relief techniques tied to its financial projections. Implementation will generally depend on agreement between owner(s), management and creditor(s). For LDEs under the RT, the RT will review and decide on debt relief measures.

29. Government Imposed Obligations. Government orders to enterprises, e.g., to operate social assets or to provide certain goods or services, will be identified, and their costs to the enterprises quantified. Possibilities of cost recovery through adequate prices charged to users, or through financial compensation by the authorities, will be elaborated, and their financial impact assessed. The relative competitiveness and sustainability of continued provision of the services by the enterprise will be evaluated.

30. Investment. Plans established with RAU's help may include recommendations for new investments, but such investments will not be provided by the RT (except for spare parts). Instead, they are to come from commercial banks once the "passive" restructuring is implemented, or from private local and foreign investors.

31. Privatization. To the extent that the restructuring plans do not provide for liquidation, every plan is to include, or lead to, privatization in full or in part as a priority goal. Opportunities for privatization should be not be disregarded pending implementation or completion of the plans. The privatization would be carried out by SPC.

I. LIQUIDATIONS

32. Voluntary Liquidation. The imposition of a hard budget constraint by the RT (and other creditors) will force a number of enterprises to initiate voluntarily their full or partial liquidations, without the need to initiate legal process. Liquidations recommended by enterprises (with RAU assistance) in their own plans, and accepted by the RAU (and other creditors), or demanded by the RT or other creditors and accepted by a cooperative management, may be undertaken voluntarily by enterprise management under the supervision of the RT, with advice from the RAU.

33. Imposed Liquidation. Liquidations may be imposed by the RT or other creditors, either on application to SPC or by application to the court under law. In either case, the RT (and other creditors) must have the legal possibility to rapidly replace enterprise management with a liquidator/administrator, in order to implement liquidation in a controlled fashion. The RT would need to impose the liquidation, e.g., if the existing management is not willing, capable or trusted to carry out the liquidation. The RT-appointed liquidator would replace management also in cases where a liquidation starts voluntarily but then fails to meet the timetables, or otherwise dissatisfies the RT. The liquidator would have the necessary independent powers and manpower to initiate and supervise the implementation of liquidation, and of other restructuring actions required by the RT.

34. Asset Sale. The sale of assets and business units of the enterprise, both under voluntary and -- upon RT request -- imposed liquidations, could be handled by SPC's relevant departments in charge of privatization, which have substantial experience in the sale of assets and going concerns through competitive methods. Potentially, SPC could consider establishing a special division for the sale of assets of liquidated enterprises. To which extent such a SPC division, or rather RAU, could also advise enterprises on the liquidation-related issues such as labor termination, minority shareholders' rights, contracts, social assets, termination of leases and contracts, and transfers of financial, environmental and other liabilities, needs to be further reviewed.

J. IMPLEMENTATION OF THE RESTRUCTURING ADVISORY UNIT

35. World Bank Support. Starting in March 1995 a short-term consultant will assist the already on-going establishment of the RAU, funded under the Bank's Technical Assistance Loan. Starting in about June 1995, assistance will be provided for the operation of RAU, as specified in the draft terms of reference shown in Annex II.1(b).

I. NECESSARY CONTEXT

36. Economic Context. Successful restructuring requires a certain degree of macroeconomic stability and market liberalization, so that meaningful signals guide restructuring. Both are expected to be the case during the years of the RAU's operation.

37. Enterprise Governance. Enterprises can only be expected to restructure and operate efficiently if they are under effective governance. Clear lines of management accountability for performance to owners (which in initial cases will be the state as represented by SPC, to be followed by private owners after the privatization of the firms as part of their restructuring), and the imposition of a hard budget constraint particularly by the RT, are essential for success.

38. Legal Framework. The new draft Bankruptcy Law is expected to be adopted in the first half of 1995, and provisions for out-of-court conciliation and liquidation are being developed with donor assistance. The latter in particular should be harmonized with concepts embodied in the RT/RAU framework. The legal framework for collateral/pledges, and for property rights and contracts in general, is expected to be strengthened as well in the first half of 1995, especially through the issuance of a new Civil Code.

39. Private Consultant Services. Licensing, tax, and other rules for service professionals should be reviewed with a view to facilitating the emergence of private advisory services.

40. Environment. To be enforceable, environmental standards need to be realistic and possibly in line with international standards, and would best be imposed along a pre-announced timetable that allows existing facilities to adjust to them. The monitoring and legal enforcement capacity of the Ministry of Ecology and Bio-Resources (MEBR) is being strengthened with Bank assistance. Work on the policy framework regarding contingent liabilities from past pollution has started, and would be further advanced through the experience and assistance under this Project.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

RESTRUCTURING ADVISORY UNIT

CORE TECHNICAL ADVISORS TEAM

DRAFT TERMS OF REFERENCE

A. BACKGROUND

1. Kazakhstan's economy is undergoing a transition from central planning, state ownership, closed markets and high specialization to decentralized market mechanisms, private ownership, and open international competition. In the course of this transition, enterprises are now required to take serious measures to adjust to entirely different circumstances. The primary objectives of enterprises under the old system were to increase their production capacity, output and employment. There was little emphasis on return on investment, efficiency or market demand. Enterprises were simply production units that responded to the directives of governmental plans. Enterprise management had little autonomy. Nor was there financial discipline or accountability imposed on enterprises. Investment and working capital were mostly financed from the government budget or loans from the banking system, according to governmental plans, often without effective repayment obligations. Extensive social services further burdened enterprises. Consequently, many of Kazakhstan's enterprises are not well suited for operating in a market economy.

2. The exact financial status and viability of most enterprises are not well known, due to weaknesses in accounting and statistics, high inflation, long delays in inter-republican payments, rapid changes in the economic environment, and other factors. By mid-1994, liquidity became very tight and there has been a rapid growth in payment arrears, severely straining the Budget and impacting output. As a result a large number of enterprises are financially insolvent. This problem is expected to increase as energy prices move towards international levels and interest rates rise towards positive levels in real terms. Yet, so far only limited restructuring and liquidation has taken place.

3. In view of the need for adequate incentives for restructuring, substantial restructuring of enterprises is in principle better left to the new owners after privatization.¹ However, there are several circumstances justifying governmental intervention. One of them is the current situation where the government has become a substantial creditor with little discipline to stop the ever mounting arrears which now also endanger privatization. Restructuring is traditionally driven by creditors with the burden on debtors to demonstrate viability, sustainability and prospects for turnaround. However, the ability of Kazakhstan's enterprises to undertake restructuring design and implementation is hampered by the scarcity of the requisite professional managerial and technical advisory services which have become essential for operating in a market economy.

4. As part of a comprehensive program to address these problems, the Government has formed the Rehabilitation Trust (RT) under the supervision of the Ministry of Finance (MOF) to assume the debts of the largest distressed enterprises (LDEs). The RT, as creditor, is to impose financial discipline on the LDEs,

¹ The share majority of more than 2,000 medium and large scale state enterprises (200-5,000 employees) are supposed to be included in the mass privatization program. These shares will be held directly by the State Property Committee until such time as those shares are transferred to the investment funds that participate in the share auctions (with privatization investment coupons that they mobilize from the citizens). Very large commercial state enterprises (more than 5,000 employees) and state enterprises in certain special sectors like energy and mining/metallurgy will not be included in the mass privatization program but eventually be privatized on a case-by-case basis as soon as the investment climate, privatization implementation capacity, and regulatory environment permit.

liquidating them, unless they can convince the RT that they are economically viable and financially sustainable in a competitive market environment. The RT has required each such LDE to provide it with a viability assessment and restructuring or liquidation plan, designed to sustain or liquidate the enterprise within the limits of a strictly defined budget "envelope".

5. To satisfy enterprises' needs for professional advisory services, the Ministry of Economy (MOE) has established the Restructuring Advisory Unit (RAU). The RAU is an independent unit attached to the MOE. The RAU has been asked to give its first priority to providing advisory services to LDEs assigned to the RT. The RAU's other, minor, task is to support the privatization programs of the SPC through pre-privatization advice to enterprises. A full description of the objectives, priorities, structure and tasks of the RAU are set forth as an annex hereto, which is an integral part of these Terms of Reference (TOR). A description of the RT is set forth as a further annex to these terms of references for informational purposes.

B. PROJECT OBJECTIVES

6. The primary object of this Project is to assist the RAU provide professional advisory services to enterprises in satisfaction of RT requirements. The second object is to train RAU staff and build capacity for market based advisory services.

C. ASSISTANCE STRATEGY

7. The contract will be awarded to one company ("the Consultants") to provide the RAU with a Core Team of four full-time, resident, long-term consultants as well as two to three short-term consultants to work directly with the RAU for a period of 14 months, commencing in approximately May, 1995. The long-term resident consultants will include three enterprise restructuring experts, including one with extensive legal training and experience, and one environmental specialist. The resident consultants will be supported, especially during critical strategy development phases of the project, by a non-resident senior restructuring expert. Other institution strengthening experts, such as management information system specialists, will be used on an as needed basis.

8. Immediately after the start-up of the project, the Core Team will lead the quick diagnostic review (hereafter referred to as "quick scan") of LDEs designated by the RT. It is expected that approximately 30 LDEs will be included in the "Quick Scan" exercise. The level of effort would not exceed about three person-weeks per LDE and should be completed within six months. It is thus expected that two teams will simultaneously carry out the "Quick Scan" at designated LDEs. Each team will be lead by one of the long-term resident advisors and will include additional short-term consultants and industry experts. Each team will also include at least two RAU staff, who will both assist the team and receive on-the-job training.

9. The external experts may be backed up, as required, by their home offices, but the assistance strategy is to provide the RAU with a team of highly qualified, long and short-term consultants performing their work in Kazakhstan, thus providing continuity of assistance on site. One of the three long-term consultants will be an environmental specialist. It is understood that the consultants may need to draw expertise from one or more specialized firms. The Consultants are therefore encouraged to combine with other consulting firms as necessary.

10. It is expected that at the end of the term of the contract awarded under these Terms of Reference, another contract will be awarded to continue a Core Team for another term of one year. The precise terms of reference for the follow-on contract will be determined according to the progress and needs of the work.

11. The Consultants will coordinate with other consultant teams under the World Bank's various assistance projects who will deal concurrently with strengthening the SPC and the legal and policy foundations for the case-by-case privatization of very large and special enterprises; assisting in the mass privatization program; enhancing state enterprise governance; enhancing the regulatory and foreign investment framework generally and the mining sector in particular. The Consultants will liaise with a team of consultants undertaking pilot restructuring exercises for the Karaganda Metallurgical Combine and the Achysai Polymetallic Combine and also with EU-TACIS, USAID and EBRD funded consultants working on the restructuring and privatization of some very large enterprises.

D. COUNTERPARTS AND IMPLEMENTATION ARRANGEMENTS

12. The counterpart is the RAU attached to MOE. In their work on individual enterprises, as well as the related skill transfer, the Consultants will also enjoy logistical and administrative support, as well as specific advice on local circumstances, from staff of the relevant oblast-level economic departments, which in these particular tasks shall work directly under the authority of the RAU head and RAU's leader of the specific project.

13. In their practical case work and skills transfer, the Consultants will work closely with enterprise management and, as directed by the RAU, with staff of other institutions concerned with particular cases. The collaboration with counterpart personnel should help reach consensus on the enterprise analysis and restructuring and liquidation recommendations.

14. A Project Implementation Unit (PIU), located in MOE (currently within the National Agency for Foreign Investment, NAFI), will be responsible for supporting procurement, contractual and logistical arrangements, as well as for disbursements.

E. ACTIVITIES AND OUTPUTS

15. The Consultants will have three main tasks, listed below in order of priority:

- (i) assist the RAU in meeting its objectives and priorities (as described in detail in the attached concept note), by organizing, carrying out and supervising the provision of professional advisory services, limited to the assisting LDEs in satisfying the RT's requirements for quick scans, in-depth viability and strategic assessments, and restructuring and liquidation plans;
- (ii) train RAU, enterprise staff, and as feasible also staff of MOE and SPC involved in liquidation or restructuring, in the goals, techniques, methodologies and implementation of viability assessments, restructuring and liquidation exercises; and
- (iii) develop replicable models, case studies, written manuals and commentary on viability assessments, restructuring and liquidation exercises.

16. Responsibilities and duties of the Consultants under the first and second tasks would include assisting the RAU as follows:

- (i) carry out the quick scan (as defined in the attached concept note);
- (ii) assist in the preparation of terms of references for in-depth viability and strategic assessments, combined with restructuring and liquidation plans; and offer assistance and guidance to the short-term teams carrying out this in-depth assessment and planning work;

- (iii) review the list of enterprises referred to the RAU and determine which economies of scale can and should be achieved by combining certain of them for analysis by one single Project Team. It is possible that a large number of LDEs may be referred to the RAU, almost at once, early in the Project. The Consultants should assist RAU in combining groups of them by sub-sector, size, location or other characteristics in order to reduce the number of Project Teams and related contracts to a manageable, but still efficient number;
 - (iv) assist in the preparation of the enterprises for the work, working with enterprise management, establishing a likely timetable, and collecting the data needed for inclusion into tenders for the Project Team consultants;
 - (v) prepare terms of reference for each Project Team, including consideration of the required Team skill mix and applicable budget constraints, and also preparation of the necessary information memorandum for bidders;
 - (vi) supervise management of Project Teams, including participation as Team Leader in certain cases as RAU deems appropriate, in the implementation of the viability analyses and restructuring and liquidation recommendations;
 - (vii) prepare critical paths and scheduling of the Project Team tenders and their work plans, including monitoring of their performance and timeliness of deliveries;
 - (viii) plan and implement office and management systems necessary for the RAU to efficiently manage and monitor the Project Team work. Some of the necessary systems would include:
 - * compilation of all legislation, regulations, decrees, opinion letters from local and foreign counsel;
 - * an information database on enterprises referred by the RT and SPC;
 - * a "case book" and "file box" whereby all relevant documents and computer discs pertaining to a particular enterprise would be maintained together;
 - * a system to efficiently monitor conclusions and rationale and recommendations of the Project Teams;
and
 - * a backup system for all critical documents and electronic data.
 - (ix) assist in development of specific viability assessment, restructuring and liquidation recommendations. This work includes development of techniques, methodologies, procedures, and means of implementation based on international best practice and consistent with the legal, social, environmental and economic conditions prevailing in Kazakhstan. It is envisaged that the establishment of these assessments and recommendations address the main elements listed in detail under the heading "Tasks" in the attached concept note for the RAU.
17. In connection with the Consultants' second task, the local learning experience should be multiplied through the following arrangements:
- (i) The analytical work shall be conducted jointly with enterprise staff;

- (ii) the main methodology and other lessons on the formulation of viability assessments, restructuring and liquidation plans learned from particularly instructive cases chosen by the Consultants, shall be documented, and translated into Russian;
- (iii) in the course of their work, Consultants team members shall conduct informal training sessions on the methods and issues of the particular work, as well as on enterprise restructuring in general. The total number of days of such training, commensurate with the limited funding of the project, shall be indicated in the Consultants' proposal; and
- (iv) the Consultants will give a formal presentation of their reports to, and discuss them with, the officials of the RAU, the RT, and other agencies or creditors concerned, and the enterprises' management.

F. REPORTING

18. The Consultants will first submit an inception report to the RAU and the World Bank for approval, within one month after the agreed starting date of the assignment. The inception report would, inter alia, refine the proposed methodology and project timetable; clarify information requirements that the authorities and the enterprises need to satisfy to permit the studies; and report on any problems encountered or expected, and remedies taken or proposed. At the end of month three, the Consultants will submit a brief progress report; it will list past and planned activities, outputs, and inputs, and report problems encountered and remedies introduced or proposed. At the end of the assignment, the Consultants will submit a final report that lists all the activities, output, and inputs of the Consultants and summarizes the main practical problems encountered in carrying out the assignment. These three administrative reports -- interim, progress, and final report -- shall be submitted to RAU and MOE in one English and two Russian copies, respectively; to the World Bank in two English copies; and to further agencies or the RT as seen appropriate by the Consultants and the RAU.

19. The substantial findings and recommendations for each enterprise shall be documented in a technical report. Each report will each include two parts: viability analysis and restructuring/liquidation recommendations. Detailed enterprise-specific information shall be presented in separate annexes, to facilitate safeguarding confidentiality. Each technical report shall first be submitted in draft final form to the RAU and the World Bank for comment. The finalized versions shall then be submitted in one English and two Russian copies to the LDE or enterprise, and two English copies to the World Bank.

G. CONSULTANT QUALIFICATIONS

20. The Consultants will be selected on the basis of their proposal (including also the training activities), the qualifications of the firm, and the adequacy of the team members including the project manager. Team members should have extensive proven expertise in enterprise restructuring, with a substantial exposure to the industrial sectors in formerly socialist economies, especially Eastern Europe and the CIS. At least one member will have extensive, practical experience in liquidations, another should be a management specialist, and both of these should have corporate finance experience. A third will be an environmental specialist with extensive experience in managing environmental audits and contacts concerning experts qualified to make technical and cost assessments of damage, clean-up, remedial and prevention measures. Experience dealing with social assets in transitional economies would be useful. Russian or Kazakh language facility would also be very useful for the assignment.

H. INPUTS AND FUNDING

21. The consultant contract will cover:
- * fees including overhead;
 - * consultant travel, accommodation, and living expenses;
 - * project-related communication, report distribution, and office supplies;
 - * translation, interpretation, English and Russian language secretarial support; and
 - * a contingency of about \$100,000 that can be used flexibly with agreement by the Consultants, RAU, MOE, and the World Bank.
22. The Government will make available to the consultants:
- * assistance in the arrangement of housing, hotel rooms, visas, and travel;
 - * data and legal texts as requested by the consultants and required for carrying out their assignment;
 - * adequately furnished office space with telephone facilities, as well as easy access to photocopy and facsimile services.
23. The contract with the Consultants shall amount to no more than US\$2,300,000.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT
STUDY TOUR PROGRAM FOR ENTERPRISE MANAGERS
CONCEPT NOTE

A. BACKGROUND

1. The Republic of Kazakhstan suffers from a scarcity of modern management and marketing capabilities in both production and service enterprises, stemming primarily from a legacy of isolation and lack of contact with world markets. Over the past seventy years, the socialist command system, together with a bias towards military production and capital goods rather than consumer goods, have created rigid patterns of management practice that are not well suited to a more flexible, market-oriented environment. At the enterprise level, many managers were in the past accustomed to focus on the management of physical production and the procurement of inputs, rather than on market-oriented tasks like corporate strategy planning, product development, market research, marketing, financial management, and so forth.

2. A modern market economy requires building the knowledge by all market participants of a wide variety of implicit and explicit rules and procedures that enable a market economy to function. It also requires an array of institutions that facilitate the smooth functioning of these markets. This "market infrastructure" of capabilities and institutional experience that together make up the organizational backbone of a market economy has taken decades to develop in the Western market economies. The Republic of Kazakhstan, however, lacks much of this experience, and lacks the time needed for know-how to develop in a slow, incremental fashion. This learning process is further complicated by the demands of managing short-term crises during the country's transition phase.

3. To effectively jump-start the process of development of market-supportive capabilities and institutions, some mechanisms may be more effective than others. Many managers and support institutions in Kazakhstan lack exposure to modern management, production and marketing practices, and to the operation of market-supportive institutions. Formal training courses and seminars are effective mechanisms to transfer some types of information, but certain aspects of the functioning of a market economy can best be transferred by having people see for themselves what works. Study tours, if very rigorously organized to meet specific needs, can be an effective training mechanisms for this. After the Second World War, the United States invited many thousand enterprise managers from Western Europe to rigorously designed study tours of companies in America. This mechanism accomplished a rapid, wide-scale, and effective transfer of modern business know-how. For the former Soviet Union countries whose enterprise managers, similar to Western Europe after the War, are well educated and experienced but lack exposure to international practices, this model promises to be very useful.

4. On a pilot basis, two first study tours have taken place in June 1994 with funding by the World Bank and in collaboration with the Ministry of Economy, after an initial seminar hosted by the Government's Institute for Improvement of Professional Skills and organized by the World Bank's Economic Development Institute (EDI). One tour brought about 15 garment industry managers for 4 weeks to Taiwan, and the other tour took 15 fruit and vegetable processing industry managers to the United States. The preparation and conduct of these tours have provided useful and encouraging experience. Expanding the scope of the tour program several-fold, and raising its cost efficiency, calls for some changes of the initial arrangements that are incorporated in this text. With those adjustments, the program could be funded for about a year starting in spring 1995 by the proposed Financial and Enterprises Development Project of the World Bank and supported by business organizations in the host countries, and further expanded with the funding of other donor institutions.

B. OBJECTIVES

5. The longer-run objective of this project component is to have a rapid and sustained impact on the enterprise sector of Kazakhstan's economy. It attempts to do so by transferring a wide range of know how, and creating catalysts for market-oriented change at the enterprise level and in key market support institutions. The know how would relate mainly to business management and enterprise operations, but also to market organization and government policies. The impact would be multiplied through systemic dissemination and follow-up efforts within Kazakhstan.

6. About 160 managers of enterprises and support institutions would directly participate in the tours under the Project. In the process, it would allow to further fine-tune the methodology, and test the organizational arrangements in Kazakhstan and the host countries. Having a well-proven approach and experienced institutional partners should make attracting funding for further tours from other donor institutions, beyond 1995, easier. Moreover, Kazakhstan's experience with the program would also help other CIS countries replicate the study tour model.

C. ASSISTANCE STRATEGY

- (i) Nature of the Tours. Critical for the success of the program is the intensity of the learning experience of the participants, and the wide multiplication of this experience in Kazakhstan. This requires that the tours be preceded by specific seminar training in Kazakhstan; be well prepared and densely scheduled; involve continuous discussion and written reflection of findings while in the field; involve all participants in disseminating their findings through writing of joint reports, conduct of seminars, and other means; and involve further follow-up activities in the longer term in collaboration between the participants and program institutions. Also important for direct future application of the acquired knowledge is the team approach. In order to participate in the program, the enterprises will have to propose qualified managerial teams of 2-3 people. The selection for both the in-country seminar and the study tour will be based on the principle that the team-average score is the qualifying factor.
- (ii) Host Countries and Sub-Sectors. The program will send carefully selected individuals from Kazakhstan to more developed countries in North America, Western Europe and/or the Far East. The final country selection will largely depend on the cooperation of adequate host organizations, but also on travel costs and on the characteristics of the respective economic sub-sectors. The economic sub-sector will be chosen by the Steering Committee in agreement with the host country institutions and the World Bank. The main selection criteria should be the likely impact study tours will have on the sub-sectors; highly monopolized or regulated sub-sectors such as public utilities would be avoided. The sub-sector selection will take into account host country arrangements, if applicable. The general program for each study tour, and principles underlying any necessary last-minute modifications, will be proposed by the host country institution, subject to the approval of the Steering Committee and final review of the World Bank.

In the event that host country institutions choose to play limited roles, consultants will be retained to assist in the design, organization and management of the study tours.

- (iii) Number of Tours and Participants. The World Bank Project itself would support 10 study tours with about 16 tour participants each, thus totalling some 160 tour participants. The pre-tour seminars would involve about twice this number of persons, i.e. about 32 trainees for each of the ten seminars. As a rule, each enterprise selected to participate would send 2-3 people to attend the pre-tour seminar. The tour participants would be selected from among those seminar participants.

In addition to the trainees themselves, the tour team would include one or two interpreters with strong language and secretarial skills. It could also include one technical writer with foreign language skills and relevant industry background, who would assist the compilation of the team reports in publishable form. Furthermore, most tours would include one further person, either staff of the Tour Program Secretariat (TPS), a staff of another Government agency, or a trainer from the participating local training institutions; this shall enhance their effectiveness in tour program management and training. The total number of tour participants from Kazakhstan would therefore be a maximum of 20.

The tour team would be accompanied in the host country by an external consultant and/or staff of the host country institution.

A key feature of the program is its emphasis on widespread dissemination of these participants' findings to other managers in their sub-sectors, to multiply their new know-how in Kazakhstan. Moreover, the tours would lay the basis for a larger number of further tours funded by other organizations. Thus, the total number of tour participants might exceed the above 160 in this Project's one-year period, and might expand in subsequent years.

- (iv) Trainees' Background and Qualifications. The program aims mainly at managers of medium and large enterprises, and of some rapidly growing new enterprises, who have the proven capability and decision-making authority to introduce changes in their organizations based on what they know and learn. Some preference will be given to private or privatized companies. Also included in the tours could be a maximum of two staff (per tour) from institutions that are most critical in supporting the transition to a market economy, such as training, research, and policy-making institutions. Each study tour would concentrate on one single economic sub-sector, such as the pilot study tour in the garments subsector in mid-1994. The sub-sectors could be from the industrial (including agro-business) and service sectors, including sectors that provide professional business services like market research or advertising to other enterprises.
- (v) Trainee Selection. The trainee selection would follow a two-step process: Selection to the pre-tour seminar, and selection from there to a study tour. The participants of the pre-tour seminars would be selected according to the following mechanism. The planned seminar and tour for a sub-sector would be widely publicized through the media like local business journals and newspapers but also radio and possibly television, through public offices, and through information given to enterprise unions and similar associations; the objective of the marketing will be to indiscriminately reach all enterprise of the chosen subsector. The announcement would include the fee charged to enterprises for each participant for the pre-tour seminar, and the selection criteria in case that the number of interested enterprises and applicants for the seminar exceeds the available space. The selection will be undertaken by the training institutions in collaboration with the consultants/trainers based strictly on the published criteria. The selection criteria would mainly be objective ones that can be easily measured.¹ These criteria will be

¹ The scoring criteria for selection to the pre-tour seminar have been tentatively agreed as follows:

- (i) Number of staff (>500: 10 points; 200-500: 5 points; <200: 0 points)
- (ii) Rapid growth of the company (growth of employees during 1994 >50%: 5 points)
- (iii) Share of output from the tour sub-sector in total output (>51%: 10 points)
- (iv) Location (outside Almaty City and Almaty Oblast: 5 points)
- (v) Management level of team member (high: 10 points; medium: 5 points)
- (vi) Length of professional service (>5 years: 10 points; 2-5 years: 5 points)
- (vii) Education of team members (tertiary: 10 points; secondary: 5 points)
- (viii) Age (<35 years: 10 points; 35-55 years: 5 points)
- (ix) Foreign language proficiency (English or host country language: 10 points)
- (x) Initial summary business plan (submitted: 10 points).

agreed on in principle upon negotiations of the World Bank Loan, and approved in detail by the Steering Committee in agreement with the World Bank. As a basis for this selection, the applicants would submit their resumes, descriptions of their firms, and brief tentative development plans for their enterprises. The selection will be made based on the team-average scores. The proposed team from each enterprise will number no less than two and no more than three people.

The tour participants will be selected from among the seminar participants strictly according to a set of further pre-determined criteria developed by TPS in discussion with the World Bank and the local training institutions, and approved by the Steering Committee and the World Bank. These selection criteria will relate mainly to the qualification of the seminar participants as demonstrated by the seminar performance. The evaluation will be done by the seminar trainers. It will be critical that unqualified candidates not succeed in entering the tour teams despite influences that might be exerted on their behalf. Again, the selection principle will be team performance.

7. Program Evaluation. To ensure maximum effectiveness of the study tour program in the longer run, the experience and learning results of the tours need to be carefully reviewed, lessons drawn, and adjustments made to the approach, organization, and procedures. For this purpose, a mid-term review shall be carried out after the first four or five tours, and a final review after the tenth tour. The reviews would involve, among other things, interviews, questionnaires, analysis of dissemination and follow-up activities, and so forth. (The impact on the participants' enterprises and on their sub-sectors, by contrast, could be reasonably assessed only quite some time after the tours, however.) The evaluation would be prepared by the Tour Program Secretariat with assistance by consultants, and reviewed and discussed by the Steering Committee and all institutions involved, including the World Bank.

8. Related Activities. Naturally, an increasing number of managers and government officials from Kazakhstan have been visiting foreign countries on official and business travel. Moreover, some bilateral donors like USAID and the German Carl Duisburg Foundation have been inviting managers for short study tours or more extended traineeships. However, these travels are usually one-time events rather than part of an extensive program for Kazakhstan, and they do commonly not include the kind of rigorous unified procedures and intensive preparation, follow-up and dissemination efforts envisaged under this Project. As to the World Bank, it envisages funding under an already existing Technical Assistance Loan ten 2-6 months internships for managers starting in early 1995, as a way to test further, additional modes of overseas training.

D. INSTITUTIONAL ARRANGEMENTS

9. The institutional arrangements would include several elements, the details of which remain to be determined.

- (i) A Steering Committee should be formed. It could comprise equal numbers (one third, respectively) of (a) representatives from Government agencies and/or ministries, including not only the Ministry of Economy (MOE) and possibly also a representative of the Presidential Apparatus; (b) representatives of some business associations or unions, and (c) participants of the first two pilot study tours that took place in June 1994. The Steering Committee would oversee the program; provide direction on the detailed features of the program consistent with the agreements with World Bank and other donor institutions; and help mobilize support from host country organizations and other donors. The Steering Committee would not be directly involved in the implementation activities of the program, such as the selection of participants.
- (ii) Implementation Unit. The study tour program could be coordinated by a Tour Program Secretariat (TPS) under Department of Training Personnel for the Market Economy, under the Ministry of

Economy. The TPS would be responsible for the overall coordination of the program; contractual arrangements with external consultants and trainers; the logistical arrangements of the tour travel out of Kazakhstan; and the mid-term and ex-post evaluation of the program.

- (iii) Local Training Institutions. The Kazakh Management Academy will most likely be the local training institution contracted by the Government to organize and carry out the in-country seminars, including marketing of study tours and the selection of candidates, and the follow-up activities. It would provide all the physical facilities for training and accommodation of the trainees and trainers; provide at least two highly qualified local trainers for the seminars, with prior experience in similar training carried out by EDI; jointly with the TPS plan and advertise the training seminars and related study tours; and be responsible jointly with the external consultants and trainers for the selection of seminar and tour participants. The Academy will allocate two qualified staff full-time during the duration of the Project, and will be provided with necessary office equipment under the World Bank Loan.
- (iv) Host country institutions. One or several foreign host country institutions would arrange the company visits; support the logistical arrangements within the host country; and provide experts to accompany the tours. They could also be involved in the pre- and post-tour activities in Kazakhstan. The visited enterprises would be expected to make high-level managers and experts available for discussions with the study group, and in the process transfer management and operational know how to the visitors, free of charge. It is therefore important that the host country institutions have good contacts with the enterprises in the respective economic sub-sectors. Potential interest in participating in the tour program has been expressed, for example, by the International Chamber of Commerce and by the European Association of National Productivity Centers, both of which have national member organizations in many developed countries. Some of their national organizations themselves, such as the German productivity center (called Rationalisierungs-Kuratorium der Deutschen Wirtschaft, RKW), have also directly expressed strong interest.
- (v) EDI. The World Bank's Economic Development Institute (EDI) would provide guidance to the seminar activities through the provision of training materials and the provision of EDI staff as resource persons at some or all of the seminars. EDI has also been training CIS citizens as management trainers who could be engaged as resource persons at the seminars.
- (vi) Consultants. Foreign consultants would participate as trainers in the seminars; in this context help select the seminar and tour participants. If necessary, consultants will also help arrange the enterprise visits overseas; accompany the tours; and potentially be involved in some of the follow-up activities after the tours. The foreign consultants may also provide advice to the Kazakh Management Academy and TPS in their activities. The extent of the consultants' involvement could be reduced if foreign host country institution(s) chose to play an active role in seminar and tour activities.

E. ACTIVITIES

10. The main activities would be the following:

- (i) Pre-Tour Seminars

Several weeks before each tour, a 7-10 days seminar will be held at a local management training institution in Almaty. There would always be two such seminars at the same time, allowing the same consultants/trainers to teach both seminars in parallel. To further reduce the costs of consultant/trainer involvement, two pairs of seminars could be held back-to-back.

The seminars would be hosted by one or two local institutions. They would provide the training facilities; arrange (or provide in-house) accommodation and catering for the participants; assist with the advertisement of the seminars and tours; take the lead role in selecting the seminar participants; provide some local trainers to the seminars; and evaluate seminar participants for selecting among them the tour participants.

Each seminar would involve two foreign consultants/trainers. Some of them could potentially be CIS citizens who have earlier gone through the full cycle of EDI's training-of-trainers program. EDI itself would try to provide one staff to each round of seminars.

Each seminar would have about 32 trainees from up to 16 enterprises, out of which 16, from up to 8 enterprises would then be selected for the study tours. The seminars would be conducted in Russian and English, with interpretation provided in part by those interpreters who would subsequently accompany the tours. The technical writers who would join and support the tours would participate in the training seminars as well.

The pre-tour seminar would provide training in the main fields of business administration, with a focus on the respective economic sub-sector of the participants. In the course of the seminar, the participants would continuously improve the business development plan for their enterprise, the first outline of which they would have submitted as part of their seminar application. The selection of the tour participants will be based to a large extent on the quality of the business plans emerging by the end of the seminars. During the tours, the tour participants would continuously further upgrade their business plans.

(ii) Study Tours

The study tours themselves would last for an average of 4 weeks. A tour team would visit one country, or several neighboring countries. The enterprise visits would be for one to three days each. The participants would meet with the host enterprise management; have extensive discussions with technical experts of various departments of the host enterprises; visit the plants and office facilities; and possibly also meet some of the firms' suppliers and clients to better understand the market relations within the industry. Visits to relevant Government agencies and support institutions could also be included.

The tours would be highly structured. Every evening, the participants would meet to discuss their findings. At various stages, the participants would produce memoranda and draft small reports. Each participant could be assigned specific tasks during the tour, so that the team cover the entire subject matter. At the end of the tour, the participants together would produce a comprehensive report about their findings for dissemination to other enterprises in Kazakhstan. The technical writer accompanying the tour would support the writing process; so would the external consultants on the tour.

(iii) Dissemination of Findings, including Post-Tour Seminars

On their return, each team would finalize substantial technical report, plus potentially shorter specialized papers, on feasible recommended changes in their sub-sector, based on their tour experience. The writing of these papers and sections of the technical report will be organized at the beginning of the study tours so that each participant clearly understands what his or her individual contribution should be. The TPS with support by the local training institutions would oversee the publication and distribution of these reports. Team members also would give series of seminars in different regions of Kazakhstan about their observations and conclusions to enterprises or institutions of their subsectors, with the assistance of the TPS and potentially the local training institutions. Displays of information materials and small product specimen collected on the tour, videos of factories visited, could enhance the seminar success.

Participants from institutions other than enterprises might be required to agree contractually to continue working at their institution for at least one year after the tour. Moreover, all participants would be contractually responsible for specific post-tour activities to disseminate their findings.

(iv) Follow-up Technical Services

The TPS with support of the participating host country organizations would arrange for follow-up services recommended by the study tour teams. Services likely to be of high value might include the provision of translated technical materials or summaries thereof; visits to participating enterprises by host country experts for follow-up advice; the provision of data on the operational and financial performance (especially on labor and energy productivity, standard work loads, etc.) of average and "best practice" enterprises in host countries, as reference points for productivity improvements in Kazakhstan; and the establishment of a library of practical industry and trade journals. Moreover, each tour team should meet a year after their tour for exchanging their experience in the implementation of findings. Their cooperation during the tour might also trigger the establishment of permanent sub-sectoral structures like specialized trade associations or research and development consortia. Some of these follow-up activities could be funded by the Government from the World Bank Loan within the overall amount allocated to this Loan component; some other activities would rely on host country support.

In the longer run, the provision of follow-up technical services, and indeed the implementation of the continued tour program itself, might be provided by a Kazakhstan Productivity Center. A host country partner institution participating in the tour program in 1995 might in fact help the Republic of Kazakhstan eventually establish such a national center.

E. TIMING

11. Detailed operating procedures for the study tour program have been developed and then refined in the course of the two pilot tours of June 1994, and have again been modified to facilitate program expansion and cost effectiveness. The revised procedures would be agreed with the World Bank upon negotiation of the World Bank's Finance and Enterprises Development Loan. The institutional arrangements should also be decided and finalized, and the Steering Committee and TPS appointed and established, by that time. The selection of economic sub-sectors, and a refined timetable for tours and seminars, could be undertaken subsequently.

12. The procurement process for consultants and trainers could start in February 1995, so that contracts with them can be finalized in May, 1995. The first tours could then depart in July 1995. A slightly faster schedule could be realized through use of the Project Preparation Facility (PPF) of the above-mentioned Loan from the World Bank.

F. INPUTS AND FUNDING

13. Foreign currency costs would include

- (i) overseas travel and subsistence expenses of tour participants, including translators and technical writers;
- (ii) fees, travel, subsistence, and sundry expenses of foreign consultants/trainers. The foreign consultants/trainers would spend approximately the following time on the Project: planning and preparation of the program and the tours (4 person-months), pre-tour seminars (5 person-months), tours (10 person-months), dissemination and other follow-up activities (4 person-months), and evaluation (2 person-months);

- (iii) host country administration expenses;
- (iv) some office equipment for the TPS and local training institution(s); and
- (v) some costs of follow-up activities such as the purchase of trade journals.

14. It is proposed that the foreign currency costs up to a maximum US\$1.8 million equivalent be funded from the World Bank's Financial and Enterprises Development Loan. This Loan has been appraised and negotiated, and is awaiting presentation to the World Bank's Board of Directors for approval. A large part or all of item (iii), however, should be provided by host country partner institutions. These institutions would provide assistance in arranging the enterprise visits and host country tour planning, accompany the largest part of the tours, and help conduct follow-up activities; they would do this free of charge as a contribution to Kazakhstan's economic development and international business relations. Other international and bilateral donors would be invited to fund the expansion and continuation of the tour program on a grant basis.

15. Local currency costs would include, inter alia:

- (i) the operating expenses of the TPS, which would be borne by the Government;
- (ii) the costs incurred by the local training institutions for preparing and hosting the seminars, and for providing some of the seminar trainers. These costs should be covered by the fees charged to the participants. These fees, in local currency, would be set at levels that demonstrate the participants' sincere commitment to the program, and that are affordable for them or their companies;
- (iii) salaries of local translators and technical writers. It is assumed that the participation in the study tours will be sufficiently attractive for these individuals to provide their services at moderate fees, covered by the World Bank Loan;
- (iv) local costs involved in result dissemination and follow-up services. These costs would be borne in part by the participating enterprises, and in part by the Government.

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

"Rehabilitation Trust"

CONCEPT OUTLINE

A. OBJECTIVES

1. As the economy's monetary constraints are hardened, the banks and the Budget are increasingly suffering from arrears on claims on enterprises. A policy and institutional framework is being developed to address this problem. The commercial banks need to play a key role in this effort. However, they are still too weak in governance and capabilities to deal with all their distressed borrowers, and especially with the largest ones. To contain the burden arising from these largest debtors, and then to force them to restructure or to liquidate them, a Rehabilitation Trust (RT) would be established.

B. MAIN PRINCIPLES

2. The RT would deal with those enterprises that constitute the biggest financial burden on banks, the Budget, and suppliers. Some of these firms warrant passive restructuring (i.e., turnaround without major new investment), and others without prospects for viability should get liquidated. The RT will force such action by hardening the budget constraint of these up to 40 firms; it will cut them off from any inflow of funds except through the RT. It will then make any provision of funds, or relieve from debts, conditional on thorough restructuring and privatization, or else liquidation.

3. If possible in view of the legal context, the creditor and owner roles will be kept separated. The RT will control financial flows and debt restructuring, based on its review and approval of the firms' comprehensive restructuring plans. The elaboration and actual implementation of the restructuring plans will be the responsibility of the firms, with assistance and guidance provided by a Restructuring Advisory Unit attached to the Ministry of Economy.

C. ENTERPRISE SELECTION AND DEBT TRANSFER

4. Number of Firms. The RT will deal with up to 40 firms, to keep the RT manageable. The precise figure will depend on the concentration of debt at the time of selection.

5. Selection Criteria. The RT will deal with firms that are the biggest burdens on creditors in terms of outstanding non-performing net liabilities to banks, enterprises, and the state's budget and extra-budget funds. This criteria does not necessarily reflect future losses (whose estimate would require also price assumptions) and repayment capability but it can be measured objectively and without in-depth analysis of the enterprises. Public service enterprises like utilities or railroads, which cannot well be liquidated, will be excluded from the RT, with potential exceptions where the distress of such an enterprise stems clearly from inefficiency rather than from state pricing decisions.

6. Almost all the firms meeting these criteria will likely be majority state-owned, but the RT will also deal with privatized firms that meet the criteria and are therefore presumably too difficult to handle for the commercial banks.

7. Selection Decision. Data for the above criteria has been collected from the enterprises since August 1994. Based on these criteria, a first list of 15 firms has been decided and published, whereas a second list of 16 firms has been selected by the Ministry of Economy jointly with the inter-ministerial

Commission on Enterprise Liquidation and Turnaround, and is subject to formal confirmation by Presidential Decree or a Government decision.

D. CONDITIONS FOR SUPPORT BY THE REHABILITATION TRUST

8. Viability Analysis and Restructuring Plans. Each firm will first be requested to establish a viability assessment including a restructuring proposal will be established. If the restructuring proposal is accepted in principle by the RT a very detailed implementation plan will be produced and carried out. If, by contrast, the firm does not produce a restructuring proposal, is found non-viable, or the restructuring plan is rejected then a plan or liquidation/sale of assets will be produced and carried out. Preparation of the viability assessments and restructuring plans is the responsibility of the firms and their owners (State Property Committee, state holding companies, etc.); it is up to them to prove that the firms can become sustainably viable and solvent through a restructuring program that is economically efficient. To support this, a consultant-assisted Restructuring Advisory Unit is being created. Some restructuring plans may reach economic but not financial viability; they may still be accepted by the RT if the Government concludes detailed long-term performance contracts for these firms, indicating the compensation for specific unprofitable activities.

9. The restructuring plans will be reviewed by RT staff, negotiated by RT management, and accepted or rejected by the RT Board. Failure to present and obtain approval for a restructuring plan triggers liquidation.

10. Implementation Progress. Support from the RT will remain strictly tied to the implementation of the time-phased restructuring plans. If implementation is incomplete or fails to make a firm financially viable, the firm shall be liquidated and its assets sold. Replacement of the firm's management in the case of minor shortfalls in restructuring progress could be a credible intermediate enforcement tool.

11. Privatization. To improve governance and make the restructuring sustained, privatization will generally be expected to be part of the restructuring plan, except for firms on a pre-specified list of exclusions from privatization.

12. Sunset Clause. Each firm must leave the RT within less than 4 years after its entry, either through liquidation or through release into financing by banks on commercial terms. To reinforce this constraint, the RT itself shall be terminated after 4 years. It is presumed that the banking sector will by then be able to address on its own the problems of new large loss-makers.

13. Liquidations. Liquidations will be initiated and driven by the RT in its role as dominant creditor. The RT itself should play the role of liquidator. The draft revised bankruptcy law and related state enterprise turnaround provisions need to clarify the powers of a dominant creditor like RT in liquidation. RT should, however, use assistance by the State Property Committee (SPC) for the actual sale of company segments or assets in the liquidation process.

E. REHABILITATION TRUST SUPPORT TO FIRMS

14. Liquidity Support. During their analysis, planning and restructuring (or time-phased liquidation), the RT will financially assist the firms through lines of credit. The outstanding amount of each firm's line of credit will be compulsorily limited to 2-3 months of the production schedule agreed under the restructuring program, according to sub-sectors. Interest arrears will automatically reduce the amount of the line. The RT will closely supervise the firms, aimed at minimizing further losses and preventing asset dissipation.

15. Technical Advice. Many important elements of the restructuring plans such as the closure of non-viable activities, disposal of non-viable and non-core assets, staff reductions, collection of the firms' receivables, etc. will require mainly technical support. These activities will be implemented by the firms with help by their owners and the Restructuring Advisory Unit. Privatization as part of restructuring plans would be carried out by SPC according to the National Privatization Program.

16. Debt Relief. The RT will provide firms with debt restructuring in line with the requirements of the restructuring plans. The National Bank of the Republic of Kazakhstan (NBK) will restructure its transferred central credit resources in a parallel manner. The RT could also provide relief from social liabilities like severance pay and pensions of laid-off personnel.

17. Relief from Social Assets. For social assets hitherto operated by the firms, the restructuring plans prepared by the firms will indicate, with a timetable, which assets will move under the operation of the municipalities and which will remain under operation by the firm but be financially supported by the municipalities and/or through cost recovery from users. In cases of enterprise liquidation, social facilities will be sold to the private sector, transferred to the municipalities or other appropriate administrations, or closed down and liquidated. They shall not be owned by the RT for any extended period of time.

18. Environmental Liabilities. Actual or contingent environmental liabilities of enterprises will remain with the enterprises, or taken over together with the enterprises by investors, or assumed by the Government (particularly in its role as enterprise owner) but not the RT. Moreover, the RT will take environmental issues in consideration when making judgments about the viability of enterprises and when deciding the financial support for them.

19. New Capital Investment. The RT will not provide investment finance, except for purchases of spare parts and minor equipment that is critical for maintaining clearly viable production lines. Investments in substantial new assets shall instead be funded by investors and commercial banks after the passive restructuring and release from the RT.

20. Liquidation Support. The RT will cover the costs of an orderly liquidation program.

F. FUNDING OF THE REHABILITATION TRUST

21. Funding Needs. Funding will be required for: (i) debt purchases; (ii) debt restructuring; (iii) the firms' operating losses, working capital credit, severance payments, and minimal maintenance investments; and (iv) the RT's administration.

22. Funding Sources. The enterprise debt will be transferred to the RT together with the refinancing of such debt from central credit resources, and together with the enterprises' deposits in the respective banks. The initial equity capital, will be provided from the national budget. Annual cash flow deficits of the RT will be funded, within annual ceilings, through the Ministry of Finance (MOF) from the state budget, and through refinancing facilities provided by NBK and RT bonds, at market interest rates and guaranteed by the Government.

G. ORGANIZATION OF THE REHABILITATION TRUST

23. Corporate Form: The RT shall be established as a state-owned joint stock bank with special status.

24. Ownership. The RT shall be owned entirely by the state, with the state (here in its role as creditor of the enterprises) represented by the MOF.

25. **Governance.** It is envisaged that RT Board be chaired by the Prime Minister or the First Deputy Prime Minister overseeing economic reform, and will include minister or deputy minister level representatives of MOE, MOF, NBK, and the President's Apparatus, and independent experts in enterprise and financial management. Board members will be confirmed by Presidential Decree.
26. **Management.** The management will be headed by a local managing director with strong experience in financial institutions.
27. **Incentives.** Management incentives will be linked to the reduction of budgetary costs, cut of enterprise losses, privatization or liquidation of firms, and keeping firms no longer than 3-4 years under the RT.
28. **Staffing.** The RT will have an adequate number of local professionals, with specializations in finance, business, law, liquidations, and social security. Staff will participate in overseas secondments, courses given by foreign experts, and on-the-job training by the RT's advisors.
29. **Assistance.** A consultant team will help develop the organization, train staff off and on the job, and supplement local staff with special expertise. The team will consist of technical advisors and, as team leader, a senior advisor to the RT's leadership.
30. **Structure.** Small units shall be responsible for financial/economic analysis, financial restructuring, liquidation, legal counsel, administration. Part of the RT's work will be contracted out.
31. **Decision-Making.** The approval of restructuring or liquidation plans, and decisions on the volume of financial support to the enterprises, will be decided by the RT Board. It operates within an annual financial envelope proposed by MOF and approved by Parliament as part of the budget process.
32. **Financial Control.** Each selected firm will keep only one account, with the required sub-accounts, in the nearest and adequately equipped branch of a commercial bank which is yet to be determined. All financial transactions of the firms will transit through this account, and will be a priori controlled and authorized by the RT loan officer in charge. These controls and authorizations will be based on detailed monthly financial programming prepared by firms and agreed upon by RT management. Any shipment of goods will be authorized only after receipt, by the RT, of a payment order or a L/C fully and irrevocably guaranteed by a bank eligible to NBK's credit auction system and, for exports, by a foreign bank counter-guaranteed by an eligible domestic bank. Any purchases of goods or services will have to be preceded by the issuance, by the RT, of a fully and irrevocable guarantee of the payment order issued by the firm or of a L/C. Payment orders issued by the firm and not guaranteed by the RT will not be executed. Matured tax, financial, and supplier obligations will be automatically deducted from the account.

G. ESTABLISHMENT OF THE REHABILITATION TRUST

33. **Institutional Setting.** As a temporary institution, the RT will not develop its own network, facilities and banking services. It will be located in the premises of one commercial bank, potentially Turanbank, and use, under a fee-based contractual arrangement, its network and its technical facilities. The RT will have direct access to the bank's communication and computer systems. In each branch where an account of one of RT's clients is located, a loan officer of the designated commercial bank will be seconded to the RT on a part-time or full-time basis. This officer will be in charge of maintaining close working relations and communication channels with the firm, monitoring on a daily basis all its financial transactions and reporting to the RT headquarters. The financial transactions of the firms will be performed through a commercial bank's network and facilities, and this bank will be fully compensated by the RT for all services provided.

34. Transfer of Financial Accounts. All bank loans of the selected firms will be transferred to the RT, together with their bank deposits and the centralized credit resources to refinance the loans. The float (payment orders issued and received by a firm but not paid) will continue to be managed under the previous accounts of the firm for 90 days, and the net situation at the end of this period will be transferred to the RT. **If these transfers of resources are lower than the transfers of liabilities, banks will be allowed to transfer to the RT additional non-earmarked central credit resources up to the amount of this gap.** These mandatory transfers will be effected in appropriate legal contractual forms between the banks and firms involved, NBK and the RT in order for the validity of existing claims to be retained. Central credit resources transferred to the RT will be guaranteed by the Government.

35. Legal Basis. **A Presidential Decree will outline the RT's legal status, supervisory organs, authority, responsibilities, principles, etc. A detailed RT Statute will elaborate the RT's organization, Board, management, etc.**

36. **The draft revised Bankruptcy Law and the draft Regulation on Turnaround and Bankruptcy of State Enterprises (for streamlined processing) shall provide the necessary powers for liquidation and restructuring, but the latter draft needs improvements to be workable and to give the RT sufficient powers for liquidation/sale of assets.**

37. World Bank Support. **The Bank's Technical Assistance Loan is supporting an ongoing consultant assignment to help further plan and establish the RT, envisaged to be completed by about June 1995. The Bank's proposed Financial and Enterprises Development Loan would help fund long-term advisors who would assist the further institution building (training, info system, policy advice) and operations (assessing restructuring plans; developing financial engineering options; first liquidations, etc.). The national budget that would provide the main funding for the RT is expected to receive support under a proposed Economic Reform Loan.**

38. Donor Coordination. The European Bank (EBRD) is funding a current study on banks' internal work-out units and on a turnaround fund for very promising yet financially distressed small and medium enterprises, and plans supporting both kind of institutions through a loan. This target group of enterprises differs from that of the RT, and the initiative is hence complementary.

H. NECESSARY MACROECONOMIC AND STRUCTURAL CONTEXT

39. Macroeconomic Context: Kazakhstan is under a standby arrangement with the IMF whose Board has agreed in late August, 1994, to a revision of that standby. The first quarter targets may have been met; an IMF mission is currently in the field to review the progress and discuss new targets for the rest of the year. Inflation objectives may need to be relaxed in view of a recent arrears clearing exercise. The RT will support stabilization by forcing the restructuring or liquidation of the largest debtors, thus following up with on the clearing exercise with concrete restructuring action.

40. Liberalization. In the context of the Bank's Rehabilitation Loan, Kazakhstan has made good progress on price and trade liberalization, but less on ensuring competition. Continued progress will further ensure that meaningful signals guide the restructuring, and that the constraints of firms are not softened through major subsidies, protection, or monopolization.

41. Enterprise Governance. Discipline shall be imposed on the firms by their creditors as well as their owners. The main tool to enhance governance is privatization, which has made good progress with the current national roll-out of all tracks of the National Privatization Program. In general, firms shall be privatized before restructuring; if they are not sellable without some prior restructuring (like presumably in the case of the RT's firms) then privatization shall be part of restructuring plans. The governance of firms

prior to privatization, which is at present exercised by SPC and its state holding companies, will be enhanced in 1995 with technical assistance by the Bank.

42. Financial Sector Reform. A comprehensive reform program for the financial sector is being developed by NBK with collaboration by other agencies and with assistance by the World Bank. The RT mechanism is to some extent independent of these comprehensive reforms. However, they shall avoid re-occurrence of arrear and liquidity problems of the current magnitude, and enhance the banks' capability to eventually handle even very large distressed enterprises on their own. A legal and institutional framework for government securities, including Government-guaranteed bonds that might be used to fund the RT program, is being developed with assistance by the IMF and USAID.

43. Legal Framework. In the last 15 months, Kazakhstan issued new laws on banking and central bank, and regulations on central credit resources, bank supervision, bank governance, securities, etc. A Commercial Code with comprehensive contract law provisions is being drafted. Draft legislation and amendments on collateral, bankruptcy, state enterprise turnaround, which are critical to the RT, as well as on banking, securities, and several financial instruments, are expected to be introduced in early 1995, i.e., prior to the start of RT operations. The draft provision on state enterprise turnaround and bankruptcy needs to be strengthened, and the further changes of the draft Bankruptcy Law kept on a sound course, to ensure a conducive framework that allows the RT to enforce restructuring and undertake liquidations without involvement of the courts while the relevant capabilities of the latter are gradually developing.

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

Advisory Services for the Operation of the "Rehabilitation Trust"

DRAFT SUMMARY TERMS OF REFERENCE

A. BACKGROUND

1. One of the central objective of the reform policy of Kazakhstan is to develop a sound and efficient banking system that will be in charge of playing a key role in the adjustment of the enterprise sector through the enforcement of stronger financial discipline on individual firms, the work-out of their non performing liabilities and the allocation of their financial resources based on the creditworthiness of their potential borrowers.
2. The economic and financial restructuring of the public enterprises with the largest arrears to banks, suppliers, employees and the Budget cannot, however, be led and supported by existing banking institutions, given the magnitude of their problems, the social dimension of their situation, and the amount of human and financial resources required to restructure them.
3. In this context, the authorities have decided to isolate up to 40 enterprises with largest arrears from the rest of the banking sector and to create a Rehabilitation Trust that will be in charge of: (i) taking over the risk exposure of the banking sector on these enterprises; (ii) enforcing a hard budget constraint on them through a tight control of their finances; and (iii) financing their deficits based on the implementation of restructuring programs aimed at restoring the financial condition of viable ones and at liquidating the non-viable ones. A detailed concept note for this Rehabilitation Trust is attached to these terms of reference.
4. The preparatory work required for this institution to be fully operational during the second quarter of 1995 is being implemented by the authorities with the assistance of external consultants funded under a Technical Assistance Loan provided by the World Bank. These consultants are advising on the legal documents, structure, processes, information system, etc. of the emerging institution.

B. OBJECTIVES

5. The objectives of the proposed assignment are to: (i) finalize the detailed arrangements required for the institution to be fully operational and (ii) assist the management of the Rehabilitation Trust in performing its tasks in an efficient manner.
6. In a first step, the Consultant will review in detail the preparatory work already achieved in order to confirm, or, when required, propose to amend, the feasibility of the retained scheme. This review will include the preparation of the concrete steps necessary for the Bank to be fully operational as soon as possible.
7. In a second step, the Consultant will provide: (i) the managerial assistance required for the Bank to be a financially and institutionally strong institution; and (ii) the technical assistance required to assess the restructuring programs proposed by the enterprises, design on this basis the conditionality and the structure of the financial support that could be provided by the Bank, closely monitor developments in the situation of the firms and take remedial actions when required.

C. ASSISTANCE STRATEGY

8. This assignment will be carried out by a specialized consulting firm or financial institution having high credentials, a long experience in the financial and technical issues to be covered, and a good knowledge of the specific situation of economies in transition, in particular in CIS countries.

D. COUNTERPART AND IMPLEMENTATION ARRANGEMENTS

9. The consultants will work directly with the staff of the Rehabilitation Trust. Responsible for the implementation of this assistance under the World Bank loan is Project Implementation Unit at the Ministry of Economy (currently at the National Agency for Foreign Investment, under MOE). This Project Implementation Unit will assist procurement, disbursements, and related matters under this component of the World Bank's Financial and Enterprises Development Project that is envisaged to finance the assistance.

10. This assignment is expected to start in about May 1995 and to end in about November 1997. The first step of the study is anticipated to be carried out in three months. In its proposal, the Consultant will present a detailed timetable for the tasks to be performed within this time frame that will be agreed upon during the negotiation of the contract.

E. ACTIVITIES AND OUTPUTS

11. The Consultant will provide a team of experienced experts who will work full time in the Bank, the possibility to send specialists on short term assignments to review the technical aspects of restructuring programs, and a quality assessment and technical back-up from headquarters.

12. The core team of permanent experts will consist of three persons:

- (i) a project manager, who will be the deputy or the personal advisor of the chief executive officer of the Bank. He will be in charge of providing policy and operational advice for the overall management of the bank, assisting in the implementation and the supervision of all procedures required for the functioning of the bank, and preparing or reviewing documents presented to its decision making bodies. He will participate in the executive committee of the Bank.
- (ii) a financial specialist, who will be the deputy or the personal advisor of the financial director of the Bank. He will be in charge of providing advice for the financial management of the institution and the structuring, including their legal aspects, of its financial facilities, reviewing the financial aspects of the restructuring programs presented by the enterprises, and setting up and supervising the procedures required for the delivery of the financial support to be provided by the Bank and for the monitoring of enterprises' financial developments.
- (iii) an industrial specialist, who will be the deputy or the personal advisor of the technical director of the bank. He will be in charge of reviewing the technical components of the restructuring programs and of monitoring their implementation.

13. The consultants would work directly with the staff and management of the Rehabilitation Trust and advise them in all policy, legal, institutional, financial, and operational matters directly relating to the Rehabilitation Trust and its work. The envisaged institutional set-up, financing mechanisms, and operational procedures are outlined in the attached concept note.

F. REPORTING

14. The consultants would provide an Inception Report within two months after starting their assignment, for clearing with the Rehabilitation Trust management, the Government, and the World Bank. Thereafter, they will issue bi-monthly Progress Reports. Within two weeks after completing their field work, the consultants will issue a Final Report. All reports shall be submitted in English and Russian language to the Rehabilitation Trust management, its Board, the Project Implementation Unit at the Ministry of Economy, and to the World Bank.

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

INSTITUTIONAL STRENGTHENING PROGRAM OF COMMERCIAL BANKS

CORE TERMS OF REFERENCE

A. SCOPE OF THE PROGRAM

1. For each Kazakh bank, the twinned foreign bank or consultant (hereafter referred to as the "Consultant" even if it is a bank) selected to deliver technical assistance will utilize the diagnostic study report and on-site discussions with management in order to prepare an institutional development program tailored to that bank's particular strategy, needs, and resources. The Consultant will generally act in an advisory capacity during the implementation phase of the program, although line responsibilities may be requested in some critical areas. Training of counterpart and other staff, particularly in new banking processes that are developed, will form an important part of the Consultant's duties. All plans assume significant involvement of Kazakh bank staff in order to promote skills transfer, minimize the cost of foreign consultants, and to ensure that the program remains consistent with the environment and strategy of the bank. The Consultant should arrange for, and will be responsible for, all the service required by the Kazakh bank under this program. Limited sub-contracting arrangements are allowed under terms of the contract, but services for which this option is to be employed must be specified in the Consultant's proposal and contract documentation.

2. The institutional development programs will be structured in nine "modules" corresponding to basic functional areas of banking: (a) strategy; (b) organizational structure and procedures; (c) planing, budgeting, and financial control; (d) credit management; (e) financial management; (f) marketing; (g) branch management; (h) human resources and training management; and (i) technology. However, not all participating banks will pursue or require assistance in all nine modules. The detailed content, prioritization and timetable of each module will be individually developed to take account of each bank's particular strategy, needs, and resources as indicated by the results of the diagnostic studies.

(a) Strategy

3. In the strategy area, the Consultant will: (i) refine and expand the bank's business planning process to cover all important areas of strategic analysis and decision; (ii) train the bank's management in its use; (iii) work with the bank's management to develop an operational strategic plan for the bank, and a concrete program for its implementation; and (iv) work with line managers to translate the strategic plan into specific plans and goals for each major area of the bank.

4. This module will include a market analysis and a profitability analysis of customers, products, and units, and a definition of the bank's mission, goals, basic strategies, target markets, products and services, resource requirements, and action programs covering both corporate and retail banking.

(b) Organizational Structure and Procedures

5. The Consultant will work with management to: (i) assess the existing organization structure of the head office and of a sample of branches; (ii) plan a new organization structure for the head office focused on successfully executing the strategic plan and making the structure more market-oriented; (iii) plan a new organization structure for branches that will be tested before finalizing the model that will be used for all branches; (iv) identify the required staffing levels and the main skill requirements in each organization unit; (v) assess the general procedures of the bank, and propose required changes both at each unit level and for

the relation between these units; (vi) prepare a concrete plan for implementing the new structures and procedures.

6. In defining new organization units, the Consultant will provide sufficient detail about each unit and the relations between them, for the bank to be in a position to successfully implement it -- e.g., the unit's basic mission, main responsibilities, and key functions for carrying out each responsibility, control system, and procedures, as well as the required staffing levels and main skill requirements as noted above.

(c) Planning, Budgeting, and Financial Control

7. The Consultant will develop with the bank management: (i) a revolving planning and budgeting process based on a simple projection tool of the balance sheet, flow of funds, and income statement of the bank that will include details required to prepare annual budgets at both centralized and decentralized levels; (ii) budget procedures and control mechanisms; (iii) the minimum analytical tools required to follow, on a monthly basis, the results of the bank and to initiate the development of cost-accounting techniques to be used for monitoring the performance of the bank's profits centers.

8. The Consultant will also help the bank to conceive the different internal control mechanisms that are required for the management to have an overall accurate assessment of the situation of the bank. In this context, the flow of information between the different units of the bank will be organized in order to be easily consolidated in a coherent reporting system.

(d) Credit Management

9. The Consultant will: (i) assess the bank's existing credit policies, processes, organization and skills - covering domestic and hard currency lending, enterprise and individual lending, and project finance, from origination through analysis, approval structuring, pricing, collateral policies, disbursement procedures, administration, monitoring, classification, provisioning and problem loan management -- in the context of the credit requirements of the strategic plan and good credit management practice; (ii) identify areas that need to be improved or developed; (iii) work with management to make those improvements with the objective to build a fully effective credit management system; (iv) document the new policies and procedures in a credit manual; (v) train a core staff in utilization of the new or modified processes; (vi) identify the additional skill development needed by the bank to effectively execute and sustain the system; and (vii) identify the automation requirements of the new credit management system. In this context, the Consultants will also familiarize staff of the local bank with appropriate environmental due diligence procedures.

(e) Financial Management

10. The Consultant will: (i) assess the full scope of the bank's financial management processes, organization and skills, and identify needed improvements; (ii) work with management to make needed improvements in priority areas -- which, at this point, are anticipated to include the accounting system, financial reporting, management information, asset/liability management, liquidity management, and treasury operations; (iii) train a core financial staff in utilization of new or modified processes; (iv) identify additional skill development needed by the bank to effectively execute and sustain the system; and (v) identify the automation requirements of the new financial management system.

(f) Marketing

11. In conjunction with the strategic planning module, the Consultant will work with the bank's management to: (i) prepare a concrete marketing plan for the bank and its main businesses, recognizing the different needs of corporate and retail banking; (ii) specify the organization and other resources needed for

executing the plan; (iii) develop key marketing techniques to be used by the bank in each business area; and (iv) identify the skills needed by the bank to sustain a successful marketing program. The Consultant is expected to transfer skills of market analysis and market planning to the bank during this work, and to generate a formalized market planning and development process.

(g) Branch Management

12. In this area, the Consultant will: (i) review the current system of managing branches, and identify needed improvements, particularly in control and risk management; (ii) review the process of planning the branch network and identify needed improvements; (iii) select, with management, a "typical" branch, redesign its work flows, organization, staffing, physical layout, equipment, quality standards for operations and customer service, and other major operating elements so that it can serve as a model for all other similar branches in the network; (iv) plan the development of a computer system for assembling branch asset and liability data on a real-time basis; and (v) prepare a plan for developing a cost-accounting system at the branch level and for improving head office/branch communications.

(h) Human Resources and Training Management

13. The Consultant will work with management to build an effective human resource management system, refining existing human resources processes such as recruiting, remuneration and incentives, and building or improving human resources processes such as performance/potential appraisal, individual development planning, transfer and promotion, and succession planning. The Consultant will also train a core human resources staff in the utilization of new or modified processes and identify any additional skill development needed for an effective ongoing human resources management function.

14. During the course of the project, the Consultant will also: (i) assess the organizational culture; (ii) identify major aspects of the culture that require change in order for the bank to successfully operate in a commercial, competitive and market-oriented mode; and (iii) define the actions needed to achieve these changes.

15. After the new organization structure is defined, the Consultant will work with training staff to: (i) conduct a training needs analysis of key jobs in all units; (ii) prioritize training needs, with a view towards the required integration of training with the business plan, and organize them into a training master plan that meets priority training needs within the required time period and budget constraint; (iii) reassess the training tools presently used; and (iv) make needed improvements in areas such as planning external and internal training activities, methodologies for training course development and delivery, training materials, identification and evaluation of external training facilities, selecting and preparing trainers and trainees, and training evaluation.

16. As noted in the above sections, the Consultant is expected to train managers and core staff in all new banking processes developed or modified during the project. The scope and type of training is to be determined between the Consultant and bank management, based on the relative advantage of the Consultant providing such training compared with other potential providers. The following methods will be utilized for delivering training: (i) "on-the-job" training for the bank's managerial staff who are working with the Consultant; (ii) training of core functional staff in utilization of new or modified processes developed by the Consultant in each module of work; and (iii) additional training of managers and professionals in high priority areas as decided between the Bank management and the Consultant.

(i) Technology

17. In this area, the priority for the Consultant will be to clearly define user requirements and refine the bank's automation program in the context of the bank's overall strategic plan, to ensure the most cost-effective implementation.

18. The Consultant may need to achieve this goal through several stages: (i) evaluating the bank's existing hardware architecture and systems engineering and its near-term automation program in the context of the new strategic plan; (ii) working with management and its consultants to refine and update the program; and (iii) continuing to update the program as new banking processes are developed. In addition, the Consultant will identify priority needs for development of core technology skills and technology management processes, and for the efficient use of the information system by the bank's staff and management.

19. It should be noted that each bank under the institutional strengthening program will, in addition to the consultancy under these terms of references, have access to funding for information technology under the same World Bank Loan.

B. REPORTING

20. At a minimum, the technical assistance contractors will prepare, and review with the management of participating banks, the following:

- * Within two months of commencing work, a detailed, updated work plan, including the proposed level of effort (work-weeks/months) and scheduled outputs;
- * monthly financial reports providing information on a number of key financial parameters [format will be given at negotiations];
- * quarterly progress reports documenting findings, conclusions, recommendations, end-products, issues and proposed next steps.

21. Specific reporting requirements, including contract budget and implementation progress measurement criteria, will be agreed between the participating banks and the contractor during contract negotiations.

22. The two-month updated work plan and all subsequent monthly and quarterly reports will be submitted to the project implementation unit at the National Bank of the Republic of Kazakhstan (NBK). It is the responsibility of the consultant to ensure that these are received within two weeks subsequent to the end of the month/quarter, regardless of the status of discussions with management.

23. Participating banks will also be required to prepare semi-annual evaluations of the program and submit these to the project implementation unit at NBK.

C. COST ESTIMATES AND BUDGET

24. Each institutional development program will be designed and negotiated to meet the particular needs of the participating bank which it is intended to serve. No two programs will be identical. However, most participating banks will adopt programs requiring consultant inputs in the nine functional modules as outlined below.

Work Modules	Work-Weeks Depending on Size of the Bank
a. Strategy	30 - 50
b. Organization and Procedures	15 - 25
c. Planning, Budgeting and Financial Control	15 - 30
d. Credit Management	30 - 45
e. Financial Management (including systems)	
* Liquidity Management	25 - 40
* Foreign Exchange Management	15 - 25
* Accounting Infrastructure	40 - 50
* Internal Control / Audit	15 - 30
* Other	10 - 20
f. Marketing	15 - 25
g. Branch Management	10 - 30
h. Human Resources and Training Management	20 - 30
i. Technology Assessment and Plan	20 - 35
Total	<u>260 - 435</u>

25. Based on a preliminary assessment of the situation and needs of pre-selected banks that will be further analyzed during the comprehensive diagnostic process, the costs of these programs (not including automation equipment) should be around US\$2.5 million for the largest banks and about US\$1.5 million for a medium-sized bank. The total costs of the four programs is estimated at no more than 8 million. (This figure does not include the provision of bank information technology to the same local banks under the same World Bank Loan.)

26. At a minimum, the following results will be obtained during the first year of the project:

- * Development and initial implementation of the strategic plan;
- * development and implementation of the organization structure and key procedures;
- * development and implementation of the planning and budgeting process;
- * implementation of key elements of the credit management system, particularly those focused on risk management and problem loans management;
- * implementation of key elements of the financial management system, particularly those focused on liquidity management, risk assessment, and overall profitability;
- * development and initial implementation of the marketing plan;
- * implementation of key human resources management systems, particularly those related to recruiting, remuneration, incentives, appraisal, and development;
- * analysis of the training needs, and initiation of training in new processes developed in the other modules of the project;

- * improvement in the branch management and control system and branch networking planning; and
- * refinement and updating of the automation strategy and development plan.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT
COMMERCIAL BANKING DEVELOPMENT COMPONENT

CONDITIONS FOR PARTICIPATION OF LOCAL AND FOREIGN BANKS

1. Many banks in Kazakhstan have expressed an interest in: (i) developing financial, business and institutional relations with foreign banks integrated in international capital markets; and (ii) strengthening their operational procedures through an access to professional advice from banking professionals practicing in advanced market economies. Some banks have started to open correspondent accounts with western banks and to benefit from short term training facilities offered by such institutions. Most banks consider, however, that they need stronger institutional relations with experienced foreign partners to rapidly overcome their main institutional weaknesses and to operate successfully in a market oriented economy. Their first attempts to attract foreign banks as minority shareholders and to develop joint-venture affiliates did generally not materialize. This shows that the local economic, financial and legal environment is still considered too unstable to develop such close relations on their own.

2. Experience indicates that twinning arrangements are the most efficient and cost effective way to successfully develop comprehensive, long-term institutional development programs. NBK and the banks that have been identified by the World Bank as potential candidates have expressed a strong interest in such arrangements. The main objective of such programs is to help local banks to develop strong and sustained bilateral relations with a foreign partner that would facilitate the development of their international relations and would provide them with a comprehensive technical assistance and institutional development program and with the opportunity to benefit from a direct transfer of know-how, products, procedures and systems. They would also bring partner banks a diversification of their non interest income and an opportunity to develop their knowledge of the local economy.

3. Most important conditions for such arrangements to be successful are: (i) for both partners to have consistent profiles and a strong commitment to build a long term partnership; (ii) for the local banks to have a full autonomy and a strong governance together with a sufficient size and capital base, an acceptable financial condition, reasonably good prospects, as well as clear objectives and an adequate absorption capacity; and (iii) for the foreign banks to have an international culture, a first hand knowledge of transitional economy and an interest to develop a long term relationship with Kazakhstan, a size and an international organization consistent with the flexibility and the secondment of staff required by such contracts, as well as adequate class and on-the-job training facilities.

A. THE SELECTION PROCESS OF LOCAL PARTICIPATING BANKS

4. Two large commercial banks still controlled by the Government have first been tentatively preselected based on: (i) their importance to the domestic economy; (ii) the role they should continue to play in the provision of banking services in Kazakhstan, in particular to its low income population located in remote areas; (iii) the weakness of their present organization and procedures and their willingness to engage in restructuring programs to consolidate their situation; and (iv) their desire to build long term relations with reputable foreign partners engaged in the same kind of activities. They are: (i) Agroprombank, which is specialized in the provision of financial services to the agricultural and agro-processing sectors, that play a key role in the Kazakh economy; and (ii) the People's Bank, which is the former State Savings Bank that has been recently transformed into a common universal joint-stock bank and lost most of its privileges. Both face severe institutional and technological weaknesses and, at least in the case of Agroprombank, a distressed financial condition.

5. The other participating banks will be two medium-sized emerging private sector banks that will be selected through a three-phased screening process. This small number is explained by the fact that the size and the equity base of most new private banks are still too small and their condition too fragile for such twinning arrangements to be feasible. Indeed, it is expected that, with the on-going rationalization of the monetary policy and the progressive reinforcement of prudential standards, about half of them will rapidly disappear through closures, liquidations and mergers.

6. The first phase of the selection process consisted of a tentative screening of the existing around 200 banks' balance sheets data as of end April 1994, as reported to the National Bank of Kazakhstan (NBK). Criteria used were the size of their capital and of their assets, the distribution of their ownership, the level of their capital adequacy ratio before provisioning, their liquidity position, their focus on the private sector and the structure of their liabilities. Five banks emerged from this process, three having met the pre-selection criteria and two being in a position to meet them soon through pending increases in their paid-in capital. One has been eliminated due to its easy access to, and already close relations with, a reputable international bank. Other preselected banks have expressed a strong interest in the proposed twinning arrangements with foreign banks and confirmed their desire to rapidly meet international standards for both their financial condition and their banking practices.

7. The second phase consists of comprehensive financial and institutional diagnostic studies of all preselected banks, including Agroprombank and the People's Bank, conducted by international auditing firms. These detailed studies have been carried out starting August 1994, and the first preliminary reports have been submitted since January 1995. These studies aim at: (i) confirming that preselected banks meet, or are in a position to meet in less than one year, the pre-selection criteria, (ii) assessing in detail their financial, institutional and technological condition, and (iii) designing, with their management, a time-framed institutional and automation development plan.

8. The third phase will consist of the accreditation of all selected banks. Banks participating in the program will be required, in order to be accredited, to: (i) maintain compliance with five prudential standards, that are presented in Box 1 below, and with all requirements issued by NBK, with the temporary exception of Agroprombank; (ii) commit themselves to implement an institutional and automation development plan and to be annually audited according with generally accepted international accounting standards; (iii) demonstrate a genuine managerial autonomy and maintain adequate accounting and reporting standards, as well as acceptable financial, organizational and efficiency performance standards, that are presented in Box 2 below; and (iv) implement active and sound banking policies, with a focus on the emerging private sector, in both their resource mobilization and their lending activities.

9. The accreditation will be given by NBK and conditioned by its prior receipt of a "no objection" notice from the World Bank. Banks that will comply with most, but not all, important accreditation criteria will still be able to participate in the program if they present a detailed and timely monitorable action program aimed at redressing their situation that is acceptable to both NBK and the World Bank. The same procedure will be used in case a participating bank drops out of compliance during the implementation of the program.

BOX 1**PROPOSED PRUDENTIAL STANDARDS FOR PARTICIPATING LOCAL BANKS**

All participating local banks will have to agree to maintain compliance with five prudential standards related to: (i) their capital to weighted assets ratio, (ii) their liquidity position, (iii) the level and the concentration of their exposure to single and to connected parties, (iv) their foreign exchange exposure, and (v) the classification of their risk assets portfolios and their level of provisions.

NBK has already introduced, and recently upgraded, prudential regulations covering the first four standards. Compliance with the first two ones conditions banks' access to NBK credit auction market. NBK is meanwhile requiring compliance with the first four ones for banks to access the auction market. Data related to the level and the concentration of single and aggregated, large or connected, exposure are however only gradually becoming available for a sufficient number of banks to assess the feasibility of this objective, since the related prudential regulation were introduced only in the second quarter of 1994. NBK is also currently preparing the loan classification methodology that will have to be used by all banks. Based on the results of the analysis of the loan portfolios and the assessment of the financial condition that are included in the forthcoming diagnostic studies, NBK expects also to be in a position to introduce a regulation regarding provisioning requirements, in a realistic and phased-in manner in the first half of 1995.

The compliance with prudential standards that will be required from participating banks are expected to be the following:

CAPITAL ADEQUACY

Assessed as the ratio of equity capital to risk weighted assets, the minimum capital adequacy ratio will be 4 percent by end 1994 and will be increased by one percentage point each following year up to 8 percent by end 1998. The weights will be those presently used by NBK, as they are almost entirely in line with usual international standards.

LIQUIDITY RATIO

Assessed as the ratio of highly liquid assets to total liabilities, it will have to be maintained above 30 percent. This ratio could however be replaced by a more significant one when participating banks will have developed the required information system, as long as the new ratio is acceptable to the World Bank.

LEVEL AND CONCENTRATION OF LARGE AND CONNECTED EXPOSURE

The recently introduced prudential regulation related to the single and aggregated ceilings on large and on connected exposure is in line with usual international practice. However, it will very probably have to be phased in a realistic manner over the medium term. The annual ceilings that will be retained for this project will be determined based on the preliminary results of the diagnostic studies that are being received at present.

FOREIGN EXCHANGE EXPOSURE

Participating banks will have to limit their open position in any single foreign currency to a maximum of 15 percent of their capital and the total of them to a maximum of 30 percent of their capital, as in line with the prudential regulation recently introduced by NBK.

CLASSIFICATION OF RISK ASSETS AND LEVEL OF PROVISIONS

If acceptable to the World Bank, the classification of risk assets of participating banks will be the same one as the one that will be introduced by NBK in the forthcoming months. Indeed, it is expected to be a simplified version of usually accepted international standards and to be identical to the one that will be used by international auditors in their forthcoming assessment of the loan portfolio of the ten largest banks of Kazakhstan. The level of provisioning will be determined based on the results on the diagnostic studies whose preliminary versions are being received at present.

All participating banks will have to comply with the minima that will be finally retained for the project, with the exception of Agroprombank. Its minima will be determined based on the results of its financial diagnostic and on the restructuring plan that will serve as the basis of its overall development program.

Box 2**PROPOSED INTERNAL PERFORMANCE STANDARDS
FOR PARTICIPATING LOCAL BANKS**

All participating local banks will be required to keep complying with internal performance standards related to: (i) their management effectiveness; (ii) accounting and reporting standards; (iii) development and efficiency targets; (iv) financial management and profitability.

MANAGEMENT EFFECTIVENESS

Standards related to their management effectiveness will be based on the managerial autonomy of the bank, the adequacy of boards' guidance and surveillance and of internal control systems, the soundness of internal policies and procedures and their actual implementation, and the quality of the planning and budgeting processes.

ACCOUNTING AND REPORTING SYSTEMS

Banks' accounting and reporting standards will be required to follow generally accepted international ones with the objective of giving a fair and true image of their conditions. Annual, quarterly and monthly reports will be based on the ones required by NBK, that will be further developed with the introduction of a new chart of accounts, and will be complemented by supplementary information if required.

DEVELOPMENT AND EFFICIENCY

Each bank will develop a set of quantitative performance target that will be used to monitor its development and the improvement of its efficiency. These targets will cover the structure of its assets and its liabilities, its market shares in its core business activities, as well as usual productivity and efficiency measures of capital and human resources.

FINANCIAL MANAGEMENT AND PROFITABILITY

Financial management and profitability performance standards will cover the adequacy of the asset-liability management system, with an emphasis on the assessment and management of financial risks and of financial independence and the monitoring of net income developments in relation to earning assets, profit centers and equity.

The terms of reference of annual external audit will include an assessment of recent developments and of required future progress in these four areas. The updating of annual internal performance standards will be based, if required, on the results of these external audits. The overall objective of the development programs of each bank will be to reach sound banking practices, as usually defined by external auditors, by the end of the twinning arrangements.

B. THE SELECTION PROCESS OF FOREIGN PARTNER BANKS

10. A number of foreign banks have already expressed an interest to enter into twinning arrangements with Kazakh banks. A more systematic identification of such potential partners will be launched over the next two months, jointly by NBK and the World Bank, taking into account the different profiles of preselected local banks and indications related to the trade financing activities already developed with Kazakhstan by some international banks. Initial contacts between foreign and local banks will be initiated when the preliminary results of the diagnostic studies are available and have been reviewed and discussed. Preconditions required for a foreign bank to be included in the list of institutions that will be invited to submit a proposal will be a strong track record, a sound financial condition and reputable banking practices, long experience in activities to be developed by local banks, an opening in international relations, adequate training facilities, and experience of transitional economies. The selection of these banks will be made according to the usual World Bank procurement procedures, with a ceiling of 25 percent on the amount of services that would be subcontracted to external individual consultants or consulting firms. The final decision for the selection of foreign partners will be made by each local bank, with the assistance of an evaluation committee set up by NBK.

C. THE DESIGN OF THE INSTITUTIONAL DEVELOPMENT PROGRAMS

11. The institutional strengthening program for each bank participating in the Banking Development Component of the project will be implemented with the assistance of its partner foreign bank. This assistance will be provided in the framework of a contract negotiated between each domestic bank and its foreign partner. Typically, these contracts will define the relations between the two parties, describe services to be provided by the foreign bank and the modalities of their delivery, include the composition of the foreign bank team and of the local bank counterpart team and set the remuneration and payment agreement, and the reporting and performance review process. Each program will be tailored to the needs of each participating bank on the basis of the conclusions of the institutional component of the diagnostic studies. These programs will be structured in different modules corresponding to the core activities of each bank. Activities to be developed under each module will be incorporated in a Master Plan, detailed in concrete steps and time framed. This Master Plan will be updated semi-annually jointly by twinned banks. Draft terms of reference for these institutional development programs, which present a typical example of the content of the different modules that will compose a program, are shown in Annex III.1(a).

D. THE DESIGN OF THE AUTOMATION DEVELOPMENT PROGRAM

12. The design of the automation development component of each program will be closely integrated within the institutional strengthening program of each participating bank. It will, therefore, be only progressively defined, based on the conclusions of the diagnostic studies, the financial condition and prospects of each bank, and the automation strategy that will be integrated in the overall strategic plan to be developed by each bank as the first stage of its institutional development program. As a consequence, the initiation of these automation programs will typically start between 6 months and 1 year after the beginning of the institutional ones. A typical program will include financing for information technology experts to write user specifications, as well as for the provision of hardware and software, and for training. The low capital base of participating banks, together with the basic requirements of sound foreign exchange risk management, calls for cautious and progressive automation development strategies and for prudent foreign exchange borrowing policies. These two constraints will be fully taken into account in the design of the technological sub-components of each bank program and are reflected in the following description of the financing aspects of this project.

E. TERMS AND CONDITIONS OF THE FINANCING OF THIS COMPONENT

13. The component related to commercial banking development of the loan of the World Bank to the Government of Kazakhstan will be matched with grant funding and will be on-lent by NBK to participating banks at the following conditions:

Grant Funding:	For each bank, 50 percent of the cost of the institutional development program, up to a maximum US\$1.5 million.
Loan Amount:	For each bank, the remaining cost of the institutional and automation development program, up to a maximum US\$3 million or the amount of the capital of the bank, whichever is the lowest.
Currency:	US dollar
Term:	10 years
Grace period:	4 years

- Interest Rate: Interest rate of 10-year U.S. Treasury Notes, plus 2 percent, adjusted and payable semi-annually.
- Commitment Fee: The commitment fee shall be a percentage equivalent to that paid by the Government on undisbursed amounts of the World Bank Loan. The commitment fee shall be payable on the undisbursed amount of the respective subloan, beginning to accrue 60 days after the date of the signature of the on-lending agreement.
- Repayment Term: During the grace period, interest only. Afterwards, semi-annual installments of equal amounts of principal plus interest on the remaining outstanding principal.

F. TIMETABLE

14. The comprehensive institutional and operational diagnostic studies started in August 1994, with draft all but two report completed in draft form in January 1995, and finalization of all reports expected by end March 1995. On the basis of their conclusions, preliminary contacts between foreign and local banks will be rapidly initiated in order for the banks to be in a position to launch their invitation for proposals in early 1995. The first contract for the institutional development components is expected to be signed before end August 1995, and for the last of the four banks before end 1995. These contracts will cover periods of 2 to 3 years, according to the strategy and the absorption capacity of each local bank. The automation development components will typically be launched during the first quarter of 1996, and their implementation shall be completed in the last of the four banks by mid-1997.

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

INSTITUTIONAL DEVELOPMENT FOR ON-SITE BANK SUPERVISION, PHASE II

DRAFT TERMS OF REFERENCE

A. BACKGROUND

1. An important aspect of the transition process to a market economy in the Republic of Kazakhstan is the development of capacity for prudential supervision over the banking system by the National Bank of the Republic of Kazakhstan (NBK). Since the system of prudential supervision in the country is in its formative stages, it is necessarily beset by a number of problems. These include shortage of adequately trained staff; problems of effectively dealing with the large specialized banks; supervisory procedures that were designed to ensure compliance with economic regulations which are now outdated; and a financial system that is heavily distorted by a massive outstanding amount of subsidized credit and of non-performing loans to loss-making state enterprises. NBK and the Government have started to reform the monetary policy and to better control the situation of state enterprises, which would make it possible for prudential supervision to be more effective.

2. The World Bank will provide a first phase of assistance to NBK's new Bank Supervision Department (BSD) between spring 1995 and spring 1997 under a Technical Assistance Loan. Two resident experts will train teams of newly recruited BSD staff in basic on-site examination skills on the job by conducting with them partial examinations of some twelve banks per year. In the first year they will thus train about twenty staff. In the second year, they will repeat that training with a new batch of about twenty further new staff.

3. This basic training needs to be enhanced by further training in specialized bank supervision skills, adjusted to the specific circumstances of the banking sector. As in most transition economies, Kazakhstan's banks vary in performance, and many are in a fragile condition. Therefore, BSD is likely to face problems in the following areas -- problem banks, risk management, quality of loan portfolios, insufficient liquidity and solvency ratios, indirectly connected lending, and volatility of banks' financial conditions. The BSD staff that has been trained for one year in basic supervision skills should therefore be further trained in a second year in these specific areas. This training will again take place on the job, through actual examinations of banks with the guidance of foreign advisors. This phase II of the training for on-site bank supervision will be supported by this component of the Bank's Finance and Enterprises Development Loan.

B. OBJECTIVES

4. The main objective of this component is to deepen the technical assistance provided for on-site examination in phase I under the Technical Assistance Loan, by funding specialized on-the-job training in priority areas. Specifically, the goals are to strengthen the capabilities of BSD in the areas mentioned above, through:

- * enhanced staff skills and experience, and through on-the-job training;
- * the development of specific examination guidelines and manuals, and of methodologies required to adapt usual standards to the Kazakh economic environment;
- * specific policy advice to BSD and NBK officials; and
- * setting precedents of quality examinations and follow-ups of commercial banks in various conditions and of intervening in problem banks.

C. ASSISTANCE STRATEGY

5. This Project component will overlap and deepen the basic on-site supervision training provided in phase I through on-the-job training under the Technical Assistance Loan (2 experts for about 2 years); some classroom training under an European Union grant, executed by the Bank of England; and classroom training as well active off-site supervision advice provided under a USAID grant. Phase I should start in March, 1995, but not before the NBK has completed to hire the first batch of recruits. Phase II will commence after the first year of phase I is largely completed. The trainees of phase I will enter phase II of the program for a year of more specialized training. At the same time, a second batch of new trainees will enter phase I; they will then commence their phase II training in early 1997. The NBK will continue hiring new staff for the division of on-site examination to reach a total of about 10 older staff and 40 newly recruited staff by the end of 1995.

6. For phase II, the World Bank will finance two advisors starting the earliest in January 1996, or close to a year after the NBK has recruited the necessary staff and started phase I of the assistance. These advisors will assist in conducting full on-site examinations and interventions in problem banks with the trained staff. They will also help develop appropriate manuals and guidelines; participate in higher-level discussions on the results of the examinations; and provide policy advice to the BSD and to NBK officials. One of the two advisors will be specialized in risk management and dealing with problem banks. The second new advisor will specialize in loan processing procedures and in loan portfolio classification.

7. The BSD will select, with the recommendations of the phase I and II World Bank-funded advisors, eight BSD staff who have demonstrated outstanding performance during training and bank examinations in phase I to act in future as examination team leaders. The phase II advisors will then assist teams of examiners who will have been trained in Phase I to execute comprehensive examinations of banks. It is expected that each team will be comprised of five persons, including the team leader, and will work under the guidance of the bank supervision advisor. Each training cycle/examination is expected to last approximately three months. It is estimated that during one year the advisors together would assist at least twelve full examinations.

8. The technical assistance will be carried out over a period of up to 2 years, starting in about January 1996. This will permit effective use of the technical assistance and help avoid overload of limited counterpart resources within the bank supervision department.

D. COUNTERPART AND IMPLEMENTATION ARRANGEMENTS

9. The agency in charge of implementing this project, as part of the World Bank's Finance and Enterprises Development Loan, is the National Bank of Kazakhstan (NBK). The Project Implementation Unit for this component of the Financial and Enterprise Development Loan will be responsible for contractual and logistical arrangements. The technical main counterpart agency for this component will be the Banking Supervision Department of the NBK.

10. The two new advisors will work under the leadership of the lead advisor on Phase I, until his departure. At that time, one of the new advisors will be selected as team leader. The advisors will also closely coordinate activities with the resident banking supervision specialists of other donor agencies, especially the EU-funded classroom trainer and the IMF and USAID-funded advisors on off-site examination, bank licensing, supervision regulations, and BSD organization, to the extent that they are still employed by that time.

E. ACTIVITIES AND OUTPUTS**(a) On-the-job training and advise in the execution of full examinations**

To prepare for the examinations, the BSD Director, the manager of the on-site supervision division, together with the advisors will prepare a list of the twelve banks to be examined during the first year by the foreign advisors and staff of the BSD. The NBK plans to make material related to these banks available to the advisors, in order for them to prepare the examinations. Meetings between the BSD and the banks will be arranged by BSD to present the advisors and the examination teams to these banks in order to coordinate the examination work. These meetings will take place at least two weeks prior to every examination. Examinations will increasingly allow the participation and responsibility of BSD's new examination team leaders. The advisors will:

- (i) propose the selection criteria for the twelve banks to be fully examined during the first year of Phase II, and the topics to be covered during these examinations; of those banks, some will be classified as problem banks, and will be examined under the advice of the specialized advisor on problem banks;
- (ii) assist the preparation of materials necessary to conduct the examinations, including what may be available in the banks, and conduct strategy sessions with the BSD team who will participate in the examinations;
- (iii) conduct four three-day preparatory sessions on the specific tasks to be carried out by each team during the examinations;
- (iv) advise in the execution of the examinations; it is expected that each examination will last for up to three months and that each advisor will be responsible for six banks per year;
- (v) provide assistance and guidance for the preparation of the examination report and review inputs from BSD staff participating in the examinations;
- (vi) prepare and monitor a follow-up scheme aimed at periodically reviewing the implementation of the examiner's recommendations, and assist in the preparation of a conclusion for those banks where the process of examination, implementation, and review has been completed.

(b) Policy Advice and Guidelines

Formal meetings will be held weekly between the Director or Deputy Director of BSD, the head of the on-site supervision division, and the advisors of phases I and II of the program to discuss the development of the program. The advisors will:

- (i) provide advice to BSD and other NBK officers as appropriate on issues that they identify during the examination process, and on strategies to deal with specific issues of problem banks, and on others related to banking supervision as requested by the NBK;
- (ii) conduct at least two half-day seminars in the first year on the examination of problem banks, risk management, and portfolio classification, for NBK's leadership and higher level staff. Similar brief high-level seminars will be conducted in the second year;
- (iii) hold two half-day seminars on problem banks, risk management, and loan classification for commercial bank managers;
- (iv) prepare technical notes to be included in the bank examination manuals and guidelines that will be used by the division. They will not be intended to be used as a unique source of knowledge in the subject, since the overall goal is to develop the personal analytical skills of the examiners. The manuals shall be targeted to deal with the specific conditions of the banks in Kazakhstan, and aim at facilitating the introduction of internationally accepted banking practices.

(c) Formal Training

The resident foreign advisors will:

- (i) coordinate with the USAID-funded trainers and the phase I advisors on the classroom training program on problem banks, risk management, loan processing procedures, and portfolio analysis and classification, and on the assessment of the overall financial condition, including its sustainability, of banks;
- (ii) help BSD and the USAID-funded trainers prepare training materials for the seminars on dealing with problem banks and risk management, which should include case studies on actual on-site examinations of problem banks and of loan portfolio analysis and classification methods;
- (iii) provide further instructive materials in Russian, which should be targeted at the specific level of skills of the BSD staff and at the status of the banking sector; and
- (iv) during the second year of their assignment, continue some of the classroom training that had in the first year been provided by the USAID-funded trainers. The training should be concentrated on perfecting examination techniques, and on problems banks, risk management, and portfolio analysis. The advisors will conduct at least two one-week courses.

11. **Confidentiality.** This program is being carried out exclusively for the purpose of developing a basis for strengthening the banking supervision capabilities of the NBK and initiating on-site bank examination practices. Accordingly, the advisors will neither discuss with nor distribute to parties outside the NBK, the World Bank, and the management of the relevant bank, without their explicit authorization, any aspects or details relating to their findings.

F. REPORTING

12. The advisors will submit an inception report no later than six weeks after commencing their assignment. Thereafter, they will submit quarterly reports on the implementation of the project. All reports shall be submitted to the NBK in two Russian language and one English language copies, respectively; and to the World Bank in two English copies. These reports shall be in informal style. All such reports will enumerate the inputs, activities and outputs of the last period; the contribution to the project objectives; the problems encountered, remedies sought, and further remedies; the detailed plans for the coming period; and suggested changes to the plans for subsequent periods; and miscellaneous further issues. The reports will annex all distributed training materials and contributions to examination manuals and guidelines. The examination reports shall be provided to the NBK and the examined banks in two Russian-language copies, respectively. The World Bank will be provided access to these reports by NBK upon request.

G. ADVISORS QUALIFICATIONS

13. The advisors should be bank examiners and/or auditors with extensive experience in the preparation of examination reports, who have also experience in training. One of them must have recognized experience in examination of and strategy formulation for problem banks. The other must have loan portfolio analysis and classification experience in developing financial systems. They should also have policy advice experience. Familiarity with transition economies will be highly valued. Advisors shall not be replaced, during the course of the program, without the prior agreement of NBK and the World Bank. Knowledge of the Russian or Kazakh languages will be highly appreciated.

H. INPUTS

14. The advisors' contract will cover:

- * fees including overhead;
- * travel, accommodation, and living expenses;
- * project-related communication, report distribution, and office supplies;
- * translation, interpretation, and English-language secretarial support;
- * office equipment (computers, printers, facsimile machines, copiers, etc) as far as needed in addition to equipment provided in phase I of the program, to be passed to the NBK at the time of project completion.

15. The NBK will make available to the advisors:

- * assistance in the arrangement of housing, hotel rooms, visas, and travel;
- * Russian-language secretarial support;
- * data and legal texts as requested by the advisors and required for carrying out their assignment;
- * a furnished office with telephone.

16. Included in the contract shall be contingency of 5% that can be used flexibly but only with prior approval of NBK and the World Bank.

I. BUDGET AND FUNDING

17. The Project is proposed to be funded under the Finance and Enterprise Development Loan of the World Bank to the Republic of Kazakhstan. This Loan has been appraised and negotiated, and is awaiting presentation to the World Bank Board of Directors in march 1995. The total Loan will likely amount to about US\$62 million equivalent. It is designed to support the payment system and the development of commercial banks, and further reform initiatives in the enterprise and financial sectors. The consultant contract shall not exceed US\$963,000.

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

LONG-TERM PAYMENT SYSTEM

CONCEPT NOTE

A. BACKGROUND

1. The transformation of a centrally planned economy into a market economy fundamentally changes the role and operation of the payments system. In a well developed market, the payments system is an effective mechanism for (i) channeling credit transfers to producers and consumers of goods and services, (ii) improving the availability of working capital to enterprises to meet their trade obligations, (iii) facilitating foreign investments, (iv) playing a critical role in market economies by expediting the circulation of money between economic players, (v) regulating the financial conduct and viability of the participants, (vi) facilitating proper financial sector operations oversight of credit and liquidity risks, (vii) reduce the float in the system, (8) improve liquidity management, and, (viii) protect the rights of financial intermediaries and customers. The proposed component of the Project is designed to support the establishment of these objectives in Kazakhstan's financial sector through a long-term program.

2. The concepts in this component have been coordinated with the overall policy framework recommended by the IMF and its cooperative partners. These partners include payment system technical specialists from the Bank of Japan, and experts of the Bank of France for the implementation of a new chart of accounts of the National Bank for financial reporting, monitoring and statistical analysis.

3. On recommendations from both IMF and the World Bank, a separate Payment System Division has been created within the National Bank of the Republic of Kazakhstan (NBK) to take a lead role in the coordination activities concomitant with the design and operation of the payments system. An Information Technology Sub-committee has also been formed to evaluate the technical features of the payments system and promote the transfer of responsibility for processing of customer and ledger accounts from NBK to the commercial banks.

B. THE PRESENT PAYMENTS SYSTEM

4. Nineteen regional clearing centers are presently supporting a daily average of 200,000+ intra and 70,000 inter-bank financial obligations and transactions. These volumes are expected to grow at an annual rate of at least 10% though growth rates of 25% could be expected in view of the present low base. These transactions are settled within 2-3 work days in the greater Almaty area, where electronic data transfers have been introduced recently. Regional transactions are settled within 7-10 work days resulting in a high negative float (a net reduction in monetary assets held by financial intermediaries); the additional delay is due primarily to an inadequate telecommunication infrastructure, and the geographic dispersions of the regional clearing centers. Special courier services have been contracted to reduce the data transmission delays to and between the clearing centers. The clearing centers are all automated, with the finality of settlements being performed at each region where each branch of each bank has a correspondent account (settlement account) and a reserve account for each bank is maintained at Almaty. These accounts are debited after they are checked against incoming transactions for sufficient cover. If there is insufficient cover in an account, all debits on that account are frozen pending injection of funds (refinancing or overdrafts) by NBK, or receipt of credits against that branch account. Owing to deficient data processing capacities and linkages between regional centers, the settlement balances are "netted out" twice a month at Almaty, and the reports distributed thereafter to the commercial banks. This, coupled with the lack of an accurate and timely in-house account maintenance capability and knowledge of aggregate reserves/correspondent balances across the branch network, forces

financial institutions to maintain a high level of correspondent reserves at each branch. The correspondent and reserve accounts are maintained independently, increasing the domestic "float" in the system, which shows up on the books of NBK and therefore reduces the overall liquidity of the banking system.

5. In addition to the nineteen NBK Clearing Centers, there are about 255 Cash Centers at the district and 19 at the regional levels. These support the distribution of currency to financial institutions, the provision of working capital/account maintenance for state-owned enterprises, and the collection and transmittal of debit/credit advices to the Clearing Centers for computer processing. The Cash Centers lack adequate automated processing capacities, and the need to use courier/postal/teletype services in some cases, for transmission of data to the clearing centers, contribute to the system delays. Some bank branches have a rudimentary electronic linkages to the regional centers for data transmissions, though the lack of adequate regulations/controls has resulted in some cases of fraud. The recent introduction of checks for wholesale trades has not been entirely successful due to an insufficient legal framework to protect against fraud. However, the continued use of checks in the future is being encouraged, as the appropriate rules, regulations and standards will be developed during the design of the payments system.

6. There are five large commercial banks with the People's Bank (former Savings Bank) having the largest branch network of 4,400 branches, of which about 1,200 may be considered to be significant deposit mobilizers with more than 10,000 accounts each. It has a staff strength of approximately 18,000. The other four banks have branch networks ranging from 30 to 330 branches. These four banks are making concerted efforts to achieve self-sufficiency in their internal account processing and institutional operations through internal automation programs. These are microcomputer-based with local area networks and accounting software developed locally. The more active and bigger of the branches are now submitting end-of-day balances electronically, together with supporting documentation, to the regional centers in an attempt to reduce the processing delays. This system engineering is suitable for smaller banks, although some of them are rapidly growing; the larger banks would need to graduate to a more sophisticated architecture in order to improve liquidity management and customer service. A number of critical constraints are, however, hampering the commercial banks in their efforts to improve their operations. These include:

- * The NBK payments system (and customer accounting) software developed in Russia is relatively old and does not support the modalities of a two-tier banking system -- e.g. individual clearing accounts are maintained for each branch of each bank, revaluations are not supported, and the concept of paper truncation (electronic version of paper-based instructions) has not been introduced. Additionally, the computer hardware(s) are operating at full capacity resulting in processing delays. Recently, NBK has replaced this hardware and accounting software with a newer accounting software, again developed in Russia, which operates on powerful microcomputers and performs account closings within 3 hours. The microcomputers were partly purchased by NBK and partly supplemented with those procured through the Bank's Technical Assistance Loan. This is a temporary measure pending the implementation of a long-term in-house solution in the banks themselves. However, this interim solution does ameliorate somewhat the overall processing timeframes.
- * The lack of institutional capacity, and foreign exchange resources, on part of commercial banks to computerize their accounts which are still being maintained centrally by NBK. Because of the inefficient data processing support from NBK, the bank branches receive their daily account statements, from the regional centers, after at least a three day delay while liquidity reports are generated monthly. This results in poor loan portfolio, credit risk, treasury functions and network liquidity management, and, necessitates bank branches to maintain manual "shadow" accounts.
- * The inefficient payment and accounting system -- with concomitant uneven and uncertain cash flows -- also contributes to the large inter-enterprise arrears through slow execution of payments, ineffective

management of working capital, and risks associated with automatic granting of overdraft facilities in the absence of accurate account balances.

- * Locally developed microcomputer-based accounting software does not conform to the requirements of modern commercial banking practices for both front and back-office operations, including the basic requirements of treasury management and double-entry accounting functions.

C. THE PROPOSED REFORM STRATEGY

(a) Interim Improvements

7. The Project would support the design and implementation of a long-term payments system/network which would be owned and operated by the NBK. As an interim measure, the World Bank's Technical Assistance Loan is instituting by mid-1995 a few key short term and low cost improvements to the existing payments hardware and software; these are again being implemented by NBK. These improvements basically build on the newly introduced accounting system which maintains the accounts of the banks, and would be a precursor to the more comprehensive solution. The interim improvements support:

- * the procurement and installation of powerful microcomputers or work stations, and telecommunication devices at the Cash Offices and the Regional Clearing Centers. The end-of-day accounting cycle would be accomplished within 3 hours at each regional center. The regional centers would "net" the reserve and settlement accounts for each bank, and transmit electronically the "netted" clearing balances to NBK headquarters;
- * data entry of payment orders at the Cash Centers and forwarding of inter and intra-transactions electronically to the regional centers. This will reduce the workload at the clearing centers, and facilitate monitoring and control of corporate liquidity and reserve positions;
- * the possibility of transmitting "high value" inter-bank transactions on a priority basis from regional offices to NBK headquarters and enacting the finality of "next day" settlements on the books of NBK;
- * creation of an overnight inter-bank indebtedness matrices at the regional centers and a national matrix in Almaty, after the existing NBK accounting system successfully updates the accounts. This would facilitate the generation of overnight liquidity (correspondent and reserve balances) reports for each bank. The NBK has directed the banks to consolidate their correspondent accounts; the above attributes would enable the banks to accomplish this feature; and
- * the operation of the new chart of accounts/accounting software for the automatic generation of accounting entries with data entry being limited to specific data items (e.g. sector, type of institution).

(b) Long-Term Payments System Objectives.

8. The second phase of the payment system modernization program would start concurrently with the implementation of the short term solution, but the long-term system will start operating only after more than 2-3 years after the interim system -- upon start of the long-term system, the equipment purchased in 1994 for the interim system will be used to support the long-term system, as explained below. External specialists (contracted by NBK in coordination with the other financial institutions) have been undertaking a study to elaborate on the feasibility and design of the long-term program. The study is scheduled to be completed by end March 1995. The NBK has already undertaken to implement certain key business and policy recommendations made by both IMF and the World Bank. A number of policy decisions were tentatively

agreed on by NBK; these decisions are being incorporated by the consultants in the design of the long-term payments system unless there was a justifiable reason for a modification.

9. Some of the objectives of the new system would be to: (i) perform finality of settlements on a daily basis, consolidation of cash in vault, reserve, settlement balances; (ii) maintenance of one settlement account per institution; (iii) acceptance of both gross and netted values (with the latter emerging from bi-lateral and multi-lateral clearing arrangements); (iv) development of a "real time" high value system; and (v) inclusion of private sector representatives in the decision making process to foster cooperation and competition and also support private sector initiatives for bi or multi-lateral clearings between financial institutions. The modernization program would include the establishment of:

- * the reconstitution of the National Payments Council to provide oversight over the development and implementation of the payments system;
- * an internal NBK senior management team responsible for the conceptualization of the payments system and for coordinating decision-making across organizational boundaries;
- * a financial risk management framework and regulations (including incentives/penalties for compliance with standard timeframes for finality of settlements) defined in cooperation with trade groups and financial players. This would support the operation of an inter-bank market by shortening the maturity of the financial trades, and facilitate the development of new money market instruments and government securities. The framework would also importantly enforce the concept that NBK should be the "lender of last resort";
- * the definition of NBK's role in the finality of settlements, overdraft/refinancing mechanisms, queuing rules, avoidance of systemic failures, audits etc.;
- * rules for identifying pricing norms/structures for the cost effective utilization of the payment network, financial intermediaries and participants; institutional structure of the network; payment system membership rights; competition and cooperation; and, legal recourse for the customers of the system;
- * the definition of national standards (for existing and planned instruments and magnetic cards) and linkages with international networks (e.g. Swift);
- * the provision of a retail book-entry capability and accommodation of credit/pre-paid cards, checks and other financial instruments;
- * appropriate data security and back-up features to prevent fraud and systemic failures, as well as to ensure continuity of operations; and
- * the possibility of the ultimate privatization of the three regional clearing centers, with NBK retaining the processing of the settlement function.

(c) System Architecture

10. This component of the Financial and Enterprises Development Project would support the implementation of reasonably powerful computer system(s) at three major regional sites (Almaty, Northeast and West), with all three of them supporting clearing functions but only the Almaty center accomplishing settlements and maintaining the settlement (correspondent) accounts. This architecture was based on a volume/workload analysis of existing and expected transactional activities. Additionally, the loan would include payments system application software, and telecommunication links to ensure that the clearing centers

and financial intermediaries are networked, and that the NBK oversight role is supported adequately. This architecture was discussed with both NBK and the consultants performing the payments system feasibility study, and was endorsed by all parties. The three centers would each have duplexed machines for back-up, while the Almaty database (comprising almost 66% of the national workload) would be replicated in the Northeast region for effective disaster recovery. This network would be owned and operated by NBK and be known as the National Payment Network. The Project would include substantive classroom and on-job training, and facilities management for an initial limited period until NBK staff become self sufficient. The selected contractor would be required to perform the detailed design, programming and implementation of the payment system application software within the framework identified through the feasibility study.

(d) NBK Functions

11. The National Bank computer network would also enable NBK to improve its central banking functions (e.g. foreign exchange, balance of payments, bank supervision, statistical analysis, general and subsidiary ledger accounting) through the procurement, customization and implementation of a comprehensive banking application software package. The network would allow both "gross" and "netted" financial obligations to be received from banks in electronic and paper-based media, with the latter being phased-out as the banks become technologically self supportive. The NBK headquarters would have access to an on-line inter-bank indebtedness matrix for oversight purposes as well as for injection of collateral, refinancing etc. to avoid system failure. The project could also support the establishment of an off-site prudential supervision system which would complement the on-site activities and provide indicators to assist in identifying problem areas.

(e) Telecommunication Network

12. The use of satellite communication links between the three regional sites would be investigated, and utilized if determined to be cost effective; a planned fiber optic link between Almaty and the Northeast region could also be utilized for the back-up of the Almaty database. The poor feeder links from remotely located bank branches to the three clearing centers would be facilitated with the availability of the 255 cash center workstations and modems that are part of the Interim Payment System) to act as "gateways" to the network where the bank branches cannot, or decide not to, use the telephone lines on a dial-up basis. The cash centers in the future would only maintain public sector accounts as well as perform as cash distribution centers; it is quite feasible that their number would be reduced in the future, but the telecommunication gateway equipment would be retained to facilitate linkages with the payments system network.

(f) Commercial Banks' Customer Accounting

13. A complimentary sub-component of this Long-Term Payment System component would support commercial banks to become self-sufficient in their customer accounting functions by making available a modern banking software package. This package would be the same as that for internal NBK operations and would be complemented with a version for microcomputers -- or at least be well integrated and seamless with the minicomputer version installed at the clearing centers etc. To achieve this target, NBK would identify a cut-off date for commercial banks to become self-sufficient, which is presently targeted for early 1997. After this date, NBK would discontinue processing the customer accounts for commercial banks. Two senior banking/information technology specialists financed through this Loan, would for the initial year advise and audit -- on a as and when required basis -- the commercial banks' on their individual automation programs, and recommend cost effective solutions. Some of the benefits expected through the availability of a modern and comprehensive banking application software package include:

- * improved financial and treasury management, and asset and liability management;
- * foreign exchange management and foreign exchange correspondent banking;

- * enhanced credit risk management and development of credit policies and procedures, creditworthiness analysis, problem loan management, and the design of secure lending instruments;
- * better quality of services and streamlined operations to accommodate new instruments (such as factoring, leasing, and mortgage financing); and
- * upgrading of accounting practices, in particular the development of financial, cost, and management accounting.

14. In the case of four large and four medium-size banks, the customer accounting would also be facilitated by the provision of computer hardware etc. as part of their development programs funded by this World Bank Loan (for four banks) and EBRD (for further four banks). For the remaining state-owned, private and joint-stock commercial banks, the banking application software package would be made available at a charge to be determined by the National Payments Council; they would need to procure the hardware from their own budgets.

(g) Coordination with Magnetic Card Program

15. NBK is implementing a modern magnetic card message authentication and switching center as a "pilot" exercise in a selected regional location, and envisages a nationwide use of magnetic cards (debit and credit) in an increasingly "cash-less" economy. NBK plans to seek co-financing by other donors or even joint venture arrangements for this endeavor. The design of the payment system would assure that such initiatives would be closely interconnected to capture any cross border, high value and "netted" obligations which would affect liquidity and reserve positions.

D. IMPLEMENTATION, COSTS AND RISKS

16. The investment costs of this project are estimated at a total of approximately US\$23.85 million. Of this, the general banking application software sub-component including software licensing, customization, and advisory information technology services amount to about US\$5 million equivalent. Thereof about US\$2.2 million equivalent are incremental costs for making the software also available to a number of commercial banks (especially those that do not participate in the institutional development program for banks); the other costs stem from NBK's computing needs for its own operations (see above). The cost of the payments system network itself is expected to total about US\$19 million equivalent. The operating costs for the first three years would amount to US\$2.2 million in foreign currency and about T46 million (US\$0.9 million equivalent).

17. The implementation schedule foresees the commencement of operation by July 1997, and completion of the last implementation steps -- on-site implementation assistance and operations management by the supplier -- by June 1998.

18. The reform process and the system design are aimed at minimizing various potential risks: (i) The system design would be flexible enough to accommodate both gross and netted inputs, which would be important if there are future changes in major commercial banks' modus operandi and in bi-lateral clearing arrangements. (ii) Commercial banks might well decide to perform multi-lateral clearings, and transmit the "netted" balances to the Payments System's network workload. However, the NBK network would still be required for settlements on the books of the NBK, and for NBK's internal central banking functions. Moreover, the NBK system would still process on a gross basis the high value transactions, and those low value transactions that are not covered by multi-lateral clearing. In any case, the largest banks would likely not be able to implement comprehensive multi-lateral clearing for several years. (iii) There is a potential risk of delays in the computerization of commercial banks' operations. However, competition and a mandated cut-off date for banks to achieve self-sufficiency would pressure the banks to institute effective automation

programs and linkages. The availability of application software would also assist the banks in this endeavor. (iv) Delays in the implementation of the new network would be minimized by phasing, under the Project, payments to the contractor on the basis of milestones and specific pre-defined deliverables.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT
TECHNICAL ASSISTANCE FOR PROJECT IMPLEMENTATION
DRAFT TERMS OF REFERENCE

A. BACKGROUND

1. The Republic of Kazakhstan envisages concluding with the World Bank an Agreement for a Financial and Enterprises Development Loan of US\$61 million to support critical institution and infrastructure building in the financial and enterprise sectors. The Project has been prepared since 1993; Loan negotiations were conducted in January 1995; and the Project is planned to be implemented from April 1995 until end 1997.
2. The Loan would help finance information and communication technology, training, and technical assistance. In the enterprise sector, the Project would: (i) continue the World Bank's assistance for the implementation of the Government's privatization program, including case-by-case privatization; (ii) provide advisory services for the defensive restructuring and privatization of distressed large enterprises, or for their liquidation; and (iii) transfer modern market economic know-how to enterprise managers through a program of highly structured study tours. In the financial sector, the Project would support: (i) advice for the start-up and operation of a debt resolution institution ("Rehabilitation Trust") to force the restructuring and resolve the debts of thirty to forty insolvent enterprises that burden the banks, state budget, and other creditors most severely; (ii) institutional development programs for two promising medium-size banks and restructuring programs for two large, formerly specialized banks, consisting of intensive three-year assistance by foreign banks ("twinning") and of equipment and software for bank automation; (iii) strengthening of prudential bank supervision at the National Bank through on-the-job training of bank examiners, with increasing specialization on problem banks; and (iv) the long-term investments for a new domestic payment system aimed at, *inter alia*, same-day finality of settlements and real time processing of high value transactions. In addition, the Loan would fund assistance for the implementation of this Project.
3. Government authority for the management and implementation of the Financial and Enterprises Development Project will lie for the main financial sector components (payment system, commercial bank development program, and bank supervision) with the National Bank of the Republic of Kazakhstan (NBK); for privatization assistance with the State Property Committee (SPC); and for the Rehabilitation Trust, Restructuring Advisory Unit, and manager study tours program with the Ministry of Economy (MOE). NBK has recently created a Project Implementation Unit (PIU) with four local staff within its External Economics Relations Division. SPC is establishing a similar PIU, with at least two local staff, before end February. MOE already has been operating a PIU for one and half years under the National Agency for Foreign Investment (NAFI), which is located under MOE.
4. The Project involves the procurement of goods such as computers, software, and telecommunication equipment, especially for the financial sector components, as well as consultancy in all the above-mentioned Project components.
5. According to World Bank policy, procurement is the responsibility of the Borrower. However, for many years before Kazakhstan's Independence, public sector procurement was carried out centrally from Moscow through long established and experienced trading companies. As a result, no international procurement capability was developed locally at the time, and it is still limited today. Technical assistance is therefore required to enable the above agencies to apply appropriate procurement practices as well as related disbursement and other functions, for the efficient and timely use of scarce foreign exchange resources to support critical reforms in the financial and enterprise sectors.

B. OBJECTIVES

6. It is proposed that the services of a consultant firm ("the Consultant") will be financed through the use of proceeds from the Financial and Enterprises Development Loan and its Project Preparation Facility, to assist technical staff at NBK, SPC, and MOE with the full range of procurement and disbursement advisory services for a period of initially one year. The Consultant's services will be obtained through a competitive selection process in compliance with the World Bank's guidelines. Based on Project implementation requirements, the extension of this contract beyond the first year will be subject to the prior review and approval of the NBK, in consultation with SPC and MOE, and the World Bank. This Loan will provide funding initially for 1 resident and 2 semi-resident advisors, and some limited home-office support.

C. RESPONSIBILITIES OF NBK, SPC, AND MOE IN THE PROJECT**(a) Overall Project Implementation**

7. Overall implementation responsibilities of NBK, SPC, and MOE in their respective areas of responsibility under the said Loan will include the following:

- * coordination of their activities with those of concerned ministries, other public entities, trading companies, participating commercial banks, and consultants, in order to monitor project implementation for ensuring consistency and timeliness of all the Project components;
- * monitoring of the procurement of, and the disbursement for, the goods and services purchased through the Loan;
- * management and administration assistance as may be necessary for the successful implementation of their assigned elements under the Loan, consistent with that of the overall Project;
- * compilation of their respective component-related contributions to the Project Progress Reports and Project Completion Report.

(b) Procurement

8. NBK, SPC, and MOE, as well as the four participating local commercial banks (with regard to the commercial bank development component) will be responsible for the procurement of all goods and services under their respective Loan components. The following summary of responsibilities should be read with the World Bank's Procurement Guidelines.

9. Procurement of Goods. Goods to be procured under this Loan will consist primarily of computers, telecommunication equipment, software, and office equipment. It is tentatively estimated that the Project will entail 6-10 procurements through International Competitive Bidding (ICB). For procurement under ICB procedures, NBK, SPC, MOE, and the participating local commercial banks, with the assistance of the Procurement Consultant, will be responsible for undertaking and monitoring the following activities:

- * advertising in local and international professional and press media, and advising foreign delegations of Bank members countries, including CIS countries who have become members of the Bank, and Taiwan (China);
- * preparing bidding documents using the World Bank's *Standard Bidding Documents* for the procurement of goods and computers, respectively;
- * distributing/selling bidding documents to prospective bidders;
- * inviting bids from suppliers in eligible countries;

- * conducting the bid opening process and the evaluation of bids; and
- * when designated to do so, signing and finalizing the contract.

10. For non-ICB procurement, NBK, SPC, MOE, and the four participating local commercial banks, assisted by the Consultant, would ensure that the appropriate procedures specified in the Loan Agreement, are being followed, including:

- * soliciting written quotations from a list of potential suppliers in eligible countries;
- * soliciting quotation on sole-source basis and negotiating with suppliers for spare parts or other proprietary items; and
- * after receipt of a "no objection" notice from the World Bank to proceed with the process, placing purchase orders and contracts with selected suppliers.

11. In the area of contract administration, NBK, SPC, and MOE, assisted by the Consultant, will be responsible for the following:

- * collecting documentation, such as inspection certificates, certificates of origin/manufacturer/manufacturers'/suppliers' guarantees, bills of lading, beneficiary insurance certificates, and manufacturers' invoices;
- * forwarding documentation to the clearing agent;
- * handling insurance claims; and
- * assisting in the preparation of withdrawal applications with the required supporting documentation, and arranging payments to suppliers.

12. Technical Assistance. For technical assistance and training, NBK, SPC, MOE, and the participating local commercial banks, with assistance by the Consultant, would:

- * prepare or, where drafts were already prepared during Project preparation, review and finalize Terms of Reference acceptable to the World Bank, prepare consultant short lists, solicit proposals, review bid evaluation and endorse consultant contracts, ensuring that the selection procedures and contracts comply with the Loan Agreement and Project Agreement and with Bank guidelines for recruiting consultants; and
- * monitor the implementation of technical assistance contracts to ensure their timely execution. The above concerned agencies would also ensure that the consultants receive the supporting services agreed (secretarial support, counterpart staff, office facilities, etc.); can freely travel to, from, and within Kazakhstan have access to documents and other necessary information; are paid in a timely and professional manner; and provide acceptable outputs and periodic reports for each assistance component.

(c) Disbursement

13. NBK, SPC, and MOE will be responsible for the disbursement of funds, the preparation of withdrawal applications, and the collection of documents for their respective Loan components. Disbursement will start once the Loan becomes effective, except for selected initial activities that are expected to be funded under the Project Preparation Facility (PPF), which will be an advance to the Loan. The World Bank's Disbursement Handbook, which outlines disbursement procedures for Bank Loans, provides additional information on the procedures and should be read in conjunction with this section. Withdrawal applications will be fully documented, except for expenditures against contracts valued at less than US\$ 10,000 equivalent, which will be made on the basis of certified statements of expenditures detailing the individual transactions. The documentation to support these expenditures will be retained by NBK, SPC, and MOE, respectively, for at least one year after receipt by the World Bank of the audit report for the year in which the last disbursement is made. This documentation will be made available for review by the auditors (see sections below on Reporting, Accounting, and Auditing) and the World Bank upon request.

14. Project Preparation Facility (PPF). A PPF is expected to be approved prior to mid-March, 1995, to finance some activities related to the start-up of project implementation. Disbursement procedures to be followed under the PPF are the same as for the Loan, as discussed below.

15. Special Account. To facilitate and expedite the disbursement of funds, NBK, SPC, and MOE will each open a Special Account in a commercial bank acceptable to the World Bank. The Special Account will be maintained in a fully convertible and stable currency. Documentation requirements for replenishment allocations will follow the same procedure as described above. In addition, monthly bank statements of the Special Accounts, which have been reconciled by the respective agency, should accompany all replenishment requests.

16. The commercial bank or banks selected to be the depository bank of each of the Special Accounts should be selected as soon as possible (criteria are defined on page 31 of the Disbursement Handbook). These Special Accounts should be in the name of the Borrower and will be administered by the respective authorized representatives of NBK, SPC, and MOE on behalf of the Borrower. Two signatures will be required to execute any transaction from an account. The Special Accounts will be replenished at monthly intervals, or more frequently if necessary.

17. Goods. For goods to be financed under this Loan, contracts will include payment terms and NBK, SPC, and MOE will have to ascertain, before approving the contracts, that these payment terms are in line with Bank disbursement procedures. The acceptable disbursement procedures for this component will be the following:

- * procedure of special commitments for letters of credit;
- * in the case where no letter of credit has been used, direct payments to the suppliers by either of the concerned agencies through the Special Account can also be effected.

(d) Reporting, Accounting and Auditing

18. NBK, SPC, and MOE, with assistance by the Consultant, would each establish and maintain a sub-system of their existing management information systems covering all procurements financed by the Loan including information received on all procurement transactions, including the identity of the user, the kind of goods purchased, the contract value, identification of the bidders and the winning supplier, the key dates for the bidding process, and the subsequent fulfillment of the contract.

19. The above information will allow NBK, SPC, and MOE to monitor their respective Project implementation elements, and will also provide the basis for each of the concerned agencies to prepare the regular Project Progress Reports and, together with the Bank, the Project Completion Report required after the Loan has been disbursed and closed.

20. NBK, SPC, and MOE would each also establish appropriate sets of accounts within their existing accounting systems, in order to provide information on receipt and use of funds, in line with the terms of the Loan Agreement. The system would ensure timely and accurate accounting of all transactions under the Loan, and clear presentation of the financial information. It should enable identification of the use of all funds by components and categories of good imported. The accounting should reflect the movement of the receipts and payments through the Special Account, with balances agreed with monthly financial statements from the holding commercial bank and with periodic statements from the World Bank.

21. A condition of the Loan will be that the financial statements and reports on the Loan (including the Special Accounts) be audited in accordance with generally accepted auditing standards by independent auditors acceptable to the World Bank. As the NBK has considerable experience in financial matters and also is the organization responsible for the implementation of the greater portion of the Loan, it is envisaged that it will

then assume the responsibility for engaging an experienced and qualified independent auditing firm through a competitive selection process acceptable to the bank. The independent audit firm will conduct audits on NBK, SPC, and MOE according to audit criteria and a report submission timetable acceptable to the World Bank.

D. IMPLEMENTATION ASSISTANCE TO NBK, SPC, AND MOE UNDER THIS PROJECT

22. Concept of the Assistance: To enhance the capacity of NBK, SPC, and MOE to exercise the functions described above, the Loan includes an implementation assistance component of a total US\$1.5 million equivalent, to be used over close to three years. The assistance would also benefit the four local commercial banks that will be selected to participate in the commercial bank development component of the Project in their procurement and contract administration activities.

23. These terms of reference cover the first 12 months of the assistance. An experienced procurement advisor firm (the Consultant) would provide advice, assistance, and training on procurement, contract administration, disbursement, project reporting/accounting, and project coordination. It is envisaged that the firm would place one full-time resident procurement advisor with particular information technology expertise at NBK; a semi-resident advisor with mainly consultant procurement experience at SPC; and a (semi-)resident advisor, with special experience in disbursements, spending about four person-months at MOE and allocating about further 2-3 person-months to NBK and SPC, respectively, depending on workload. In close consultation with NBK, the advisor(s) supporting NBK would also provide implementation assistance to the four participating local commercial banks. The field team would receive back-up from headquarters of the consultant company, especially in specialized information and communication technology matters, and be supported by local assistants and translators/interpreters under contract with the firm. The advisor working at NBK, or the one working at all three agencies, will be the leader of the consultant team; he or she will also advise on, and assist, project coordination. Neither of the individuals shall be replaced except with the explicit approval of NBK and the World Bank, and of SPC or MOE as will be appropriate.

24. In the subsequent 1.5 to 2 years, implementation assistance would continue to be provided to NBK and SPC but with fewer person-months per year, partly on a short-term basis. This future activity is not covered by these terms of reference. Based on its performance during the first nine months, and the remaining implementation assistance needs, the contract of the Consultant might be extended, subject to prior review and approval of the NBK and the World Bank, in consultation with SPC and MOE.

25. Advisor Activities.

(a) Sub-Component: Project Coordination

The Consultants will support and ensure coordination between the implementation units at NBK, SPC, and MOE; the technical staff at NBK, SPC, and MOE; the Ministry of Finance, which represents the Borrower of the World Bank Loan and which oversees the Rehabilitation Trust; the participating local training institutions; the Rehabilitation Trust and Restructuring Advisory Unit; the National Payments Council and the Tour Program Steering Committee; the commercial banks that are direct Project beneficiaries; and the consultants providing various forms of assistance under the Loan. They will also provide liaison with consultant teams that support other related projects of the World Bank or other donor agencies.

(b) Sub-Component: Procurement

For procurement of goods conducted according to International Competitive Bidding (ICB) procedures or non-ICB procedures, the Consultants will provide advice and assistance to the implementation units at NBK, SPC, and MOE in all the activities listed in paras. 9 - 11. For the procurement of consultants/trainers (para. 12), the Consultant will advise and assist in the development of terms of references, the preparation for bid

evaluation, and the review of bid evaluation and endorsement of consultant contracts, and help ensure that the selection procedures and contracts comply with the Loan Agreement and with Bank guidelines for the recruitment of consultants. The Consultant shall also advise on contract negotiations. The Consultants will not themselves place orders or sign contracts, and shall not be members of the evaluation/selection committees.

(c) Sub-Component: Contract Administration

The Consultants will advise and assist in the administration/monitoring of contracts for goods including the collection of documentation; forwarding of documentation to the client agent; handling of insurance claims; and arrangement of payments to suppliers. The Consultants will also advise and assist in the monitoring of implementation of technical assistance contracts to ensure their timely and satisfactory execution, including acceptable outputs and periodic reports as specified in the contracts. The Consultants will also help ensure that the consultants under such Technical Assistance Contracts receive the supporting services agreed, and are paid in a timely and professional manner.

(d) Sub-Component: Disbursement

The Consultants will advise and assist the implementation units at NBK, SPC, and MOE in the preparation of withdrawal applications, the collection of documents for their respective Loan components, the arrangement of payment to suppliers, and the administration of the Special Accounts.

(e) Sub-Component: Accounting and Reporting

The Consultants will advise the implementation units at NBK, SPC, and MOE in accounting under the Project as specified above; advise them in the establishment and maintenance of information systems for the procurements financed under the Loan; and advise and assist in the preparation of progress reports.

(f) Sub-Component: Training

The advisors will provide training on all of the above described matters (a) to (e) to their counterparts at the implementation units of NBK, SPC, and MOE, mainly on-the-job but also through formal and informal seminars totaling at least four weeks over the one-year period. They will also assist the identification of, and arrangement of implementation unit staff participation in, suitable training seminars abroad. The Consultants will also provide brief ad-hoc instruction to the technical staff of counterpart agencies as will be needed to ensure timely procurement and adequate contract execution, especially on the procedures to be followed in conducting tenders, evaluating bids, and negotiating contracts.

26. Reporting by the Consultant. The Consultant will provide to the three concerned agencies and the World Bank an inception report after one month of work on this assignment; a progress report after each quarter year; and a final report at the end of the year. The reports shall be in informal style, and report on the Consultant's activities, contribution to objectives, problems encountered, remedies sought or proposed, and refined timetable of activities for the next quarter year. These reports are to be provided to the concerned agencies (NBK, SPC, and MOE, as well as the Ministry of Finance) in two Russian and one English copies, respectively, and to the World Bank in two English copies.

27. Consultant Qualifications. The Consultant will be chosen chiefly on the basis of the demonstrated personal qualifications of the three field advisors. The experts shall have substantial experience in procurement advice and in practical execution of a wide range of implementation services; a basic understanding of financial systems (NBK's advisor) and enterprise sector reform (MOE's and SPC's advisors); significant field experience in developing countries and possibly transition economies; and experience with large aid projects, preferably of the World Bank. NBK's advisor shall have particularly strong expertise in information and communication technology, and another advisor in disbursements under World Bank

procedures. In the case of all three advisors, Russian language skills would be highly appreciated but are not indispensable.

28. Inputs. The Consultant contract will cover:

- * consultant fees including overhead;
- * international and local flights, accommodation, and living expenses;
- * interpretation, translation, and operational assistance;
- * office equipment of no more than US\$ 40,000 for the personal use of the advisors during their visits to Kazakhstan, to be taken over by the respective counterpart agencies after completion of the consultant assignment;
- * sundry business expenses (communication, supplies, distribution of reports, etc.);
- * a contingency of 5% that can be used flexibly with prior approval of NBK and the World Bank, and SPC and MOE as appropriate.

29. The Government through NBK, SPC, and MOE for their respective components will make available to the Consultants:

- * assistance in the arrangement of multi-entry visas, travel, and local accommodation;
- * data, legal texts, and any other information as requested by the Consultants and required to carry out their assignment;
- * Russian language secretarial support; and
- * furnished office space with telephone facilities.

30. Budget and Funding. The assistance is planned to be funded under the Financial and Enterprises Development Loan of the World Bank. The Loan has been appraised and negotiated on January 14 and is scheduled for Board presentation on about March 15, 1995, with signature and effectiveness shortly thereafter. The total Loan is proposed to amount to US\$62 million. The authorities envisage using a Project Preparation Facility (PPF) of the World Bank to fund the early disbursements for this contract; the PPF agreement would be concluded prior to Board presentation of the Loan.

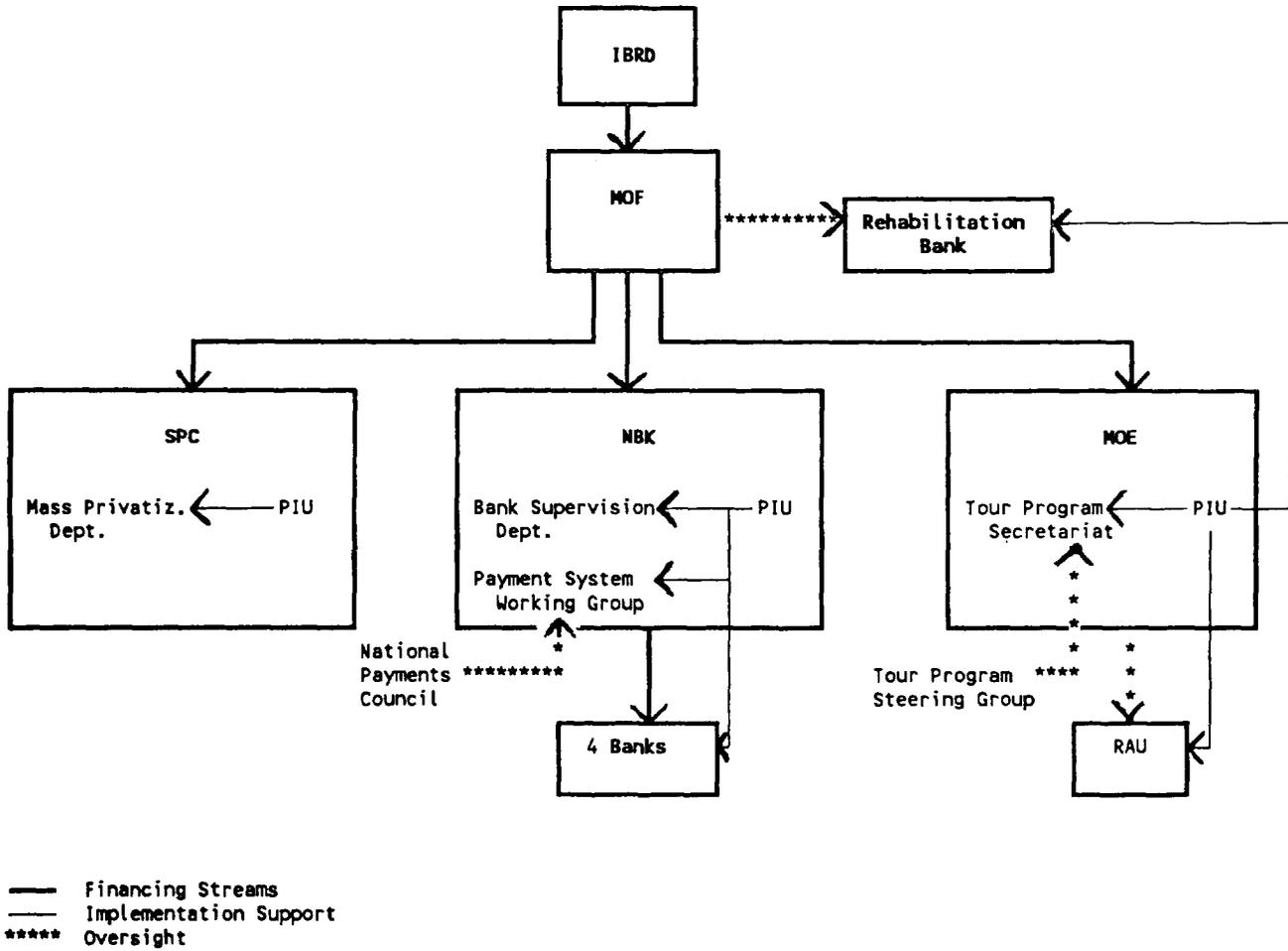
31. The funding of the Consultant contract (for one year of service) shall not exceed US\$715,000.

32. Further Sub-Components not Covered by the Consultant Contract. The Loan and PPF would also finance formal training of technical staff of the two counterparts NBK and SPC who so far been less involved than MOE in procurement and disbursement under World Bank loans. Three persons, respectively, who are directly involved in procurement and disbursement activities under this Project shall attend a training course of up to one month in procurement, accounting, disbursement and basic finance at the World Bank or a designated training institution. The participants shall be nominated by the respective agency and approved by the World Bank. The participants will have to commit themselves contractually to remaining directly involved in the Project for at least one year after the overseas training, unless released from this duty by their agency with World Bank approval.

33. Timing: The first advisor is expected to be fielded no later than May, 1995, and the last of the three advisors no later than by June, 1995.

REPUBLIC OF KAZAKHSTAN
 FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT
 INSTITUTIONAL ARRANGEMENTS UNDER THE PROJECT

Fig. V.1: Project Implementation Arrangements



**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

DETAILED PROJECT COSTS ^{/a}

Component	Local Cost	Foreign Cost	Total Cost	Foreign Costs as % of Component Cost	Component Costs as % of Total Costs
	(US\$'000 equivalent)				
1. ENTERPRISE SECTOR					
a. Privatization Assistance Phase II	1,143	4,061	5,204	78%	7%
b. Restructuring Advisory Unit	2,147	8,770	10,917	80%	15%
c. Manager Study Tours	342	1,912	2,254	85%	3%
SUBTOTAL: ENTERPRISE SECTOR	3,632	14,743	18,375	80%	25%
2. FINANCIAL SECTOR					
a. Rehabilitation Trust	310	2,190	2,500	88%	3%
b. Commercial Banking Development	2,290	14,703	16,993	86%	23%
c. Bank Supervision Phase II	260	1,050	1,310	80%	2%
d. Long-term Payment System	1,172	25,801	26,953	96%	37%
SUBTOTAL: FINANCIAL SECTOR	4,032	43,725	47,756	92%	65%
3. PROJECT IMPLEMENTATION ASSISTANCE	344	1,281	1,625	79%	2%
SUBTOTAL: BASE COST	8,008	59,750	67,756	88%	93%
4. CONTINGENCIES ^{/b}					
a. Price Contingency	146	1,261	1,407	90%	2%
b. Physical Contingency	397	3,355	3,752	89%	5%
SUBTOTAL: CONTINGENCIES	543	4,616	5,159	89%	7%
TOTAL COSTS	8,551	64,363	72,914	88%	100%

^{/a} More detailed cost estimates for each Project component are included in the Project File.

^{/b} These are unallocated contingencies. Under all Project components 1.-3., consultant contracts include contingencies (5% of each consultant contract's volume) that are integral parts of the estimated costs of the individual Project components and are therefore not included in the unallocated contingencies. Exceptions are consultancy and training that are part of the equipment contract under component 2.d, and short-term consultancies under component 1.b.

REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

DETAILED PROJECT FINANCING
(US\$'000 equivalent)

Component	Local				Foreign				Total				Total Project Cost	IBRD Financing as% of Cost
	GOK/NBK	Local Firms/Banks	IBRD	Other Donors	GOK/NBK	Local Firms/Banks	IBRD	Other Donors	GOK/NBK	Local Firms/Banks	IBRD	Other Donors		
1. ENTERPRISE SECTOR														
a. Privatization Assistance Phase II	200	0	943	0	0	0	4,060	0	200	0	5,003	0	5,203	96%
b. Restructuring Advisory Unit	435	485	1,227	0	0	0	8,770	0	435	485	9,997	0	10,917	92%
c. Manager Study Tours	14	230	98	0	0	0	1,712	200 <u>/b</u>	14	230	1,810	200 <u>/b</u>	2,254	80%
SUBTOTAL: ENTERPR. SECTOR	649	715	2,268	0	0	0	14,542	200	649	715	16,810	200	18,374	93%
2. FINANCIAL SECTOR														
a. Rehabilitation Trust	100	0	210	0	0	0	2,190	0	100	0	2,400	0	2,500	96%
b. Commercial Banking Development	0	994	648	648 <u>/b</u>	0	0	11,352	3,350 <u>/b</u>	0	994	12,000	3,999 <u>/b</u>	16,993	71%
c. Bank Supervision Phase II	101	0	138	21 <u>/c</u>	0	0	861	189 <u>/c</u>	101	0	999	210 <u>/c</u>	1,310	76%
d. Long-term Payment System	925	0	247	0	2,180	0	23,601	0	3,105	0	23,848	0	26,953	88%
SUBTOTAL: FINANCIAL SECTOR	1,126	994	1,243	669	2,180	0	38,004	3,540	1,126	994	39,247	4,209	47,756	86%
3. PROJECT IMPLEMENTATION ASSISTANCE														
SUBTOTAL: BASE COST	1,907	1,709	3,723	669	0	0	53,827	3,740	4,087	1,709	57,550	4,409	67,755	85%
4. CONTINGENCIES <u>/a</u>														
a. Price Contingency	55	48	43	0	97	0	1,159	5	152	48	1,202	5	1,407	86%
b. Physical Contingency	148	130	119	0	210	0	3,129	16	358	130	3,248	16	3,752	87%
SUBTOTAL: CONTINGENCIES	203	178	162	0	307	0	4,288	21	510	178	4,450	21	5,159	86%
TOTAL COSTS	2,110	1,887	3,885	669	2,487	0	58,115	3,761	4,597	1,887	62,000	4,430	72,914	85%

/a Under all Project components 1.-3., consultant contracts include contingencies (5% of each consultant contract's volume) that are integral parts of the estimated costs of the individual Project components and are therefore not included in the unallocated contingencies. Exceptions are consultancy and training that are part of the equipment contract under component 4.d, and short-term consultancies under component 1.b.

/b Donor to be confirmed.

/c United States Agency for International Development (USAID).

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

**MAIN CONTRACTS
PROCUREMENT METHODS AND CRITICAL PROCUREMENT STEPS**

Component	Contract Type	Base Cost (US\$ million) /a	Procurement Method	No. of Contracts	Preparation of Bidding Documents	Issuance of Invitation to Bid	Signing of Contract
PRIVATIZATION ASSISTANCE II Privatization Implementation Assistance	Consultants	4.92	Shortlists of 4-6 firms with selection based on technical merit	10	March, 1995 - January, 1996	May, 1995 - March, 1996	August, 1995 - August, 1996
RESTRUCTURING ADVISORY UNIT Core Consultant Team	Consultants	2.42	Shortlist of 4-6 firms with selection based on technical merit	1	February, 1995	March, 1995	June, 1995
Short-Term Consultancy to Support Company "Quick-Scans"	Consultants	0.79	Shortlist of 4-6 firms with selection based on technical merit	1-2	March, 1995	March-April, 1995	June, 1995
Consultancy for In-Depth Studies of Individual or Several Companies	Consultants	7.36	Shortlist of 4-6 firms with selection based on technical merit	7-10	April, 1995	May, 1995	August, 1995
MANAGER STUDY TOURS Tour & Training Consultant	Consultants	0.66	Shortlist of 4-6 firms with selection based on technical merit	1	February, 1995	March, 1995	June, 1995
REHABILITATION TRUST Consultancy for Operation	Consultants	2.18	Shortlist of 4-6 firms with selection based on technical merit	1	February, 1995	March, 1995	June, 1995
COMMERCIAL BANK DEVELOPMENT Technical Assistance through Foreign Banks	Consultants	8.00	Shortlists of 4-6 firms with selection based on technical merit	4	March - May, 1995	May - August, 1995	August - December, 1995
Systems Hardware & Software	Goods	8.84	ICB (80%); Direct Contracting (11%); LIB (5%); and IS (4%)	15-20	November, 1995 - April, 1996	December, 1995 - June, 1996	April, 1996 - October, 1996
BANK SUPERVISION PHASE II Bank Examination Trainers	Consultants	1.00	Shortlist of 4-6 firms with selection based on technical merit	1	July, 1995	August, 1995	December, 1995

Component	Contract Type	Base Cost (US\$ million) <u>/a</u>	Procurement Method	No. of Contracts	Preparation of Bidding Documents	Issuance of Invitation to Bid	Signing of Contract
PAYMENT SYSTEM							
Turnkey system contract	Goods and Services	19.23	ICB	1	March, 1995 - May, 1995	June, 1995	November, 1995
Commercial Banking Software	Goods	6.17	ICB	1	March - April, 1995	May, 1995	October, 1995
Information Technology TA for Commercial Banks	Consultants	1.11	Shortlist of 4-6 firms with selection based on technical merit	1	March - May, 1995	June, 1995	October, 1995
PROJECT IMPLEMENTATION ASSISTANCE							
Advice and Assistance for Procurement, Disbursement, etc.	Consultants	1.40	Shortlist of 4-6 firms with selection based on technical merit	1	December, 1994 - February, 1995	March, 1995	June, 1995

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

IBRD DISBURSEMENTS

Category	Amount			Total	Percent of Expenditures to be Financed
	NBK	SPC	MOE		
	(US' 000)				
Computers, Equipment, and Other Goods	30,850 <i>/a</i>	-	120	30,970	100% of foreign expenditures 100% of local expenditures (ex-factory costs), and 75% of expenditures for other items procured locally
Consultant Services	5,545 <i>/b</i>	5,198	12,158 <i>/c</i>	22,901	100% of expenditures
Training	999	78	1,102	2,179	100% of expenditures
PPF Refinancing	200	100	1,200	1,500	
Unallocated Contingency	3,500	-	950	4,450	
TOTAL	41,094	5,376	15,530	62,000	

/a Including US\$8,000,000 equivalent for the commercial bank development component.

/b Including US\$4,000,000 equivalent for the commercial bank development component.

/c Including US\$1,850,000 equivalent for the Rehabilitation Trust component.

**ESTIMATED IBRD DISBURSEMENTS
(US\$'000)**

Component		FY 95	FY 96	FY 97	FY 98
1.a	Privatization Assistance, Phase II	-	1,385	3,618	-
1.b	Restructuring Advisory Unit	407	3,963	4,009	1,618
1.c	Manager Study Tours	118	1,692	-	-
2.a	Rehabilitation Trust	144	1,206	700	350
2.b	Commercial Banking Development	-	4,200	5,600	2,200
2.c	Bank Supervision, Phase II	-	166	500	333
2.d	Long-Term Payment System	-	13,500	8,000	2,348
3.	Project Implementation Assistance	337	604	414	138
	Contingencies	15	2,092	1,715	628
TOTAL DISBURSEMENTS					
	Annual	1,021	28,808	24,556	7,615
	in Percent	1.6%	46.5%	39.6%	12.3%
	Cumulative	1,021	29,829	54,385	62,000
	in Percent	1.6%	48.1%	87.7%	100.0%

IMPLEMENTATION SCHEDULE
Privatization Assistance Phase II

Major Milestone Events	Estimated Target Dates
Efforts to ensure substantial funding from other donors for case-by-case privatization terminated	March 31, 1995
Grant-funded consultants to assist the management of the case-by-case program fielded	March 31, 1995
Decision on use of Loan funds for mass privatization or case-by-case privatization or both.	April 15, 1995
Selection of the first batch of privatization candidates for inclusion under the Project.	April 20, 1995
Issuance of tenders for consultants to handle the first batch of enterprises.	April 30, 1995
Fielding of the first consultant team under this Project component.	August 1, 1995
All consultant assignments under this Project component substantially completed.	September 1, 1997

Restructuring Advisory Unit

Major Milestone Events	Estimated Target Dates
Determination of RAU's organization and staffing	April 20, 1995
First tender issued for in-depth restructuring or liquidation plan of one enterprise (whose viability or non-viability appears relatively certain)	April 31, 1995
Issuance of operating procedures and of methodology guidelines for RAU	May 10, 1995
First study tour for RAU staff	May 15, 1995
Contract with core and quick-scan consultant teams signed	June 20, 1995
Core team and quick scan consultants commence work	July 1, 1995
First team to write in-depth restructuring plan of one enterprise commence work	July 31, 1995
Equipment purchases for the RAU substantially completed	September 30, 1995
Completion of quick scans and final report	November 15, 1995
Last study tour for RAU staff financed under this project	March 31, 1996
Completion of in-depth restructuring/liquidation assistance financed under this Project	November 15, 1997
Completion of core team assistance to RAU	December 31, 1997

IMPLEMENTATION SCHEDULE
Manager Study Tour Program

Major Milestone Events**Estimated Target Dates**

Tentative sub-sector selection	March 31, 1995
Contract signed between the Government and the Kazakh Management Academy	March 31, 1995
Completion of study tour I-IV marketing	April 30, 1995
Fielding of consultants	May 31, 1995
Completion of selection for seminars I-IV	June 5, 1995
Completion of in-country seminar for study tour I & II	June 30, 1995
Completion of in-country seminar for study tour III & IV	July 15, 1995
Completion of study tours I-IV	August 31, 1995
Completion of study tour V-VIII marketing	August 31, 1995
Beginning of follow-up activities	September 15, 1995
Completion of selection for seminars V-VIII	September 15, 1995
Completion of in-country seminar for study tour V & VI	October 15, 1995
Completion of in-country seminar for study tour VII & VIII	October 31, 1995
Completion of study tours V-VIII	December 31, 1995
Completion of study tour IX-X marketing	December 31, 1995
Completion of selection for seminar IX-X	January 15, 1996
Completion of in-country seminar for study tour IX & X	February 15, 1996
Completion of study tours IX & X	April 15, 1996
Completion of follow-up activities	August 31, 1996

IMPLEMENTATION SCHEDULE
Rehabilitation Trust

Major Milestone Events**Estimated Target Dates**

Appointment of RT Supervisory Board and Chief Executive Officer	March 31, 1995
Finalization of the list of selected enterprises	March 31, 1995
Issuance of the RT's organizational chart and general operational procedures	March 31, 1995
Issuance of a Government decision referring to the founding Presidential Decree	April 15, 1995
Issuance of necessary special banking licenses to the RT	April 15, 1995
Registration of the RT's finalized charter	April 15, 1995
Issuance of legal provisions for out-of-court conciliatory procedures between creditors and debtors	April 30, 1995
Specification of the contractual arrangements between the Government, NBK and the RT	April 30, 1995
Detailed specification of the liquidity support to be provided to viable selected firms and its conditionality	April 30, 1995
Detailed data on the financial condition of the selected firms assembled	April 30, 1995
Issuance of guidelines for the preparation of draft restructuring programs to be submitted by firms	April 30, 1995
Specification of the legal and contractual arrangements for the transfer of banking liabilities of selected enterprises to RT	April 30, 1995
Specification of the contractual arrangements between the RT and a commercial bank regarding premises, facilities and banking services	April 30, 1995
Initiation of close monitoring of the financial and economic developments in the firms	May 15, 1995
Detailed specification of the required budgetary and cash control mechanisms to be implemented by the RT	May 15, 1995
Detailed specification of the financial restructuring tools to be used by the RT and their conditionality	May 15, 1995
Recruitment of high level local staff substantially completed	May 15, 1995
Issuance of NBK directive related to the clearing of payment instruments issued by selected firms and their access to bank credit	May 15, 1995
First transfer of banking liabilities of selected firms to the RT	May 31, 1995
Implementation of the budgetary and cash control mechanisms of selected firms	May 31, 1995
Contract with long-term advisors signed	June 25, 1995
Long-term advisor team fielded	July 10, 1995
Mid-term review of the assistance	February 15, 1996
Completion of the technical assistance	December 15, 1997

IMPLEMENTATION SCHEDULE
Commercial Bank Development

Major Milestone Events	Estimated Target Dates
Accreditation and selection of the two private medium-size local banks	April 15, 1995
Agreement with the two formerly specialized banks (henceforth: "large" banks) on their restructuring strategy	May 31, 1995
Completion of shortlists for foreign banks/consultants for TA to the first of the two medium banks	June 15, 1995
Issuance of consultant tender for the first medium bank	June 20, 1995
Completion of shortlist for foreign banks/consultants for TA to first of the two large banks	July 1, 1995
Issuance of consultant tender for the first large bank	July 15, 1995
Signing of consultant contract for the first medium bank	September 30, 1995
Signing of consultant contract for the first large bank	November 30, 1995
First assistance mission for the first medium bank	October 15, 1995
First assistance mission for the first large bank	December 15, 1995
Review of automation plan of the first medium bank	November 30, 1995
Completion of specifications for IT purchases of the first medium bank	February 15, 1996
Issuance of tenders for most major IT packages for the first medium bank completed	March 15, 1996
Review of automation plans of the two large banks	March 31, 1996
Completion of specifications for IT purchases by two large banks	April 30, 1996
Issuance of tenders for most major IT packages for two large banks completed	May 31, 1996
Signing of contracts for most major IT packages for the first medium bank completed	June 15, 1996
Mid-term review of the commercial bank development program	June 15, 1996
Signing of contracts for most major IT packages for two large banks completed	July 31, 1996
Installation of major IT packages for two medium banks completed	January 15, 1997
Installation of major IT packages for two large banks completed	April 15, 1997
Completion of the assistance to the two medium banks	December 31, 1997
Completion of the assistance to the two large banks	December 31, 1997

IMPLEMENTATION SCHEDULE
Bank Supervision Phase II

Major Milestone Events	Estimated Target Dates
Review of Phase I assistance and on this basis finalization of terms of reference for phase II	June 30, 1995
Issuance of consultant tender	July 15, 1995
Signing of consultant contract	November 15, 1995
Both advisors fielded	January 31, 1996
Mid-term review of the phase II assistance (together with completion review of phase I)	February 30, 1997
Completion of phase II assistance	December 31, 1997

IMPLEMENTATION SCHEDULE
Long-Term Payment System

Major Milestone Events	Estimated Target Dates
Introduction of Standards for Electronic Transactions -- old and new structures to be supported initially	May 15, 1995
Operation of Interim P.S. network/software to support a single correspondent account per bank (with entries referring to the same day)	May 15, 1995
Issuance of the Payments System "first stage" Tender Document	May 15, 1995
Receipt of "first stage" technical proposals	July 15, 1995
Finalization of tender "first stage" activities and clarifications to suppliers	August 1, 1995
Receipt of "second stage" proposals for Payments System	September 15, 1995
Operation of the Interim Payments System -- including next day settlement of "high value" transactions	October 1, 1995
Completion of Evaluation of Payments System proposals	October 31, 1995
Issuance of NPC Guidelines for Financial Risk Management	December 1, 1995
Finalization of Contract with Payments System lowest evaluated bidder	December 31, 1995
Commencement of Training Programs -- internal NBK	December 31, 1995
Implementation of the NBK General Ledger/Accounting System	January 1, 1996
Hardware Installation in Almaty	January 31, 1996
Release of Customized Banking Software Package to Commercial Banks	April 31, 1996
Pilot Testing of Final Payments System Software	April 31, 1996
Commencement of implementation of NBK internal sub-systems	May 31, 1996
Hardware Installation in the two other Clearing Centers	July 31, 1996
Testing/piloting of telecommunication trunk lines	May 31, 1996
Installation of Network Management Software	June 30, 1996
Parallel Operation of Payments System application software	October 31, 1996
Commencement of Payments System Full Operation	April 30, 1997
NBK discontinuance of supporting customer account processing for commercial banks	April 30, 1997
De-activation of Interim Payments System software and functionality, and integration of its hardware and telecommunication tools into the long term operations	May 31, 1997
Completion of on-site supplier Implementation assistance	July 31, 1997
Completion of on-site supplier Operations management	March 31, 1998

**REPUBLIC OF KAZAKHSTAN
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PROJECT PERFORMANCE INDICATORS

Project Component	Project Impact	Implementation Timing
Privatization Assistance II	<ul style="list-style-type: none"> (i) If supporting mass privatization: Substantial completion of mass privatization with at least 1,500 enterprises sold against privatization coupons, in a manner consistent with the principles of equitable, transparent, and competitive processes conducive for improving enterprise governance; (ii) if supporting case-by-case privatization: Substantially completed sale of at least two thirds of the firms whose privatization the Project helps to prepare. 	<ul style="list-style-type: none"> (i) First consultant team fielded by 8/95. (ii) Assistance substantially completed by 9/97.
Restructuring Advisory Unit	<ul style="list-style-type: none"> (i) Quick preliminary viability analysis carried out for at least 25 highly indebted illiquid firms; (ii) formulation of detailed plans for restructuring and privatization, or liquidation, by about 20 of these firms with Project assistance; (iii) start of actual implementation of at least half these restructuring or liquidation plans; (iv) upgrading of skills of at least 50 local individuals in enterprise turnaround or liquidation by working jointly with foreign experts on the advisory teams. 	<ul style="list-style-type: none"> (i) Core consultant team fielded no later than by 7/95; (ii) quick viability analyses started by 7/95; (iii) quick viability analysis substantially completed by 11/95; (iv) first 8 restructuring or liquidation plans completed by 4/96.
Manager Study Tours	<ul style="list-style-type: none"> (i) About 160 managers spending at least three weeks each studying enterprises on-site in market economies; (ii) about 320 managers receiving classroom training in business planning and enterprise restructuring; (iii) 10 sub-sector reports reflecting the tour teams' findings distributed locally; (iv) a model for effective manager study tours established for replication in Kazakhstan and other former Soviet Union republics. 	<ul style="list-style-type: none"> (i) First seminar starting no later than 7/95; (ii) first study tour leaving Kazakhstan no later than 9/95; (iii) last tour completed by 5/96.
Rehabilitation Trust	<ul style="list-style-type: none"> (i) At least 25 major insolvent enterprises allocated to the Rehabilitation Trust; (ii) within four years after submission to the Rehabilitation Trust, each of these enterprises would either have been liquidated, or it would have carried out substantial "passive" restructuring, strongly improved its cash flow, and initiated or completed its privatization; (iii) operation of the Rehabilitation Trust in a manner that is financially supportable by the banks and the state, and does not create major adverse expectations of general bail-out of banks or enterprises. 	<ul style="list-style-type: none"> (i) Consultant team started field work no later than 7/95. (ii) Assistance substantially completed by 12/97.

Commercial Banking Development	<ul style="list-style-type: none"> (i) The two new banks among the four assisted banks reaching international standards in operations; (ii) the two formerly specialized banks having carried out comprehensive operational restructuring, relieving them of non-viable operations and enabling them to conduct their core operations efficiently and in a way that enhances sound competition in the banking sector. 	<ul style="list-style-type: none"> (i) First assistance mission by a foreign partner no later than 11/95; (ii) all four assistance arrangements started by 2/96; (iii) equipment installation substantially completed by 3/97.
Bank Supervision II	<ul style="list-style-type: none"> (i) 40 bank examiners trained under phase I and II, including 10 specially qualified examination team leaders; (ii) 20 partial and 20 full examinations of banks carried out with consultant assistance under phase I and II. 	<ul style="list-style-type: none"> (i) Consultants fielded by 1/96.
Long-Term Payment System	<ul style="list-style-type: none"> (i) Domestic payments substantially accelerated, with same-day finality of settlements and real-time processing of high-value transactions; (ii) new system permitting the use of a significantly wider range of payment instruments than current system; (iii) substantial improvements in banks' liquidity management; (iv) general commercial banking software provided to at least 12 commercial banks. 	<ul style="list-style-type: none"> (i) Signature of main contract no later than 1/96; (ii) testing of payment system software started by 7/96; (iii) payment system fully operating by 7/97; (iv) first release of commercial banking software package to commercial banks no later than 5/96.
Project Implementation Assistance	<ul style="list-style-type: none"> (i) at least 8 local persons trained extensively in procurement or disbursement; (ii) beneficiary units receiving effective and efficient advice and assistance in procurement; (iii) at least 85 percent of disbursements under the Loan without major delays; (iv) project reporting and accounting satisfactory to the Bank. 	<ul style="list-style-type: none"> (i) Full advisor team fielded no later than 6/95.

**REPUBLIC OF KAZAKHSTAN
FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT**

SUPERVISION MISSION PLAN

Approximate Date	Main Activities	Skill Requirements	Input (Person Weeks)
5/95	Project Launch, with Review of: - Implementation Schedule - Implementation Preparations - Work Programs - Reporting/Accounting Requirements - Procurement	Task Manager Commercial Banking Specialist Fin. Restructuring Specialist Enterprise Sector Specialist Procurement/Disbursemt. Specialist Environmental Specialist	8
Subtotal: FY 95			8
8/95	Review of: - Procurement - Implementation of Services, Discussion of Inception Reports - Issues Raised by the PIUs	Task Manager Payment System Specialist Commercial Banking Specialist Fin. Restructuring Specialist Enterprise Sector Specialist	6
11/95	Review of: - Procurement - Implementation of Services - Review of Consultant Outputs	Task Manager Commercial Banking Specialist Fin. Restructuring Specialist Enterprise Sector Specialist	4
2/96	Mid-Term Review, with Review of: - Project Progress and Performance - Necessary Revisions of Implementation Schedule and Other Arrangements - Consultant Outputs	Task Manager Payment System Specialist Commercial Banking Specialist Fin. Restructuring Specialist Enterprise Sector Specialist Environmental Specialist	8
5/96	Review of Project Implementation	Task Manager Commercial Banking Specialist Enterprise Specialist	4
Subtotal: FY 96			22
10/96	Review of Project Implementation	Task Manager Payment System Specialist Enterprise Specialist	6
3/97	Review of Project Implementation	Task Manager Commercial Banking Specialist Enterprise Sector Specialist	6
Subtotal: FY 97			12
10/97	Final Supervision Mission	Task Manager Payment System Specialist Enterprise Specialist	6
5/98	Project Completion Review	Task Manager	2
Subtotal: FY 98			8



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KAZAKHSTAN FINANCIAL AND ENTERPRISES DEVELOPMENT PROJECT

- ROADS
- +— RAILROADS
- ⊗ NATIONAL CAPITAL
- ⊙ OBLAST CAPITALS
- SELECTED CITIES
- - - - - OBLAST BOUNDARIES
- - - - - INTERNATIONAL BOUNDARIES

