Document of
The World Bank

Report No: 24025-MD

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED ADAPTABLE PROGRAM LENDING (CREDIT)

IN THE AMOUNT OF US$10.5 MILLION EQUIVALENT

TO THE REPUBLIC OF MOLDOVA

FOR THE

RURAL INVESTMENT AND SERVICES PROJECT
IN SUPPORT OF THE FIRST PHASE OF THE
RURAL SUPPORT SERVICES DEVELOPMENT PROGRAM

MAY 22, 2002

Environmentally and Socially Sustainable Development
ECC09
Europe and Central Asia Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective April 29, 2002)

Currency Unit = Moldovan Lei
1.00 Lei = US$0.0741
US$1.00 = 13.487 Lei

FISCAL YEAR

January 1 -- December 31

ABBREVIATIONS AND ACRONYMS

ACSA	Agency for Consultancy and Training in Agriculture
APCP	Agricultural Pollution Control Project
APC	Adaptable Program Credit
ASF	Agricultural Support Fund
CAPMU	Consolidated Agricultural Projects Management Unit
CAS	Country Assistance Strategy
CFAA	Country Financial Accounting Assessment
DA	Development Agency
FMR	Financial Management Report
FO	Farmer Organization
GEF	Global Environment Facility
IAS	International Accounting Standards
IDA	International Development Association
LSDP	Letter of Sector Development Policy
MAPI	Ministry of Agriculture and Processing Industry
MOU	Memorandum of Understanding
MSBP	Medium-Sized Biodiversity Project
MTR	Mid-Term Review
NBM	National Bank of Moldova
NFSCA	National Federation of Savings and Credit Associations
PFI	Participating Financial Institutions
PIP	Project Implementation Plan
PPF	Project Preparation Facility
RCG	Rural Credit Guidelines
RFC	Rural Finance Corporation
SCA	Savings and Credit Association
SLA	Subsidiary Loan Agreement
SSB	State Supervisory Body
TU	Technical Unit

Vice President:	Johannes Linn
Country Director:	Roger Grawe
Sector Director:	Laura Tuck
Task Team Leader:	Hoonae Kim

MOLDOVA
RURAL INVESTMENT AND SERVICES PROJECT

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RURAL INVESTMENT AND SERVICES PROJECT

Project Appraisal Document

Europe and Central Asia Region
ECSSD

Date: May 22, 2002
Country Director: Roger W. Grawe
Project ID: P060434
Lending Instrument: Adaptable Program Loan (APL)

Team Leader: Hoonae Kim
Sector Director: Laura Tuck
Sector(s): AY - Other Agriculture
Theme(s): Rural Development; Private Sector
Poverty Targeted Intervention: N

Program Financing Data

APL	Indicative Financing Plan				Estimated Implementation Period (Bank FY)		Borrower
	IDA US$ m	%	Others US$ m	Total US$ m	Commitment Date	Closing Date	
APL 1 Loan/ Credit	10.50	53.3	9.19	19.69	09/30/2002	12/31/2005	Moldova
APL 2 Loan/ Credit	14.50	65.9	7.50	22.00	07/01/2005	12/31/2009	Moldova
Total	25.00		16.69	41.69			

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

For Loans/Credits/Others:
Amount (US$m): US$10.5 equivalent

Proposed Terms (IDA): Standard Credit
Grace period (years): 10
Years to maturity: 40
Commitment fee: 0.5
Service charge: 0.75%

Financing Plan (US$m): Source	Local	Foreign	Total
BORROWER	1.19	0.00	1.19
IDA	3.88	6.62	10.50
EC: TECH ASSISTANCE FOR CIS - TACIS	0.25	0.25	0.50
GLOBAL ENVIRONMENT - ASSOCIATED IDA FUND	0.55	1.65	2.20
BORROWING COUNTRY'S FIN. INTERMEDIARY/IES	1.74	0.01	1.75
SWEDEN: SWEDISH INTL. DEV. COOPERATION AGENCY (SIDA)	0.56	0.44	1.00
SUB-BORROWER(S)	1.05	0.00	1.05
BILATERAL AGENCIES (UNIDENTIFIED)	0.75	0.75	1.50
Total:	9.96	9.72	19.69

Borrower: GOVERNMENT OF MOLDOVA
Responsible agency: MINISTRY OF AGRICULTURE
Consolidated Agricultural Projects Management Unit (CAPMU), 9 Cosmonautilor Str., office 523, Chisinau, Republic Moldova, MD 2005
Address: 9, Cosmonautilor Str.; Room 544; Chisinau; Moldova; MD-2005

Contact Person: Igor Gorashov, General Director
Tel: (373-2) 223 106 Fax: (373-2) 226 994 Email: igorashov@capmu.md

Other Agency(ies):
Ministry of Finance
Address: 7, Cosmonautilor St., Chisinau, 2005, Moldova
Contact Person: Mrs. Mariana Durlesteanu, Deputy Minister of Finance
Tel: (373-2)228 227 Fax: Email:

Estimated Disbursements (Bank FY/US$m):

FY	2002	2003	2004	2005				
Annual	0.50	2.00	3.50	4.50				
Cumulative	0.50	2.50	6.00	10.50				

Project implementation period: FY 2002-FY2005
Expected effectiveness date: 09/30/2002 **Expected closing date:** 12/31/2005

OCS APL PAD Form Rev March, 2000

A. Program Purpose and Project Development Objective

1. Program purpose and program phasing:

Background. Since Independence in 1991, Moldova's agricultural sector has performed poorly, with a decline in production, productivity, and exports. Agricultural GDP in 2000 was less than half of its 1990 level. While the overall economy grew by 2% in 2000, agricultural GDP again declined by 3% and continues to be a drag on the overall economy. Moldova has also experienced the largest fall in GDP in the Europe and Central Asia (ECA) region with a corresponding large decline in per capita income levels. There has been an increase in poverty, accompanied by an increase in inequality – the Gini coefficient is now about twice the pre-reform level, with a fifth of the population receiving about half the income. Poverty is most severe in rural areas where 54 percent of the population lives. Rural poverty accounts for 68 percent of total poverty when poverty is defined as living on less than US$10 per month. The most recent poverty assessment suggests that the poorest of the poor in Moldova are those who comprise the landless agricultural worker group.

In Moldova, the decline in output and the resulting income and poverty levels are strongly influenced by poor agricultural performance. The agricultural sector contributes 33% of the GDP, provides over 40% of employment, and constitutes 65% of exports; and with beverages included, this figure rises to 80% of the country's total exports. Agricultural exports are the single most important source of foreign exchange income. With the agricultural sector's importance to the economy, in terms of GDP, employment, population, and the large and increasing incidence of poverty among the rural population, Moldova will not be able to achieve sustainable overall economic growth without generating growth in the agricultural sector. It will not be able to increase export income without addressing impediments that hinder the competitiveness of this sector. Additionally, Moldova will not be able to make an important reduction in poverty rates unless the continued increase in poverty among new landowners is reversed, and new landowners are given full rights to their land and are allowed to use it for the most productive purposes.

On a positive note, the recent progress on policy reform and the advanced stage of land privatization have provided an emerging platform for future recovery and growth. The reform process has been prolonged but has *finally begun* to address the fundamental issues - land privatization and farm restructuring - and has made substantial progress during the last two to three years. Of the more than 1000 state and collective farms, all but 46 have been privatized, and over three million individual titles had been issued by the end of 2001. Among them, nearly one million "legal persons" became fully registered landowners, and nearly 440,000 private farms had been established, of which 100,000 are legally registered.

Despite the recent declining trends, the agricultural and rural communities have latent capacity to grow. Moldova has some of the richest soil in the region with very favorable agronomic potential. Its agricultural sector is endowed with potential comparative advantage in major crops, particularly in high value crops such as fruits, vegetables, and wine grapes. But this potential for superior agricultural production is currently unrealized, mainly because of policy, legal, regulatory and institutional inefficiencies. It is recognized both by the Government of Moldova (GOM) and the IDA that there will have to be a consensus on a coherent development strategy for the sector that covers the priorities, sequencing, and approaches of interventions. As the first step, IDA, together with the GOM, has developed the Agricultural Sector Development Strategy (ESW- P071153), which has identified major impediments to achieving agricultural recovery and growth. The proposed Program is based on this Strategy.

The Program's objective is to provide long-term support to accelerate agricultural recovery and growth so that Moldova's agricultural sector can play its full role in providing the underpinnings for future income growth and poverty reduction.

Achieving these goals will take long-term program support, as well as multiple years of policy and investment support. The first phase of the Adaptable Program Lending (Credit) (APL) will initiate priority interventions in policy, legal and regulatory reforms, institutional capacity building, technical assistance, and investment support. An APL has been chosen since the first phase would involve substantial institution building and develop some of the new concepts to support emerging private farmers from the recent land privatization. An APL approach will allow the proper sequencing of policy, knowledge, institutional capacity building, and credit. It will also allow an interim opportunity "to check, balance and modify" the project design to ensure that the choice of intervention options under the Program is consistent with the overall strategy. The first phase (FY02-FY05) will focus on creating the foundation and will include significant support for strengthening an institutional and regulatory framework that will enhance private economic activities in the agricultural sector, while providing modest investment and complementary working capital. Once the fundamentals are in place, the second phase will actively provide additional investment support along with continued institutional support.

The Program complements the Agricultural Strategy for Moldova, which was recently developed, the Government's National Strategy for Agriculture and Agro-processing Development and the World Bank Country Assistance Strategy (CAS). The Program, including the first phase, will also be closely linked to the preparation of the Poverty Reduction Strategy Paper (PRSP) and the Third Structural Adjustment Credit (SAC III).

2. Project development objective: (see Annex 1)

The main development objective of the project is to foster post-privatization growth in the agricultural sector by improving the access of new private farmers and rural businesses to what they need to succeed - ***legal ownership status, knowledge, know-how, and finance.***

While pursuing this objective, the project would help reduce poverty by creating income-earning opportunities and improving productivity through complementary technical assistance and investment support. In this manner, profitability of the investments supported under the project could materialize. Specific support would include: (a) solidifying private ownership of land and other productive assets; (b) creating viable rural entrepreneurial legal and organizational structures; (c) establishing a private, agricultural support services system including advisory, input and output supply, marketing, and business development support; and (d) establishing a self-sustaining rural finance system to serve a large number of dispersed rural clients throughout the county.

3. Key performance indicators: (see Annex 1)

Progress toward achieving the project objectives would be tracked through a monitoring and evaluation (M& E) system built on the results of the Baseline Survey, which was carried out during project preparation in order to be able to measure the incremental impact of the Program and the project. These indicators, as well as triggers for the second phase, are included in the Project Implementation Plan (PIP), which would be reviewed during regular supervision and at a mid-term review (before December 31, 2003 or before 50% of the first phase APL is disbursed, whichever is sooner); and again, before preparations commence for the second phase of the APL. Performance indicators of the project and triggers for APL Phase II are discussed in detail in Annex 14.

The specific performance indicators are discussed in greater detail below.

Sector-wide indicators would include: (a) a more favorable macroeconomic and business environment as

measured by overall economic and sector indicators; (b) a developed land market and emergence of genuinely restructured farms as measured by the number of land transactions and registered private farms; (c) increased domestic and export sales of agro-food products as measured by increases in the volume and amount of agricultural commerce; (d) improved marketing opportunities, infrastructure and practices, as measured by increases in the number of registered agro-food distributors, exporters and other participants in agricultural trade; (e) increased production and productivity in key crop and livestock sub-sectors as measured in random sample farm budget analyses; and (f) increased non-farm economic activities and employment in rural areas as measured by village level assessments.

Institution and human development indicators would include: (a) higher awareness among farmers regarding the benefits of organizing themselves as measured by an increase in the number of and membership in organized and registered farmer groups and associations; (b) full understanding of their legal rights as land owners as measured by an increase in the number of titles; (c) heightened sense of private entrepreneurial spirit among newly created private farmers and rural entrepreneurs as measured by an increase in the number of registered private rural – individual and group – enterprises; and (d) strengthened post-privatization support services and increased access to rural advisory services as measured by the number of advisory centers and clients which will be confirmed by surveys of client satisfaction.

Financial indicators would include: (a) an increase in the institutional commercial credit flow to the rural sector as measured by the number of participating financial institutions (PFIs), i.e. commercial banks and RFC, and the total volume of credit; (b) the diversification of the rural portfolio as measured by the composition of actual lending activities of PFIs; (c) continuous compliance of PFI eligibility by at least three PFIs as confirmed by the National Bank supervision department; (d) improved loan appraisal skills of PFIs as measured by sound portfolio quality of at least an 85 percent recovery rate for all credit lines; (e) inclusion and diversification of rural finance system for small-scale, rural clients as measured by an increase in the number and volume of lending (at least 20 percent of total) under the Special Credit Line; (f) strengthened regulatory and supervision capacity of SCAs as measured by restored functions to SSB; and (g) increased rural income as measured by incremental increases in rural household incomes compared to the Baseline Survey reference data base.

B. Strategic Context

1. Sector-related Country Assistance Strategy (CAS) goal supported by the project: (see Annex 1)
Document number: 18896-MD **Date of latest CAS discussion:** 04/07/99

The proposed project is consistent with the Bank Group's Country Assistance Strategy (CAS), as set forth in the IBRD, IDA and IFC joint Memorandum dated April 7, 1999. The strategy identifies three main areas of assistance to improve economic growth and thereby increase the prospects for reducing poverty and social hardship: **macroeconomic sustainability, private sector development, and public sector reform.** The last CAS, which contained background on the economy and Bank operations was distributed to the Board in May 1999. A CAS Progress Report will be discussed by the Board along with the Third Structural Adjustment Credit (SAC III) and the proposed project.

The proposed Program and the project support the private sector development objective of the CAS. It aims to increase incomes and reduce poverty through facilitating the development of private agricultural enterprises and related post-privatization support service activities in rural areas. To ensure that private farmers have access to adequate services and information and can operate within an improved incentive framework, the strategic actions, as stated explicitly in the CAS, would be pursued by the project. In

addition, the findings of the recently completed Agricultural Development Strategy for Moldova provide foundations for the key policy, legal, institutional and regulatory intervention options being pursued in the proposed Program and the project.

2. Main sector issues and Government strategy:

Key policy, structural and institutional issues and constraints of the agricultural sector have been analyzed in the ***Agricultural Strategy for Moldova – Accelerating Recovery and Growth*** (ESW- June 2001). The main findings and recommendations were discussed in a public forum, which took place in December 2001, with the participation of the Government, NGOs, civil society, financial institutions, and donors. In parallel, the Government has requested IDA support to revitalize the agricultural sector through the promotion of widely shared economic growth and the reduction of poverty in rural Moldova. The Agricultural Strategy and the proposed Program constitute a part of such efforts.

Key Factors for Accelerating Agricultural Recovery and Growth in Moldova. Accelerating future agricultural recovery and growth will require addressing a number of key constraints in the macroeconomic and business environments, in agro-processing and trade, at the farm level and in non-farm rural development. The weak public institutional capacity, as well as the newly developed and still fragile private entrepreneurs in rural areas, must also be taken into consideration if Moldova is to experience recovery and growth in the agricultural sector and the overall economy. Experiences from the 1990s confirm that the initial expectations for this transformation may have been overly optimistic, and the transition process in agriculture is far more complex than originally envisaged. Increased social problems and poverty have led to a reversal of key policies. If Moldova is to achieve the challenging goal of regenerating growth in the agricultural sector, outstanding policy issues must be addressed. These include: (a) the possible reversal in land privatization; (b) the inertia to return to collective farming; (c) increased Government intervention in production, trade and exports; (d) policy distortions regarding state grain reserves; and (e) the subsidy program to intervene in agricultural crediting.

Macroeconomic Factors. The legal, regulatory, and operating environment in Moldova is not conducive to overall economic and agricultural growth. Excessive regulation has led to multiple avenues for rent seeking and corruption. Inconsistent policy design and policy implementation have led to an increase in the shadow economy, while the sporadic introduction of taxes/bans and their subsequent repeal has led to uncertainty among agricultural producers. In addition, subsidies for agriculture have been wasted and should be rationalized to be fiscally affordable, transparent, and targeted with minimum distortions. A poor investment climate has discouraged new enterprise entry and foreign participation. Finally, the overall legal and regulatory environment needs to be significantly improved to stimulate investment, trade, and growth.

Agro-Processing and Trade Related Factors. The slow transformation of the agro-processing sector has come at a high cost to both farmers and the economy in general. The agro-processing sector has performed poorly, thereby limiting value added, which, in turn, has contributed to poor export performance. Although the privatization of agro-processing enterprises has been extensive, the continuing challenge is to bring about the required enterprise restructuring. Weak exit mechanisms for bankrupt enterprises and poor entry incentives have prevented necessary enterprise liquidation and restructuring and inhibited the entry of new enterprises. Vertical integration has started but remains weak. Without further reforms in agro-processing, returns to investments at the farm level will not be fully realized.

Farm-Level Factors. Although land privatization has largely been completed, many corporate farm structures continue to closely resemble the old collectives. Many landowners have leased out their land to

previous collective farm directors and many are not fully realizing their rights as landowners. The lack of contract enforcement has both maintained inefficient farm managers through under or nonpayment to lessees and created uncertainty for good managers as lessees exit lease agreements prior to the expiration of lease contracts, retarding on-farm investments. Strengthening land ownership rights, providing appropriate support services and assisting in the development of a land market are required to ensure the emergence of genuinely restructured farms which will form the basis for recovery and growth. Additionally, post-privatization support services for technical, financial and business assistance must be strengthened. As farmers become more efficient, technological advancement will need to play an increasing role in generating agricultural growth. Furthermore, better access to working and investment capital is required to facilitate future, on-farm investment, and growth, which would require a broadening of rural financial markets.

Limited Non-Farm Rural Development Factors. In Moldova, non-agricultural, rural development is currently driven by growth in agriculture – an increase in agricultural income spurs demand for consumer goods, which induces growth and diversification in non-farm economic activities. To improve the response to increases in demand, a favorable environment for new enterprise entry needs to be created and maintained. This should raise overall rural incomes, provide additional resources for agricultural investments, and increase off-farm employment opportunities to allow surplus labor to leave the agricultural sector, which will raise labor productivity. The Government must provide the necessary incentives to encourage new enterprise entry, including improving knowledge, skills and access to capital. Investments in rural infrastructure, water, telecommunications, education, and health services, can facilitate non-farm rural development.

Weak Public and Private Institutions. Moldova's institutional environment is in transition. At the moment, the main public institution providing assistance to agriculture is the Ministry of Agriculture and Processing Industry (MAPI), which is responsible for, among others things, designing and implementing strategies for agricultural development, preparing the laws and legal acts for the agriculture and processing industries, promoting information services, and facilitating business networking in the sector. Other public institutions, such as customs, fiscal authorities, and law enforcement agencies, also impact agriculture through their various activities. However, these institutions lack capacity and tend to be driven by a desire to control private initiative, so they often create numerous barriers to business entry and activity that many aspiring entrepreneurs find impossible to surmount. At the same time, private farmers have emerged, and other private institutions have begun to appear, but they lack necessary information, skills, knowledge, and productive assets to truly become efficient. A growing number of non-governmental organizations (NGOs) are also active in rural areas, but their activities and impact are limited and generally localized and they lack institutional capacity. Few of them provide services to a large number of beneficiaries, and even fewer cover a significant geographical area.

Government Strategy

During the preparation of the Agricultural Strategy and the project, the Government and IDA have engaged in debates over sector issues and constraints. The Government recognizes the strategic importance of, and attaches high priority to, the revitalization of the agricultural sector through accelerated recovery and growth, which in turn will reduce rural poverty. The main objective of the Government's program is to transform the agriculture sector based on private ownership and a market-based system that is more efficient and responsive. In order to achieve this objective, the Government is committed, with support under SAC III and the RISP, to implementing reform oriented agricultural policies while correcting problems of the past decade. In addition, with the help of donor support, the Government plans to establish institutions that will provide information and other support services to the agricultural sector.

Specifically, the Government has identified the following key areas on which it will further focus its reform efforts: (a) sustaining a favorable macroeconomic framework and business environment; (b) maintaining liberal agricultural policies on pricing, trade, marketing; (c) developing a functioning land market; (d) ensuring the emergence of genuinely restructured farms with legal, private ownership; (e) providing post-privatization support services for emerging private farmers; (f) improving the rural financing system; and (g) increasing the competitiveness of the agro-processing sector. These key strategic areas and specific measures to achieve them are spelled out in the Letter of Sector Development Policy (Annex 13).

More recently, the Government has prepared an Interim Poverty Reduction Strategy Paper (IPRSP) which sharpens the focus on poverty and is founded on three pillars: (a) sustainable and inclusive economic growth that will provide the population with productive employment, (b) social protection policies that target those most in need; and (c) human development policies that emphasize increased access to basic services. As articulated in the Government's IPRSP, the promotion of sustainable growth and inclusive development is the overarching priority in the Government's development and poverty reduction strategy. The Government continues to support the view that sustainable and rapid economic growth will be achieved through a model of development based on private sector growth and the development of export industries in areas where Moldova has a comparative advantage. The Government plans to develop an export-led growth strategy to diversify export products based on its comparative advantage and to gain access to nontraditional export markets. While the actions and implementation mechanisms to achieve these objectives are less clearly defined for the agricultural sector, efforts are being made to further define them. In the near term, however, the Government's main priorities are: (a) to overcome the general crisis in the agriculture and the processing industry; (b) to achieve national food security; (c) to increase the production of competitive, high value-added agricultural and food exports; and (d) to promote rural area development as a natural, social and cultural framework for the re-vitalization of economy.

The Interim Poverty Reduction Strategy Paper, report 21426-MD, was discussed by the Executive Directors on December 19, 2000.

3. Sector issues to be addressed by the project and strategic choices:

Accelerating future recovery and growth of the agricultural sector would require addressing the key constraints discussed in section B.3. More specifically, the project would provide strategic support to address the following sector issues.

Issue: Restrictive Policy and Regulatory Measures. The project would provide support by linking policy and investment operations. Together with SAC III, the project would attempt to eliminate restrictive policy and regulatory measures, modify impeding regulations, and reduce the number of administrative requirements and fees. By addressing these issues, the project would reduce the cost of doing business and encourage the entry of new enterprises. This goal would be achieved through continuous policy dialogue as outlined in a Letter of Sector Development Policy (LSDP). The success in realizing this goal would be measured against the defined triggers for phase II of the APL.

Issue: Inadequate Land Markets. While privatization of land has progressed, with over three million land titles issued, the number of land transactions is still limited. The initial distribution of land and asset shares alone is insufficient to fuel a resurgence of agricultural productivity unless the land is portioned and distributed in rational scales. A functioning land market would allow consolidation of land ownership and/or usage by those who are willing and able to farm, while allowing others to unload the land in return for other assets that would allow them to engage in alternative economic activities. At the same time,

conflicts among lessors and lessees have been identified as an additional constraint to land transactions and the development of a functioning land market. The project is designed to provide post-privatization legal services to those interested in leasing, purchasing or selling land to facilitate land transactions, to educate new land owners about their legal rights, and to disseminate information about land availability for sales, leases, and prevailing price levels.

Issue: Inadequate Post Privatization Support Services. The breakup of collective structures and the disappearance of the centralized upstream and downstream support services have left the new landowners without key support services. A Rural Gap Assessment (1999) and a Baseline Survey (2001) conducted during project preparation confirm this critical lack of services to support agricultural production, particularly access to knowledge, markets, and finance. These gaps lead to inefficiencies at all stages of the production and marketing chain, and many of the new farmers are compelled to limit themselves to subsistence production. The project's main goal is to restore the post privatization support services that are market responsive and more suitable for smaller scale private farmers and rural entrepreneurs. The project includes specific components to develop private advisory services and new farm organizations and to provide information on prices and market requirements, on access to capital and input markets, and on agronomic and business practices.

Issue: Insufficient Rural Finance Intermediation and Limited Access to Commercial Credit. The lack of access to finance by private farmers has negatively affected rural growth. Newly created private farmers do not have cash or other assets to use as collateral to make the equity contribution usually required by commercial banks. While land is legally allowed as collateral and there are limited transactions taking place, commercial banks are still reluctant to take land as full value collateral. Access to financial services is particularly important to post-privatized farmers and rural entrepreneurs so that they can take advantage of the recent market reforms to adjust input use, modify output mixes according to market signals, and invest in new technology to improve the productivity of their land and labor. Emerging agro-businesses similarly lack the means to invest in adequate storage, grading, packing, processing and distribution equipment, and facilities. With the exception of relatively large-scale commercial farms, most of the small-scale, private farmers and the newly emerging rural enterprises have not been able to obtain loans from commercial banks. The project would address this issue through providing multi-prong support. The project would provide a credit line component for the sector with an innovative mechanism to improve incentives that would build upon successful Savings and Credit Association support while directly addressing constraints faced by lenders and borrowers.

This will be done first, through addressing the reluctance of commercial banks to lend to rural clients. Commercial banks are reluctant to lend to farmers and rural entrepreneurs because: (a) the typical loan size is too small and transaction costs too high; (b) small-scale clients do not normally have adequate collateral; (c) lending to the rural sector is perceived to be risky due to a lack of past lending history, accounts, and client information; and (d) the still imperfect legal system to enforce loan recovery makes repossession and disposal of pledged assets extremely difficult. The project would address these constraints by: (a) providing training to lenders until they are more familiar with lending to rural clients, including farmer organizations, which will help reduce both the bias and "perceived risk" associated with small loans; (b) organizing farmers to capture economies of scale, increase average loan sizes, and continue the wholesale lending to SCAs to reduce transaction costs; (c) providing a one-time grant to substitute for the lack of equity; and (d) streamlining lenders' internal procedures for dealing with problem loans. In addition, the project would provide direct support to rural clients for developing concrete business plans for bankable projects and for improving collateral and other financial instruments for sharing and reducing price and quantity risks, such as crop insurance, price insurance, hedging futures markets, and warehouse receipts. A priority task is to make moveable property such as machinery, equipment, livestock, inventories,

accounts receivable, and warehouse receipts into an acceptable form of collateral. This could be accomplished by improving the legal framework, helping to establish the registries, making out-of-court settlements possible, and helping banks to understand the process of securing collateral, including the disposal of secured property.

Issue: Limited Information and Support Network at Grassroots Levels. The project would promote a decentralized, participatory approach to building institutional capacity to deliver what farmers need most at the village level – information.. An intended outcome of the project would be the emergence and effective functioning of multiple grassroots-based groups that would gradually fill the institutional vacuum that has characterized Moldova's rural sector since the collapse of the old system. The emphasis on private and non-governmental institution building also reflects the need to compensate for the severe financial and institutional weakness of the public sector. A wide range of services, both upstream and downstream, including support for marketing, at village levels have been identified and tested. These services are expected to be replicated under the project.

As discussed above, the project, as a first phase of an APL, has made strategic choices first to focus on creating a foundation for the development of viable farming structures, on restoring a functioning, support-services network and market chains, and on providing critically lacking agricultural credit. Focused efforts are being made to create a sound legal basis by supporting the enactment of key laws such as: Laws on Business; Laws of Pledges, including moveable collateral; amendments to the Land Code and Peasant Farm Laws; Laws on Bankruptcy; and Laws on Debt Restructuring, to name a few. In doing so, a strategic decision was also made to exclude from the first phase other important tasks such as research, agricultural education, plant and animal quarantine, quality control, and the rehabilitation of irrigation systems, services that fall more in the realm of public sector activities. These activities will be included in the subsequent phase of the APL. In addition, a public sector reform agenda under the SAC III will address, in parallel, key legal, regulatory, and institutional issues.

4. Program description and performance triggers for subsequent loans:

The Program will have two phases. As discussed earlier, the first phase would establish the basic foundation for private farmers and entrepreneurs to initiate economic activities by providing new, private farmers and rural businesses what they need to succeed – ***legal ownership, knowledge, know-how, and finance*** – while pursuing the long-term program support as discussed in Section 3.B. Given that there are over 400,000 private farmers in a rapidly changing, dynamic environment, the first phase will only be able to address the needs of a fraction of the private farmers with regards to these core areas of support. The second phase of the Program will be built upon the outcome and lessons learned from the first phase. The second phase is expected to continue supporting the development of the policy, legal, and regulatory framework while expanding the institutional and financial support initiated under the first phase to a larger number of beneficiaries.

Performance Triggers. Progress toward achieving the Program's objectives will be monitored through a monitoring and evaluation (M&E) system of key performance and policy-relevant indicators (see Annex 15 for more details). The M&E system will also include a set of triggers that are simple and measurable. The **triggers** include: (a) the clear formulation and continuous adherence to the priority legal and regulatory reforms as articulated in the Letter of Sector Development Policy (LSDP); (b) the creation of fully developed legal statutes for private farms and rural entrepreneurs as measured by increasing numbers of registered private farms and rural businesses; (c) the efficient operation of NGOs involved in advisory and rural business development services as demonstrated by at least 35 active service providers with at least 100 active, on-going contracts, and at least 100 legally registered, new, rural businesses; (d) the successful

integration of commercial banks into rural financing as demonstrated by at least three fully functioning and active participating financial institutions (PFIs); (e) a sound portfolio as measured by a minimum 90 percent recovery rate under the rural finance component; (f) adequate regulatory and supervisory capacity of the State Supervisory Body (SSB) as demonstrated by all licensed SCAs being in full compliance with the prudential regulations with minimum default rates, for example, less than 5 percent; (g) SCAs' internal resource mobilization rate of a minimum 10 percent, which will be measured by the co-financing ratio of SCA resources with IDA funds; (h) the disbursement of at least 75 percent of the first-phase credit line operation with demonstrated financial viability of sub-projects and a sound portfolio quality; and (i) the disbursement of the non-credit line components or evidence that an equivalent quantity and quality of technical assistance have been provided and have resulted in enhanced local institutional capacity.

C. Program and Project Description Summary

1. Project components (see Annex 2 for a detailed description and Annex 3 for a detailed cost breakdown):

The proposed project would have three main components plus support for project management:

(a) Rural Advisory Services;
(b) Rural Business Development Services;
(c) Rural Finance; and
(d) Project Management.

The first component would provide the most essential information to emerging private farmers; the second component would create legally registered rural businesses with business plans; and the third component would provide finance to bankable rural clients. The first two components would provide predominantly technical assistance, while the third component would provide private investment support along with the necessary technical assistance to participating financial institutions. The first three components are closely linked, with each dependent on the others for successful outcomes.

Parallel GEF activities. In addition to the above components, two parallel, GEF-funded activities will be implemented as a part of the overall RISP framework to support the post-privatization agricultural sector. They are the Agricultural Pollution Control Project (APCP) for US$ 5 million equivalent and scheduled for implementation by August 2003, and the Medium-Size Biodiversity Project (MSBP) for US$ 1 million equivalent, which is already being implemented until 2005. The GEF facilities will provide matching grant funds to support the Special Credit Line of the RISP (US$ 2 million under ACPC and US$ 200,000 from MSBP, respectively). In addition, APCP would also provide technical assistance through the advisory service providers to mainstream environmental concerns into agricultural practices and to assist the Government in promoting the adoption of environmentally-friendly practices in crop and livestock production as well as in those rural agro-industries that contribute to nutrient pollution, including wetland and integrated watershed management. Implementation of the GEF projects will be carried out by their own respective project implementation units, except for the grant funding for the Special Credit Line, which will be implemented through arrangements under the RISP.

Component 1: Rural Advisory Services (US$ 2.95 million, with IDA financing US$ 1.60 million)

The Rural Advisory Services Component would finance service contracts and training, through which it would establish a nationwide network of decentralized, privately-owned, rural advisory service providers (SPs). The component would provide information, knowledge, and know-how to newly-established, private rural entrepreneurs. A variety of services will be provided covering, among other topics, business, finance,

agronomic and other technical areas, as well as information on marketing prospects, legal and tax implications to business management and credit availability. Services will be demand driven, hands-on and provided at the on-farm and beneficiary level. Clients in the villages would assume an active role in identifying the areas of their needs to meet the changing demands of a market economy, including agricultural restructuring and the continuing land privatization. The need to transform agricultural producers into business entrepreneurs will also be addressed under this component. Rather than creating new advisory centers, this would be done by tapping into the already existing network of service providers and augmenting their capacity through the provision of capacity building support.

Advisory services would be provided through competitive contracting based on advertisement, open bidding and independent evaluation and selection. The competitive contracting system would promote innovation as it relates to the continuous development of extension methodologies and contents that are relevant to farmers, and, in this manner, would have the largest impact. This component would promote an open and systematic exchange of information and cooperation within the network of SPs in order to develop more depth through specialization, to stimulate creativity through the sharing of different experiences and approaches, and to learn from those SPs who are more efficient and effective. The advisory services will be provided to clients based on partial cost recovery, which will increase gradually over time. The component will also provide training of SPs and members.

A capacity assessment of potential SPs was carried out for 90 SPs and based on the results of the assessment and a set of eligibility criteria, 35 SPs have been pre-qualified to participate in the competitive contracting process. A detailed operational manual, contracts, selection criteria and procedures, as well as monitoring and evaluation procedures, including a client feedback system, have been designed and are being piloted with support from TACIS and the Project Preparation Facility (PPF). Pilot results confirm that demand for information is substantial, a wide range of highly relevant topics are being covered, and SPs themselves are keen to improve their own capacity to better serve their future clients.

Component 2: Rural Business Development Component (estimated at US$ 2.49 million, with IDA financing US$ 0.5 million)

The Rural Business Development Component would finance technical assistance, training of trainers and rural entrepreneurs, and operational support for local development agencies (DAs) with an aim to create legally registered, self-owned and sustainable rural businesses, which would be potential clients of financial institutions. The component would provide, based on expressed demand, support for the formation of viable farmer organizations (FOs), agribusinesses, marketing entities, and other rural businesses with proper legal and operational status. This component would extend beyond the basic advisory information services furnished in the first component by providing support for the preparation of business strategies, the identification of profitable products and potential markets, the conceptualization of business ideas, the development of business plans, and ultimately the preparation of loan packages. Per client demand, this component would also provide the technical assistance to initiate the operations. Once established and operationalized, new groups could also receive post-creation support on a cost-sharing basis. FOs and agribusinesses with viable business plans would potentially have access, subject to the discretion of participating financial institutions (PFIs), to investment and working capital credits under the rural finance component of the project.

The component would support all forms of private ownership, including individual private farmers, enterprises, cooperatives, FOs, limited liability firms, and joint stock companies. The aftermath of the land privatization has confirmed that farmers can join their efforts and rationalize the scale and production mode by forming FOs or cooperatives. FOs are considered to be an efficient and democratic tool to enhance

rural businesses. The Savings and Credit Associations (SCAs) system, which started in 1997 in Moldova, is a good example of a successful FO movement. The recently enacted *Laws on Business Cooperatives* provide the necessary legal framework. This component would also provide information and the required documents for registering enterprises, assist clients with the confirmation of their legal status, inform them about their legal rights, and provide other institutional support for new agribusiness enterprises, including strengthening the operational, financial and management capacity of groups.

A detailed component operational manual, standard contracts, selection criteria and procedures, as well as monitoring and evaluation procedures, including a client feedback system, have been designed and tested under a pilot launched in the fall of 2001 with the support of DFID, the Soros Foundations and the PPF. Three DAs registered as NGOs are currently active, and participation of additional NGOs with experience in grassroots mobilization would be solicited. At the end of March 2002, about 50 new businesses have been registered, of which about 40 have finalized business plans, and about 20 loan applications for an aggregate of US$800,000 equivalent have been prepared and submitted. The results of the pilot are promising, but they also highlight the need for modifications of the operational implementation modality, reflecting the dynamic nature of rural economy that is emerging in rural Moldova.

Component 3: Rural Finance Component (estimated at US$ 13.75 million, with IDA financing US$ 8.0 million, including US $0.2 million for TA)

The Rural Finance Component addresses the lack of access by the newly emerging private farmers and rural entrepreneurs to investment and permanent working capital. This component would build on the successful pilot results of the Rural Finance Project (ICR Report No. 23365), a "Learning and Innovation Loan" (LIL), a PPF pilot credit-line, and other technical assistance supported during project preparation. Results of the pilot are summarized in Annex 16.

Under the component, there would be two credit line facilities: (a) a general commercial credit line and (b) a special credit line with a "matching grant." A more detailed description of this component can be found in Annex 2. Credit line operational guidelines, the main terms and conditions, and monitoring, evaluation and reporting requirements are articulated in the Rural Credit Guidelines (RCG). In addition to providing credit at prevailing commercial interest rates and terms, the component would also support the provision of technical assistance to participating financial institutions (PFIs), the State Supervisory Body (SSB), SCAs, and the National Federation of Savings and Credit Associations (NFSCAs).

Sub-Component 3.1: General Commercial Credit Line (US $ 7.73 million, with IDA financing US$5.8 million)

The General Commercial Credit Line (GCL) would provide investment and permanent working capital loans at commercial terms to private rural entrepreneurs through eligible PFIs, that is, commercial banks and the Rural Finance Corporation (RFC). This credit line would be open to a broad range of creditworthy individual and group clients, including, among others, agricultural producers, processors, and marketing and service enterprises in rural areas. PFIs would maintain full autonomy in the selection of borrowers, the approval of sub-projects, and the determination of lending terms, and they would bear the lending risks.

Intended beneficiaries are those who have commercially viable and bankable projects with adequate collateral, satisfactory financial rates of return and demonstrated repayment capacity. Representative farm models and a sector comparative analysis indicate that agricultural investment loans in vineyards, orchards, and other high value crops would have adequate rates of return but would require relatively long repayment periods. Investments in vineyards, for example, would require a minimum repayment period of 10-13

years, with a five-year grace period. This component would provide such long-term resources to the agricultural sector. The eligibility criteria for borrowers, maximum loan limits per borrower, and free limit and procedures for prior review by IDA are discussed in Annex 2 and RCGs. Eligibility of PFIs would follow the well-tested criteria established six years ago under the Private Sector Development Project (PSD). The four PFIs selected to take part in the pilot credit line are already participating in the PSD credit line operations. The RISP would also rely on the Technical Unit (reporting to the Ministry of Finance) for regular updates to verify that the PFIs fully satisfy the National Bank of Moldova's banking requirements and PFI eligibility criteria.

This credit line would continue to support Savings and Credit Associations (SCAs) based on the outcome of the Rural Finance Project and findings of the ICR. In addition to lending to SCAs, particular emphasis would be placed on internal resource mobilization and control within SCAs, supervision and regulation of SCAs by SSB, and building coordinated support through the National Federation of SCAs.

Sub-component 3.2: A Special Credit Line with a Matching Grant (US$ 5.525 million, with IDA financing US$2 million and GEF US$2.2 million)

The Special Credit Line (SCL) is designed specifically to assist newly created and registered small-scale, private farmers, groups of farmers and rural entrepreneurs. Because they are newly created, these entities lack credit history, collateral, and adequate equity for the self-financing that is required by institutional creditors. In order to compensate for these shortcomings, the SCL would offer a matching grant to eligible borrowers. Each sub-loan under the SCL would consist of a credit portion and a conditional grant portion. These loans would be provided at commercial lending terms and interest rates, and PFIs would have full autonomy in loan approval. The eligibility criteria and operational modalities, including prior and post review by IDA, are detailed in the Rural Credit Guidelines (RCG) and summarized in Annex 2.

The matching grant would enable potential clients with sound business plans an opportunity to access commercial credit for the first time and to build up productive assets so that they can continue to borrow from institutional creditors in the future. The matching grant would also provide benefits to lenders by reducing the total outstanding portfolio risk by the grant amount, thereby decreasing provision and reserve requirements. The Government is keen to support the matching grant scheme under the budget since it would also provide an opportunity to replace distortionary interest subsidies with a more transparent and effective way of providing initial financial support to new, private farmers. Because of the subsidy element of this facility, all due diligence, prior to and after loan approval, would be carried out with full disclosure of information on the recipients, utilization of funds, and effectiveness of the grant. Each legal entity will be able to receive the grant on a "one time" only basis.

Two IDA-executed GEF grants would provide co-financing for the matching grant. With the RISP as an anchor, the Agricultural Pollution Control Project (APCP) and the Medium Size Biodiversity Project (MSBP) would provide funds to introduce and promote environmentally sound agricultural production activities. Newly created private farmers lack both knowledge and incentives to make environmentally friendly investments. These two projects would provide an excellent opportunity to demonstrate sound environmental management practices for agricultural producers and processors.

Sub-component 3.3: Institutional Capacity Development For Rural Finance System (US$0.5 million, with IDA financing US$0.2 million)

This sub-component would provide technical assistance on agricultural lending to the PFIs. While the banking sector in general, and the selected PFIs in particular, are generally in good condition to support the

development of a sustainable rural finance system in Moldova, lending to agricultural clients, especially to new private farmers, newly created farm organizations or rural enterprises, is new to most of the PFIs. The Government has preliminarily agreed, and the PFIs have welcomed the proposal, that the Government would provide partial compensation to PFIs for the relatively higher transaction costs of making small size loans to a large number of geographically dispersed rural clients. The PFIs have also expressed their willingness to partially cover the cost of the technical assistance. In coordination with CAPMU, technical assistance would be provided through the existing banking training center or other qualified training agencies. Training programs and training arrangements, financing and cost recovery would be determined during the appraisal.

Specifically, technical assistance and training would be provided for: (a) strengthening commercial banks' capacity in rural lending; (b) promoting commercial banks' lending to SCAs and their members through training in SCA appraisal, access to savings, etc.; (c) developing RFC's capacity for lending directly to individual or group borrowers; (d) strengthening the State Supervisory Body (SSB)'s regulatory and supervisory capacity for SCAs; (e) improving the National Federation of SCA's capacity to provide better support services to its SCA members; (f) establishing a legal registration system for moveable property and warehouse receipts as acceptable collateral; and (g) exploring various risk mitigating options such as risk equalization funds, crop insurance, hedging, etc. to enhance sustainability of the rural finance system. The possibility of participating in "distance learning" to learn from similar experiences of other countries would be also explored.

Component 4: Project Management Component (estimated at US$ 0.5 million, with IDA financing US$ 0.4 million)

This component would provide technical and financial support for project management. Project implementation and supervision would be the responsibility of the Consolidated Agricultural Projects Management Unit (CAPMU), which has demonstrated its capability to manage the implementation and preparation of Bank-funded projects in Moldova's rural sector. In addition, CAPMU would also implement the special credit operation for environmentally sound investment financed by two GEF grants. CAPMU has a staff adequately trained in administrative functions such as disbursement and accounting, procurement, monitoring and evaluations, and reporting. But with new projects with multiple components to coordinate, CAPMU staff would need additional training. In addition, an unallocated fund would be set aside for special studies in areas not directly covered by the project components, for example, the consolidation of fragmented land holdings into viable farms. The budget for the Project Management Component would also include funding for the annual audits of the project accounts.

Component	Sector	Indicative Costs (US$M)	% of Total	Bank-financing (US$M)	% of Bank-financing
Component 1. Rural Advisory Services	Other Agriculture	2.95	15.0	1.60	15.2
Component 2: Rural Business Development Services	Agro-Industry & Marketing	2.49	12.6	0.50	4.8
Component 3: Rural Finance	Agricultural Credit	13.75	69.8	8.00	76.2
Component 4: Project Management	Institutional Development	0.50	2.5	0.40	3.8
Total Project Costs		19.69	100.0	10.50	100.0
Total Financing Required		19.69	100.0	10.50	100.0

2. Key policy and institutional reforms supported by the project:

As discussed in Section B of this PAD, the proposed project would provide an opportunity to complete sector reforms through continuous support for privatization, through ongoing facilitation of the development of the private sector and through steady promotion of reforms in the legal and regulatory systems of agribusiness, trade and marketing. Furthermore, the proposed project would strengthen the rural financial system and initiate interventions aimed at alleviating rural poverty and evening out disparities in income levels among the rural population. The analytical work already done - the Rural Gap Assessment, the Agricultural Sector Development Strategy, and the Baseline Survey - has provided a concrete basis for identifying key policy and institutional reforms that would create a conducive environment for the proposed project and, ultimately, for the entire sector. While the recent Government change creates an additional challenge, the project would continue to pursue the necessary reforms as identified.

As discussed earlier in Section B.3, the Government's specific agreement in the form of a Letter of Sector Development Policy (LSDP) has been obtained (Annex 13). The project is also closely coordinated with preparation of the Third Structural Adjustment Credit (SAC III). Some of the specific actions under the SAC III include the repeal of several restrictive laws, regulations, and practices that impede agricultural investment, trade and exports and hinder the emergence of cooperatives and other groups.

3. Benefits and target population:

The process of providing basic information and know-how, creation/registration support, and, ultimately, access to credit would generate the following **benefits**:

- Empowerment of the rural population through access to information, strengthened legal rights, improved bargaining power of the farmer groups and associations, and mobilization of human and social resources at community levels;
- Establishment of local institutions with adequate capacity to serve a large number of private farmers and rural entrepreneurs nationwide;
- Enhanced social capital as a result of the building of local institutions at the grass-root level and improved governance in the villages, through increased participation in decision making and resource allocation, thereby fostering more effective and transparent public and private services agencies;
- Strengthened capacity of financial institutions with an increased awareness of the newly created private farmers and rural enterprises as potential clients;
- Broad and deep outreach of the rural finance system encompassing small-scale borrowers with limited access to institutional credit, and including those clients lacking credit history and equity participation;
- Enhanced awareness for commercial viability and accountability by new rural enterprises with reduced reliance and expectation for government subsidies;
- Increased agricultural productivity through improved access to finance and various support services and through the establishment of trading links. It is expected that agricultural production would increase on a per hectare, as well as a total hectare basis;
- Improved marketing opportunities and channels through the establishment of farmer marketing organizations. In addition, vertical integration would be enhanced through supporting investments in production, processing and marketing activities;
- Opportunities to generate income, increase employment, and reduce poverty. With farmers empowered to use their privatized assets efficiently, and with the ability to borrow, the provision of the Special Credit Line would provide special entry support and allow rural poor to enter into commercial activities which would reduce poverty and improve living standards; and

- Diversification of the rural economy through supporting a broad spectrum of rural economic activity and by providing the necessary training, information and credit.

Target Population. The main target population would be newly privatized landowners who now have titles in their hands but limited opportunities to generate income from them. New forms of organization - private farms, emerging farmer group organizations, cooperatives, and other private, rural entrepreneurs that aim to improve their production capacities and efficiency to compete in a new market economy - all would be the intended beneficiaries. There would not be geographical targeting. The group and participatory approaches built into the advisory and rural business development support services with the special credit line would open the window of opportunity to poor farmers, many of whom are women. Experiences from rural micro-finance programs worldwide confirm that women are, indeed, more disciplined and responsible borrowers, who, with access to a small amount of credit, can increase their ability to generate income and improve household food security and well being, especially for their children.

4. Institutional and implementation arrangements:

Implementation period. Implementation of the project would take approximately four years (FY02-FY05).

Project Management and Monitoring – Executing Agency

Agricultural Steering Committee (ASC). The overall supervisory functions would be provided by the ASC, which is chaired by the Minister of Agriculture and includes representatives of the Ministries of Agriculture, Finance, Economy and Environment, National Bank of Moldova, as well as representatives of the farmers' union and non-governmental organizations. The ASC would regularly supervise project implementation by the various institutions described below and coordinate relations with the various ministries and other stakeholders. An assurance was obtained that the ASC would not be involved in the day-to-day implementation of the project; in particular, the ASC would not be involved in subloan appraisal or approval decisions which would be fully delegated to PFIs.

Consolidated Agricultural Project Management Unit (CAPMU). Day-to-day project implementation would be the responsibility of the CAPMU, which was created by consolidating all project management units that were implementing various donor-funded agricultural projects. CAPMU is currently managing all Bank/IDA projects in the agriculture and rural sectors and has been the key agency responsible for coordinating preparation of the RISP. CAPMU has full-time project coordinators devoted to the advisory, rural business development, and rural finance components, as well as an environmental specialist. CAPMU also has experienced accounting, financial management, procurement, disbursement, and M&E specialists, many with previous experience in working with World Bank supported projects. Through CAPMU, coordination among donor-funded projects has improved, and institutional linkages among the Government, project management, and the IDA have been simplified.

Other Implementing Agencies. The following agencies would be involved in the project implementation:

Component 1- Rural Advisory Services

Service Providers (SPs). During the capacity assessment of service providers, all existing agencies, including those created by various donor-funded technical assistance projects, have been considered and evaluated. One prerequisite was that each agency has strong interest and commitment to implement the component and has adequate basic capacity and willingness to improve it further. SPs would be comprised

of a team of local consultants with the principal roles of serving as the physical network officers, the first contact-point for farmers, and implementers of the contracted services. Around 35 service providers are expected to serve under the project.

National Extension (Advisory) Board is comprised of a maximum of seven members representing the Ministries of Finance and Agriculture, private and donor organizations, and SPs. Among other functions, the Board would develop future strategies, appoint the coordinator of the National Agency for Consultancy and Training in Agriculture, review extension/advisory needs and identify the priority strategy and tasks accordingly, as well as agree on additional activities to be carried out through the extension network on behalf of the Borrower.

National Agency for Consultancy and Training in Agriculture (ACSA) is an executing arm of the Board, which would be responsible for the day-to-day implementation of the advisory component and the management of the network of SPs. The main functions include monitoring and implementing selection criteria, approving the "standard service package," arranging contracts, technical backstopping, facilitating cooperation among the SPs, and maintaining quality advisory services. ACSA would have a direct supervisory and support role for SPs and would monitor and evaluate the performance of SPs and their individual local consultants. In addition, ACSA would be in charge of the collection and dissemination of information and innovations and would play a coordinating role in the set-up of demonstration plots and the creation of training courses.

Component 2: Rural Business Development Component

Development Agencies (DAs). DAs are private, NGOs, with adequate capacity and experience in supporting rural business development support. DAs would be selected based on eligibility criteria and would be expected to maintain their eligibility. DAs would carry out fieldwork to support the formation of farm organizations, to assist them in the process of legal registration, and to faciliate them in the realization of their business plans. Several organizations in Moldova have been involved in similar activities, for example, in the formation of SCAs. DAs are expected to work closely with the institutions involved in the rural finance component. Contracts for DAs and quality of services would be managed by CAPMU.

Component 3: Rural Finance Component

Private Commercial Banks. Private commercial banks that meet the eligibility criteria of participating financial institutions (PFIs) would implement the general and the special credit lines and lend to individuals, FOs and SCAs. In order to become PFIs, banks would have to meet the established eligibility criteria (which are consistent with those established under the PSD line of credit) and be willing to serve a wide range of agribusiness and rural clients. PFIs, following on their own business strategies and operational guidelines, would lend to eligible borrowers for investment and permanent working capital at prevailing market interest rates and commercial terms. Four commercial banks currently participating in the PSD credit operation – Agroinbank, Moldinconbank, Victoriabank, and Banca Sociala – have signed the Subsidiary Loan Agreement under a pilot credit operation and are active in lending. Two additional banks, Fincombank and Universalbank, have completed a questionnaire and expressed interest in participating in the project, but their eligibility still has to be confirmed. During implementation of the project, the same PFI monitoring arrangement currently being implemented under the PSD project will be followed. The National Bank will submit a written confirmation that participating banks are in full compliance with the National Bank's banking requirements, and the Technical Unit, as a unit within the MOF, will collect and submit pertinent data on a semi-annual basis for IDA review and confirmation.

Rural Finance Corporation (RFC) was created as a non-bank, financial intermediary in 1997 under the Rural Finance Project, during the period when the banking sector in Moldova was undeveloped and unwilling to lend to the rural sector. Currently, RFC is one of the biggest lenders to the agricultural sector (over 40 percent of total lending for agricultural production) as well as to SCAs (70 percent of the total cumulative lending to SCAs). RFC is operating according to Prudential Rules and the Laws on SCAs. RFC shareholders are SCAs, which are required to put 6 percent of the loan amount into RFC capital. Results from the implementation completion review of the RFP confirmed that a lack of direct lending to members of SCAs is impeding the development of more advanced SCA members who no longer wish to borrow based on mutual guarantees. To address this issue, RFC has established a direct lending window, which will lend to both groups of farmers and individuals.

Savings and Credit Associations (SCAs). As of April 2002, 359 SCAs are legally registered, licensed and actively operating. The total number of SCA members borrowing has reached 25,150 and continues to grow. The average loan amount per SCA member continues to be about MDL 2,400 (US$ 185 equivalent), with the maximum loan limit set at MDL 15,000 (US$ 1,150 equivalent). Most of the loans are made for a period of up to one year, and most provide working capital to finance agricultural and livestock production. Mobilization of savings has begun, totaling about MDL 612,000 (US$ 45,300 equivalent). Under the project, SCAs will borrow from all PFIs and make retail loans to their members.

The State Supervisory Body (SSB) for SCAs is a separate entity belonging to the Ministry of Finance which was created in late 1998 to license and supervise SCA operations. The main functions of SSB are: (a) overall supervision of SCAs, in particular verification of their compliance with the prudential guidelines; (b) introduction of the necessary changes in the legislation to allow more adequate supervision; and (c) work on improvement of prudential guidelines for SCAs, in particular on capital and liquidity requirements. Until now, experience with SCAs has been very good, with a repayment rate of near 100 percent. To date, the SSB has suspended the licenses of ten SCAs. However, the varying needs and requirements of the borrowing SCA members have given rise to a serious problem. With the development of businesses in rural areas, there are some members requiring larger loans and at a longer maturity, which makes the mutual guarantee arrangement difficult. With increased diversification and attendant risks, the role of SSB is even more critical. SSB needs to improve its capacity to provide adequate supervisory functions. The proposed project would provide such support to SSB including staff training.

The National Federation of Savings and Credit Associations (NFSCA) was created in January 1999, under the Rural Finance Project (RFP). The main functions of NFSCA are to: (a) represent the interests of members; (b) develop and implement unified standards for SCAs on financial management, internal regulations, and auditing; (c) resolve conflicts between SCAs and their members, or third parties; (d) provide legal assistance; (e) establish a monitoring and information system for SCAs which includes regular financial reporting; and (f) provide other forms of support to SCAs, such as assistance in accessing information. Although the NFSCA has been in operation for only a short period of time, it has negotiated collaborative arrangements with other agencies and seems to have generated substantial support as witnessed by an increasing number of members, which currently stands at 150 SCAs or 55 percent of all SCAs in the country.

Financial Management. Overall responsibility for financial management of the project will rest with CAPMU. The Bank conducted a financial management assessment of CAPMU and concluded that its financial management arrangements are satisfactory and acceptable to the Bank. Project management-oriented Financial Monitoring Reports (FMRs) will be used for project monitoring and supervision and, subject to the foregoing, the indicative formats of these are included in the CAPMU accounting manual. CAPMU will produce a full set of FMRs quarterly throughout the life of the project. FMRs will not be used for disbursement purposes but rather Bank-financing will be disbursed under the Bank's established procedures, including Statements of Expenditures (SOEs).

Audits. No significant issues have arisen in the audits of previous Bank-financed projects implemented by CAPMU. CAPMU's previous and current auditing arrangements and findings are satisfactory to the Bank and it has thus been agreed that similar audit arrangements will be adopted for RISP, to include RISP's project financial statements, SOEs and Special Account. The terms of reference that were used for audit of CAPMU-implemented projects for CY2001 will be extended to include RISP from CY2002. The audit of the project will be conducted by independent private auditors acceptable to the Bank, on terms of reference acceptable to the Bank, and procured by CAPMU through the Least-Cost Selection procurement process. The annual audited project financial statements will be provided to the Bank within six months of the end of each fiscal year and also at the closing of the project. The contract for the audit will be awarded during the first year of project implementation and thereafter, extended from year-to-year with the same auditor, subject to satisfactory performance. The cost of the audit will be financed from the proceeds of the credit.

Monitoring and Evaluation. Monitoring and evaluation (M&E) of the project would be regularly undertaken based on the M&E indicators and mechanisms that have been set-up for each component and sub-component. CAPMU would compile *quarterly project progress reports* and submit them to the Steering Committee, the concerned ministries and IDA. A baseline survey, which was carried out in January 2001, established the reference points to monitor the project's incremental impact. The M&E work would be guided by the logical framework presented in Annex 1 as well as specific output and impact indicators as agreed during negotiations. Based on the results of the year-end M&E review, lessons learned would be incorporated into CAPMU's work programs for the subsequent year.

A Mid-Term Review (MTR) for the project would be carried out no later than June 30, 2004, or when 50 percent of the project is disbursed, whichever is earlier. Beneficiary surveys and assessments would be carried out for the Mid-Term Review and repeated at project completion. An Implementation Completion Report (ICR) would be prepared within six months *before* Credit Closing; CAPMU and the Ministry of Finance would contribute to this ICR. Details of the M&E system of the project are summarized in Annex 15.

D. Project Rationale

1. Project alternatives considered and reasons for rejection:

Lending Instruments. Given the critical nature of the policy issues to be addressed, a sector adjustment operation was considered. But the critical training and institutional capacity building support that are required ruled this out as a suitable instrument. Step-by-step efforts would be needed to put in place the necessary institutions and mechanisms; they would then have to be tailored to the actual needs and capabilities in an economy undergoing dramatic transition. A LIL was considered and rejected, mainly by the Borrower, given the significant amount of experimentation and piloting currently being carried out under the Project Preparation Facility (PPF) and also under various multilateral and bilateral donor-funded activities in Moldova. A sectoral investment and finance operation is, therefore, considered the appropriate

instrument for the objectives being pursued.

With regard to policies, the project is being prepared and designed in parallel to SAC III, which will address, among other obstacles, the key policy, legal, institutional and regulatory impediments that the agricultural sector is facing.

Optimal Project Interventions. Several different models to achieve the project goals were considered. One of them was the "ARIA" village-restructuring model. ARIA, which was created under the PSD project, has been actively engaged in the restructuring of 10 villages. While this model has some merits, it does not have the outreach features that are important to address the needs of over 1,500 villages and over 400,000 registered private farms. Instead, the project would establish a wide system of private, local service providers and development agencies, which will have to maintain a certain quality of staff, services and outputs.

Focus of Project. Given the broad agenda for the sector, various areas of support have been considered, including, inter alia, the provision of rural infrastructure and leasing operations. Over 3 million land titles have been issued and over 400,000 private farms have been legally established but most have no concrete means to generate income. A more narrowly focused project would support the creation of farmer organizations to capture economies of scale, provide information so that farmers can make intelligent decisions, and make available rural finance so that farmers can build productive assets to realize their dreams.

Two Operations Combined into One. Initially two separate IDA operations were considered – a TA project focused around institution building, and a rural finance project to inject credits into the sector. In order to maximize the synergy between the complementary nature of the two operations, a decision was made to combine them into this proposed project.

Support for Private Institutions. Rather than restructuring public institutions, a strategic choice was made to develop support service systems based on private entities. The provision of services to farmers through government agencies has proven neither effective nor viable. The centralized marketing and procurement system of the past was equally unsustainable. This project will ensure that clients' needs and preferences are reflected during the organizational support stage for farmers groups, based on a participatory approach at the village level, and during the selection stage for service providers, based on the implementation of a decentralized, decision making process. In order to realize this important goal, during the inception period the project would focus primarily on information dissemination, on-site campaigning, and frequent communication.

Local Non-Governmental Organizations. A strategic decision was made to build and rely on local non-governmental institutions at the village level by mobilizing teams of trained, highly motivated, local consultants or groups of consultants.

Directed Credit. Based on OD8.3, special due diligence work was done to compare the effectiveness for rural clients of an open credit line versus a directed credit line. The latter option was selected because a survey of commercial banks during preparation confirmed that, in general, banks are still reluctant to lend to farmers or small-scale, rural entrepreneurs due to perceived high risks, relatively high transaction costs associated with making small loans, and the banks' lack of understanding of agriculture or rural sectors. In addition to the provision of credit, the project would, through parallel TA support, address the current constraints that prevent commercial banks from lending to rural clients and mobilizing savings in rural

areas.

Financial Intermediation. Under the first Rural Finance Project, a non-bank financial institution, RFC, was created to on-lend the IDA credit line to SCAs. Now, however, the banking sector in Moldova is at a level where major commercial banks are willing to diversify their lending activities to include rural clients. The project would include as many eligible commercial banks as possible and provide necessary TA to enable them to overcome "misperception" and actively lend to rural clients. The project would help diversify the portfolios of these commercial banks and help strengthen their loan appraisal skills for rural lending. One of the expected outcomes of the project is that commercial banks would become engaged in diversified lending activities, including to a wide spectrum of clients in rural areas.

Poverty Alleviation Program Through the Special Credit Line. The Government has recognized that it does not have a comparative advantage in selecting investments that will help alleviate poverty in rural areas. The Government of Moldova, instead, will earmark a specific amount of the IDA credit to provide special support to newly formed groups and small-scale entrepreneurs; it will rely on the commercial banking system to appraise, approve, and supervise investment loans. As incentives to commercial banks to lend to rural poor, the Government will provide, among others things, transaction cost support and complementary grant schemes to borrowers.

2. Major related projects financed by the Bank and/or other development agencies (completed, ongoing and planned).

Sector Issue	Project	Latest Supervision (PSR) Ratings (Bank-financed projects only)	
		Implementation Progress (IP)	Development Objective (DO)
Bank-financed			
Agriculture	Agriculture I (completed)	S	S
Agriculture	Rural Finance (completed)	S	S
Agriculture	Sectoral Adjustment Loan, Credit I and II (completed)	S	S
Social	Social Investment Fund	S	S
Public Sector Management	Private Sector Development I	S	S
Multi sector	Private Sector Development II	S	S
Urban Development	First Cadastre	S	S
Other development agencies			
USAID	Land Privatization; Agricultural Service Centers; Farm Shops; Post privatization Support		
EU TACIS	Export Promotion; Agricultural Marketing; Development of Agricultural Machinery Supply and Services, Advice Centers; Reform of Agricultural Education, Training and Research		

Japanese	Agricultural Equipment and Leasing		
British Know-How Fund	TA for Farmers Associations; Rural Livelihood Project; Support for SCAs/SSB		
IFC	INCON Project		
EBRD	Vininvest		
GTZ	ProComerz Technical Assistance Project		
Soros Foundation	MMA Project; Farm Shops Foundation Project		

IP/DO Ratings: HS (Highly Satisfactory), S (Satisfactory), U (Unsatisfactory), HU (Highly Unsatisfactory)

3. Lessons learned and reflected in the project design:

International experiences in activities similar to those proposed under this project have been evaluated. The key lessons learnt and considered during project preparation are summarized below.

Rural Support Services. International experience indicates that successful investment in support services has two main requirements: first, a strong government commitment to create a favorable environment for the development of profitable and sustainable farming and to provide financial support to strengthen these services providers (this commitment will be sought and recorded in the form of a LSDP and SAC III); and second, the financial and operational sustainability of services providers with a gradually increasing self-financing ratio. Farmers would be empowered through participation in governing bodies at the local, regional and national levels of the support services organizations. Recipients of the services should appreciate the value of such services and be willing to pay a fee for, at least, partial cost recovery. Finally, an independent monitoring system would be developed to evaluate the changing environment and client needs and to monitor the capacity of service providers to modify their operations.

Rural Business Development Support. Assessment of various donor programs in Moldova indicates that business development support should be demand driven, relevant for beneficiaries, and have concrete business benefits. Experiences of the Moldovan Microfinance Alliance (MMA) and the Rural Development Center under the First Rural Finance Project confirm that business promotion and the creation of viable local enterprises take a long time and necessitate considerable effort and resources; this often results in such institutions having to deal with donor dependence issues. To address this issue, beneficiaries will cover a part of the cost and there will be a form of success fee from those accessing commercial credits. The project would keep costs low and provide relevant services at affordable prices. Nevertheless, it will take several years for the business service providers to achieve full cost recovery and financial autonomy.

Developing Farmer Organizations (FOs). The World Bank has vast experience in promoting farmer organizations in developing countries. Among some of the lessons learned are that development of a cooperative or farmer organization requires a combination of support including training of all stakeholders, especially FO members and leaders, the establishment of pragmatic management systems, and sound business development strategies, as well as arrangements for the funding of business activities. Furthermore, all stakeholders must be involved in the promotion and activities of the movement. Members,

laymen leaders, staff and promotion agencies all need to be given training and opportunities to participate and contribute to the success of the farmer groups. Because cooperatives are primarily business organizations that can help improve the economy of their members *only* if their business activities are profitable and sustainable, it is imperative that the FO development support be demand-driven with full participation of vested members.

Rural Finance. Although rural finance credit programs, particularly micro-finance programs, can raise living standards and increase farm productivity, isolated credit-only interventions do not have a significant sustaining impact on the rural economy. Complementary actions, such as investment in capacity building for borrowers and lenders and removal of constraints that impede flows of funds to the rural sector are also necessary to make rural finance an effective tool in developing rural economies. From analyzing other rural finance operations, we have learnt that macro-economic stabilization, market liberalization and privatization are all prerequisites for effective financial interventions. Rural credit projects often face difficulties due to: (a) the rarity of profitable opportunities for lending; (b) PFIs unaccustomed to rural lending and unfamiliar with the clientele; (c) the high risks particularly if the PFI concentrates lending only on agriculture and/or in a limited geographical area; and (d) the high transaction costs of rural lending are high relative to other lending opportunities. The project is designed to address these difficulties. Lending through groups such as SCAs reduces risk without physical collateral and allows those unable to access institutional credit on their own to be able to borrow; furthermore, group lending is cheaper for lenders. Training of PFI staff in appraisal and supervision as well as improving the environment for secured lending will help mitigate the higher costs and risks of agricultural and rural lending. At the same time, the main emphasis should not merely be to provide credit, but also to stimulate savings as well. Finally, a successful credit line operation should be established on a broad-based clientele and be accompanied by complementary TA support to improve risk assessment by loan officers, to assist clients in developing "bankable" projects and to support institutional development within the PFIs. Therefore, comprehensive TA support is being included in the proposed project.

4. Indications of borrower commitment and ownership:

A series of actions on the part of the Government best demonstrates its strong commitment for the project. Namely, the Government of Moldova has: (a) nearly completed land privatization; (b) passed the Law on Business Cooperatives; (c) advanced privatization of agricultural entities in up- and down-stream sectors; and (d) acknowledged that post privatization agricultural support services are key for generating economic recovery. Specifically, the Government has demonstrated substantial commitment to developing a successful SCA system, and seeks additional IDA support following completion of the first Rural Finance Project, a LIL. The Government created the Consolidated Agricultural Project Management Unit to coordinate the experiences gained from a decade of loan support by various donors, and to maximize the effectiveness of future support. To actively supervise project preparation activities, the Government also established the Steering Committee, with representations from the key Ministries of Agriculture, Finance, and Economy, from non-governmental agencies, and from private organizations that support farmers. Further, the Government obtained and effectively used a Project Preparation Facility (PPF) to implement pilot operations of the rural business development, advisory services, and pilot credit line components, including the matching grant support. Finally, the Government is also involved in negotiations around a variety of key policy reforms that will be supported under SAC III.

5. Value added of Bank support in this project:

Since the Bank's operation commenced in the Republic of Moldova in 1993, the Bank Group has supported the Government in the design, analysis, and realization of its development strategies through various lending and non-lending operations. With regard to lending activities in the agricultural sector, the Bank

has gained experience through the implementation of the First Agriculture and Rural Finance projects and through structural adjustment operations. The Bank's participation in this project would: (a) heighten awareness of poverty reduction and its linkage to the PRSP through increased alignment with the overall Government Strategy; (b) encourage a participatory approach to reflect a broad range of society's interests; (c) restore a balance between adjustment and investment operations; (d) enhance the effectiveness of ongoing initiatives; and (e) lead to strong monitoring and evaluation based on a clearly defined set of benchmarks. Moreover, the Bank can draw upon its extensive experience in poverty alleviation and agricultural and rural development in many other countries, including, most recently, the projects on agricultural support services in Albania and the Kyrgyz Republic. In addition, the Bank will play an important coordinating role with other donors, including EU-TACIS, SIDA and DFID, by designing sector development strategies and enhancing institutional capacities that are compatible with a market economy.

In parallel, improvement of the legal and regulatory system through policy dialogue would be promoted through SAC III and continuous policy dialogue through ESW work. Being consistent with the overall agenda of the Program, the project would require a proper sequencing of policies and institutional reforms that would foster a business and policy environment conducive to private economic activities. In this sense, the project would be an integral component of the broader country assistance agenda of the Bank group and would have to be closely coordinated with other related Bank operations in Moldova.

E. Summary Project Analysis (Detailed assessments are in the project file, see Annex 8)

1. Economic (see Annex 4):

○ Cost benefit NPV=US$ million; ERR = % (see Annex 4)

○ Cost effectiveness

● Other (specify)

Since the project is based on client demand which was confirmed through a baseline survey, it is not possible to estimate *a priori* the types and magnitudes of sub-projects that will be financed under the project. Therefore, no attempt was made to estimate aggregate economic rates of return of the project. Instead, a series of crop budgets, farm models, and other typical investment models have been developed to indicate expected results; they are presented in detail in Annex 4.

The main quantifiable benefit at the farm level will be improved agricultural production, both in terms of increased productivity and improved product quality as confirmed by higher farm gate prices. Other benefits emerging from the project would include increased efficiency as a result of enhanced advisory services and improved farmer organization schemes that will allow for increased access to high quality inputs. Additionally, the project would result in: (a) an enhanced flow of technical information; (b) increased value added for agricultural commodities; (c) broadened market institutions; (d) improved marketing practices resulting from an efficient flow of price and marketing information; and (e) expanded institutional capacity among rural finance institutions. The project is also expected to improve the welfare of rural areas and enhance governance at the village level as a result of utilizing a participatory approach to develop a democratic and autonomous decision-making system. With increased access to information and advice, the confidence of the village communities would be improved and the sense of isolation in the rural areas would be reduced.

2. Financial (see Annex 4 and Annex 5):

NPV=US$ million; FRR = % (see Annex 4)

As discussed above, since it is not feasible to estimate the IRR for the entire project, an alternative cost-benefit analysis was carried out based on crop budget and farm model analyses of representative investments. There are very few price distortions as both input and output markets are liberalized, become

increasingly competitive, and bear limited taxes and subsidies. They represent typical activities that could be implemented though the project components and financially supported under the rural finance component. Overall, the analysis promises positive returns on the potential investments and confirms their financial viability. Detailed models are available in the project file and a summary is presented in Annex 4.

Crop Budgets. Crop budgets for eight commodities were prepared showing "with" and "without" scenarios. The results show substantial increases in yields resulting from the use of better seeds, more fertilizers, and better agronomic technology, with an attendant potential increase in farm income. Incremental gross margins after project implementation range from 45 percent for sunflowers to 198 percent for potatoes. Since there is no Government control of these commodities, covariance between financial and economic analysis is expected to be minimal. The fact that Moldovan farm-gate prices are lower than international prices reflects a relatively lower quality for some of these products but also derives from lower imputed labor costs in Moldova. Full details of the crop budget and farm model analyses are in the project files.

Farm Model and Investment Analyses. Nine different farm and investment models were developed and analyzed in detail. Confirming the results of the crop budget analysis, representative farms (orchards, vineyards) and agro-businesses (milk collection, grain flour milling, sunflower oil milling, fruit drying, small irrigation, harvester combine, tractor with implements, etc.) all show positive incremental net income and IRR ranges between 20-25 percent, with the exception of wine grapes (the lowest at 12 percent) and small-scale irrigation (the highest among the samples at 60 percent).

Financial Summary of Key Agencies. Key agencies involved in the project implementation (e.g. SCAs, SPs, DAs, PFIs, etc.), have prepared summaries of their budgets and financial projections, first, to determine the cost effectiveness of delivering respective services or products by each institution, and second, to determine their need for financial support until full cost recovery can be achieved. The results are summarized in Annex 5.

Cost Recovery. The rural advisory and business development services components would be based on cost recovery, which will start low and gradually increase. Under the rural advisory component, a standard package of "basic and general" information will be provided to the beneficiaries free of charge (i.e. public goods with no cost recovery). For special services required by clients and provided by extension specialists, the beneficiaries would pay incremental fees, which are expected to gradually increase over the project implementation period. All subloans are expected to be fully repaid - except for the special credit line, under which recipients would be required to first repay 80 percent of the loan portion; then, once the principal and interest of the loan portion are fully repaid, the remaining 20 percent would become effective as a grant and would no longer be a liability of the borrower nor a risky asset for the lender. *The phasing (percentage and schedule) of the cost recovery was discussed and agreed upon during negotiations.*

Fiscal Impact:

The project makes a clear distinction between "public expenditures" (no or partial cost recovery) and private investment (full cost recovery), and the required budget has been prepared and reviewed by the Government. The Government contribution will come largely in the form of tax rebates to local services providers and consultants who would have to pay all required taxes. IDA and donor funds will finance net payments only. On the required fiscal expenditure, it is expected that the first two components of the project would include support for, among other items, institutional capacity building, recurrent costs, training, and establishment costs (for example, to acquire computers, facilities, materials). The Special Credit Line also includes non-repayable grants, which will be financed either by the Government through

its budget or by donors through grants, including GEF grants.

For those components that will generate income, the proposed project is expected to have a positive impact on the state budget, as it will indirectly contribute to increased tax revenues by raising the output and profitability of beneficiaries. For the advisory component, the proposed scheme under the project will replace the "public extension services" that used to be funded by the Government, yet have proven to be ineffective. The new system will be based on at least "partial cost recovery" and it will be more efficient, thereby incurring relatively lower recurrent costs. The rural business development and rural finance components would have limited fiscal impacts resulting mainly from additional income generation of the beneficiaries. It is not expected that costs related to the components would negatively impact other public services provided.

3. Technical:
Moldova, with a long history of agriculture, has the adequate technical expertise required to implement the project. Furthermore, the technical approaches suggested under the project are sound and take into consideration technical experiences of similar components both in Moldova and in other countries. In addition, an independent Quality Enhancement Review panel that included relevant technical experts evaluated the technical approaches and found them acceptable.

4. Institutional:
There are a number of legal, regulatory and institutional constraints to the development of private commercial farming and effective and competitive trade in agricultural inputs and outputs. A team of local experts is now assessing these constraints and formulating an agenda for remedial action that would be implemented under the project. One specific example of where this arrangement was successful was the identification of the need to adopt a suitable law on cooperatives, which was approved by the Government during project preparation and has now been enacted. Other areas where institutional reforms and support are required will be identified along with specific actions to be taken.

4.1 Executing agencies:

The principal executing agencies are the Ministry of Finance and the Ministry of Agriculture. In delegating the day-to-day functions to the Consolidated Agricultural Project Management Unit (CAPMU), these agencies would have the overriding implementation role. An Agricultural Steering Committee with representation of the Ministries of Agriculture, Finance and Economy, and non-governmental agencies has been established, which regularly supervises CAPMU activities. The rural business development component would involve organizations that would assist in the formation of farmer organizations, as well as in developing the processes for realizing the planned activities. These organizations would be selected according to their previous experience in a given field. Several organizations in Moldova have been involved in similar activities related to the formation of Savings and Credit Associations (SCAs). The rural advisory and business development support would build on existing service providers and NGOs with an aim to link them in a network that would eventually cover the entire country. This network of service providers would be overseen and coordinated by a national extension agency, which would also supervise the performance of the service providers. The rural finance component would continue to cooperate with the institutions established under the Rural Finance Project and would seek collaboration with the commercial banking sector for the general and special credit lines.

For all other institutions involved in project implementation (as listed in Section C.4), including CAPMU, DAs, National Extension (Advisory) Board, ACSA, service providers, producer associations, RFC, SCAs, commercial banks, the State Supervisory Body, and the National Federation of SCAs, a systematic, institutional capacity assessment was carried out.

The systematic institutional assessment includes: (a) an assessment of the main functions of each institution under the project; (b) an assessment of its current capacity including staffing and budget; (c) identification of capacity gaps and other areas to be improved; (d) identification of specific support to be provided under the project to address the capacity gaps; and (e) analysis of the M& E system that would be utilized to continuously monitor effectiveness of each institution during the project implementation.

4.2 Project management:

The Consolidated Agricultural Projects Management Unit (CAPMU) would be the primary project management institution. It reports to the Ministry of Finance, but is overseen by an inter-agency steering committee chaired by the Minister of Agriculture. CAPMU was recently created through the merger of several project-specific PIUs, and has considerable experience with managing the implementation of Bank-supported projects.

4.3 Procurement issues:

An ECSSD procurement specialist joined the appraisal mission and carried out the procurement assessment. CAPMU has on staff, a full-time procurement specialist, trained at an international training center in Turin, who is adequately familiar with the various procurement guidelines and procedures required under Bank projects. Continuous training will be provided for CAPMU staff, including on procurement. Procurement practices implemented during preparation, including those supported by the PHRD and PPF, confirm that CAPMU and the beneficiaries have an adequate understanding (although occasional clarifications from IDA may be needed) on procurement requirements. The IDA procurement specialist will join the project launch workshop to initiate the procurement practices of the project on a sound footing. A summary of the procurement assessment is in Annex 6.

4.4 Financial management issues:

The Bank conducted a financial management assessment of CAPMU and concluded that its financial management arrangements are acceptable to the Bank.

The Borrower is in compliance with its audit covenants of existing Bank-financed projects. Previous and current CAPMU project financial statements and auditing arrangements are satisfactory and it has been agreed that these will be replicated for RISP. The annual audited project financial statements will be provided to the Bank within six months of the end of each fiscal year and also at the closing of the project.

The latest Country Financial Accountability Assessment (CFAA) of September 26, 1995 was prepared at a time of considerable transition and therefore, in view of the time that has since elapsed, the CFAA is now considered to be out-of-date. However, the I-PRSP of November 15, 2000 confirms that improvement is required in the management of public expenditures, including the budget process and budget execution, as well as cash and debt management. Thus CAPMU has developed policies and procedures that operate in addition to those of the current public expenditure management framework to minimize project financial management risks. In 2000, the Bank conducted a Country Portfolio Financial Management Review (CPFMR) of all projects under implementation in Moldova and identified some common financial management issues; the Bank confirmed that all such issues have been appropriately addressed in the design of RISP financial management arrangements.

The banking sector in Moldova is relatively weak. However, CAPMU has opened all of its projects' Special Accounts in a single commercial bank acceptable to the Bank whose financial status and statements are reviewed on an ongoing basis by the Bank. As these arrangements have been satisfactory, they will remain in place during RISP project implementation.

5. Environmental: Environmental Category: F (Financial Intermediary Assessment)

5.1 Summarize the steps undertaken for environmental assessment and EMP preparation (including consultation and disclosure) and the significant issues and their treatment emerging from this analysis.

The project falls into the World Bank's FI category, as it will mainly provide funds to lending institutions that on-lend the funds to qualified applicants to implement a wide variety of rural development activities. As required for FI category projects, a comprehensive Environmental Review (Environment Sector Review, dated March 2001, in project files) was conducted by international and local consultants to: (a) assess the adequacy of the legislative framework for environmental assessment; (b) identify institutions that would be responsible for the EIA under RISP; (c) determine TA and training needs for these institutions to adequately implement the environmental assessment (EIA) requirements; and (d) propose procedures for environmental screening, EIA preparation and implementation, possible mitigation measures for certain sub-projects, and monitoring and evaluation of implementation of EIA requirements.

The activities to be financed under RISP will be small, demand-driven investments in farm and non-farm income generating activities. Given the small size of the activities financed under the project, the environmental impacts of individual subprojects are expected to be small. However, the specific activities, their potential environmental impacts, and local cumulative impacts can only be known during project implementation. For this reason, the project will put in place an environmental review and screening mechanism that will: (a) carry out environmental review and assessment as needed in accordance with Moldovan Law and World Bank requirements; (b) prevent financing of projects with significant environmental impacts, and (c) identify mitigation measures for the project with less than significant environmental impacts, to be implemented as part of the subproject activities. To guide PFIs and CAPMU in this process, an environment section was developed as part of the Rural Credit Guidelines for PFIs under RISP, providing mechanisms for environmental screening of proposals, preparing an EIA and supervising its implementation.

The Project will build capacity in CAPMU to undertake the environmental reviews and ensure that the mitigation measures are followed. This technical assistance will be co-financed by a grant from the Global Environment Facility through the Agricultural Pollution Control Project, APCP. As a result, potential environmental impacts will be avoided or minimized by applying a set of good practices directed to farmers through the advisory Components of the RISP, such as providing guidance to clients on environmental and agricultural sustainability matters when advising on agricultural production activities. In addition, the APCP and the Lower Dniester River Biodiversity Project (a second GEF-financed project) will support environmentally sustainable agriculture technologies, such as organic farming, and provide farmer education on environmentally sound practices. These projects will provide incentives to farmers and extension services to enhance agricultural productivity in an environmentally friendly manner:

> The **Agricultural Pollution Control Project (APCP)** aims to reduce nutrient (N&P) pollution from agriculture through adoption of environmentally-friendly practices in crop and livestock production and rural agro-industries, as well as related policy improvements. The APCP will be implemented as an integrated component of RISP. The Project would provide up to 20 percent grant cofinancing for rural credits issued under RISP to address the incremental cost of eligible nutrient reducing environmental investments such as crop rotation, conservation tillage, efficient manure management practices, promotion of organic farming, nutrient management, buffer strips along rivers, and soil and water quality monitoring, and other similar activities. The APCP will also support preparation and implementation of a model wetland and integrated watershed management plan for one of the tributaries of the Prut River in the Lower Prut Basin to reduce nutrient load and improve biodiversity conservation. Under its TA Components, the APCP will

also strengthen CAPMU and PFI capacity in integrating environmental concerns into agricultural practices through advisory services, environmental screening of credit applications, and monitoring of implementation of environmental plans on the ground by the rural population.

The **Lower Dniester Biodiversity Conservation Project** will create a national park in the Lower Dniester River region to conserve globally significant biodiversity and promote sustainable natural resource uses. The Lower Dniester Biodiversty Project will also co-finance environmentally sustainable non-farm investments. Management plans developed under the Project for various zones of the Park will identify farm and non-farm income generating activities for rural populations surrounding high-conservation lands that integrate biodiversity-friendly practices and aim to achieve incremental biodiversity benefits. This Project will provide grant cofinancing for RISP credits to address incremental costs for biodiversity conservation for commercially viable and replicable investments, such as in small-scale processing facilities for food/medicinal goods like milk, cheese, flour mills, fruits, berries and nuts, medicinal plants; bee-keeping; cultivation of valuable genetic species, including ancestors of wild species; traditional handicraft activities; development of nature tourism and home stay activities in the national park, buffer zone, and transition zone.

5.2 What are the main features of the EMP and are they adequate?

For projects requiring an EIA, the EIA will identify whether an EMP is needed.

5.3 For Category A and B projects, timeline and status of EA:
Date of receipt of final draft: N/A

The Environmental Review was prepared in March 2001.

5.4 How have stakeholders been consulted at the stage of (a) environmental screening and (b) draft EA report on the environmental impacts and proposed environment management plan? Describe mechanisms of consultation that were used and which groups were consulted?

Extensive consultations with stakeholders groups have taken place in various parts of the country including stakeholders from the Ministry of Environment, NGOs and farmer organizations. A workshop was held with a number of NGO representatives and government specialists to identify major issues and problems, including environmental, facing rural people and how these problems would be best addressed. Results from the workshop were supplemented with a background description of agricultural and rural conditions, and current activities in Moldova. These two initiatives provided a base upon which a number of assumptions in terms of probable agricultural and rural activities to be supported through the project would be made. Also, the Environmental Review was carried out on the basis of discussions with the Ministry of Environment.

5.5 What mechanisms have been established to monitor and evaluate the impact of the project on the environment? Do the indicators reflect the objectives and results of the EMP?

CAPMU and the lending institutions will environmentally screen each proposed activity, based on the Guidelines and Environmental Checklist. Where screening indicates that an EIA is required, the lending agency will direct the proponent to conduct and submit to RISP management an acceptable EIA prior to funding approval. CAPMU will have the responsibility for verifying the need for an EIA and advising the project proponent on EIA preparation, and monitoring the sub-project implementation, including ensuring that the sub-project meets the environmental requirements of the country and is consistent with the Bank's guidelines. CAPMU will include an officer responsible for environmental management, based on EIA Guidelines. This individual, and relevant staff of the PFIs, would be given appropriate training as described in the Guidelines, again supported by APCP.

The following is a preliminary procedure for environmental screening and EIA preparation, review and approval: (a) application for line of credit is submitted to the lending institution; (b) lending institution determines whether or not the activity will require an EIA, based on an Environmental Check List; (c) if EIA is needed, application is forwarded to CAPMU management for confirmation; (d) responsible officer reviews application and verifies need for an EIA; (e) if EIA is required loan applicant is informed; (f) if the applicant wishes to proceed, he carries out an EIA (guidelines to be provided) and submits EIA to CAPMU through lending institution; (g) CAPMU reviews EIA and suggests revisions and eventually approves or rejects project on the basis of the EIA; (h) if approved, CAPMU will monitor the activity to ensure that it is in full compliance with the management plan.

Monitoring. Frequent monitoring by the Bank and CAPMU will be required to ensure that mitigation is carried out and to also determine whether or not additional impacts, not identified in this environmental review, have not been overlooked. Monitoring will be carried out on a systematic basis by the project management team or its designate (e.g. a local environmental consultant). A detailed monitoring procedure will be developed and the individual(s) responsible would receive training in monitoring techniques. The World Bank should also include an environmental specialist on the occasional supervisory mission to ensure that environmental monitoring is being conducted effectively and that monitoring results are being acted upon.

Training. The Ministry of Environmental Protection and Territorial Development is responsible for administering the Law on Environmental Protection. However, apart from complex and potentially dangerous projects, this law does not address the need for EIAs on most projects. Thus, RISP management staff and lending agencies' staff will require various levels of environmental management training, to be provided under the Project based on the EIA Guidelines.

6. Social:

6.1 Summarize key social issues relevant to the project objectives, and specify the project's social development outcomes.

Two quantitative surveys and one qualitative social assessment (SA) were completed as a part of project preparation. Stakeholders were surveyed extensively during a GAP Study of, primarily, a rural support services component (December 1998/January 1999), and were consulted again during the Social Assessment (May-August 2000) and the Baseline Farm Survey (October-November 2000).

The key social issues identified throughout stakeholders analysis are:

1. The rural population is faced with many major challenges, such as insufficient income, lack of employment, and lack of access to utilities. The majority of respondents perceives standards of living as being at or even below subsistence, but this perception differs among organizations and rural households. Rural households are representatives of populations that are engaged in active farming without being organized in formally registered farm units. The net family income of private farmers is about three times the net income of rural households. Farmers are willing to associate, but group formation to yield more efficient production is being stymied by lack of information, not lack of trust.

2. Small farmers and rural entrepreneurs are virtually without organizations or infrastructure that serve their needs or articulate their interests. Old established institutions have not adjusted to meet the needs of small producers, who remain relatively isolated. A market infrastructure is the first priority of Moldovan farmers – where and how to sell goods, including training in market analysis and crop selection. Lack of information and insufficient knowledge are the major obstacles to farmer involvement in agricultural

opportunities. The potential solution to avoid isolation is dissemination of information and technical rural business development assistance.

3. The rural population is generally optimistic about its future. Seventy percent of farmer organizations and 20 percent of rural households intend to borrow in the future. However, there are many constraints toward receiving credits by rural, small-scale stakeholders. Credit inequities can be decreased by providing access to credit and building the capacity of rural financial institutions.

Social development outcomes would include: (a) establishment and strengthening of organizational capacity and social capital as seen in group formation and development of rural infrastructure; (b) empowerment through the support of grassroots organizations taht would enable rural people would be able to draw themselves out of poverty; (c) participation of stakeholders in project implementation to steer the project toward community demands; and (d) equitable, accountable and transparent governance through improved legal and regulatory systems to support commercial lending to rural clients, farmer groups and agribusinesses.

6.2 Participatory Approach: How are key stakeholders participating in the project?

In order to enable the project team to tailor the project design to fit the needs of stakeholders, separate social assessments were conducted during project preparation. The demand-driven development of the agribusiness/financial services network would ensure constant stakeholder participation in the project at various levels.

At the grassroots level, local NGOs and rural leaders would promote and stimulate farmer group activity. By implementing the participatory approach, farmers and rural agribusinesses would be assisted by the farmer organizations in joining various types of formal and informal groups, for example, service cooperatives and product councils. At the next level, the business advisory and technical support services infrastructure would be established for newly created private farmers and emerging private agri-businesses and rural enterprises. Rehabilitation and maintenance of the market infrastructure and the creation of the rural business development services would empower farmers to participate by increasing knowledge and opportunity.

Private stakeholders, represented by the commercial banking system and RFC, would participate by providing investment and working capital credits to support the broad range of agri-businesses and rural enterprises mentioned above and by helping SCAs exploit business opportunities.

6.3 How does the project involve consultations or collaboration with NGOs or other civil society organizations?

The project promotes and relies on non-governmental agencies for implementation. In addition, NGOs and other civil society organizations were extensively consulted during project identification and preparation, including in focus group meetings. Representatives of these organizations have played significant roles in project preparation as members of component-specific working groups and/or during consultations on draft working papers.

Civil society would help to implement and sustain the project. The project would utilize the experience of existing NGOs to advise, promote and stimulate various farmer organization activities, particularly developing access to finances. Civil society would participate in the rural support service component by formulating community development strategies. The project would assist the establishment of sustainable civil society organizations (professional associations, community organizations, etc).

6.4 What institutional arrangements have been provided to ensure the project achieves its social development outcomes?

For the advisory and rural business components, a capacity assessment of local service providers was carried out, which included among other activities, an assessment of representation of local interests and representatives of the community in decision making process. The service providers and development agencies are all formed by grass-roots level staff, and would be supervised and monitored directly by regional, private organizations while the national level entities would only set the broad strategies for the components. During the pilot period, services provided by local agencies were evaluated through beneficiary questionnaires, the results of which will be integral parts of future evaluations before a contract is awarded. Training of trainers is being included in the project, to directly train local services providers in addition to the beneficiaries themselves. The farm organization method would be based on the well-tested methods of social mobilization that were implemented under the first Rural Finance Project when Savings and Credit Associations were formed. SCAs, which are self-managed and accountable for their own performances, are known to be one of the most effective tools to voice community and members interests.

6.5 How will the project monitor performance in terms of social development outcomes?

The project would provide long-term, continuous and adaptable support to rural development in Moldova. Therefore, reports on project development indicators and feedback from the public and other beneficiaries would be reported quarterly. An independent agency would implement a participatory monitoring and evaluation system after CAPMU ensures that the capacity of this agency to monitor and evaluate project results is adequate.

Indicators relevant to social development outcomes would include: (a) indicators of farm organizations created or strengthened, including the number of their members; (b) the willingness and success of communities in taking responsibility for the rural development systems; (c) measures of improving or building agricultural market facilities; (d) beneficiary satisfaction with agricultural services financed under the project; (e) level of self-financing and long-term sustainability of the services provided under the project; (f) number of private farmers and rural entrepreneurs that have access to credit; and (g) the successful utilization of lending over time.

The rural finance component would strengthen the capacity of financial institutions and RFC to operate an efficient system of rural financing and provide private farmers and rural entrepreneurs easier access to finance.

Finally, the project management component, led by CAPMU, would develop the necessary administrative and financial management skills in the various agencies and field units to implement the different project components. Strengthening the regulatory and supervisory capacity of the State Supervisory Body and National Federation of SCAs is also included in the project.

7. Safeguard Policies:

7.1 Do any of the following safeguard policies apply to the project?

Policy	Applicability
Environmental Assessment (OP 4.01, BP 4.01, GP 4.01)	● Yes ○ No
Natural Habitats (OP 4.04, BP 4.04, GP 4.04)	○ Yes ● No
Forestry (OP 4.36, GP 4.36)	○ Yes ● No
Pest Management (OP 4.09)	○ Yes ● No
Cultural Property (OPN 11.03)	○ Yes ● No
Indigenous Peoples (OD 4.20)	○ Yes ● No

Involuntary Resettlement (OP/BP 4.12)	○ Yes ● No
Safety of Dams (OP 4.37, BP 4.37)	○ Yes ● No
Projects in International Waters (OP 7.50, BP 7.50, GP 7.50)	○ Yes ● No
Projects in Disputed Areas (OP 7.60, BP 7.60, GP 7.60)*	○ Yes ● No

7.2 Describe provisions made by the project to ensure compliance with applicable safeguard policies.

An environmental review has been conducted. It was used in the implementation design of the project components, as described in Section 5 above.

F. Sustainability and Risks

1. Sustainability:

Political Sustainability. The most significant risk emerges from policy uncertainties that will be monitored both under SAC III and RISP. While the Government is committed to alleviate rural poverty through regenerating growth, policy decisions are often driven by a short-term political agenda. Public discontent is frequently voiced around the issue that the country has not yet benefited from the transformation of the economy.

Government's Intervention in Non-Governmental Activities. The Government has used various means to control and interfere with a number of activities; for example, the court of accounts announced an audit of various project implementation agencies, including CAPMU. While this issue has been resolved at present, future intervention is quite possible. Similarly, the Agricultural Steering Committee has occasionally attempted to influence the flow of commercial credit to particular sub-sectors. The project documents clearly state that PFIs would have full autonomy for loan appraisal and approval decisions. This would have to be monitored during project implementation.

Financial Sustainability. With regards to the rural business development and advisory services components, financial sustainability would be achieved only gradually, and during the initial period, project financial support would be required. Cost recovery of services of a "public goods" nature rarely achieves 100 percent financial sustainability. Under the rural finance component, at the sub-project level, overall appraisal and financial analysis of the viability of each sub-project should confirm the sustainability of this component. If financial sustainability is to be achieved, PFIs must maintain a high quality portfolio through prudent operations. At the local community level, sustainability of the project would be linked to improvement in labor productivity and job opportunities, and the project's participatory approaches to promote community involvement would enhance the sustainability.

Institutional Sustainability. A strong emphasis from the beginning on local capacity development and decentralized implementation would ensure institutional sustainability. In addition, needs-focused training for local institutions and groups would be an important element of the project in the initial years.

2. Critical Risks (reflecting the failure of critical assumptions found in the fourth column of Annex 1):

Risk	Risk Rating	Risk Mitigation Measure
From Outputs to Objective		
Political uncertainties could reverse the Government's commitments to proceed with policy reforms, and to remove main impediments for private sector	H	Both SAC III and RISP have agreed on policy reform programs, which would be monitored through the Letter of Sector Development Policy; IDA and the Borrower would continue to

development.		engage in policy dialogues.
Post-privatization land ownership still being solidified; and land owners legal rights still inadequately understood.	S	Land owners would be informed of their legal rights through information campaign and legal support; and development of land markets will be supported to promote land consolidation based on market signals.
Business environment that is not conducive to private businesses.	S	Specific legal and regulatory constraints have been identified, and efforts are being made to reduce the impediments, in parallel to proactive steps to promote private activities, such as the rural business development support.
New private farmers lack knowledge, skills to develop and manage investments on commercially viable terms.	M	Transfer of know-how and basic support services through hands-on business development support and training will be focus of the RISP APL Program and the first phase.
Inadequate local institutional capacity and demand for post-privatization support services.	M	Institution capacity building and training of trainers are key focus of the APL program.
Farmers do not fully understand the benefits of joining farm organizations or other legitimate groups.	M	Intensive information campaign, on-site focus groups, training will be provided regarding benefits of private farmers organizations to increase groups' bargaining power, capture scales of economies, improve marketing prospects, etc.
From Components to Outputs		
Political influence on consultant contracts or hiring of local staff.	M	All selections will be done through open, transparent, and advertised selection processes and evaluation results will be made public.
Political influence on sub loan approval	S	Assurance would be sought to provide full autonomy for loan appraisal and approval to participating financial institutions and will be followed by regular portfolio review
PFIs lack necessary skills, experiences and interest to lend to agricultural clients.	M	Training will be provided to commercial banks, simplified loan appraisal procedures, creation of a group lending window, improved MIS, etc. will reduce the transactions cost
Donor activities are not coordinated	M	A comprehensive inventory of all donor supported rural programs will be updated and regularly shared with the donor community for improved coordination and synergy.

Overall Risk Rating	S	

Risk Rating - H (High Risk), S (Substantial Risk), M (Modest Risk), N(Negligible or Low Risk)

3. Possible Controversial Aspects:

Potential controversies could emerge from the Government's sudden reversal of key agricultural policies. The Letter of Sector Development Policy attached to the project provides a vehicle for continuous policy monitoring and dialogue.

G. Main Credit Conditions

1. Effectiveness Condition

1. At least one eligible PFI signs the Subsidiary Loan Agreement with the Ministry of Finance.

2. Other [classify according to covenant types used in the Legal Agreements.]

Condition for the Board. The following condition was met:

The Government of Moldova has submitted a ***Letter of Sector Development Policy***, signed on May 10, 2002, which is acceptable to the Association.

Conditions for Negotiations. The following conditions for negotiations have been met.

1. The Government of Moldova has endorsed the project concept, components, implementation arrangements, and cost and financing plans.

2. The Government of Moldova has submitted a draft ***Letter of Sector Development Policy*** with key areas of reforms and an action plan to be implemented during the period of the APC Program.

3. The Government of Moldova has submitted a set of trigger points for starting the second phase of the APL with measurable performance indicators, including those that can measure the institutional capacity building.

4. The Government of Moldova has endorsed statutes, an operational manual, and budget and staffing requirements for CAPMU, and commits to maintain CAPMU with full support during the project implementation period with adequate staffing and funding support.

Others:

Dated Covenant. The Government shall reinstate the supervisory functions of the State Supervisory Body (SSB), including licensing of savings and credit associations, no later than December 31, 2002.

Implementation: The Government of Moldova shall: (a) implement the project according to the agreed Project Implementation Plan, Operational Manuals, and Rural Credit Guidelines; (b) maintain CAPMU

with staff, resources and TOR acceptable to IDA; (c) maintain the Agricultural Steering Committee until project completion with staff, resources and TOR acceptable to IDA; (d) implement the rural finance component according to the Rural Credit Guidelines; and (e) coordinate related donor technical assistance activities.

Accounts and Audits: Standard covenants will apply. RISP's project financial statements, SOEs and the Special Account will be audited annually by independent private auditors acceptable to the Bank on terms of reference acceptable to the Bank. The audited financial statements will be provided to the Bank within six months of the end of each fiscal year as well as at the closing of the project.

Monitoring, Evaluation and Reporting: Standard reporting covenants will apply. The Government of Moldova will: (a) prepare and submit quarterly progress reports within 30 days of the end of each quarter, with the first report no later than December 31, 2002; (b) prepare and submit an annul work program for the following calendar year, including procurement and financing plans; (c) prepare a mid-term review by June 30, 2004 and review with IDA by September 30, 2004; (d) ensure that environmental reviews for sub-projects requiring EIAs are carried out; and (e) supervise and monitor the quality of work of all implementing institutions involved in project implementation.

H. Readiness for Implementation

☐ 1. a) The engineering design documents for the first year's activities are complete and ready for the start of project implementation.
☒ 1. b) Not applicable.

☐ 2. The procurement documents for the first year's activities are complete and ready for the start of project implementation.
☒ 3. The Project Implementation Plan has been appraised and found to be realistic and of satisfactory quality.
☐ 4. The following items are lacking and are discussed under loan conditions (Section G):

The project is ready to start implementation. For all components, operational manuals for implementation were tested during the pilot stage, discussed in full detail with the IDA team, and modified as appropriate; they are now in place. A competitive contracting system was tested during the pilot stage and is now in place. The system calls for the public dissemination of all aspects of the system; the eligibility criteria, the evaluation procedures and committee composition, and announcements of the initial results, final selection and contracting entities. All necessary contracts for local service providers and consultants are in place, as is the supervision and monitoring system, which includes a system of beneficiary surveys for contracted services. For the rural finance component, four eligible commercial banks and RFC have signed the interim Subsidiary Loan Agreement and have implemented pilot credit operations. The demand for credit appears to be strong, as is the willingness to learn among future borrowers and lenders alike. Furthermore, an independent monitoring system of PFIs is in place to ensure continued eligibility and high portfolio quality. Donor-funded pilot activities, which would be rolled out in full-scale during the project, have begun and results are promising. Project management and supervisory arrangements – CAPMU and the Steering Committee – are in place, have been fully endorsed and are ready to begin implementation.

I. Compliance with Bank Policies

☒ 1. This project complies with all applicable Bank policies.
☐ 2. The following exceptions to Bank policies are recommended for approval. The project complies with all other applicable Bank policies.

Hoonae Kim **Team Leader**	Laura Tuck **Sector Director**	Roger W. Grawe **Country Director**

Annex 1: Project Design Summary

MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Hierarchy of Objectives	Key Performance Indicators	Data Collection Strategy	Critical Assumptions
Sector-related CAS Goal: Increased rural incomes and reduced poverty through facilitating the development of private agricultural enterprises and related post-privatization support service activities in rural areas.	**Sector Indicators:** * Poverty headcount in rural areas declines. * Higher levels of production and productivity of commercial farm units, * Developing land market with increasing number of land related transactions. * Increased export volumes of agricultural production.	**Sector/ country reports:** ESW reports	**(from Goal to Bank Mission)** Continued political commitment by GOM to proceed with policy reforms and removal of main impediments for private sector development.
Program Purpose: Accelerated private sector led agricultural recovery and growth to provide underpinnings for future income growth and poverty reduction in Moldova. **Program Phasing:** **Phase I:** Creation and strengthening of the institutional and regulatory frameworks for emerging rural businesses; **Phase II:** Additional investment support to the target group.	**End-of-Program Indicators:** * More favorable macroeconomic framework and business environment; * Improved competitiveness of the agro-processing sector; * Developed land market; * Sustainable support services system for rural businesses; * Sound rural financing system; * Improved diversification and development of off-farm activities.	**Program reports:** * Supervision reports. * Mid-term review report. * APL Phase I trigger review. * Project progress reports.	**(from Purpose to Goal)** * Continued political commitment by GOM to proceed with the policy reforms. * Willingness of GOM to proceed with removal of the main impediments hindering development of the private agriculture and processing sectors. * Coordination between GOM, IDA and other donor agencies. * Legal and regulatory framework for land market development is in place with ownership rights fully defined and protected. * Local institutional capacity and demand for post-privatization services are adequate. * Commercial banks have the capacity to adequately deal with risks associated with rural lending.

Project Development Objective: Foster post-privatization growth in the agricultural sector by improving the access of new private farmers and rural businesses to what they need to succeed – legal ownership status, knowledge, know-how, and finance.	**Outcome / Impact Indicators:** * Increased production and productivity in key crop and livestock sub-sectors in the regions where project activities are conducted. * Number of viable new and improved rural businesses engaged in economic activity in the project areas: 900 individual and 600 group businesses. * Improved access to rural advisory services: – Number of advisory centers operating – 35 – Outreach: 1,100 villages. – Proof of client satisfaction in surveys. * Improved market access and marketing practices for agro-food producers, measured by increased volume of exports from the project area. * Increased non-farm employment in rural areas measured by the number of non-ag businesses. * Increased rural income in project areas as compared to baseline survey. * Increased lending to rural clients by project PFIs by at least 50%. * Increase in number of PFIs lending to micro-finance clients. * Sound portfolio quality with acceptable recovery rate of at least 90% for all creditline components.	**Project reports:** Project progress reports. Comprehensive reports (baseline/interim/final) based on semi-open interviews with a representative sample of villages and of households (project/non-project) to assess the economic and social impact of project interventions: production levels, situation of livestock production; efficiency of machinery services; level of satisfaction; level of food security and income at farm level.	**(from Objective to Purpose)** * An adequate macro policy framework is in place. * Existing impediments for marketing and export are diminished. * Improved marketing and export facilities will lead to agricultural value added. * Key farm inputs are available in country in sufficient amount and quality. * Commercial banks overcome their reluctance to lend to rural businesses and farmer organizations. * Privatization and farm restructuring processes continue. * There is reasonable coordination of all rural projects and cooperation with other donor agencies.

Hierarchy of Objectives	Key Performance Indicators	Data Collection Strategy	Critical Assumptions
Output from each Component: **I. Rural Advisory Services** Access to information and advice for those operating in the agricultural sector, improved through a nation-wide network of advisory service providers in project areas.	**Output Indicators:** * High awareness of farmers regarding the availability of rural advisory services. * At least 200,000 farmers and rural entrepreneurs have benefited from the advisory services. * An increase in number of clients per advisory center. * At least 50% of all clients are repeat clients. * Types of advice provided by service centers. * Viability of service centers as measured by cost recovery of at least 50%. * Satisfaction of service center network with operation.	**Project reports:** * Quarterly project management reports. * Semi-annual reports on progress of separate project components * Supervision reports * Evaluation reports	**(from Outputs to Objective)** * Type of knowledge required for advisory services is available in sufficient amount and quality. * Sufficient key inputs are available to accommodate increasing agricultural production. * Clients are increasingly willing to pay for good quality advice.
II. Rural Business Development Farmers strengthened in developing effective, self-owned and sustainable new and existing rural businesses and farmer organizations.	* Number of rural businesses and farmer organizations created – 900 individual and 600 group businesses. * Increased number of members in the farmer organizations. * Increased marketing opportunities for agro-food producers. * Increased productivity and income for owners / members of newly created businesses; improved access to credit from commercial banks.	* Quarterly project management reports. * Semi-annual reports on progress of separate project components. * Supervision reports. * Evaluation reports.	* Legislation necessary to improve the business environment for the private sector is enacted and implemented. * In the case of farmer organizations, the target beneficiary group generally appreciates the benefits of joint activities.

III. Rural Finance **1. General Commercial Credit Line** Increased flow of investments and working capital to private creditworthy entrepreneurs in rural areas and continuous support of the micro-finance movement.	* Number and quality of business plans submitted to banks for financing. * Number of loans provided – at least 400. * Number of beneficiaries (owners/members) who have received loans – at least 1,000. * Increased share of loans to agriculture and rural sectors in PFIs loan portfolios at least by 50%. * Number of loans provided to newly created SCAs –at least 100. * Growth of the membership in existing SCAs by at least 10 percent.	* Quarterly project management reports. * Semi-annual reports on progress of separate project components. * Supervision reports. * Evaluation reports.	* Potential borrowers have the skills and knowledge to prepare financeable business plans.
2. Special Credit Line with a Matching Grant Strengthened sustainability of newly created and registered small scale private farmers, farmer groups and entrepreneurs, providing loans with special built-in incentives.	* Number of loans to newly created and registered small-scale private farmers and farmer groups – at least 250. * Number of total beneficiaries (owners/members) who have borrowed – at least 1,000. * Repayment performance – at least 90% recovery rate on PFI loan portfolio.	* Quarterly project management reports. * Semi-annual reports on progress of separate project components. * Supervision reports. * Evaluation reports.	* Potential borrowers have the skills and knowledge to prepare financeable business plans and to be able to make good on the loans, in order to benefit from the special credit line.
3. Institutional Capacity Development for Rural Finance System Strengthened skills and capacity of PFIs, through	* Number and quality of training programs and	* Quarterly project management reports.	* PFIs have the willingness and commitment to

provision of technical assistance on agricultural lending.	arrangements for PFIs. * Increased share of loans to agriculture and rural sectors in the PFIs loan portfolios – increase by 50%. * Acceptable rate of delinquency on loans to agriculture and rural sectors by PFIs – recovery rate of minimum 50%.	* Semi-annual reports on progress of separate project components. * Supervision reports. * Evaluation reports.	participate in the training arrangements.

Hierarchy of Objectives	Key Performance Indicators	Data Collection Strategy	Critical Assumptions
Project Components / Sub-components:	**Inputs: (budget for each component)**	**Project reports:**	**(from Components to Outputs)**
I. Rural Advisory Services Establish a nationwide network of decentralized, privately-owned, rural advisory service providers, based on competitive contracting. Pilot projects.	US$m 2.95	Quarterly project management reports prepared by CAPMU (procurement management, financial reports, project progress reports i.e. physical delivery of goods and services, number of advisory service providers running, number of farmers demanding services). Quarterly disbursement reports.	Advice given is appropriately used and has an impact. There is reasonable coordination of all rural projects, and cooperation with other donor agencies. There is adequate counterpart funding.
II. Rural Business Development Finance technical assistance, training of trainers and rural entrepreneurs, and operational support for local development agencies (DAs) with an aim to create legally registered, self-owned and sustainable rural businesses, which would be potential clients of financial institutions. Pilot projects	US$m 2.49	Quarterly project management reports prepared by CAPMU (procurement management, financial reports, project progress reports i.e. physical delivery of goods and services, number of farmers demanding services). Quarterly disbursement reports.	An adequate legal framework has been created for the formation of private businesses, including business cooperatives, production cooperatives, peasant farms, LTDs, JSCs. There is reasonable coordination of all rural projects, and cooperation with other donor agencies. There is adequate counterpart funding.
III. Rural Finance **1. General Commercial Credit Line** Provide investment and permanent working capital loans at commercial terms to private rural entrepreneurs through eligible PFIs	US$m 7.725	Quarterly project management reports prepared by CAPMU (financial reports, project progress reports i.e. number of loans)	Farmers have improved access to credit, with PFIs being more responsive to the needs of small and first time borrowers.

2. Special Credit Line with a Matching Grant Assist newly created and registered small-scale, private farmers, groups of farmers and rural entrepreneurs.	US$m 5.525	Quarterly disbursement reports	
3. Institutional Capacity Development for Rural Finance System Provide technical assistance on agricultural lending to PFIs.	US$m 0.5		
IV. Project Management Support of project implementation unit and additional studies required during implementation.	US$m 0.5		

Annex 2: Detailed Project Description
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

The proposed project would have three main components plus support for project management:

(a) Rural Advisory Services;
(b) Rural Business Development Services;
(c) Rural Finance; and
(d) Project Management.

The first component would provide the most essential information to emerging private farmers; the second component would create legally registered rural businesses, with business plans; and the third component would provide finance to bankable rural clients. The first two components would provide predominantly public investment combined with technical assistance, while the third component would provide private investment support along with the necessary technical assistance to participating financial institutions. The first three components are closely linked, with each dependent on the others for successful outcomes.

Parallel GEF projects. In addition to the above components, two parallel, GEF-funded projects would be implemented as a part of the overall RISP framework to support the post-privatization agricultural sector. They are the Agricultural Pollution Control Project (APCP) for US$5 million equivalent, and the Medium-Size Biodiversity Project (MSBP) for US$ 1 million equivalent. The GEF facilities would provide a matching grant fund to support the Special Credit Line of the RISP (US$2 million under ACPC and US$200,000 from MSBP, respectively). In addition, APCP would also provide technical assistance through the advisory service providers to mainstream environmental concerns into agricultural practices and to assist the Government to promote the adoption of environmentally-friendly practices in crop and livestock production and in those rural agro-industries that contribute to nutrient pollution, including wetland and integrated watershed management. Implementation of the GEF projects would be carried out by their own respective project implementation unit, except for the grant funding for the Special Credit Line, which would be implemented through arrangements under RISP.

Component	Component Financing/inputs	Expected Output	Expected Impact
1. Rural Advisory Services	* Service contracts for general contract (basic advisory). * Service contracts for special contracts (client demand driven topics). * Training of local service providers. * Minor office equipment.	* Service contracts awarded through open, competitive contracting procedures, minimum 1,000 contracts. * Establishmenty of a demand driven/client oriented advisory delivery system. * A pool of trained local advisory specialists. * Establishment of a nationwide network of minimum 35 service providers.	* Enhanced knowledge of new private farmers on basic requirements. * Enhanced awareness of value of information, advisory services. * Improved knowledge of land owners' rights and opportunities. * Improved agricultural productivity.

2. Rural Business Development Support	* Contracts for Development Agencies for complete chain of requirements to register as legal entities. * Pre-creation operational support for new farmers and rural business. * Post-creation operational, managerial support for new farmers and rural business. * Training of trainers.	* Legally registered new rural businesses. * Legally registered individual farms. * Well prepared operational, organizational and managerial structures in the newly created rural businesses. * Well prepared business plans. * Well prepared loan packages.	* Solidified legal status of new rural businesses. * Built-in operational, managerial and organizational capacity among new businesses. * A pool of viable rural businesses to trigger spill over effects to the rest of rural economy. * A pool of trained local specialists to continue to serve future rural clients. * Matching of BPs with financing.
3. Rural Finance	* Investment and permanent working capital loans. * Special matching grant to eligible, relatively poor clients. * TA for participating financial institutions. * TA for improving rural finance system.	* Substantial loan portfolio, with broad outreach. * Increased number of first-time borrowers. * Improved capacity of PFIs.	* Mainstreaming of agricultural credit delivery into banking sector. * Significant flow of resources to agriculture sector. * Improved agricultural productivity. * Diversified rural economic activity. * Reduction in poverty.
4. Project management	* Incremental operational expenditures. * Training of PMU staff on procurement, FMS, environment, social and other fiduciary duties. * Audit and other studies to measure impacts of the project.	* Well established project management unit and proper procedures, internal control, reporting, M&E capacity.	* Well implemented project. * Strategic and properly sequenced project implementation. * Effective utilization of foreign borrowed resources. * Effective utilization and efficient coordination of donor TA grants.

By Component:

Project Component 1 - US$2.95 million

I. Rural Advisory Services

The Rural Advisory Services Component would finance service contracts and training, through which it would establish a nationwide network of decentralized, privately-owned, rural advisory service providers (SPs), which would provide information, knowledge and know-how to newly established, private rural

entrepreneurs. A variety of services would be provided covering, among other topics, business, finance, agronomic and other technical areas, as well as information on marketing prospects, legal and tax implications to business management and credit availability. Services would be "hands-on" and provided at the on-farm level. Services would also be demand driven as clients in the villages would assume an active role in identifying the areas of their needs, which would include responding to the changing demands and needs that are associated with the emergence of a market economy, agricultural restructuring, and the continuing land and asset privatization. The need to transform agricultural producers into entrepreneurs would also be addressed under this component. Rather than creating new entities, this would be done through tapping into the already existing network of service providers and augmenting their capacity through the provision of capacity building support.

Advisory services would be provided through competitive contracting based on advertisement, open bidding and independent evaluation and selection. The competitive contracting system would promote innovation as it relates to the continuous development of extension methodologies and contents that are relevant to farmers, and, in this manner, would have the largest impact. This component would promote an open and systematic exchange of information and cooperation within the network of SPs in order to develop more depth through specialization, to stimulate creativity through the sharing of different experiences and approaches, and to learn from those SPs who are more efficient and effective. The advisory services would be provided to clients based on partial cost recovery, which would increase gradually over time. This component would also provide training of SPs and members.

A capacity assessment of potential consultants and service providing agencies was carried out, and a pool of qualified local specialists was identified to participate in the pilot advisory operation. A detailed operational manual, contracts, selection criteria and procedures, and monitoring and evaluation procedures, including a client feedback system, have been designed and are being piloted with support from TACIS and the Project Preparation Facility (PPF). Pilot results confirm that demand for information is great, a wide range of highly relevant topics is being covered, and SPs themselves are keen to improve their own capacity to better serve their future clients.

1. Description of the Component

Contracted activities would include:

- Provision of assistance and information to producers in the agricultural and food sector on business planning to support potential investments, legislation and management issues including organizational forms, marketing and financial management;
- Support to increase farmers' familiarity with the use of improved production practices;
- Improved access to appropriate input supply, seed, fertilizer and marketing channels;
- Provision of assistance to farm organizations to obtain better services and solve common problems;
- Support to improve access to information through specific seminars, training sessions, field days and demonstration plots, as well as through the collection, systematization and active distribution of information;
- Identification of specific problems faced and possible remediation on local, regional and national levels;
- Cooperation with all institutions and organizations actively involved in advisory services in Moldova; and
- Support to encourage specialized programs on a demand basis.

2. Implementation Arrangements

A complete Operational Manual and Component Implementation Plan are in place along with sample contracts. Regular monitoring and evaluation, reporting and independent client satisfaction survey systems are in place and have been tested during a pilot.

The component would be coordinated and implemented through organizations at three levels:

- **At the national level**: ACSA would provide specific services and be supervised by the National Extension Board; and
- **At the regional level**: Service Providers would function as operational centers for teams of local consultants; and
- **At the community level**: through local advisors/consultants working directly with rural households.

The National Extension Board (NEB) is comprised of seven members, representing the Ministries of Finance and Agriculture, private and donor organizations that financially support service providers. Among other responsibilities, the Board would be required to: (a) appoint the coordinator of the Agency for Consultancy and Training in Agriculture (ACSA), (b) review the extension/advisory needs, (c) set the priority strategy and tasks, (d) develop statues for ACSA and (e) agree on additional activities to be carried out through the extension network on behalf of other agencies.

Agency for Consultancy and Training in Agriculture (ACSA) is an executing arm of the National Extension Board which would be responsible for the day-to-day implementation of advisory services by the network of SPs, including (a) monitoring and implementation of selection criteria, (b) approving the "standard service package," (c) arranging contracts, (d) technical backstopping, (e) facilitating cooperation between the SPs, and (d) representing the country's interest in maintaining quality advisory service. ACSA would have a supervisory and supportive role and would monitor and evaluate the quality of service providers and their individual local consultants. In addition, the agency would be in charge of the collection and dissemination of information and innovations and would play a coordinating role in the set-up of demonstration plots and coordinating training courses. ACSA consists of a number of representative bodies of previously existing service provider networks. The executive directorate of this agency consists of five people and it would be responsible for the network of service providers, their contractual arrangements, technical backstopping, facilitating between the service providers and representing the extension service.

Network of Service Providers (SPs). Existing organizations that enter into a contract with the project are called "Service Providers" and they function as advisory centers with the additional tasks of forming a team and coaching local consultants. During the capacity assessment of service providers, all existing agencies, including those created by various donor-funded technical assistance projects, have been considered and evaluated. One prerequisite was that each agency has a strong interest coupled with the commitment to implement the component and an adequate basic capacity and willingness to improve it further. SPs would be comprised of a team of local consultants with the principal roles of serving in the physical network offices, as the first contact-point for farmers, and as implementers of the contracted services. A total of 90 candidate service providers/consultants were assessed, of which about 20 were pre-qualified to participate in the initial stage of implementation. Additional SPs would be identified and trained and would join the project during implementation. Around 35 service providers are envisaged for the project.

The roles of an SP include being: (a) a physical network node where information is systematically organized in the form of written material and databases; (b) a contact-point for farmers and investors in agriculture and processing, for receiving/purchasing specialist information about farming in the region; and (c) a contact point for local consultants, for administration of contracts, for coaching (organization of training courses and common activities) and for monitoring of volume and impact of contracts.

Typical Composition of an SP. An SP would consist of two staff in the advisory center and 8 to 10 local consultants operating at the village level. A total of 35 service providers are envisaged under the project, gradually growing from approximately 20 in year one, to 30 in year 2, and reaching the number of 35 starting year 3 (Seventeen SPs have already been contracted under the pilot phase of the project). These 35 SPs are expected to provide sufficient coverage of services so that the number of contracted SPs would remain constant for the remaining implementation time of the project. The service provider center would serve as (a) a place for communication of local consultants with their peers, (b) a focal point for visiting farmers and (c) a communication center and library, equipped with a computer providing access to email and databases. The project would, where necessary, supply basic computer equipment and provide basic training for its use, as long as users of these advisory centers establish satisfactory user and security plans and agree to allow the removal of the equipment if the Center ceases to operate adequately. Service providers would report quarterly to ACSA and would supervise the activities of the local consultants.

Local Consultants. Local consultants would enter into a service contract with the service provider in their locations. Extension contracts are expected to commit, in total, around 350 local advisors to spending not more than 60 percent of their time on extension tasks. At present, there are an unknown number of specialists in Agronomy, Livestock Production and the social fields involved in provision of information and advice to farmers and farming households. Advisors who have a "Routine Tasks Contract" with the project would have to visit the service center at least one full day per fortnight. Local consultants and the staff of the advisory centers would receive around three weeks of training with an initial focus on the functioning of the service provider network, extension and advisory methodologies and monitoring mechanisms. The following year two weeks of refresher training would be offered, focusing on feed back from the field, the fieldwork itself, and on other identified important topics.

3. Selection Process

An interested service provider would submit a proposal detailing its service capacities, the staff at the advisory center, and the local consultant identified to work with the center. A commission nominated by the National Extension Board would review all proposals. Selection would be based on predetermined selection criteria and proposals would be ranked accordingly. Results of the short-listing process would be submitted to ACSA, which would decide on the final number of service providers to be contracted.

The proposals would be analyzed by an evaluation committee according to the following selection criteria: (a) SP's experience; (b) SP's facilities and equipment; (c) curricula vitae of core staff; (d) curricula vitae of additional staff; (e) problem analysis work area; and (f) work plan.

The evaluation process is central to the concept of a competitive bidding procedure, assuring transparency, which allows for the broadest participation possible and the selection of the best SPs based purely on qualitative criteria. As such, the evaluation team would be requested to:

- Review the proposal against the approved set of criteria;
- Evaluate proposals according to the criteria-weighting schedule;
- Support criteria ratings with detailed comments as necessary;

- Support recommendations with detailed comments that may be communicated to applicants; and
- Submit all completed review documentation, including proposals, to ACSA by the due date.

The selection process of the SP and the evaluation work of the SP would require approval by the NEB. In addition, the SP selected in the first year would require approval by the WB. The selection process would be continued in year two in time to allow contracting of the SPs by February.

4. Selection Criteria

The SP must:

(a) Provide the basic office, training facilities and at least two core staff members working from the SP's office, one trained in the legal, financial or management field, and the other in the agronomy, veterinary or animal husbandry field.
(b) Provide an assessment of its regional coverage (number of villages, number of primarias), a description of how it intends to cooperate with other specialists or organizations of different professional backgrounds in the specified localities to address questions of different disciplines, and a plan for how it is intends to cooperate with farmers and farmer groups on the development of the advisory program.
(c) Submit an assessment of the main problems in its area and describe how it plans to support the clients in overcoming these problems (including the composition of the proposed team).
(d) Be registered as a legal entity with a special bank account and an acceptable, internal financial administration.
(e) Have qualified staff with at least six months experience in the field of advisory services in the area for which it is tendering.

5. The Role of CAPMU

CAPMU would have the overall responsibility of overseeing, coordinating and monitoring project implementation. CAPMU would appoint one full-time staff project coordinator, reporting directly to the General Manager of CAPMU and then through to the Agricultural Steering Committee. In particular, CAPMU would be responsible for:

- Coordination and supervision of the implementation of the component's concept as described in detail in the Implementation manual of the RISP Rural Advisory Component;
- Participation in and monitoring of the selection process of SPs;
- Monitoring and assessment of the performances of SPs and ACSA;
- Coordination of dissemination of information related to the Rural Advisory component of RISP;
- Supervision of training programs for SP's advisors and procedures of certification;
- Clear quarterly reports submitted by ACSA and by SPs;
- Cooperate with all institutions and organizations actively involved in advisory services in Moldova; and
- Providing the GOM with information, statistics and advice on the development of the advisory network within the Republic of Moldova.

6. Contractual Arrangements

Three types of contracts would be issued under the Rural Advisory Services component: (a) the contract between ACSA and the Service Provider centers for the standard routine contract package, (b) contracts between the service provider center and the local consultants to deliver the standard package; and (c) special contracts for additional specific topics with demonstrated need or for the establishment of demonstration plots.

(a) **Contractual Arrangements between ACSA and SP.** The contracts that the project would offer to Service Providers would have a maximum duration of eleven months. The contracts summarize the activities of the service providers and specify the number of and general scope of contracts the Service Provider may enter with his team of local consultants. A total contracted time of SPs and team of local consultants would not be more than 60% of the total available time of the consultants; this percentage would decrease to 40% at the end of the project period.

(b) **Contractual Arrangements between SP and Local Consultants or Sub-contractors.** The SP's core staff would enter into contracts with its team of local consultants. The routine contract would provide for the same amount of time for the local consultants as well as the SP core team. The contract amount per consultant would be fixed. The SP is required to present its contractual arrangements with its local consultant and potential sub-contracted agencies before the contract between ACSA and SP is finalized.

(c) **Special Contracts.** There would be two types of special contracts: special contracts for the contracted SPs in addition to their routine contracts and special contracts for organizations to conduct clearly specified activities. SPs can apply for special contracts to conduct special activities which have proven in high demand by farmers in the area, examples of which include demonstration plots, special seminars or special outside advice needed for certain topics.

Cost Sharing by Beneficiaries. The advisory services promoted would operate on the concept of cost participation by beneficiaries. For certain activities, beneficiaries would be expected to share the cost of advisory services. The services requiring cost participation could potentially include:

- Advice that leads to production increase, provided the production can be easily measured, marketed and leads to increased income: the advisor may agree with clients to be paid a proportion of the marginal yield (the yield above the agreed normal average);
- Educational and informational material: efforts would be made to recover at least the printing costs of the more elaborate manuals or magazines;
- Assistance in preparing farm accounts for tax purposes; and
- Preparation of a business plan to accompany a credit application.

7. Financing and Reporting Mechanisms

Reporting Mechanisms

Regular reporting would be done at several levels. On the local level, monthly reporting would be required, while reporting between the regional and the central level would be done on a quarterly basis:

(a) Local consultants submit monthly reports to their SP center. These reports should comprise a detailed description of activities conducted, including the names of farmers visited, the number of villages visited, the number of seminars or groups meetings conducted and other related topics. These reports would also include plans on the activities foreseen for the following month. Reports by the local consultants would be filed in the SP center and would be available on request by ACSA for monitoring and evaluation

purposes.

(b) The SP core staff would report quarterly to the ACSA. These reports should include a summary of the activities conducted by the SP team and would also include financial statements. ACSA would call quarterly meetings with all SPs in alternating service provider centers to discuss the quarterly reports delivered by the SPs and the main issues arising from the reports.

(c) ACSA would combine the quarterly reports of all SPs into a summary report that would be presented to the NEB and CAPMU for its quarterly meetings. The report would include a description of existing problems, the main activities conducted and an assessment of the main areas of demand for advice by farmers. The NEB would give recommendations based on these reports and would support any necessary adjustment of strategy decisions for the following period.

Flow of Funds

Based on the contract, ACSA would pay SP teams in installments upon receiving and approval of the required progress reports from the SPs. SPs would then pay their teams of local consultants according to their contracts. Payments for special contracts would be made according to the conditions specified in the contract.

8. Training Activities and Certification of Extension Consultants

The component would provide both formal and informal training. The component design encourages informal training among SPs through its networking approach. Formal training would be provided to the selected SPs before the actual implementation of the advisory activities on the ground. This would cover among other topics, methodologies of extension, legal issues related to farm activities in Moldova, farm management issues, technological issues, and marketing. The SP core staff would receive additional training in the operation of the service center as well as on accounting and reporting requirements. ACSA would prepare the training in cooperation with a training specialist advising on suitable approaches to the various training activities.

Project Component 2 - US$2.49 million

II. Rural Business Development

The Rural Business Development Component would finance technical assistance, training of trainers and rural entrepreneurs, and operational support for local development agencies (DAs) with an aim to create legally registered, self-owned and sustainable rural businesses, which would be potential clients of financial institutions. The component would provide, based on expressed demand, support for the formation of viable farmer organizations (FOs), agro-businesses, marketing entities, and other rural businesses with proper legal and operational status. This component would extend beyond the basic advisory information services provided in the first component by providing a comprehensive program of information campaigns and promotions, an institutionalized system of training, and an opportunity for gap assessment of at the village level. This component would also make available: (a) support for the preparation of group business strategies, (b) identification of profitable products and potential markets, (c) assistance in conceptualizing business ideas, developing business plans, and preparing loan packages, and (d) technical assistance needed to start the operations. Once established and in operation, groups could also receive post-creation support on a cost-sharing basis. FOs and agro-businesses with viable business plans would potentially have access to investment and working capital credits under the rural finance component of the project, subject to the discretion of participating financial institutions (PFIs).

All forms of private ownership would be supported, including individual private farmers, individual enterprises, cooperatives, limited liability firms, and joint stock companies. The aftermath of the land privatization has confirmed that farmers could join their efforts and rationalize the scale and production mode by forming FOs or cooperatives. FOs are considered to be an efficient and democratic tool to enhance rural businesses and services which otherwise would not be accessible to individual farmers. The Savings and Credit Associations (SCAs) system, started in 1997, is a good example of a successful FO movement. The recently enacted Laws on Business Cooperatives provide the necessary legal framework. This component would also include the provision of information and the required documents for registering enterprises, confirmation of the legal status and legal rights of newly privatized agribusinesses, and other institutional support for new agribusiness enterprises, including strengthening the operational, financial and management capacity of client groups.

A detailed operational manual, contract formats, selection criteria and procedures, a broadly based selection committee, and monitoring and evaluation procedures, including a client feedback system have already been designed, and a pilot project was launched in fall of 2001 with the support of DFID, the Soros Foundations and the PPF. Three DAs registered as NGOs are actively participating in the pilot operation. Participation of additional local NGOs, e.g. the Rural Development Center (RDC), the Moldova Microfinance Alliance (MMA), producers' associations and other agencies experienced in grassroots mobilization, would be solicited to advise, promote and stimulate farmer group activity. As of end March 2002, about 50 new businesses have been registered, of which about 40 have finalized business plans, and a number of loan applications valued at about US$800,000 equivalent have been prepared and submitted. The results of the pilot are promising, but they also highlight the continuous need for modifications of the operational implementation modality, reflecting the dynamic nature of the rural economy that is emerging in rural Moldova.

1. Institutional Set-up

Implementation of this component would involve Development Agencies (DAs) who would provide a broad range of services to the individuals willing to set up businesses in rural areas, services which would include pre-registration support (covering explanation of the business concepts, selection of the development opportunities, business plan development), support during the legal registration process, and post-registration support to ensure good business operational practices in the new company. Their specific responsibilities would include:

(a) Promotion of the concept of rural business development to rural population and the dissemination of materials on potential development opportunities;
(b) Diagnostic studies of the potential for development of rural businesses, and identification and selection of individuals willing to start up a new individual or group business;
(c) Provision of assistance in assessment of the submitted business proposals, including provisions for consulting, training and guidance services to selected rural businesses and assistance in defining the best internal procedures acceptable by all members of the group businesses;
(d) Assistance in preparing sustainable/bankable business plans and credit applications, including all documents necessary for registration, financial and operational plans, and internal regulations for group businesses;
(e) Provision of assistance to rural businesses during the legal registration process;
(f) Assistance to new rural businesses in developing their operational activities (marketing, accounting, development/growth) and in establishing efficient managerial and accounting systems.

2. Implementation Arrangements

This component would extend beyond the basic advisory information services provided under the Rural Advisory Services component by providing a comprehensive program of information campaigns and promotions, an institutionalized system of training, and an opportunity for gap assessment at the village level. This component would also make available (a) support for the preparation of group business strategies, (b) the identification of profitable products and potential markets, (c) assistance in conceptualizing business ideas, developing business plans, and preparing loan packages, and (d) the technical assistance needed to start the operations. Once established and operational, the groups would also receive port-creation support on a cost-sharing basis. FOs and other legally registered business entities with viable business plans would potentially have access to investment and working capital credits under the rural finance component of this project, subject to approval of the participating financial institutions (commercial banks or the RFC).

Three Development Agencies are active in the component project. Each DA has five teams with two members, a total of 15 Development Teams (DTs). A total of 30 development officers are working in the field providing support to potential businesses. Each DT would cover an average of 20 villages per year (or 100 villages over the five-year implementation period), and on an ongoing basis, work with 10 rural businesses during creation and 20 rural business after creation.

3. Selection Process of Development Agencies (DAs)

A special selection committee, consisting of the representatives from the Ministry of Economy, Ministry of Agriculture, Ministry of Finance, DFID and four persons from CAPMU would select the participating DAs on competitive basis. The selected DAs would undergo a rigorous training program to ensure that they have sufficient capacity to provide high quality support to the potential businesses. The training would include among other topics:

- Participatory communication and planning techniques;
- Experience accumulated from similar projects in Moldova, such as, the SCA program;
- Case studies of similar Rural Business Development projects in other countries;
- The forms of legal entities that might be created;
- Member Agreements;
- Financing methods available for funding rural businesses;
- Member financing arrangements for farmers' organizations and group rural businesses; and
- Marketing and promotion.

4. The Role of CAPMU

CAPMU would have the overall responsibility for implementing the component, including the selection and contracting of DAs. CAPMU would appoint one full time staff member reporting directly to the CAPMU General Manager and then through to the Agricultural Steering Committee. In particular, CAPMU would be responsible for:

(a) Co-ordination of the creation, development and delivery of information, training and consulting services necessary for the formation and development of viable rural businesses;
(b) Co-ordination of foreign technical assistance;
(c) Establishment of work plans, targets, quality standards and key indicators for each DA;

(d) Development of work procedures for mobile teams;
(e) Monitoring, supervision, evaluation of the work of DAs against predetermined criteria;
(f) Setting up (including providing the secretariat) specific working parties for ensuring a smooth exchange of information between the DAs and the other actors involved in rural business development;
(g) Working with Donors involved in rural business development, coordinating their activities; and
(h) Organizing consultation workshops with other programs, institutions, and projects involved in rural business development in order to harmonize approaches, methodologies and geographic coverage.

5. Contractual arrangements

An annual contract would be signed between DA and CAPMU, which would include detailed terms of reference for specific activities that DA would provide under the component, including the budget and funding support

6. Financing and Reporting Procedures

(a) Monitoring and Reporting Arrangements

In order to monitor the implementation of the component, a financial accounting and management system has been designed, which includes evaluation of actual DA activities in business development against the annual work plans and disbursement as well as internal control of fund flows to DAs. This system has been developed with the assistance of a certified accountant and verified by an auditor. Annual audits would be carried out at the end of each calendar year, and would be submitted as a part of the progress report to IDA.

(b) Flow of funds

All payments to the implementing DAs would be made through CAPMU against disbursement requests from DAs. CAPMU's financial management capacity has been strengthened through improvement of the accounting software used and the hiring of an assistant accountant to ensure sufficient capacity for project financial management.

7. Expected Outputs and Outcomes of the Component

The component would generate:

(a) Rural businesses and FOs created and owned by farmers, run for their benefit and having an open membership. They would be legal entities, with operational and management structures that are equipped to function in a market economy. The legal structure would be designed to meet the operational requirements of the business being created as well as the needs and aspirations of members;
(b) Increased awareness among the rural population of the benefits and requirements of developing both individual and group businesses in rural areas;
(c) Consistent and clear information and hands-on guidance on various aspects of business creation;
(d) Advice, assistance and training during the formation and post creation of rural businesses;
(e) Local capacity of trained business development agencies;
(f) Improved linkages between different agents involved in rural activities (rural business, FOs, traders, processors, public administration, advisory services, commercial banks, etc.); and
(g) Recommendations and good practices to be shared by all interested parties involved in rural business development.

In **quantitative terms**, the project is expected to create and launch at least 900 individual and 600 group rural businesses to actual operation. These would represent an annual average of 150 individual and 100 group rural businesses to be supported each year.

Project Component 3 - US$ 13.75 million

III. Rural Finance

The Rural Finance Component would provide post-privatization support to Moldova's agricultural and rural sectors through a variety of credit instruments, channeled through the commercial banks and Rural Finance Corporation (RFC). During the first phase, this component would provide US$13.25 million of credit line and US$0.5 million of technical assistance.

This component would provide **investment and working capital credits** at commercial terms to support a broad range of private agricultural and rural enterprises owned by joint stock companies, limited liability companies, cooperatives, and individuals. The project area would be restricted to rural Moldova, defined as the whole of the country except the official municipal boundaries of the two major cities: Chisinau and Balti.

This component would also provide **technical assistance** to strengthen the rural financial system through capacity building support for commercial banks particularly in rural lending. Commercial banks are generally reluctant to lend to agricultural clients because: (a) the typical loan size is too small and transaction costs are too high; (b) small scale clients normally do not have adequate collateral; (c) lending to rural sectors is perceived to be risky due to a lack of client information, past lending history, and accounts; and (d), the still imperfect legal system to enforce loan recovery makes repossession and disposal of pledged assets extremely difficult. These constraints would be addressed under the project. In addition, technical assistance specifically on lending to agriculture would be provided to PFIs through the existing banking training center.

Additionally, this component would expand and strengthen the current functions and capacities of the Rural Finance Corporation (RFC) and Savings and Credit Associations (SCAs), established under the Rural Finance Project (FY98). The following weaknesses and issues have been identified as outstanding at the closing of the RFP and would be addressed under RISP. They include: (a) small membership and bond association; (b) management of the SCA by one or two persons; (c) weak financial and overall management of SCAs, (d) inadequate financial controls; and (e) lack of training. Extensive training of both SCA management teams and other members would be proposed as a key activity to deal with the identified shortcomings. The component would also improve, through technical assistance, the legal and regulatory system to support commercial lending to rural clients. This includes strengthening the regulatory and supervisory capacity of the State Supervisory Body (SSB) and National Federations of SCAs (NFSCA). In the past, the regulatory activities of the SSB have been constrained for several reasons, including the rapidly increasing number of new SCAs, an insufficient budget, the absence of highly qualified staff, and lack of comprehensive prudential norms, to name just a few. The National Federation of SCAs, which was created to represent interest of SCAs, also faces several similar problems in its development. The project would provide help to these two organizations through technical assistance and training.

The component would have three sub-components: (a) a General Commercial Credit Line, including lending to SCAs; (b) A Special Credit Line with a Matching Grant; and (c) Institutional Capacity Building.

1. Subsidiary Loan Agreements

Participating financial institutions (PFIs) would sign a Subsidiary Loan Agreement (SLA) with the Ministry of Finance. Eligibility criteria of PFIs are discussed in detail in the next section of this annex. Among other criteria, the SLA would specify the following:

(a) The Subsidiary Loan would be denominated in MDL and /or US$;

(b) The interest rate on the MDL portion would be variable (floating) based on the reference rate which shall be equal to the average between the annual inflation rate projected by NBM for the current year and the actual inflation rate of the preceding year. The reference rate shall be reviewed jointly with IDA, MOF, and PFIs and revised semi-annually as necessary. To the basic reference rate, a fixed margin of 1% would be added for administration costs and a margin of 1-2% to cover the foreign exchange risks borne by the Borrower. The FX premium would be revised, based on the actual fluctuations of the currency during the interest adjustment;

(c) The interest rate on the US$ portion would be variable (floating), based on the reference rate which shall equal the 6-month LIBOR rate for US$. The reference rate shall be reviewed jointly with IDA, MOF, and PFIs and revised semi-annually. A margin of 1% would be added at all times to the reference rate to compensate the Borrower for its administrative costs and risks; and

(d) Subsidiary Loan period. The principal amount of the Subsidiary Loan shall be repaid by PFIs over a period of 15 (fifteen) years, inclusive of a grace period not exceeding 3 (three) years, in accordance with a detailed amortization schedule that would be furnished to the PFI by MOF before the expiration of the grace period indicated above.

Other terms and conditions of the Subsidiary Loan Agreements are fully detailed in the Rural Credit Guidelines (RCGs). During negotiations, the RCG and SLA would be discussed and agreed upon and attached to the Minutes of the Negotiations.

2. Eligibility Criteria and Procedures for Selection of PFIs

The project would be implemented through commercial banks and RFC. In order to be a Participating Financial Institution (PFI), commercial banks must meet, at all times, a set of financial and management criteria and have signed a Subsidiary Loan Agreement (SLA) with the Ministry of Finance (MOF).

Potential PFIs are individually appraised by the International Development Association (IDA) and the Borrower, in conjunction with the CAPMU and the Technical Unit (created for monitoring of commercial banks under IBRD's Private Sector Development Loan), with particular attention given to the overall lending capabilities and the financial and portfolio performances. The same standards shall be used by the CAPMU to constantly monitor the continued eligibility of currently operating PFIs. A PFI would be required to meet the criteria outlined below:

A. General Standards:

(a) Comply with all banking laws and prudential regulations of the National Bank of Moldova (based on BASEL stabdards) acceptable to IDA.
(b) Undergo an annual audit that is conducted in accordance with international accounting and auditing standards.

B. Financial Standards:

(a) At all times, meet the prudential regulations issued by the National Bank of Moldova, with a particular focus on the following:

- Maintaining at all times the required risk based capital adequacy ratio of at least 12%;
- Meeting the minimum capital requirements established by the NBM from time to time for the respective type of license B or C, as held by the PFI. Banks holding an A license would not be eligible to become a PFI;
- Maintaining a level of loan loss provision at all times at least equal to the minimum required according to the regulations of the NBM;
- Being in full compliance with the legal reserve requirements of the NBM;
- Limiting its exposure to a single, related, connected borrower and insider parties to a percentage of the PFIs' total capital, as defined and prescribed by the NBM,

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

C. Managerial Standards:

(a) Have qualified and experienced management;
(b) Have a Board of Directors, responsible for setting the overall bank policy and for performing appropriate oversight of the bank's operations;
(c) Have a sound business plan with appropriate budgeting and budget control procedures;
(d) Have sound lending policies and procedures;
(e) Have adequate and functioning internal audit unit, and satisfactory internal control and audit procedures, confirmed by external auditors;
(f) Not be exposed to undue interest rate risk, confirmed by annual audited financial statements;
(g) Have an internal reporting and management information system capable of providing sufficient information necessary for managing the bank's operations, performance and risks.

D. Other Standards:

(a) Have a sufficient network of branches in rural areas or an adequate network of mobile credit officers; and
(b) Have the necessary staff, knowledge, physical and other resources to implement the credit line under the Project.

3. Comparable Rates for the Basic Reference Rates

The proposed cost of funds would be positive in real terms and compares favorably with the other existing comparable interest rates in the market as of end-February 2002:

COF to PFIs under RISP in MDL	10.2%
Average rate on deposits in MDL	12.47%*
Deposits over 12 months, for legal entities, in MDL	13.93%*
Interbank market rates in MDL	5.84%

NBM's long-term (over 5 years) credit rate	13.5**

* Although the actual annual inflation for 2001 was 6.3%, the deposit rates remain high; due to the lack of full credibility in the commercial banking sector, the banks must pay a "risk premium" to encourage clients to place deposits.
** This long-term rate is set by the NBM, as it is serving a number of state programs; this rate is calculated on the basis of the inflation level over the last five years.

4. Detailed Features of the Credit Lines

A. A General Commercial Credit Line (US $ 7.725 million)

This Credit Line (C/L) would finance the provision of investment and working capital loans to the private agricultural and rural sectors at prevailing interest rates and commercial terms through the eligible PFIs. This credit would be open to a broad range of creditworthy rural entrepreneurs, including producers, processors, marketing and service enterprises, and other private enterprises in rural areas. It is envisioned that the ratio between investment loans and working capital loans (excluding the portion of funds disbursed to SCAs) is expected to be at least 75% : 25%.

Eligibility Criteria for Sub-projects. In order to achieve the Project Objectives, eligible sub-projects would include:

(a) on-farm investments for development of agricultural and livestock production, including the provision of seasonal working capital credit, as appropriate;
(b) investments (including permanent working capital) for development of processing, storage, packing, marketing and other related agricultural service sectors and agro-businesses; and
(c) diverse rural productive and commercial activities based on sound business plans and demonstrated repayment capacity. Such activities would include small-scale production, artisans, trade, rural tourism, handicraft production, etc.

All proposed sub-projects would be supported by sound business plans, demonstrating technical and financial viability, satisfactory cash flow and loan repayment capacity.

Eligible Beneficiaries. Eligible beneficiaries would include farmers, small- and medium scale agricultural processing, marketing, and service enterprises and non-agricultural rural economic activities, operating as joint stock companies, limited liability companies, farmers' associations, cooperatives, partnerships or individuals.

Sub-borrowers' Participation. Sub-borrowers should be required to make contributions of no less than 20% in cash or in kind from their own resources towards sub-project costs. This excludes sub-loans financed under sub-component B as described below.

Repayment Terms and Interest Rates of Sub-loans. Repayment schedules of sub-loans financed under the Credit Line would be based on projected cash flows and repayment capacity of sub-borrowers, and would include a grace period of up to 3 years, as and when required and justified. Grace and amortization periods would be based on the type of investment financed and the projected (estimated) cash flow, and would be commensurate with the repayment capacity of the borrower. However, in no case would repayment periods exceed the useful life of the investment financed. In this connection, it should be noted that appraisal projections made by the PFI should demonstrate a debt service coverage ratio of minimum 1.3 over the life of the sub-project for investment projects, calculated on the basis of the borrower's total debts, and a net cash flow of at least 120% of the loan amount for working capital loans.

Choice of Currency of Sub-loans. PFIs would make sub-loans to beneficiaries denominated and repayable in either US$ or MDL, as determined by each sub-borrower at the time of signing the sub-loan agreement with the PFI.

B. Lending to Savings and Credit Associations

This sub-component would provide financing for qualified SCAs that meet the prudential regulations.

Repayment Terms and Interest Rates of Sub-loans. The repayment period of sub-loans to SCA, principal and interest shall not exceed 12 months.

Currency of Sub-loans. All sub-loans for the SCAs shall be denominated and repayable only in MDL.

C. A Special Credit Line with a matching grant (US$ 5.525 million).

This sub-component would provide sub-loans for investment and investment-related working capital as and when justified, to new, post-privatization rural businesses in whatever legal form, to registered family farms, and to individual entrepreneurs in rural areas. The loan would be complemented by a matching grant. Under this sub-component, borrowers would have a one-time restricted access to the grant.

The Government has requested that this special credit line be included in the Project because these newly created enterprises, emerging private farmers and rural entrepreneurs, lack the credit history, the necessary self-financing (normally 20-30%), and/or adequate collateral normally required by commercial banks. In order to help overcome the problems of inadequate equity and collateral and to give initial access to commercial credit, the proposal of a one-time matching investment grant – up to 20% of the sub-loan amount - to complement the commercial loan as a substitute for the equity requirement is under consideration. The grant is also expected to encourage adoption of new farming or improved production technologies while facilitating access to commercial credit by groups and individual borrowers. As with the General credit line, all sub-projects should be supported by sound business plans.

These loans would be provided at commercial lending terms and interest rates, and PFIs would have full autonomy in loan approval. The maximum loan amount to one borrower would be kept relatively low in the beginning and would be limited to US$ 30,000 equivalent.

Maximum financing size: Under this special support credit line, the maximum loan size shall not exceed US$ 30,000 equivalent. The additional benefit to sub-borrowers of this credit line, the matching grant, shall be limited in size to 20% of the eligible sub-loan amount.

Eligibility criteria for sub-projects: Eligible are investments in any economic activity: agriculture (production, processing and marketing, input supply and service provision), small-scale industry, trade and commerce, rural tourism, handicrafts, services, other non-agricultural economic activities that are considered economically and financially viable, as well as technically feasible. The activity should have an acceptable business plan, and, on the basis of the projected cash flow, demonstrate the ability of the sub-borrower to service the sub-loan according to the repayment terms agreed between the PFI and the sub-borrower. The debt service ratio (DSR) for the sub-loan should be no less than 1.3, calculated on the credit portion of the sub-loan.

Eligible Beneficiaries for the Special Credit Line

Eligible beneficiaries of this special credit line include any newly registered enterprise in whatever legal form - individual entrepreneur, farmer, limited liability company, joint stock company, business cooperative, etc. – as well as first-time borrowers from a financial institution (except those borrowing from SCAs). Beneficiaries must permanently reside in their localities.

Sub-borrower's Participation. Sub-borrowers under this sub-component shall be required to contribute from their own resources, in cash or in kind, no less than 10% of the estimated cost of sub-projects.

Repayment Terms and Interest Rates of Sub-loans. Generally, sub-loans would comprise two components; first, a credit portion subject to regular repayment with interest, and second, a GRANT portion, which would be a "standing loan" with a balloon payment due on the final maturity date of the loan portion. The grant portion would not exceed 20 % of the sub-loan amount. The credit portion would bear regular prevailing commercial interest rates, as determined by the PFI. Grace and amortization periods for the credit portion of the sub-loan shall be based on the type of investment financed and the projected cash flow, and they should be commensurate with the type of beneficiaries financed and their repayment capacity. The SCL would support investment loans with a minimum 2 year repayment period, based on actual cash-flow.

Currency of Sub-loans. All sub-loans would be denominated in MDL.

D. Proposed Operational Modalities for Implementation of the Investment Grant under the Special Credit Line

(a) The grant portion would be financed by the MOF, international donor organizations and possibly IDA (if adequate donor funding is not available). Since the grant portion does not bear interest, the grant funds would be transferred by the financiers to a special, non-interest bearing Grant Funding Account with the MOF. CAPMU would be responsible for transferring the grant resources to the PFIs, in accordance with the Statements of Expenditures submitted on the special sub-loans granted to beneficiaries and upon confirming the eligibility of the sub-projects to receive the grant. Funds received by PFIs, would be credited to a special, non-interest bearing investment grant deposit account.

(b) Upon full and timely repayment of the credit portion of the special sub-loan with interest, and full compliance with all other conditions stipulated in the sub-loan agreement, the beneficiary would not be obliged to repay the grant portion to the PFI.

(c) In case of non-compliance by the sub-borrower with conditions of the sub-loan agreement, or in the case of misuse of funds or default on the regular repayment of the credit portion by more than (5) five working days, beneficiaries would be required to repay, with interest, the full grant (balloon) portion of the sub-loan, upon demand, in accordance with conditions to be included in the sub-loan agreement, and not on the final maturity date as stipulated in the sub-loan agreements. The repaid grant portion funds shall be used for financing of grant portion of new loans.

(d) The operation of this investment grant arrangement would be reviewed by MOF, in conjunction with CAPMU and the International Development Association at least once a year, or more often, should the information/reports furnished by PFIs, as mentioned above, warrant such review.

E. Rural Finance Component - Implementing Agencies

CAPMU, which has solid experience in implementing IBRD and IDA projects, would have the overall responsibility for overseeing, coordinating and monitoring project implementation as well as ensuring that all legal agreements, project-related guidelines and instructions are complied with. CAPMU has hired a full-time staff project coordinator. Under the Rural Finance Component, CAPMU's areas of responsibility include:

(a) Overall relations with IDA including liaison with IDA task manager and staff and IDA disbursement department, on all project-related matters;

(b) Periodic allocation of Credit funds to PFI, in accordance with the request received from PFI, based on performance of each PFI in project implementation, efficiency, lending costs and margins, as well as other considerations established by the Agricultural Steering Committee;

(c) Review of statements of expenditure (SOE) and related documentation submitted by PFI to CAPMU, to verify eligibility of sub-borrowers and sub-loans and to confirm, in writing, of approval or disapproval of SOEs;

(d) Preparation of applications for withdrawal of funds from the Credit, both directly from IDA and from the Special Account opened and maintained by MOF in a local bank;

(e) Transfer of Credit funds, including funds for investment grants, to participating financial institutions (PFI) based on statements of expenditure mentioned above;

(f) Supervision and monitoring of lending activities by PFI to ensure compliance with terms and conditions of subsidiary loan agreements and RCG; periodic reviews of interest rate structure and lending margins, assessments of the quality of the Project financed loan portfolio, adequacy of lending procedures, and identification of technical assistance requirements by PFI;

(g) Maintenance of the data base on all financial transactions related to all components of the Project, preparation of the Consolidated Project Account and Project related financial statements, and the safeguarding of all supporting documentation;

(h) Monitoring, in coordination with NBM, of PFIs' continuing compliance with eligibility criteria;

(i) Ensuring that adequate information on all project-related financial transactions is submitted to, processed and recorded by MOF, in accordance with procedures agreed between MOF and CAPMU; and

(j) Collection of necessary information from all participants in project implementation for preparation of periodic Project progress and other reports, to be submitted to GOM, IDA etc.

It would be the responsibility of the **MOF** to:

(a) maintain the Credit account for the IDA credit and service the Credit in accordance with agreed repayment schedule;

(b) sign subsidiary loan agreements with PFI and maintain respective subsidiary loan accounts;

(c) maintain accounts for the investment grant funds deposited with PFI;

(d) maintain accounts on grant funds received from other donors;

(e) prepare payment notices for interest and principal payable on account of subsidiary loans and ensure timely collection from PFI;

(f) review, periodically, with CAPMU and in consultation with IDA, interest rates to be charged on subsidiary loans to PFIs;

(g) maintain accounts on interest collected from PFI, both in US$ and domestic currency and the application (utilization) of funds collected for coverage of foreign exchange differences and other purposes; and

(h) contract, jointly with CAPMU, external auditors, acceptable to the IDA, to audit the project accounts, in accordance with the provisions of the Credit Agreement and IDA requirements.

Technical Unit (TU) was created under the First Private Sector Development Project (PSD 1) as an independent unit at the NBM, with a number of functions, including but not limited to the selection of PFIs and the monitoring of their continued eligibility for the implementation of the credit line resources, as well as the development and implementation of the C/L provisions and regulations, including ongoing supervision of their compliance by PFIs and beneficiaries; etc.

The TU has recently been moved to the MOF. Under RISP, the TU would continue to:

(a) qualify and disqualify the PFIs for participation in IDA credit lines;
(b) monitor the PFIs according to the agreed eligibility criteria; and
(c) collect the relevant financial data and other information for regular due diligence work, and (d) cooperate closely with IDA team and the National Bank of Moldova to ensure that RISP PFIs meet the project eligibility criteria at all times.

Project PFIs – Commercial Banks and RFC. All disbursements from the credit line to final beneficiaries (sub-borrowers) would take place through commercial banks and Rural Finance Corporation, which has set up a new direct lending department.

F. Financing and Reporting Mechanisms

(a) **Accounts and Record-keeping.** For the subsidiary loan, the PFIs would maintain separate subsidiary loan accounts in the respective currencies (US$ or MDL) for each portion of the Credit Line (sub-components A and B) withdrawn. PFIs have to establish in their accounting systems the appropriate accounting codes to permit identification of sub-loans made under the Project. Separate codes should be introduced for sub-loans under each sub-component (A and B) and for sub-loans according to the currency of denomination.

(b) **Reporting Requirements.** The project PFIs would be required to submit to CAPMU periodic (quarterly) Project progress reports in accordance with uniform reporting formats that would be prescribed by CAPMU.

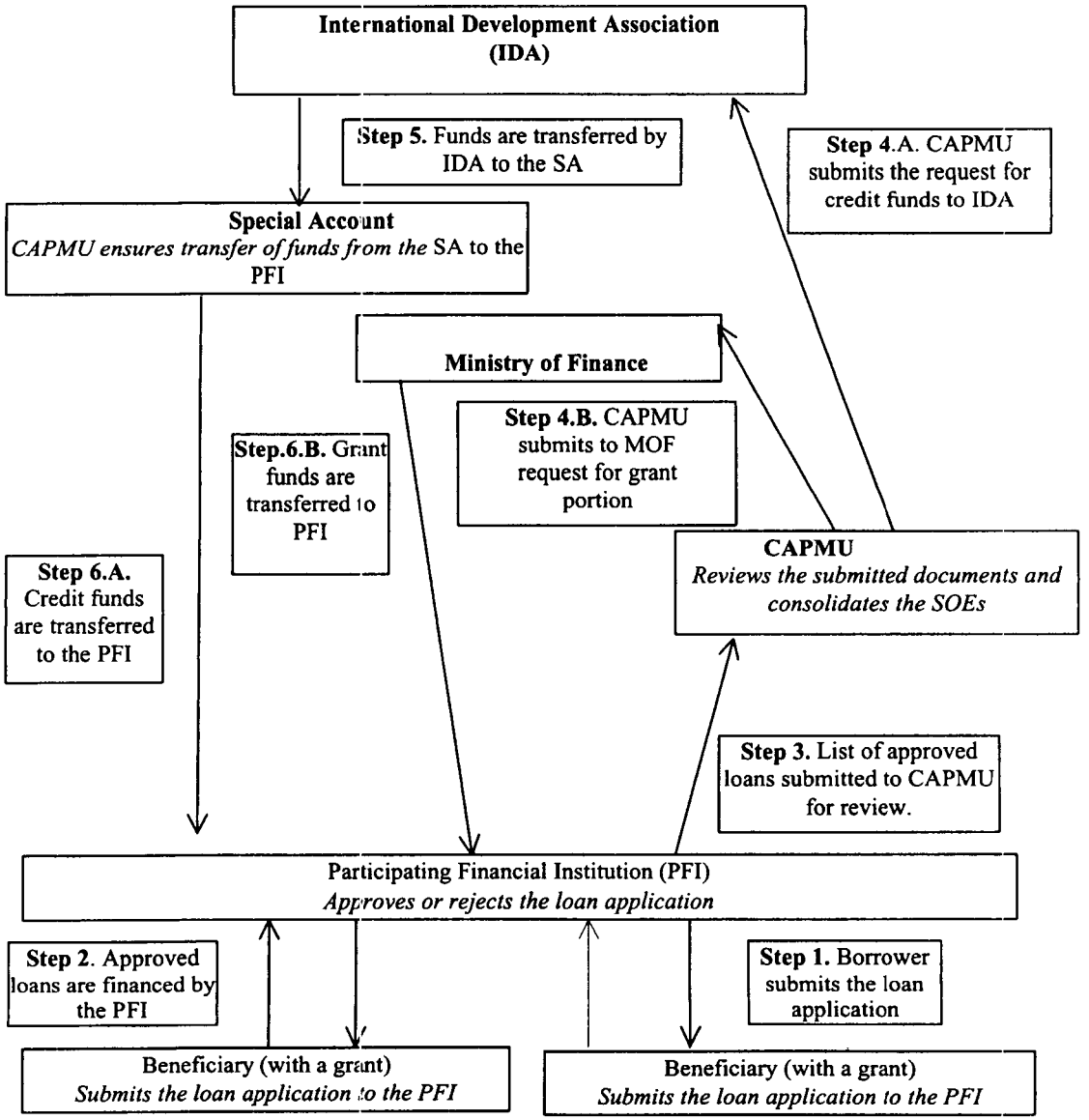
(c) **Audit.** The accounts and any additional records maintained by the PFIs should be adequate to

reflect, in accordance with sound accounting practices, the operations, resources and expenditures in respect of the Credit Line operations under the Project.

Flow of Funds

Periodically, as agreed between the PFI and the CAPMU, PFIs would prepare Statements of Expenditure (SOE), in the format described in Attachment 1 of the Rural Credit Guidelines (RCG). Separate SOEs shall be submitted for sub-loans denominated in US$ and MDL, and separate SOEs shall be submitted for sub-components A and B. SOEs shall be submitted, together with Sub-project Information Sheets (Attachment 2 of the RCG) and other sub-loan related supporting documents, as requested by CAPMU, to CAPMU for review and clearance. Promptly after receipt of withdrawal applications, CAPMU shall review such applications and accompanying documentation. CAPMU shall inform the PFI in writing regarding approval or denial of the withdrawal application. CAPMU shall consolidate the SOEs received from PFIs, withdraw eligible funds from the Credit Line, and transfer them to the account of PFI as indicated in the successful withdrawal application of the PFI.

Flow of Funds and Decision-making under the Rural Finance Component



Project Component 4 - US$0.50 million

IV. Project Management

This component would provide technical and financial support for Project management. Project implementation and supervision would be the responsibility of the Consolidated Agricultural Projects Management Unit (CAPMU), which has demonstrated its capability to manage the implementation and preparation of Bank-funded projects in Moldova's rural sector, specifically,

the First Agriculture Project, the Rural Finance Project and the Rural Investment and Services Project. CAPMU staff would handle common administrative functions and help develop the necessary administrative and financial management skills in the various agencies and field units that would implement the different Project components. Some funds would be set aside for special studies in areas not directly covered by the Project components, including, for example, the consolidation of fragmented land holdings into viable farms. The budget for the Project management component would also include funding for Project monitoring and evaluation of activities as well as for the annual audits of the Project accounts.

Annex 3: Estimated Project Costs

MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Project Cost By Component	Local US $million	Foreign US $million	Total US $million
1. Rural Advisory Services	2.07	0.73	2.80
2. Rural Business Development Services	1.53	0.83	2.36
3.A Rural Finance Credit Lines	5.57	7.55	13.12
3.B Rural Finance Technical assistance	0.14	0.33	0.47
4.Project Management	0.38	0.10	0.48
Total Baseline Cost	9.69	9.54	19.23
Physical Contingencies	0.06	0.08	0.14
Price Contingencies	0.22	0.10	0.32
Total Project Costs[1]	9.97	9.72	19.69
Total Financing Required	9.97	9.72	19.69

[1] Identifiable taxes and duties are 0 (US$m) and the total project cost, net of taxes, is 19.69 (US$m). Therefore, the project cost sharing ratio is 53.33% of total project cost net of taxes.

Annex 4 Economic and Financial Analysis
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Cost and Benefit Analysis Summary

The Rural Investment and Services Project (RISP) would contribute toward the creation of viable private farms, farm organizations (FOs), and agribusinesses that would have adequate access to information, advisory services, marketing support and ultimately financial resources. Since the project is based on demand by clients, and involves credit line operations, it is not possible to estimate *a priori* the types and magnitudes of sub-projects that will be financed under the project. Therefore, no attempt was made to estimate aggregate economic rates of return of the project. Instead, a series of crop budgets, farm models and other typical investment models have been developed as indicative results that are expected from the project. Two categories of benefits have been considered: (a) at the farm level; and (b) at the FO/rural enterprise level. Detailed analytical models and results of the analysis are available in the project files.

Crop Budgets and Farm Model Investment Analysis

The main quantifiable benefits at the farm level will be improved agricultural production in terms of both an increase in crop productivity and an improvement in product quality. Enhanced marketability of these products will also command higher farm gate prices. The potential direct and indirect benefits captured in the analysis include: (a) increased efficiency due to improved access to high quality inputs and an enhanced flow of technical information; (b) increased value added of agricultural commodities; (c) improved marketing practices resulting from efficient flow of price and marketing information; (d) more efficient organization of marketing activities at the village level; (e) introduction of new products and services; (f) increased exports of primary and processed agricultural products; and (g) improved capacity of commercial banks, Rural Finance Corporation and Savings and Credit Associations, which will increase both access to credit and resource mobilization by the rural population. In addition to improving welfare in the rural areas, the project is also expected to enhance governance at the village level as a result of the formation of FOs, which are based on participatory planning and democratic and autonomous decision making. With increased access to information and advice, self confidence of the village communities would be improved and the sense of isolation of rural areas would be reduced.

Crop budgets for eight representative key commodities (sunflowers, winter barley, maize, grapes, sugar beets, tomato, onion, and potato) were prepared for "with" and "without project" scenarios. It was assumed that the credit line would provide working capital for quality inputs as well as for long-term investment in modern production equipment. In addition, farmers would have access to quality advisory services. The "without-project" scenario is based on the current practice (use of low quality seeds, very little fertilizers and hardly any chemicals). In the "with-project" scenario, farm gate prices are assumed to rise moderately (5 - 10 percent) as a result of a better quality of agricultural products and more competitive marketing channels. Incremental gross margins from improved use of inputs, modern equipment and benefiting from new agricultural techniques also are expected to be substantial, ranging from 45 percent for sunflowers to as much as 200 percent for potatoes. The results show substantial increases in yields (60 to 90 percent incremental yields) compared to their present levels, resulting from the use of better seeds, more fertilizes, better agronomic technology, etc. and potential increases in farm incomes. Performance of the improved seeds, and improved increases of yield is based on actual field test results.

Table 1:Incremental Gross Margin (GM) per Crop

GM per ha cropped	Winter wheat	Winter barley	Maize	Sun flower	Sugar beet	Potato	Vegetable (Tomato)	Fruit (Grape)
Present	94	74	208	58	82	323	439	422
Future	141	114	328	84	163	965	991	841
Incremental (%)	+50%	+53%	+58%	+45%	+100%	+198%	+126%	+99%

Farm model analyses for a 2 hectare farm representing a typical small farm, and a 15 hectare farm representing a typical, medium-size farm were carried out. Typical cropping patterns prevailing in Moldova were assumed in both cases. Small farms tend to engage more in labor intensive cropping patters, such as vegetables, while medium-size farms tend to cultivate more field crops such as wheat (mainly due to access to equipment) and fruit orchards (mainly due to their ability to finance working capital during long gestation periods). Farm profitability and incremental income appear to be less correlated to the size of farms and more dependent on their cropping patterns. Details are available in the project files.

Table 2: Medium-Size Individual Farm Model – Average 15 hectares (US$)

	Cropping pattern	hectare	Gross margin / ha before Project	Gross margin / ha after 5 year Project	Incremental GM per ha	**Incremental Farm Income**
Winter Wheat	34%	5.10	94	141	47	240
Winter barley	7%	1.05	74	114	39	41
Maize	17%	2.55	208	328	120	306
Sunflower	11%	1.65	58	84	26	43
Sugar Beet	7%	1.05	82	163	82	86
Potato	2%	0.30	323	965	641	192
Vegetable	3%	0.45	439	991	552	248
Fruit	12%	1.80	422	841	418	752
Various	7%	1.05	-	-	-	-
TOTAL	**100%**	**15 ha**				**$2,315**

Table 3: Small Rural Household Model – Average 2 hectares (US$)

	Cropping pattern	hectare	Gross margin / ha before Project	Gross margin / ha after 5 year Project	Incremental GM per ha	**Incremental Farm Income**
Winter Wheat	22%	0.44	94	141	47	21
Winter barley	8%	0.16	74	114	39	6
Maize	25%	0.50	208	328	120	60
Sunflower	17%	0.34	58	84	26	9
Sugar Beet	3%	0.06	82	163	82	2
Potato	5%	0.10	323	965	641	64
Vegetable	5%	0.10	439	991	552	55
Fruit	8%	0.16	422	841	418	67
Various	7%	0.14	-	-	-	-
TOTAL	**100%**	**2 ha**				**$284**

Investment Model for Farmer Organization and Agribusiness Enterprises

Over the five years of RISP implementation, *it is assumed that over 500 sustainable FOs will be established.* Based on typical model business plans gathered during the Baseline survey, and assuming FO membership size based on average membership size of current FOs, the economic benefits of FO/rural enterprises have been estimated. It was also assumed that the FOs would adopt new agricultural practices that would lead to improved productivity and quality (estimated to be about 50% as confirmed by demonstration FOs). In addition, sample investment analyses for FOs, individual commercial farmers, and agricultural/rural entrepreneurs were developed on the basis of the information gathered by NGOs from demonstration farms. The detailed work is available in the project files, and a summary is presented below. These models also assume that potential beneficiaries would have access to long-term credit under the RISP.

The main assumptions: (a) all the models are based on a ten-year period and in US$ equivalent; (b) when investments are in production assets/equipment, revenues are assumed to increase gradually and reach full capacity in year 5; (c) the beneficiaries' contribution is assumed to be 15% of the total sub- project cost; (d) depreciation has been calculated over 10 years (10%) for all equipment and over 20 years (5%) for all civil works such as building, assembly work, etc; (e) although conditions on loans will be decided by the commercial banks, for the models, an interest rate of 20% was assumed, with a maturity of 5 to 7 years and a one-year grace period on the repayment of the principal; (f) the models for orchards and vineyards assume longer terms and conditions to reflect the real situation; and (g) a tax of 28% is applied on profit as required by the law.

Nine representative investment models were developed and analyzed in detail. Confirming the results of the crop budget analysis, the representative farms (an orchard and a vineyard) and agribusinesses (a milk collection center, a grain flour mill, a sunflower oil mill, a small-scale fruit drying line, a small-scale irrigation system, a harvester combine, and a tractor with implements) all show positive incremental net income and IRR ranges between 20-31%. A notable exception is the small-scale moveable irrigation system, which shows a very high return of about 50%. Incremental financial benefits at the farm level were arrived at using a conservative estimation for the expected increase and consolidation of land cultivated by farmers. Since there are more than 300,000 private farmers in Moldova, an aggregate analysis for the project is too unpredictable and would not be accurate. Hence, aggregate returns have not been estimated.

Orchard Plantation (apple trees)

Investments in orchards, which have long gestation periods, require loans with longer maturity (minimum 8 years) and grace periods (minimum 3 years). In the orchard investment model, 10 farmers form a business cooperative group by contributing the "use" of 1 hectare each of their own land, and the group invests in total about US$24,000 over 3 years in the plantation of apple trees. The apples are expected to be sold either on neighboring markets for direct consumption or traded to factories to be processed into juice. *This model showed FIRR of 25% and annual potential gross margin per hectare of US$1,141.*

Vineyard Plantation

Investments in new vineyards are relatively riskier than orchards because: (a) investment costs are higher; (b) prices paid for grapes are lower; and (c) they require intensive maintenance during the gestation period (minimum 3 years), hence they require substantial up-front working capital. Despite the sizeable initial investment and working capital requirements, returns from vineyards would be also higher. In the case of table grapes, producers usually sell their grapes on local markets where prices are relatively high or on export markets where prices are even higher for high quality grapes. For wine grapes, farmers normally

sell to neighboring wineries, at lower prices. The more marketing options farmers have, the better prices they are able to obtain for their products and this is particularly relevant to wine grape growers. Even with relatively high investment costs (US$47,000) mainly due to expensive rootstocks, prices paid to producers are enough to generate a positive cumulative cash flow. *A business model with 10 members shows FIRR of 20% and annual potential gross margin of US$1,335/hectare.*

Milk Collection Center

In the milk collection center investment model, a group of approximately one hundred farmers with 250 cows, sell their milk (with an average yield of 6 liters per cow per day, with 275 lactation days per year). As a group, the farm gate price of milk increases from 1.30 to 1.50 Lei per liter in average and through the formation of a business cooperative, and villagers would be able to solve their marketing problems. Milk quality would also improve when premium prices are paid for better quality milk. *A model for a US$10,300 investment into a milk collection center with 100 milk producers shows a FIRR of 21% and annual revenue corresponding to full capacity use of US$6,600.*

Grain Mill

Grain is a key element of private farmers cropping patterns. By processing their own grain as a cooperative, a group of farmers would be able to capture value added from wheat production and processing while enhancing marketing opportunities. The members of the of the small-scale mill cooperative (the owners) would save the cost of milling and also generate fee incomes from providing milling services to other external clients (about US $13 per ton of raw materials equivalent). At full capacity, such a mill could service an area of some 300 hectares (1,000 tons of wheat), equivalent to the needs of an average Moldovan village. *A model for a US$24,700 grain mill with 40 members and 50 external clients shows a FIRR of 28% and annual potential revenue corresponding to its full capacity of over US$13,000.*

Sunflower Oil Mill

Farmers used to suffer from weak marketing channels and monopolistic procurement by large oil mills, which resulted in crude sunflower oil being sold at lower prices. In the investment model, farmers establish a cooperative form of an oil processing mill. The members/owners of the small-scale, modern "electric" oil mill cooperative would save themselves the cost of procuring crushing service for their own sunflower seeds (they would have to only cover the operating expenses), and also earn crushing fee income from external clients (about US$14 per ton of raw material). At full capacity, such a mill could service crops from an area of some 230 ha (600 tons of sunflower seeds), covering one or two villages. *An investment of US$10,600 into such a sunflower oil mill (operating on the same basis as a grain mill) with 40 members and 50 external client shows a FIRR of 31% and annual potential revenue corresponding to its full capacity of US$8,400.*

Small-Scale Fruit Drying Line

While some fruits are grown for direct consumption as fresh produce, another way of processing fruits consists of drying them. Dry fruits (apple, apricot, grape, plum, etc) are easy to conserve during storage or transport, and constitute very good products for export, mainly to FSU and the Middle East markets. The members/owners of the small-scale drying line cooperative would save themselves the cost of procuring drying services for their own fruits (they would have to only cover the operating expenses), and earn drying fee incomes from external clients (about US$55 per ton of raw materials). *A model for a US$25,500*

drying line with 20 members and 20 external client would produce a FIRR of 25% and annual potential revenue corresponding to its full capacity of US$15,840 for 288 tons of fresh fruit.

Irrigation System

Irrigation would have a high pay off, particularly for high value products such as fruit and vegetables. The members/owners of the irrigation equipment cooperative would invest in on-farm irrigation and have assured access to water, save the cost of irrigation fees on their own land, and also collect water user fees from other farmers (US$250 for 3,000 cubic meters per ha). In this model, the water fee is established at MDL70 (or US$0.05 per m3). *Irrigation for potato cultivation is highly profitable with FIRR as high as 50%. Another model for a US$7,800 investment into an irrigation system with 10 members and 10 external clients utilizing a multi-crop cropping pattern shows a FIRR of about 27% and annual potential revenue corresponding to its full capacity of US$4,200 for 16.8 hectares.*

Harvester Combine

Harvester combines require huge investments that individual private farmers cannot afford on their own. In the investment model, a group of farmers form a business cooperative and buy a combine harvester. The members of the cooperative would serve their own land and also provide machinery services to other farmers for a fee of $35 per ha. At full capacity, such a harvester could service about 300 ha of grain, 200 ha of maize and 100 hectares of sunflower farms for about 50 farmers in a village. *A US$60,000 investment into a combine owned by 20 members and serving 30 external clients results in FIRR of 24% and annual potential revenue corresponding to its full capacity of US$21,000 for 600 hectares.*

Tractor with Implements

Tractors with implements are often too expensive for small-scale, private farmers. In the investment model, a group of farmers form a business cooperative and buy a tractor with a set of implements for fieldwork. Based on cost savings of tractor service and fee income of US$32 per hectare, *a US$20,000 investment for a tractor by 20 members and serving 40 external clients results in FIRR of 26% and an annual revenue at full capacity of US$12,800 for the group.*

Detailed crop budgets, farm model analyses, cash flows, investment and operating expenditure analysis, and debt servicing capacity analyses are in the project files.

Annex 5: Financial Summary

MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

The overall sustainability of the Project will depend on the sustainability of each of the implementing agencies involved in the project. This annex summarizes the current financial status of the key implementing agencies involved in the Project.

Rural Advisory Services Component - Service Providers (SPs)

The Advisory Component would be implemented through competitively selected service providers (SPs). Existing organizations, such as legal dispute resolution centers, agricultural extension service providers and business consulting organizations would enter into a contract under the project. The SPs would not only provide advisory services but would also form and coach a team of local consultants and monitor the impact of contracted work. The roles of SPs include:

(a) serving as the physical network node: offices where information is systematically organized in the form of written material and databases;
(b) serving as the contact-point for farmers and investors in agriculture and processing and for receiving/purchasing specialist information about farming in the region; and
(c) acting as the contact point for local consultants for administration of contracts, for coaching (organization of training courses and common activities) and for monitoring the volume and impact of contracts.

Budget of a typical service provider (SP) is enclosed below, for year 2002: for 11 month contract, 10 local consultants and 2 consultants in SP center.

Budget Items	Value in US$
1. ***Fees for local consultants*** (routine services) (10 consultants x 11 months x 112 hours/month x $0.5/hour)	6,160
2. ***Fees for regional consultants*** (routine services) (2 consultants x 11 months x 160 hours/month x $0.8/hour)	2,816
3. ***Fees for outside consultants*** (30 man-days x $10/man/day)	300
Subtotal	**9,276**
4. ***Transportation costs***:	
Local consultants (10 consultants x 2 visits/month/consultant x 11 months x $2.0)	440
Regional consultants (10 localities x 1 visit/month x 11 months x $10)	1100
Outside consultants (30 trips x $10 per trip)	300
Subtotal	**1,840**
5. ***Incremental Operating Costs***	
Office rental (regional consultants) (11 months x $20)	220
Electricity (regional consultants) (11 months x $10)	110
Communication (inclusive local consultants) (11 months x $55)	605
Consumables (inclusive local consultants) (11 months x $35)	385
Subtotal	1,320
TOTAL of Contract (USD)	**12,436**

Equipment
The following equipment will be provided in gratuitous use to the Service Providers: **1 PC, 1 laser printer, 1 Fax/phone, 1 flipchart, Internet/e-mail software**

Rural Business Development Component - Development Agencies

ACA is a non-governmental organization (NGO), which provides support for the creation of farmer organizations and other types of rural businesses. ACA is one of the currently employed three Development Agencies (DAs) under the Rural Business Development Component of the project. Specifically, to support the newly established businesses, ACA will provide, among other, the following services: (a) dissemination of materials on potential development opportunities; (b) diagnostic studies and identification of potential business opportunities; (c) assistance in preparation of sustainable/ bankable business plans; (d) assistance in legal registration; (e) assistance to new rural businesses in developing their operational activities.

Budget of one of the DAs with three development teams is provided below. This DA was established in the beginning of 2001 and therefore lacks financial history. However, the DA has developed its business plan for the period of the next one-two years, and the budget is enclosed below. Financial sustainability of this institution is a key issue, therefore, while in the beginning a significant portion of financing for the institution would come from donor organizations and the Government, a gradual cost recovery plan is being developed.

Detailed Costs for 3 Development Teams for 9 months (April – December, 2002) ***(thousands, US dollars)***

	Unit	Quantity	Unit Cost	TOTAL
1. Investment costs				
Computer Equipment /a	Laptop	2	1.55	3.10
Mobil Phone	Mobile Phone	1	0.08	0.08
Subtotal				3.18
2. Staff Remuneration				
a. Main offices of DA				
Project Manager	Person-month	9	0.9	8.10
Office Assistant / Accountant	Person-month	9	0.3	2.70
b. Mobile Team / Development Officers				
Team Leader	Person-month	27	0.4	10.80
Development officer	Person-month	27	0.3	8.10
Subtotal				***29.70***
3. Travel Allowance /b	Month	63	0.02	1.26
4. Administrative Expenses				
Office Rent & Utilities	Month	9	0.2	1.80
Regular Calls from Main Offices	Month	9	0.10	0.90
Calls From Mobile Phones	Mobile/year	3	0.18	0.54
O&M on Equipment	lump sum			0.30
Transport expenses /c	Team	3	2.16	6.48
Consumables	lump sum			1.00
Subtotal				***11.02***
TOTAL COSTS - DEVELOPMENT AGENCY				**45.16**

a\ procured by CAPMU
b\ All staff members (excluding office assistant / accountant) are traveling 10 days / month with a 2 USD per diem or 20 USD per month
c\ 2000 km/months x 9 months x 0,12 USD/km = 2,16.

Rural Finance Corporation (RFC)

In 1997, under the First Rural Finance Project supported by IDA, RFC was created as a non-bank financial intermediary APEX institution for lending to Savings and Credit Associations (SCAs). RFC currently is one of the largest lenders to the agricultural sector (over 40% of total lending for agricultural production) as well as to SCAs (70% of the total cumulative lending to the SCA system in 2000 and over 60% of the total lending in 2001). RFC is operating according to Prudential Rules which set forth the maximum loan amount per member and total exposure to the whole group. The RFC's shareholders are SCAs themselves, which are required to put 6% of the loan amount into the RFC capital. Annex 20 provides more detailed information on the RFC and the SCA system.

Financial Status of the RFC. The balance sheet of end-1998 amounted to MDL 3,571,120, with a loan portfolio of MDL 2,288,445, liabilities to the MOF of MDL 2,702,011, and an equity of MDL 402,893. But the end-1998 balance sheet cannot be compared to those of end-1999 and end-2000, as some positions in the 1998 balance sheet have been re-classified. Enclosed is the comparative audited balance sheet of RFC for 1999, 2000, and 2001 in MDL.

RFC- AUDITED BALANCE SHEET	1999	2000	2001
ASSETS			
Current assets, of which	**13,487,500**	**35,730,214**	**60,628,286**
Net short-term loans to SCAs	8,770,497	12,830,338	20,416368
Long-term assets, of which	**417,290**	**885,683**	**983,149**
Net long term loans to SCAs	115,075	541,489	613,819
Total assets	**13,904,790**	**36,618,897**	**61,611435**
LIABILITIES			
Current liabilities	**666**	**60,334**	**226,965**
Long-term liabilities, of which	**11,893,326**	**31,600,154**	**53,831,146**
Liabilities to the MOF	11,880,066	31,594,536	53,277,322
Shareholders' equity	**2,010,798**	**4,958,409**	**7,553,324**
Total liabilities and shareholders' equity	**13,904,790**	**36,618,897**	**61,611,435**

Source: Audit reports 1999 and 2000, and the draft audit report 2001.

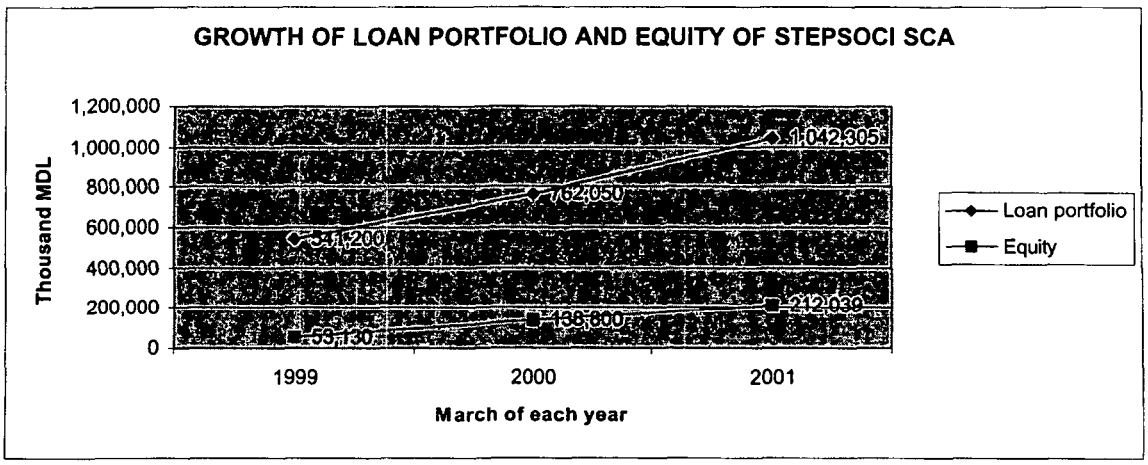
Savings and Credit Associations (SCAs)

Savings and Credit Associations (SCAs) have a dual purpose: mobilization of savings and provision of loans to their members. The SCAs operate on the basis of Prudential Regulations, which set forth all operational modalities, including the maximum exposure per member, repayment period of the loan, etc.

Currently there exist 359 active SCAs, with 38,000 members, of whom 23,000 are active borrowers. Since inception, the total lending to members continues to increase while maintaining repayment rates very high. The savings mobilization has started picking up during 2001: if at the beginning of 2001 the savings were

very small, aggregating to only about MDL 170,000 (US$ 13,000), by the beginning of 2002 the amount of deposits in the SCA had increased almost four-fold, to MDL 612,000 (US$45,300). Measures are being built into the proposed project to promote further mobilization of savings.

Below is a balance sheet of a typical SCA. The chart illustrates the trends of development of the two most important balance sheet positions - loan portfolio and shareholders' equity. This sample SCA has 243 members.



Comparative balance sheets for the three years of operation of the sample SCA are summarized below. The development is shown every year in March when the lending peaks due to the seasonal characteristics of this lending operation (80% of loans are extended for short-term agriculture-related needs).

SCA Step-Soci "Rural Credit"	30-Mar-99	30-Mar-00	% change	30-Mar-01	% change
Total Fixed Assets	641	15,668		15,260	
Loan portfolio	541,200	762,350		1,042,305	
Less Provisions	0	-300		0	
Net Loans	541,200	762,050	141%	1,042,305	137%
Total Current Assets	542,277	801,720	148%	1,089,231	136%
Total Assets	542,918	817,388	151%	1,104,491	135%
Total Paid Up Share Capital	55,410	99,807	180%	143,693	144%
Total Shareholder Equity	53,130	138,800	261%	212,039	153%
Total Long-term Liabilities	0	0		0	
Total Short Term Financial Debts	489,700	677,882		891,333	
Total Current Liabilites	489,788	678,588	139%	892,452	132%
Total Liabilities and Equity	542,918	817,388	151%	1,104,491	135%

Annex 6: Procurement and Disbursement Arrangements
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Procurement

Summary of Procurement Procedures. Proposed procurement arrangements are summarized in Tables A and A1. Consulting services, goods and works financed the World Bank Group shall be procured in accordance with the Bank's procurement guidelines (Goods and works contracts will be procured in accordance with the provisions of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996, September 1997, and January 1999; contracts for consultants' services will be awarded in accordance with the provisions of the "Guidelines for the Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January of 1997 and revised in September 1997 and January, 1999). During project implementation, the procurement plan will be updated on an as-needed basis, basically during supervision missions. All other procurement information, including capability of the implementing agency (procurement assessment report of the PIU is separately submitted) and the Bank's review process is presented in Table B and below.

Participation of Nongovernmental Organizations (NGOs). Nongovernmental Organizations (NGOs) can compete in the selection process under the provisions of Bank Guidelines, provided that they have expressed their interest in doing so, and that their qualifications are satisfactory to both the Government and the Bank. NGOs as eligible voluntary nonprofit organizations may be uniquely qualified to assist in the preparation, management, and implementation of projects, essentially because of their involvement and knowledge of local issues, community needs, and/or participatory approaches. For assignments that emphasize participation and considerable local knowledge, the short list may comprise entirely NGOs. If so, it is suggested that the QCBS procedure be followed, and that the evaluation criteria reflect the unique qualifications of NGOs, such as voluntarism, nonprofit status, local knowledge, scale of operation, and reputation. Selection of Consultants and their contracts will be based on the standard documents issued by the Bank for the procurement of such services with the minimal necessary modifications as agreed by the Bank.

Participation of Government Owned Enterprises (GOEs) in goods, works and consultants' contracts funded by the Credit/Grant. GOEs will not be eligible to participate in tenders for such contracts unless they meet the Bank's eligibility criteria. They must be legally and financially autonomous, operate under commercial law in Moldova and cannot be a dependent agency of the Beneficiary or sub-Beneficiary of the project. Interested GOEs must properly clarify their status before participating in any bid under this project. The PIU has the obligation of exhaustively checking all the related information before clearing GOE's participation with the Bank.

The Project Implementation Unit and its capacity to deal with procurement activities. **The Consolidated Agricultural Projects Management Unit** (CAPMU) is the result of a merger, or consolidation, in 1999 of the project implementation units in charge of prior agricultural projects (Agricultural I Project, Loan 40110-MD, and Rural Finance Project, IDA Credit 30310-MD), which have officially closed. For RISP, the overall project management and coordination will take place through the CAPMU, which is currently in charge of managing all Bank/IDA projects in the agriculture sector, including the preparation of RISP. CAPMU operates under the Ministry of Finance and is controlled by a Steering Committee formed by representatives of the Ministry of Finance, the Ministry of Agriculture and Processing Industry, the Ministry of Economy, two NGOs, and other relevant agencies. This Committee, chaired by the Minister of

Agriculture, oversees CAPMU and coordinates its relations with the various ministries and other stakeholders.

The implementing agency for the Agricultural I Loan ($18 million) was created in 1997, and hired the services of an international expert to handle procurement activities (13 months). Two local staff were trained by the firm, and one of them remains in CAPMU. Currently, the procurement capacity of CAPMU is limited to one local procurement specialist remaining from the prior projects (he joined the PIU in October of 1999). By mid 2001, his concrete experience in handling project procurement is as follows:

Procurement method	Packages/bidding documents prepared	Bids opened/evaluated	Contracts managed
ICB	No	1	12
LIB	No	No	1
IS	1	3	9
NS	1	1	1
DC	2	2	9
LCS	2	2	2

A procurement audit was conducted in 2001 by ECA RPA's Office on the Agricultural I Project, and its findings show that there were some inconsistencies and deviations by the PIU from procurement guidelines in applying procurement procedures in some goods contracts as well as lack of procurement control from the Bank.

This project includes a line of credit and microfinancing. Since most of the participating banks, NGOs, leasing companies, micro enterprises, and sub-borrowers may not be familiar with World Bank procurement procedures, it would be necessary to consider some work aimed at dissemination of procurement guidance, including information on requirements and procedures applied in WB-funded projects. It is expected that the Bank would also conduct a procurement workshop for the project staff and sub borrowers and that in supervision missions the PAS will conduct consultations on procurement on an as-needed basis.

Capacity Building. The current procurement expert is expected to provide on-the-job training to the staff involved in procurement as per Bank Guidelines. The procurement expert was sent to training at the ILO institute in Turin.

Procurement of Goods

The Borrower will use the Bank's standard bidding documents for procurement of goods, including Bank's regional sample documents. Procurement of computers and other equipment will be carried out through the authorized dealers of the main computer supplier.

Goods contracts estimated to cost US$100,000 or more will be procured through International Competitive Bidding.

Goods contracts estimated to cost more that US$50,000 but less than US $100,000 will be procured through International Shopping.

National Shopping (NS) procedures will be used for goods contracts estimated to cost less than US$50,000

each, to be awarded on the basis of comparison of three written price quotations from eligible local suppliers (aggregate sum: US$150,000). NS will basically cover office furniture, computers, office equipment, minor supplies and vehicles.

Procurement of Consultants' Services

Selection of Firms. Assignments estimated to cost less than US$50,000 equivalent can be procured based on shortlists comprising only local firms. No individual/firm that is debarred from bidding under World Bank financed projects, and/or any firm associated with a debarred firm or any of its staff will be hired under the Project.

Quality-and Cost-Based Selection (QCBS) will be the preferred method for selection of firms in contracts with estimated values above US$100,000.

Least Cost Selection Method (LCS) is expected to be applied to procurement of contracts for audit services. Contracts with service providers to the subloans can be procured following selection based on either LCS, if estimated to cost less than $100,000 per contract.

Consultants Qualifications (CQ) will be used for contracts estimated to cost less than $75,000 per contract.

Selection of Individuals. Individual consultants to provide a wide variety of technical assistance services will be selected on the basis of their qualifications for the assignment, mostly by comparing at least 3 CVs from potential eligible candidates. Some consultancy positions will be advertised locally in at least 3 newspaper of nation-wide circulation or internationally (UNDB on line), depending on their size and relevance.

Training, workshops and study tour expenses. Training, workshops and study tours will be carried out according to a training plan, which the PIU will revise annually and submit to the Bank for approval prior to implementation.

Procurement Procedures under Credit Line

Procurement of goods, works, and services under the credit line components will be the responsibility of the sub beneficiaries. The maximum loan size under the credit components will not exceed US$250,000. The following procurement arrangements are proposed:

Commercial Practices: Goods and works estimated to cost up to US$ 250,000, per Section 3.12 of the Procurement Guidelines for goods/works; and services estimated to cost up to US$250,000, per Section 3.12 under Consultants Guidelines may be procured at competitive prices in accordance with established commercial practices of the respective Beneficiaries, provided that such practices involve obtaining quotations from more than one supplier or contractor; and with due account being taken, in addition to prices, of other relevant factors such as time of delivery and efficiency and reliability thereof and availability of maintenance and spare parts therefore. Sub borrowers shall use the World Bank's standard and sample bidding documents, evaluation reports, contracts, etc. wherever possible, with the necessary modifications agreed with the PIU.

In no case, will the goods and works under the Credit Line be procured by sub borrowers and the participating agencies from a source or a business entity in which that sub borrower has a financial or business interest. Sub borrowers and beneficiaries financing equipment through leasing companies will not

be eligible for loans from the participating banks for the same purpose.

Incremental Operating Costs: The operating costs for CAPMU covering staff salaries (excluding Government employees), supplies, utilities, and equipment maintenance etc. would be disbursed on the basis of annual budgets to be agreed with the World Bank.

Prior Review

The following World Bank prior review requirements would be applicable:

Goods: All ICB, if any; first two International Shopping, and first two National Shopping contracts.

Consulting Services:

Consulting Firms: All TORs; all QCBS, if any; draft RFPs, short lists, evaluation reports, and draft contracts for consulting packages starting from $75,000 per contract.
Individual Consultants: All TORs; consultant's qualifications and experience and draft contracts for consulting assignments starting US$25,000 per contract.

Subloans: First three subloans from each Participating Financial Institutions; any contract amounting US$120,000 equivalent or above.

Post Review:

During the life of the Credit, independent procurement audits will be conducted for Part C1 (Subloans) of the Project. These activities will be financed out of the Credit Proceeds (Category 2) and are expected to be conducted after the second year of implementation is completed, and if deemed necessary, repeated upon completion of the Project.

Contracts not subject to Bank's prior review will be post reviewed by Bank's supervision missions on sampling basis i.e. 1 out of every 5 contracts. The frequency of procurement supervision should be every six months.

Procurement methods (Table A)

Table A: Summary of Proposed Procurement Arrangements

(in US$'000 equivalent)

	ICB	NCB	Other	N.B.F[1]	TOTAL
1. Goods	0 (0)	0 (0)	150 (125)	79	229 (125)
2. Services[b]	0 (0)	0 (0)	1,782 (1,299)	3,190	4,972 (1,299)
3. Subloans[c]	0 (0)	0 (0)	8,908 (7,200)	3,542	12,450 (7,200)
4. Incremental Operating Costs[a]	0 (0)	0 (0)	413 (330)	13	425 (330)
5. PPF Refinancing	0	0	1,546	0	1,546

	(0)	(0)	(1,546)		(1,546)
TOTAL	**0** **(0)**	**0** **(0)**	**11,253** **($10,500)**	**$6,892**	**$19,690** **($10,500)**

Table A1: Consultant Selection Arrangements (optional)
(US$ million equivalent)

Consultant Services Expenditure Category	Selection Method QCBS	QBS	SFB	LCS	CQ	Other	N.B.F.	Total Cost
A. Firms	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.30 (0.24)	0.35 (0.26)	0.00 (0.00)	0.70 (0.00)	1.35 (0.50)
B. Individuals	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	1.07 (0.80)	2.55 (0.00)	3.62 (0.80)
Total	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.30 (0.24)	0.35 (0.26)	1.07 (0.80)	3.25 (0.00)	4.97 (1.30)

1\ Including contingencies

Note: QCBS = Quality- and Cost-Based Selection
QBS = Quality-based Selection
SFB = Selection under a Fixed Budget
LCS = Least-Cost Selection
CQ = Selection Based on Consultants' Qualifications
Other = Selection of individual consultants (per Section V of Consultants Guidelines), Commercial Practices, etc.
N.B.F. = Not Bank-financed
Figures in parenthesis are the amounts to be financed by the Bank Credit.

Prior review thresholds (Table B)

Table B: Thresholds for Procurement Methods and Prior Review

Expenditure Category	Contract Value (Threshold) US$ thousands	Procurement Method	Contracts Subject to Prior Review/Estimated Total Value Subject to Prior Review US$ thousands
1. Goods	250	ICB	1/100
	100	IS	2/150
	50	NS	1/45
2. Services	250	QCBS	1/100
	100	LCS	2/150
	75	CQ	1/75
	25	Individual	3/100
3. Subloans	250	CP	10/500
4. Incremental Operating Expenses			All /150
5. PPF Refinancing			N/A
Total value of contracts subject to prior review:			**$1,370**

Disbursement

Allocation of credit proceeds (Table C)

The project will be an APL credit, with the expected disbursement period four years starting CY2002 – CY2005. The closing date of the first phase is December 31, 2005. Disbursement will follow normal IDA procedures and will be made against eligible expenditures. Table C shows allocation of credit proceeds. The financing percentages in Table C are net of any taxes as the activities under the project are tax-exempt. The Standard Disbursement Percentage (SDP) for technical assistance in Moldova is 75%.

Retroactive financing: disbursements from the credit line will only be made for expenditures that have not been made earlier than 120 days prior to the date on which CAPMU shall have received the withdrawal application.

Table C: Allocation of Credit Proceeds

Expenditure Category	Amount in US$ thousands	Financing Percentage
Goods	125	100% of foreign expenditures, 100% of local expenditures (ex-factory cost) and 80% of local expenditures for other items procured locally
Consultant Services and Training	1,299	100 of foreign expenses; 75% of local expenses
Subloans	7,200	100% of eligible sub-loans disbursed by the PFIs on or before December 31, 2003 and 80% thereafter
Incremental Operating Costs	330	90% until December 31, 2003; 80% until December 31, 2004; and 70% thereafter
PPF Refinancing	1,546	Amount due pursuant to Preparation Advance Section 2.02 (c) of this Agreement
TOTAL	**$10,500**	

Use of statements of expenditures (SOEs):

Statements of Expenditures (SOE) will be used for: (a) goods contracts with estimated costs less than US$50,000 each; (b) consultants contracts with firms less than US$75,000 and individuals up to US$25,000; (c) all sub-loan under Part C – Credit Line of the project; and (d) incremental operating costs and training. For all contracts financed under the credit line, full documentation in support of the SOE will be retained in the CAPMU for at least two years after the closing date. This information will be available for review by IDA missions during project supervision and by the project's auditors. Disbursements for

expenditures above SOE thresholds will be made against presentation of full documentation relating to those expenditures. There is no plan to move to periodic disbursements. The minimum application size for payments directly from the credit account or for issuance of Special Commitments is 20 percent of the special account authorization. SOEs will be audited in conjunction with the annual audit of the project (see description of the project's financial management arrangements below).

Special account:

To facilitate the project implementation, CAPMU will establish a Special Account before credit effectiveness and maintain it until project completion. The Special Account will be opened in a bank acceptable to IDA, and on terms and conditions acceptable to IDA. The Special Account will be drawn upon to meet payments to contractors, suppliers and consultants under the project. Disbursement of sub-loans to final beneficiaries will be based on the terms of payment in the sub-loan agreements and according to the actual expenditures incurred.

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

The Special Account will be audited in conjunction with the annual audit of the project (see description of the project's financial management arrangements below).

The total authorized allocation will be limited to US$1.0 million. The initial deposit to the SA will be limited to 50% of the authorized allocation until the aggregate amount of withdrawals from the Credit plus the total amount of all outstanding special commitments entered into by the Association (Bank) shall be equal to or exceed SDR 2.0 million. Replenishment applications should be submitted at least every three months and must include reconciled bank statements as well as other appropriate supporting documents. Project accounts will be operated for discrete activities and funded from the Special Account based on disbursement applications signed by the authorized officials.

Financial management:

Overall responsibility for financial management of the project will rest with CAPMU. The Bank conducted a financial management assessment of CAPMU and concluded that its financial management arrangements are acceptable to the Bank.

Project management-oriented Financial Monitoring Reports (FMRs) will be used for project monitoring and supervision and, subject to the foregoing, the indicative formats of these are included in the CAPMU accounting manual. CAPMU will produce a full set of FMRs quarterly throughout the life of the project. FMRs will not be used for disbursement purposes but rather Bank-financing will be disbursed under the Bank's established procedures, including Statements of Expenditures (SOEs).

CAPMU has instituted a set of appropriate accounting procedures and internal controls including authorization and segregation of duties. CAPMU's accounting books and records are maintained on a cash

basis and project financial statements are presented in United States dollars. CAPMU's information systems comprises two accounting software: (a) the project accounting software, InterProject, which is used for presenting project financial reports, including SOEs, denominated in United States dollars to the Bank; and (b) the accounting software, 1C Bookkeeping System, which is used for presenting project financial reports denominated in local currency to the Moldovan authorities. CAPMU has demonstrated in its previous projects that it is able to report on project expenditures with this system, however, CAPMU has already employed local consultants to upgrade the 1C Bookkeeping System accounting software to enable it additionally to satisfy the Bank's reporting requirements thereby obviating the need to maintain two separate accounting information systems.

No significant issues have arisen in the audits of previous Bank-financed projects implemented by CAPMU. CAPMU's previous and current auditing arrangements and findings are satisfactory to the Bank and it has thus been agreed that similar audit arrangements will be adopted for the RISP, to include the RISP's project financial statements, SOEs and Special Account. The terms of reference that was used for audit of CAPMU-implemented projects for CY2001 will be extended to include RISP from CY2002. The audit of the project will be conducted by independent private auditors acceptable to the Bank, on terms of reference acceptable to the Bank, and procured by CAPMU through the Least-Cost Selection procurement process. The annual audited project financial statements will be provided to the Bank within six months of the end of each fiscal year and also at the closing of the project. The contract for the audit awarded during the first year of project implementation and thereafter extended from year-to-year with the same auditor, subject to satisfactory performance. The cost of the audit will be financed from the proceeds of the credit.

The latest Country Financial Accountability Assessment (CFAA) of September 26, 1995 was prepared at a time of considerable transition and therefore, in view of the time that has since elapsed, the CFAA is now considered to be out-of-date. However, the I-PRSP of November 15, 2000 confirms that improvement is required in the management of public expenditures, including the budget process and budget execution, as well as cash and debt management. Thus CAPMU has developed policies and procedures that operate in addition to those of the current public expenditure management framework to minimize project financial management risks. In 2000, the Bank conducted a Country Portfolio Financial Management Review (CPFMR) of all projects under implementation in Moldova and identified some common financial management issues; the Bank confirmed that all such issues have been appropriately addressed in the design of RISP's financial management arrangements.

The banking sector in Moldova is relatively weak. However, CAPMU has opened all of its projects' Special Accounts in a single commercial bank acceptable to the Bank whose financial status and statements are reviewed on an ongoing basis by the Bank. As these arrangements have been satisfactory, they will remain in place during RISP project implementation.

During project implementation, the Bank will supervise the project's financial management arrangements in two main ways: (a) review the project's quarterly financial management reports as well as the project's annual audited financial statements and auditor's management letter; and (b) during the Bank's supervision missions, review the project's financial management and disbursement arrangements (including a review of a sample of SOEs and movements on the Special Account) to ensure compliance with the Bank's minimum requirements. As required, a Bank-accredited Financial Management Specialist will assist in the supervision process.

Annex 7: Project Processing Schedule

MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Project Schedule	Planned	Actual
Time taken to prepare the project (months)	21	21
First Bank mission (identification)	09/15/2000	09/15/2000
Appraisal mission departure	03/27/2002	03/27/2002
Negotiations	04/29/2002	04/29/2002
Planned Date of Effectiveness	09/30/2002	09/30/2002

Prepared by:

Consolidated Agricultural Projects Management Unit
Agricultural Steering Committee

Preparation assistance:

Bank staff who worked on the project included:

Name	Speciality
Hoonae Kim	Task Team Leader
Jacob Intrator	Rural Banking
Sandra Broka	Rural Finance
Frauke Jungbluth	Agricultural Economics
Steve Bartoletti	Commercial Banking
Hermine De Soto	Social Science
Ranjan Ganguli	Financial Management
Jose Martinez	Procurement
Samir Suleymanov	Operational Analysis
John Ambrose	Environment
Anatol Gobjila	Operations Officer
Benoist Veillerette	Agricultural Economics
Christer Cronberg	Agro-industry/marketing
Jacob Mann	Operational Support
Laura Tuck	Quality Assurance
Amnon Golan	Quality Enhancement Review (QER)
Zoe Kolovou	Legal Counseling
John Ogallo	Disbursement Officer

Annex 8: Documents in the Project File*
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

A. Project Implementation Plan

Project Implementation Plan
Operational Manual by Component

B. Bank Staff Assessments

Country Assistance Strategy (1999) and Progress Report (2002)
Moldova Agricultural Sector Development Strategy (ESW, 2001)
Poverty Assessment (1999)
Agricultural Support Services- Rapid Gap Assessment Report (2000)
Rural Investment and Services Project - Baseline Study (January 2001)
Social Assessment (2001)
Banking Sector Assessment (1999)
Environmental Assessment (2001 and updated 2002)
Financial Management Assessment (2001 and updated 2002)
Procurement Assessment (2001 and updated 2002)
Potential PFI / Commercial Bank Survey Questionnaire
Potential PFI Monitoring Tables(2001 and updated 2002)
Economic and Financial Analysis of Random Samples and detailed cost estimates(2001)
GEF project documents for Agricultural Pollution Control and Medium Size Biodiversity Projects (2002)
Assessment of Savings and Credit Associations (SCA) Development (2002)

C. Other

Collective Farm Debt Resolution: Moldova Case Study - The National Land Program (June 12, 2000)
Impediments to Development of Private Farming and Small Rural Business in the Republic of Moldova (1999)
Republic of Moldova: Recent Economic Developments (September 1999)
Assessment of the Negative Impact of the 2000 Drought in the Republic of Moldova (July 20, 2000)
Moldova: Agricultural Sector Analysis 1998-1999 (2000)
Horticulture Marketing in Moldova: The Current Situation, Potential Opportunities and Recommendations (November 1997)
Removing Legal and Regulatory Impediments to the Development of Private Agriculture and Agroindustry in Moldova: The Need for Vision and Incentives (November 1999)
Land Reform and Farm Restructuring in Moldova: Progress and Prospects (August 1998)
Capacity Assessment of Potential Service Providers (2001)
Farm Organization Development Report- DFID (2001)

*Including electronic files

Annex 9: Statement of Loans and Credits

MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

02-Apr-2002

Project ID	FY	Purpose	Original Amount in US$ Millions IBRD	IDA	Cancel.	Undisb.	Difference between expected and actual disbursements* Orig	Frm Rev'd
P051174	2001	HEALTH INVST FUND	0.00	10.00	0.00	9.04	3.36	0 00
P051173	1999	SOCIAL PROTECTION	0.00	11.10	0.00	8 29	3 07	0 00
P044840	1999	SOCIAL INV FUND	0.00	15.00	0.00	4.95	-1 50	0 00
P035771	1998	FIRST CADASTRE	0.00	15.90	0.00	7 23	4 09	0 00
P035811	1997	PSD II	0.00	9.00	0.00	3.30	3 82	0 00
P008558	1997	GENERAL EDUCATION	16 80	0.00	5.00	8.93	8.15	4 10
P008561	1996	PRIV SECT DEVT I	35.00	0 00	0.00	0.08	2.27	2.27
		Total:	51.80	61.00	5 00	41.83	23 25	6.36

MOLDOVA
STATEMENT OF IFC's
Held and Disbursed Portfolio
Jan - 2002
In Millions US Dollars

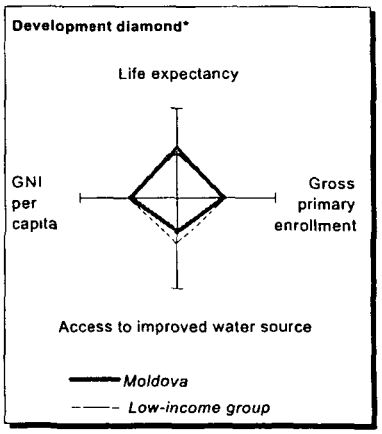
		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1997	INCON	3.70	2.00	0.00	0.00	3.70	2.00	0.00	0.00
2000	MEC Moldova	0.00	0.10	0.90	0.00	0.00	0.10	0.70	0.00
2000	Moldindconbank	1.50	0.00	1.50	0.00	1.50	0.00	1.50	0.00
2001	UF Moldova	25.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
2001	Victoriabank	4.00	0.00	0.00	0.00	2.20	0.00	0.00	0.00
	VoxTel	0.00	0.00	0.18	0.00	0.00	0.00	0.18	0.00
1999/00/01									
	Total Portfolio:	34.20	2.10	2.58	0.00	7.40	2.10	2.38	0.00

		Approvals Pending Commitment			
FY Approval	Company	Loan	Equity	Quasi	Partic
2000	Fincombank	1.50	0.00	0.00	0.00
	Total Pending Commitment:	1.50	0.00	0.00	0.00

Annex 10: Country at a Glance

MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

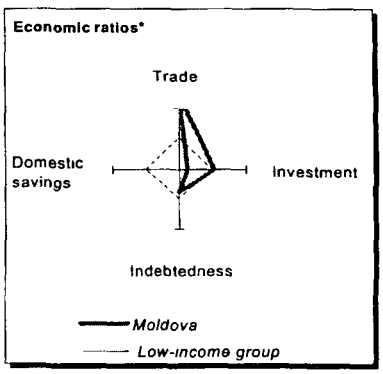
POVERTY and SOCIAL	Moldova	Europe & Central Asia	Low-income
2000			
Population, mid-year *(millions)*	4.3	475	2,459
GNI per capita *(Atlas method, US$)*	400	2,010	420
GNI *(Atlas method, US$ billions)*	1 4	956	1,030
Average annual growth, 1994-00			
Population *(%)*	-0.3	0 1	1.9
Labor force *(%)*	.	0.6	2.4
Most recent estimate (latest year available, 1994-00)			
Poverty *(% of population below national poverty line)*	55	..	..
Urban population *(% of total population)*	46	67	32
Life expectancy at birth *(years)*	66	69	59
Infant mortality *(per 1,000 live births)*	18	21	77
Child malnutrition *(% of children under 5)*	..	..	..
Access to an improved water source *(% of population)*	56	90	76
Illiteracy *(% of population age 15+)*	2	3	38
Gross primary enrollment *(% of school-age population)*	92	100	96
Male	90	101	102
Female	93	99	86



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

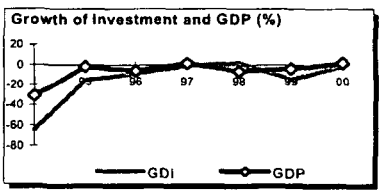
	1980	1990	1999	2000
GDP *(US$ billions)*	.	10.6	1.2	1.3
Gross domestic investment/GDP	..	25.2	22.8	22.3
Exports of goods and services/GDP	..	48.8	52.3	49.8
Gross domestic savings/GDP	.	22.8	8 8	-5.0
Gross national savings/GDP	..	..	19.0	12.8
Current account balance/GDP	..	..	-3 8	-9.4
Interest payments/GDP	.	.	4 3	3.5
Total debt/GDP	..	..	89 9	99.9
Total debt service/exports	.	..	32.4	17.8
Present value of debt/GDP	..	..	80.7	86.7
Present value of debt/exports	..	.	132.3	145.4

	1980-90	1990-00	1999	2000	2000-04
(average annual growth)					
GDP	2.8	-9.7	-3.4	1.9	3.1
GDP per capita	1 9	-9.5	-3 3	2.2	3.4
Exports of goods and services	..	1.0	-19.5	7 9	7.3

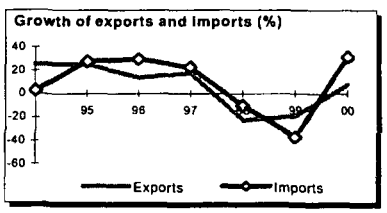


STRUCTURE of the ECONOMY

	1980	1990	1999	2000
(% of GDP)				
Agriculture			27.9	28.0
Industry	.	8.0	19.0	20.0
Manufacturing	.	..	12 0	12.6
Services	.	4 5	53.1	52.0
Private consumption		..	72.3	85.0
General government consumption	.	..	18.9	20.0
Imports of goods and services	..	51.2	66.3	77 0



	1980-90	1990-00	1999	2000
(average annual growth)				
Agriculture	..	-13.7	-6 9	0 6
Industry	.	-15.7	-17.5	5.4
Manufacturing	.	..	..	
Services	..	2.4	17 2	-1 8
Private consumption	..	6.7	-16.8	22.1
General government consumption	.	-3.9	-28.1	4.5
Gross domestic investment	.	-15.7	-14.7	-0.7
Imports of goods and services	..	4.6	-36 9	31.6

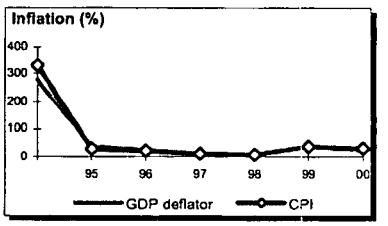


Note. 2000 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete

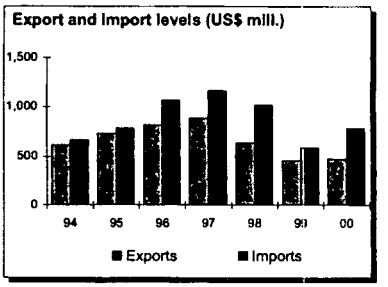
PRICES and GOVERNMENT FINANCE

	1980	1990	1999	2000
Domestic prices				
(% change)				
Consumer prices	..	..	39.3	31.3
Implicit GDP deflator	..	..	40.1	27.0
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	..	32.0	32.6
Current budget balance	..	..	-2.6	-0.7
Overall surplus/deficit	..	..	-6.0	-2.9



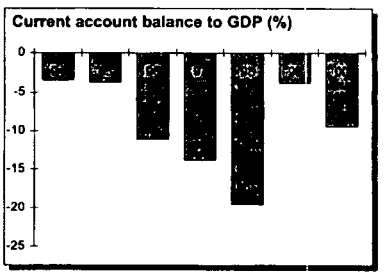
TRADE

	1980	1990	1999	2000
(US$ millions)				
Total exports (fob)	..	..	461	477
Live animals and animal products	..	..	29	23
Vegetable products	..	..	68	66
Manufactures	..	..	82	96
Total imports (cif)	..	..	597	793
Food	..	..	8	23
Fuel and energy	..	..	151	192
Capital goods	..	..	70	75
Export price index *(1995=100)*	..	..	71	67
Import price index *(1995=100)*	..	..	85	91
Terms of trade *(1995=100)*	..	..	83	74



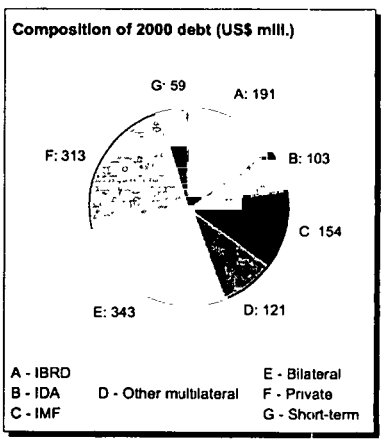
BALANCE of PAYMENTS

	1980	1990	1999	2000
(US$ millions)				
Exports of goods and services	..	..	614	640
Imports of goods and services	..	..	778	990
Resource balance	..	..	-164	-350
Net income	..	..	34	72
Net current transfers	..	..	86	157
Current account balance	..	..	-45	-121
Financing items (net)	..	..	83	172
Changes in net reserves	..	..	-38	-51
Memo:				
Reserves including gold *(US$ millions)*	..	..	181	206
Conversion rate *(DEC, local/US$)*	..	..	10.5	12.4



EXTERNAL DEBT and RESOURCE FLOWS

	1980	1990	1999	2000
(US$ millions)				
Total debt outstanding and disbursed	..	..	1,055	1,284
IBRD	..	..	199	191
IDA	..	..	77	103
Total debt service	..	..	232	137
IBRD	..	..	15	16
IDA	..	..	0	1
Composition of net resource flows				
Official grants	..	..	..	..
Official creditors	..	..	87	25
Private creditors	..	..	3	81
Foreign direct investment	..	..	34	128
Portfolio equity	..	..	..	..
World Bank program				
Commitments	..	..	66	10
Disbursements	..	..	74	36
Principal repayments	..	..	4	5
Net flows	..	..	70	31
Interest payments	..	..	11	11
Net transfers	..	..	59	19



Additional Annex 11: Sector at a Glance
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

MOLDOVA: AGRICULTURE AT A GLANCE

Total Population	4.4 mil	Food and agriculture in GDP (2001)	48%	Agricultural output in 2001 as percentage of 1989-1990 level	51%
Rural Population	47 %				
Total Area	3.4 mil ha	Food and agriculture in active labor (2000)	43%	Livestock production in 2000 as percentage of 1989-1990 level	30%
Agriculture area:	2.3 mil ha	Food and agriculture in exports (2001)	61%	Share of livestock in agriculture (1995)	32%
Arable land	81%	in imports (2001)	15%		
Orchards and vineyards	9%	Traditionally net exporter of: wine, processed and unprocessed fruits and vegetables, and pork.		Agricultural area in private use (2000)	89%
Irrigated	10%			Share of private sector in total agricultural output (2001)	75%
Forested	12%				

Indicator	1996	1997	1998	1999	2000
Agricultural employment	523,000	474,000	411,000	287,000	280,000
Labor productivity in agriculture (1990=100%)	53	62	53	48	44
Agriculture value added per worker (constant 1995 US$)	1,386,330	1,375,920	1,321,790	1,132,490	
Agriculture, value added (% of GDP)	31.40	30.21	30.45	25.12	
Agriculture, value added (annual % growth)	-11.65	-4.02	-7.21	-17.18	
Agriculture, value added (constant 1995 US$)	799,911,600	767,763,300	712,442,300	590,025,100	
Agriculture, value added (current US$)	465,891,300	501,125,600	437,728,100	259,328,600	
Fertilizer consumption (metric tons)	13,500	10,100	6.900		5,000
Food exports (million, $US)	593,000,000	641,400,000	466,600,000	307,700,00	
Food exports (% of merchandise exports)	74.00	73.40	73.8	65.3	
Land area (hectares)	3,400,000	3,400,000	3,400,000	3,400,000	3,400,000
Agricultural land (hectares)	2,555,000	2,556,000	2,556,000	2,556,600	2,300,000
Land productivity (1990=100%)					54.0
Livestock production index (1989-91 = 100%)	45.60	42.00	37.40	36.60	34.80

Additional Annex 12: Status of Land Reform
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

LAND REFORM IN MOLDOVA

Background

In recent years, ownership of agricultural land in Moldova has undergone major changes and although the process of land privatization and farm restructuring has not always been straightforward, presently, over 95 percent of agricultural land is being farmed in some form of privately owned and de-collectivized enterprise.

Initially, political support for the process was moderate and characterized by a continued struggle between conservative and pro-reform forces in the society. After a fairly bold start in 1992, when the legal base for land privatization and farm restructuring was established (Land Code - 1991, Peasant Farm Law - 1992), the process came to a virtual standstill in November 1994 after the Parliament amended land legislation and introduced a set of anti-market and anti-reform provisions in the Land Code. In January 1996, some of these provisions were examined by the Constitutional Court, declared unconstitutional and subsequently annulled. However, it was not until 1997, when the Moldovan authorities allowed the initiation of a number of land privatization and farm restructuring pilots and cleared most administrative barriers, that the pace of land reform accelerated.

The Reform Program

The initial pilot efforts were supported by TACIS and USAID. TACIS's effort was limited to 10 farms in the Ohrhei region and USAID started with one farm in the Nsiporeni region. These pilot projects revealed a number of obstacles to be overcome before a national land privatization and farm reform process could proceed. Primarily, the high level of farm indebtedness posed a problem for farm asset disposal, and the continuation of the former farm structures as legal entities raised a number of problems with respect to accounting and taxation for breakaway private farms. Approaches to resolving these problems were worked out in a second round of pilot privatizations undertaken on 72 farms with support from USAID, commencing in 1997.

These problems were directly addressed by the ensuing National Land Program (NLP), which was formally launched by the Government in 1998. The NLP was largely financed by USAID and implemented by the Center for Private Business and Reform and the East-West Management Institute, affiliated to the Soros Foundation.

Conceptually, the NLP was conducted not according to principles of restitution to former owners, but rather following mass privatization/distribution mechanisms. The methodology adopted by the NLP was based on a series of steps falling into three main stages:

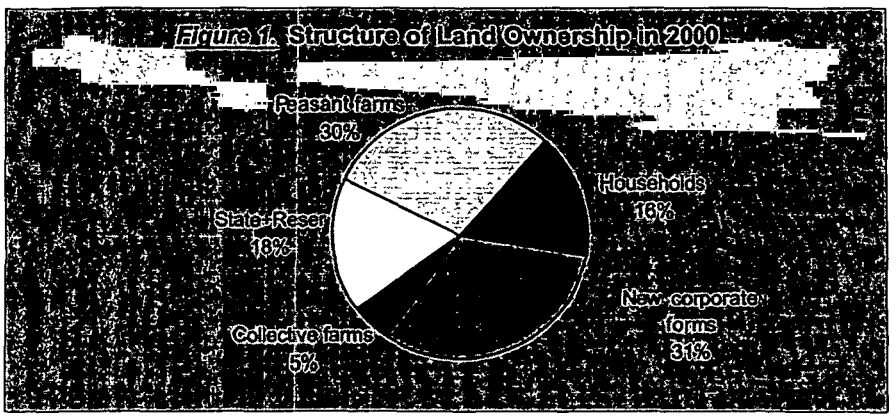
- **Stage 1**: Initial steps in privatization and reorganization, which included disseminating information on the process to the farms, informing farm members of their legal rights, and conducting of general meetings on each participating farm;

- **Stage 2**: Farm preparation, which included preparations for land privatization, the preparation for

a land tender, the allocation of parcels, and a parallel process with respect to farm property;

- **Stage 3**: Land and property distribution, including the holding of land and property tenders, debt restructuring and creation/registration of debt-free successor farm enterprises.

The outcome of the land reform process in Moldova has depended critically on the formal processes adopted by the Government under the NLP. In particular the following features are worthy of note: (a) adoption of a democratic approach at the farm level; (b) encouragement to form groups around leaders/representatives; (c) farm asset protection; and (d) farm debt restructuring.



Source: Cadastral Land Balance as of 1 January 2000

One interesting point to note is that after land privatization, a significant proportion of those receiving land shares had no desire to farm. This included a large group of the elderly and pensioners (37 percent of recipients were over 50 years old). This created a situation where a substantial proportion of the new landowners were seeking an alternative to directly operating their own farms. One such alternative was the widespread adoption of the land lease market from the point of the initial land tenders by so-called leaders/representatives, which has provided a basis for those who do not wish to farm to exit from farming. The resulting farm structure is conveniently analyzed on the basis of the division between individually farmed land and land farmed under formal leases by leaders.

The majority of such leaders have established private agricultural enterprises of a limited liability form. Of 6,299 initial leaders, 3,867 are now running registered, private agricultural enterprises. The new farm managers – the "leaders" – for the most part, have a background in farming and in many cases were either farm managers or brigade leaders prior to the land reform. With an average age of 47 years and a range in age from 20 to 80, a total of 43 percent have technical educational backgrounds in agriculture, 38 percent as agronomists and 5 percent as livestock specialists.

As of the year 2000 cropping season, 77 percent of the privatized and distributed land area was leased out to leaders, mostly in the form of medium to large entities. Leasing arrangements for land are regulated by law and are currently limited to leases not exceeding 10 years. The majority of leases, however, are currently for shorter terms, typically 1 year (25 percent) or three years (53 percent).

Many individuals who wished to continue farming on their own and in smaller units have restructured as registered peasant farms. Only 23 percent of the privatized land is farmed individually. The number of

registered peasant farms currently stands at around 84,000, with another few hundred thousand small partnerships, individual or family based entities operating unregistered.

Land farmed individually is typically organized as small farm holdings: 66 percent of individual holdings are under 5 hectares in size. The majority of such holdings are farmed directly by the individuals with other family members, but 13 percent have pooled informally with neighbors, while a further 18 percent have pooled with owners of property assets such as farm equipment.

Land holdings of private farms: 1998-2002

	Jan.1998	*Jan.2001*	*Jan.2002*
Number of unregistered peasant farms	65835	201533	248350
Number of registered peasant farms			84000
Land in possession of peasant farms, *ha*	118378	364092	448500
Average size of peasant farm, *ha*	*1.8*	1.8	1.8
Total land in individual use, *ha*	224942	701855	805426
as % of total agricultural land	*9%*	27%	31%
Average size of land plot, *ha*	*1.3*	1.4	1.4

Source: Department of Statistics, quarterly reports on *Organization of Peasant Farms*

Land Tenure 1990-2000 *(as % of agricultural land)*

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
State sector	**32.3**	**26.7**	**25.2**	**31.2**	**30.1**	**16.7**	**17.3**	**17.7**	**17.5**	**17.1**	**17.5**
State farms	27.0	23.4	20.4	14.6	12.8	0.1	1.0	1.0	1.0	1.0	1.0
Reserve fund	0.0	0.0	0.1	12.7	13.3	13.4	13.6	14.0	14.1	14.1	15.0
Corporate forms	**59.4**	**63.0**	**63.0**	**56.2**	**56.8**	**67.9**	**64.8**	**61.4**	**57.2**	**46.1**	**41.9**
Kolhoses	59.4	63.0	58.8	49.2	45.2	39.3	23.1	15.2	12.7	10.4	5.1
New corporate forms	0.0	0.0	4.2	6.2	8.9	27.6	38.9	43 0	41.7	33.9	35.8
Farmers associations	–	–	–	0.8	2.7	1.0	2.8	3.2	2.8	1.8	1.0
Individual sector	**8.3**	**10.3**	**11.7**	**12.6**	**13.2**	**15.3**	**18.0**	**20.9**	**25.3**	**36.8**	**45.3**
Peasant farms	–	–	0.0	0.3	0.7	2.4	4.8	7.8	12.2	22.3	29.8
Household plots	8.3	10.3	11.7	12.3	12.5	12.9	13.2	13.1	13.3	14.5	15.5

Source: *Cadastral Balance (end of year data)*

Challenges for Development of the Land Market

A properly functioning market for agricultural land is essential in order to realize the gains from the land reform initiative. Private sector investment in longer-term development of land assets will be linked closely to the regularized establishment of land ownership. While leasing arrangements may play an important role as a transition device and while the lease market may continue to have a significant role in the longer term, ownership is the preferred option for a majority of prospective farmers. A properly functioning land market is equally important for those who want to exit from farming, providing them with the means of

transferring the value of their land allocation into more manageable forms of asset-holding.

The purchase and sale of agricultural land has been legally possible since the first land certificates were issued in 1996. However, relatively few transactions for the sale and purchase of agricultural land have occurred to date; in 1999, there were approximately 2,000 completed sale and purchase transactions. There are, however, a number of reasons for the slow start-up of transactions in the rural land market. Having recently acquired land titles, many households which may, in the longer term, choose to dispose of their entitlement, are understandably cautious and have initially opted to lease out their land. Furthermore, the demand for land is also constrained by low liquidity in the rural economy. Few have the means to purchase land outright and financing for land acquisition is generally not available. Therefore, the limited number of transactions is not necessarily a sign of market malfunction.

There are various constraints to land market transactions, whose economic impact is likely to increase as the level of interest in transactions picks up in the coming years. The following constraints have been noted in particular:

- Transaction costs are high, especially for the purchase and sale of small plots, and include surveying costs, land transfer tax, and the titling of land.

- The land cadastre is still incomplete, and adequate transparency of rural land ownership has not yet been achieved.

- The number of steps necessary to complete a land transaction is too great, and the process could be simplified by regulatory reforms.

- The markets for brokerage functions are not yet developed, with an accompanying lack of adequate information on supply and demand for transactions in specific localities.

- Financing for land purchases remains largely unobtainable, resulting in the limiting of land purchases to those with established capital. Financing for land market transactions is important to facilitate the build-up of viable holdings by those who have skills to farm but who lack the capital to purchase outright.

What can be done to speed up the development of the land market? A land market cannot develop unless and until new landowners are able to exercise their rights to use their land independently from the leasing associations, that is, to freely lease, sell, exchange and mortgage their land rights. Thus, strengthening these rights is a key to facilitating land market development, which will result in the re-allocation of land to more efficient uses. In the 1998/99 Gap survey, 61 percent of farmers interviewed felt that it was difficult to buy or rent land. The main constraints mentioned were (a) the lack of financial resources to buy land, to pay rent or to purchase inputs for the new piece of land; (b) difficulties in finding satisfactory agreements between lessee and lesser; (c) lack of agricultural equipment; lack of information about the laws and conditions; and (d) excessive tax requirements on the part of the lessee.

Additional Annex 13: Letter of Sector Development Policy
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

GUVERNUL REPUBLICII MOLDOVA

ПРАВИТЕЛЬСТВО РЕСПУБЛИКИ МОЛДОВА

Nr. 01.05-161/28 Chişinău May 10, 2002

Mr. Johannes Linn
Vice President
The World Bank
Europe and Central Asia Region

Dear Mr. Linn:

Re: Moldova's Agricultural Development Strategy
Letter of Development Policy

1. The Government of Moldova places high priority in developing post-privatization support services in the agricultural sector, which has not reached its potential. The Government believes that the Rural Investment and Services Project (RISP) is an important opportunity to bring real and concrete results to generate growth and reduce poverty in the agricultural sector. The main development objective of the project is to foster growth in the sector by providing a combination of information, institution development and finance to new private farmers and rural businesses. While pursing this objective, the project would help reduce poverty in the rural areas.

2. The proposed RISP is an important opportunity to significantly improve Moldova's rural economy, which is still struggling to adjust to the new economic reality. With the support of IDA, the Government of Moldova seeks to further promote sustainable growth in the agricultural sector with an aim to create a competitive, private initiative driven sector. To this end, the Government reconfirms its commitment to implement agricultural policies and support agricultural institutions aimed at developing a vibrant market-oriented rural economy. We recognize that in order to achieve these goals, concrete actions are necessary on our part to realign past policies, reevaluate current priorities that are consistent with the overall fiscal conditions, and move forward boldly with more market-based set of policy instruments, institutional and legal support system. In doing so, we are committed to pursue market-based, liberal agricultural policies where synergy between the Government and the private sector can be enhanced for improved performance fiscally, and economically. We will strictly adhere to the liberal agricultural policies during the years ahead as stated in the Memorandum of Understanding on the Agricultural Sector signed in December 2001 with the World Bank.

3. We place an emphasis on development of land and credit markets in agriculture. We recognize that farm restructuring is still unfinished and much more needs to be done to help private farmers to become truly competitive in a market economy. We remain committed to complete privatization of remaining small number of collective farms, and continue the restructuring of existing farm and agro-enterprises. The Government believes that the irreversible solid foundation for developing private agriculture is in place and the next steps would be: (a) to

Casa Guvernului, MD-2033, Chişinău, Republica Moldova
Tefefon: +373-2-237795
Fax: +373-2-242696
Дом Правительства, MD-2033, Кишинэу, Республика Молдова

strengthen land ownership rights; (b) to promote development of land markets; and (c) to provide appropriate support services to post-privatization farmers.

4. The Government assures that any new land code or amendments to the existing Land Code will adhere to market-oriented principles that: (a) clearly define and protect land owners' rights, including full autonomy in use/lease of their land; (b) provide for the enforcement of real property rights through efficient institutions and effective courts; (c) facilitate and support market-based secure transactions of property rights, backed by formal contract procedures, and provide a court system that settles any disputes in a timely manner; (d) provide for property rights information to be available to all persons who request it; (e) limit to highly exceptional circumstances, Government restrictions on transactions, consolidation or use of land; (f) facilitate registration and transactions at low cost with minimum fees and taxes in the shortest possible time after application; and (g) protect land as a resource on environmental and health grounds. Efforts are already being made to reduce notary fees, simplifying documents requirements, reducing multi-notary requirements, and also to make information about land prices more readily available to potential buyers and sellers. In the event that the Government proceeds with adoption of a new land code, the Government shall adhere to the above principles and seek the World Bank's prior review and agreement.

5. Although land privatization has largely been completed, we realize that post-privatized farms, particularly large corporate farms continue to perform poorly. The lack of contract enforcement has both maintained inefficient farm managers through under-payment or non-payment to lessees, and created uncertainty for good managers as lessees exit lease agreements prior to the expiration of lease contracts, retarding on-farm investments. Many landowners have leased out their land to previous collective farm directors and many have not fully realized their rights as landowners, as indicated by the number of disputes registered at dispute resolution centers. The Government will support the system of clear and enforceable ownership rights. It will reduce the transaction costs for property sales, lease, inheritances, and provide confidence to lenders for providing secured credit against real estate. It will also facilitate effective land management, including proper valuation and property taxation.

6. In doing all the above, the Government will: (a) ensure that farming structure and sizes will be ultimately determined by transparent, market based transactions, and not laws, or decrees permitting governmental interventions on consolidation of land without the invitation, participation and approval of all affected land owners; (b) ensure that land transactions can take place freely without any undue administrative interference by Government, local authorities or neighbors; (c) maintain the institutional arrangement for the Cadastre offices, which will have trained manager, staff and institutional and technological capacity; (d) continue to seek donor assistance in providing legal aid services to farmers that cover a broad spectrum of legal services including an information campaign on land owners rights, and dispute resolution and problems regarding land transactions; and (e) carry out an information campaign for farmers about different scenarios of, and alternatives to, land leasing and swapping, procedures associated with these types of arrangements, types of contracts, standardized terms and conditions of lease contracts, etc.

7. The Government is committed to ensure that there is a sound, integrated legal framework for cooperatives based on the principles that: (a) membership should be entirely voluntary without any cohesion by government, local authority or neighbors; (b) land (through lease or otherwise) should not be required to be subscribed as equity into a cooperative nor should be required for membership; (c) employment should not be mandatory for membership in such cooperatives; (d) members should be free to exit at any time, with their original, physically

demarcated plot of land; and (e) cooperatives should be subject to bankruptcy and liquidation similar to all other enterprises, without preference.

8. We also recognize that post-privatization farmers need access to know-how, market information, and financial resources to recapitalize themselves with necessary investment which will create the basis for future growth. Learning from the past mistakes, we reiterate our commitment that provision of financial resources to private rural entrepreneurs will be made through commercial financial institutions that have full autonomy in loan risk appraisal, loan approval and rejection, as will be the case under the RISP. In parallel, we are strongly committed to creating a business environment that will foster development of private businesses in rural areas. Specific measures will include provision of legal and institutional framework to create a legal status for private individual farms, establish advisory services to provide information, knowledge and create a sustainable rural financial system that will channel investment credits.

9. We are committed to maintaining liberal agricultural policies for our agricultural producers, traders and processors. The Government has already taken bold steps to further liberalize the sector. State monopolies – Fertilitate and Cereale - have been largely privatized to promote competition in the input and output markets for farmers. Prices have been formally liberalized, and the system of administrative price setting for producers at all levels of processing and wholesaling was discontinued in 1992. Furthermore, indirect regulation through procurement prices, controlled profit margins for processors and controlled marketing margins for traders have also been removed. The past practices of introducing export bans (e.g. timber) or licensing requirements (e.g. on walnuts) as well as minimum reference prices for exports has been discontinued through official repeals. State involvement in the productive sector, such as development of a vertical monopoly in the tobacco sector, has also been resisted. In sum, the Government is committed to maintaining liberal pricing policies and minimal interference in trade or domestic marketing. We reiterate our firm position that the State will not become a direct facilitator of trade for the private sector.

10. The Government of Moldova, like other governments, plans to maintain for strategic purposes a limited quantity of grain in a State Reserve for Grain. The reserve will be maintained for emergency purposes only, not for market intervention. Procurement of the grain will only be through public auction based on cash payment. We will seek international experience to improve the current system. In particular, we will better define the operating rules for the State Reserve regarding purchasing and sales so as to limit and make more predictable their impact on market prices; gradually reduce the overall size of the reserve stocks; shift some storage to private facilities thereby improving quality of storage and encouraging private warehouse development; and eliminate in-kind grain loans or debt write-off.

11. With regard to the State Reserves, the Government is committed to: (a) limit the state reserves to the maximum level equivalent to one and half months worth of human grain consumption; (b) maintain the level of grain held by the Reserve in line with the country's fiscal situation; and (c) adhere to the following operating principles for the Reserves: (i) the reserves would not be used to intentionally influence prices or quantities of grain on the market and would be held only for "emergency" use; (ii) released based on clear criteria such as domestic prices being more than 15% above CIF prices; (iii) purchases and sales would be effected only in cash through the commodity exchanges; and (iv) there would be no net change in monthly grain balances (i.e., purchases and sales would be offset and carried out only to ensure stock rotation); and (v) public institution bodies will not engage in commodity trading of any kind, with the exception of the State Reserve Fund.

12. For the framework of the liberal agricultural regime, we will: (a) refrain from direct and indirect price control on agricultural commodities, including any margin or profit control; (b)

discontinue all reference prices for agricultural commodities; (c) suspend all export bans, reduce licensing and controls, and simplify procedures for import and export by eliminating as much paperwork as possible; (d) monitor and disseminate to the public the results of all government procurement and their financial results; (e) rely on land tax as the main tax source for the sector; (f) rationalize the Agricultural Support Fund (ASF) subsidy program, favoring post-privatization restructuring of agriculture through a transparent, non-distortionary and well-targeted system of agricultural subsidies; (g) seek prior agreement of the World Bank on design, terms and conditions of the ASF, and for the 2002 ASF, ensure that only private farmers will be eligible and have only one time, without repeated, access to the ASF; and (h) eliminate wine and tobacco subsidies as of 2003, and ensure there are no other agricultural subsidies outside of ASF, including off-budget programs, except as discussed and agreed with IDA.

13. As stated above, the Government recognizes that the sector recovery and reduction of poverty would require immediate and continuous adjustments on some of the key policies as discussed in this Letter. Through continuous dialogue with the World Bank and IMF, the Government has already been engaged in constructive discussions on agricultural policy, legal and regulatory issues. The project, in parallel to the Structural Adjustment Credit III (SAC III), will support such policy dialogues. The Government is committed to reach agreements on priority areas discussed in this letter with the understanding that each area will require follow-up actions on our part.

Yours sincerely,

Vasile Tarlev,
Prime Minister

Dmitrii Todoroglo,
Deputy Prime Minister,
Minister of Agriculture and Food Industry

Zinaida Greceanii,
Minister of Finance

Minister of Finance

MEMORANDUM OF UNDERSTANDING
Government of the Republic of Moldova
Agricultural Team of the
International Development Association

The Government of the Republic of Moldova and the Agricultural Team from the International Development Association (the IDA team), in the context of the Structural Adjustment Credit III (SAC III), seek to further promote sustainable growth in the agricultural sector. To this end, the Government reconfirmed its commitment to implement agricultural policies and support agricultural institutions aimed at developing a vibrant market-oriented rural economy. This commitment should serve as a basis for IDA/Moldova collaboration in creating a effective post privatization for the agricultural sector.

The Government and the IDA team carried out discussions on agricultural policy issues during the week of December 3-7, 2001. This memorandum represents understandings reached between the two parties during this week. It is intended to provide a framework that can serve as a basis for negotiations of SAC III. The contents of this memorandum are the position of the Agricultural Team and are subject to confirmation by senior management of IDA.

The Government and the IDA team recognized, in particular, the importance of the Land Code as a fundamental piece of legislation framing land relations in the country. The Government has agreed to create and maintain a land code that adheres to market-oriented principles, namely that it:

(a) clearly defines and protects land owners' rights;
(b) provides for the enforcement of real property rights through efficient institutions and effective courts;
(c) facilitates and supports secure transactions of property rights, backed by formal contract procedures, and provides a court system that settles any disputes in a timely manner;
(d) provides for property rights information to be available to all persons who request it; and
(e) limits to exceptional circumstances, Government restrictions on transactions;
(f) facilitates registration and transactions at low cost with minimum fees and taxes in the shortest possible time after application; and
(g) protects land as a resource on environmental and health grounds.

In light of this, the Government has agreed to cease work on the current draft Land Code. The Government will establish a working group that will work with IDA starting in January 2002 to develop amendments to the 1991 Land Code, or a new Land Code, fully based on the above-mentioned principles. Before second tranche of the SAC III, the new land code will be passed by Parliament.

The Government and the IDA team agreed that the Law on Debt Restructuring will be amended for second reading to clarify that only farms that have gone through the National Land Program, or fully adhere to the principles of the National Land Program (i.e., all land and property have been distributed, in kind, to individual land

owners, individual plots are titled and original farm is legally liquidated), will be eligible to have their debt restructured or written off.

The Government reconfirmed its commitment to maintain the administration of the cadastre system in accordance with the National Cadastre Project.

The Government provided IDA with a draft of the proposed Law on Production Cooperatives. The IDA team has requested the opportunity to comment and reserves the right to include additional SAC III measures in this area. The IDA team and the Government did, however, agree that the following principles should be respected on this subject:

a) membership should be entirely voluntary;
b) land should not be subscribed as equity into Production Cooperatives;
c) a land contribution (through lease or otherwise) should not be a requirement of membership;
d) employment should not be mandatory for membership in such cooperatives;
e) members should be free to exit at any time, with their original, physically demarcated plot of land; and
f) production cooperatives should be subject to bankruptcy and liquidation similar to all other enterprises, without preference.

The Government and the IDA team agreed that Peasant Farms that have become "large" should be transformed into another legal form. The Government currently defines "too large" as having more than 50% of labor hired-in. The Government agreed to consider other benchmarks, such as the gross value of production or the number of hectares which the team recommends as more accurate indicators of size. The Government and the IDA team agreed that, in addition to the current alternative legal forms available (e.g., LTD, JSC, etc.), farms should be given the option of a simple, new legal form, the Private Farm, which would have as its only requirement to keep accounts and pay taxes. The Government agreed to submit draft proposals to IDA by Board and fully create this legal option by second tranche.

With regard to agricultural policies for individual subsectors, the Government agreed to adhere to the following principles:

a) no minimum prices or fixed prices of any kind
b) no minimum delivery requirements
c) no designated buyers;
d) no export bans or reference prices;
e) no licensing requirements for import or export;
f) no determination of land to be planted under particular crops or production levels to be achieved; and
g) no government institutions assigned to administer the production or processing of any crop.

To this end, after signing this Agreement, the Government of the Republic of Moldova will take all necessary steps to have annulled, withdrawn or cancelled any law, decree, order, decision or other legal form, that currently requires or allows for any of the above interventions as mutually identified during the course of SAC III,

and to avoid introducing such legislation in the future. There was agreement that SAC III would support maintenance on a continuous basis of these principles.

With regard to the State Reserves, the Government and the IDA team committed to agree during negotiations on:

a) the level of grain to be held by the strategic reserve, in line with the fiscal situation of the country; and
b) the operating principles for the strategic reserves.

On this latter, the Government agreed notionally that the operational principles would likely be similar to the following:

a) the reserves would not be used to intentionally influence prices or quantities of grain on the market and would be held only for "emergency" use; released based on clear criteria such as domestic prices being more than 15% above CIF prices;
b) purchases and sales would be effected only in cash through the commodity exchanges; and
c) there would be no net change in monthly grain balances (i.e., purchases and sales would be offset and carried out only to ensure stock rotation).

Specifically, the Government agreed that following such principles would terminate the practice of requiring bakeries to purchase grain at designated prices from the Strategic Reserve and to annul Government decisions 588 and 730 before Board. The Government agreed that it would cease acceptance of payment in grain for past-due debt.

The Government provided IDA with the implementing regulations for the Agricultural Support Fund (ASF) for review, and the two parties agreed that they would be promulgated only once they are mutually agreeable. The two parties agreed to a six month review period to assess the progress of the program and to make adjustments as necessary. The Government further agreed that other significant subsidies from the budget to the agricultural sector would also be discussed and agreed with IDA.

MEMORANDUM OF UNDERSTANDING
December 10, 2001

Vasile Tarlev
Prime Minister

Carlos Elbirt
Resident Representative
World Bank

Valeriu Mironescu
Deputy Minister of
Agriculture and Food Processing

Additional Annex 14: Performance Indicators and Triggers for Phase II
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Program and Project Performance Indicators and Triggers for Phase II

Progress toward achieving the project objectives would be tracked through a monitoring and evaluation (M& E) system. A Baseline Survey (January 2001) was carried out during project preparation in order to establish a reference basis on which incremental impact of the program and the project could be measured. These indicators, as well as triggers, are included in the Project Implementation Plan (PIP), which would be reviewed during regular supervision and at a mid-term review (before June 30, 2004 or before 50% of the first phase APL is disbursed, whichever is sooner).

Program Performance Indicators

Sectorwide indicators would include: (a) a more favorable macroeconomic and business environment as measured by overall economic and sector indicators; (b) a developed land market and emergence of genuinely restructured farms as measured by the number of land transactions and registered private farms; (c) increased domestic and export sales of agro-food products as measured by increases in the volume and amounts of agricultural commerce; (d) improved marketing opportunities, infrastructure and practices, as measured by increases in the number of registered agro-food distributors, exporters and other participants in agricultural trade; (e) increased production and productivity in key crop and livestock sub-sectors as measured in random sample farm budget analyses; and (f) increased non-farm economic activities and employment in rural areas as measured by village level assessments.

Institution and human development indicators would include: (a) higher awareness among farmers regarding the benefits of organizing themselves as measured by an increase in the number of and membership in organized and registered farmer groups and associations; (b) full understanding of their legal rights as land owners as measured by an increase in titles; (c) heightened sense of private entrepreneurial spirit among newly created private farmers and rural entrepreneurs as measured by an increase in the number of registered private rural – individual and group - enterprises; and (d) strengthened post-privatization support services and increased access to rural advisory services as measured by the number of advisory centers and clients that will be confirmed by surveys of client satisfaction.

Financial indicators would include: (a) an increase in the institutional commercial credit flow to the rural sector as measured by the number of participating financial institutions (PFIs), e.g. commercial banks and RFC, and the total volume of credit; (b) diversification of rural portfolio as measured by the composition of actual lending activities of PFIs; (c) continuous compliance of PFI eligibility by at least three PFIs as confirmed by the National Bank supervision department; (d) improved loan appraisal skills of PFIs as measured by sound portfolio quality; (e) inclusion and diversification of the rural finance system for small-scale, rural clients as measured by an increase in the number and volume of lending; (f) strengthened regulatory and supervision capacity of Savings and Credit Associations (SCAs) by restoring the functions of the SSB; and (g) increased rural income as measured by incremental increases in rural household incomes compared to the Baseline Survey reference data base.

Adaptable Program Credit (APC) Second Phase Triggers

Before moving on to the second phase of the APC, the following triggers should be achieved:

(a) Continuous adherence to the priority legal, regulatory and agricultural policy reforms as articulated in the Letter of Sector Development Policy (LSDP) and the Memorandum of Understanding for Agriculture (MOU);

(b) Creation of fully developed legal statutes of private farms and rural entrepreneurs as measured by increasing numbers of registered private farms and rural businesses;

(c) The efficient operation of Service Providers for advisory services *(with a minimum 35 SPs in operation and a minimum 100 general contracts and 300 special contracts implemented)*;

(d) The effective rural business development services *(a minimum 900 legal rural business created and registered and a minimum 3 Development Agencies* (DAs) with 15 mobile teams involved in rural business development;

(e) Successful integration of commercial banks into rural financing as demonstrated by *at least three* fully functioning and active participating financial institutions (PFIs);

(f) Sound portfolio as measured *by a minimum 85% recovery* rate under the rural finance component;

(g) Adequate regulatory and supervisory capacity of the State Supervisory Body (SSB) as demonstrated by all licensed SCAs being in full compliance with the prudential regulations with minimum default rates *(less than 5%)*;

(h) Disbursement of *at least 75%* of the first-phase credit line operation; and Disbursement of *at least 75%* of the non-credit line components or evidence that an equivalent quantity and quality of technical assistance has been provided and has resulted in enhanced local institutional capacity.

Additional Annex 15: Monitoring and Evaluation System
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Monitoring and evaluation (M&E) of the project would be regularly undertaken based on the M&E indicators and mechanisms that have been set-up for each component and sub-component. The following tables summarize key elements of such indicators. Based on the results of the year-end M&E review, lessons learned would be incorporated into CAPMU's work programs for the subsequent year.

1. Rural Advisory Services Component

Project Activities to be Monitored	Method	Frequency
Development of competitive contracting system for SPs		
• Development of operational manual	Progress reports	Quarterly
• Staff training	Progress reports	Quarterly
• Training of trainers	Progress reports	Quarterly
Promotional activities		
• Development of information and training materials	Progress reports	Quarterly
• Promotion activities organization of roundtables, seminars, etc.	Progress reports	Quarterly
Development of the service provider network		
• Number of service providers employed	Progress reports	Quarterly
• Number of special contracts issued	Progress reports	Quarterly
Provision of services to farmers:		
• number of clients	Progress reports	Quarterly
• number of repeat clients	Progress reports	Quarterly
• number of verbal consultations	Progress reports	Quarterly
• number of written consultations	Progress reports	Quarterly
• number of field-days conducted	Progress reports	Quarterly
• number of round tables conducted	Progress reports	Quarterly
• number of seminars conducted	Progress reports	Quarterly
• number and subjects of business plans supported	Progress reports	Quarterly
• number of farmer groups supported through the SP	Progress reports	Quarterly
• number "match-making services" cases (linking producers and processors)	Progress reports	Quarterly

2. Rural Business Development Component

Project Activities to be Monitored	Method	Frequency
Development Agencies:		
1. Information campaigns in judets and villages		
Number of villages where the information campaign was performed	Progress reports	Quarterly
Number of meetings in villages	Progress reports	Quarterly
Number of requests received	Progress reports	Quarterly
Number of RBs and individuals supported by the DAs	Progress reports	Quarterly
2. Selection of RBs for participation in the project		
Number of feasibility studies prepared	Progress reports	
Number of selected beneficiaries	Progress reports	Quarterly
Number of signed memorandums of understanding	Progress reports	Quarterly
3. Business planning, registration, management support, training and consultancy		
Number of RBs and individuals registered as legal entities (by type of business)	Progress reports	Quarterly
Number of RBs and individuals with final business plans	Progress reports	Quarterly
Number of RBs and individuals having submitted credit applications to commercial banks	Progress reports	Quarterly
Number of RBs and individuals having received credit / grant from commercial banks	Progress reports	Quarterly
4. Activities supported after registration and loan acceptance		
Number of visits and discussion sessions	Progress reports	Quarterly
Number of seminars	Progress reports	Quarterly
Number of RBs and individuals having started their business activities	Progress reports	Quarterly
Number of RBs judged strong and sustainable enough to continue operating by themselves	Progress reports	Quarterly
Average number of RBs group activities members	Progress reports	Quarterly
Number of RBs and individuals repaying in time their credit to the commercial banks	Progress reports	Quarterly
Number of RBs dissolved	Progress reports	Quarterly
Number of RBs and individuals bankrupted	Progress reports	Quarterly

3. Rural Finance Component

Project Activities to be Monitored	Method	Frequency
CREDIT LINE IMPLEMENTATION		
1. Lending Progress, by Credit Line		
Total outstanding loan portfolio	Progress report	Quarterly
Number of borrowers ; loans	Progress reports	Quarterly
Total amount approved	Progress reports	Quarterly
Total amount disbursed, including matching grant funds	Progress reports	Quarterly
2. Loan Specifications (by Credit Line)		
Average loan amount and interest rate	Progress reports	Quarterly
Average maturity and grace period	Progress reports	Quarterly
3. Type of Loans		
Investment vs. Working capital	Progress reports	Quarterly
4. Loan Purpose		
Agricultural production	Progress reports	Quarterly
Agro-processing	Progress reports	Quarterly
Non-agricultural activities	Progress reports	Quarterly
Trade, etc.	Progress reports	Quarterly
5. Loan Pipeline		
Number and amount	Progress reports	Quarterly
Purpose and type	Progress reports	Quarterly
6. Recovery rate	Progress reports	Quarterly
7. Portfolio at Risk		
Loans with arrears as a % of outstanding loan portfolio	Progress reports	Quarterly
Non-performing loans, as a % of outstanding loan portfolio	Progress reports	Quarterly
Provisions as a % of portfolio at risk	Progress reports	Quarterly
II PFI MONITORING		
1. Financial Position		
Total asset size	Audited reports / PFI reports	Every six months
Total loan portfolio	Audited reports / PFI reports	Every six months
Long-term liabilities, including	Audited reports / PFI reports	Every six months
IDA Credit Lines form the GOM	Audited reports / PFI reports	Every six months
Deposits	Audited reports / PFI reports	Every six months
Equity and reserves	Audited reports / PFI reports	Every six months
Net operating income	Audited reports / PFI reports	Every six months
Staff and administrative expenditures	Audited reports / PFI reports	Every six months
Loan loss provisions	Audited reports / PFI reports	Every six months
Net Profit / Loss	Audited reports / PFI reports	Every six months
2. Ratios		
Capital adequacy	Audited reports / PFI reports	Every six months
ROA	Audited reports / PFI reports	Every six months
ROE	Audited reports / PFI reports	Every six months
Admin.exp. and loan loss provisions) as a % of the average loan portfolio	Audited reports / PFI reports	Every six months

Additional Annex 16: Results of the Pilot Project
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Moldova
Rural Investment and Services Project
Progress of Pilot Activity (at December 31, 2001)

1. Pilot Rural Advisory Services Component

Pilot advisory services were commenced with support of EU TACIS and a PPF. The following table summarizes the actual results of the pilot program:

Activities	No.
Number of Active Service Providers (SPs)	9*
Number of Judets Served	10
Number of First Stage Consultations (verbal) Provided	12,700
Number of Second Stage Consultation (written) Provided	1,096
Number of On-site Visits & Participants	841 / 3,725
Number of Round-table meetings and Participants	133 / 1,494
Number of Seminars held for Beneficiaries	165 / 3,288
Number of Actual Clients Served	22,303

* As of April 15, 2002, 17 Service providers have already been contracted.

Others: an operational manual and component implementation plan are in place and selection procedures, ex ante and ex post analysis of quality of services provided have been tested. The monitoring system has been established including a standard format for quarterly progress reporting to IDA.

2. Pilot Rural Business Development Support Services Component

Pilot rural business development support services have started with support of SOROS and a PPF. The following table summarizes the actual results of the pilot program:

Activities	No.
Number of Business Development NGOs	3
Number of Villages Served	123
Number of Registered Business Entities (Groups)	46
Number of Registered Business Entities (Individuals	5
Total Number of Legally Registered Business Entities	51
Number of Business Plans Developed	39
Number of Loans Applications prepared	19
Number of Loan Applications Approved	4

Others: An operational manual and a component implementation plan are in place; concrete results (in the

forms of private rural business actually registered) demonstrate the need and high demand for this type of support services program. Ex-ante and ex-post analysis systems of quality of services, including a monitoring system with a standard format for quarterly progress reporting are in place.

3. Pilot Rural Finance Component

Pilot credit line operations have begun during the second half of 2001 with four commercial banks and RFP as participating financial institutions. As of end March 2002:

- PFIs have approved a total of 20 subloans (over $300,000), and the pipelines include about 60 pending subloans (for about US$1.1 million);
- Of which 51 are for the special credit line support the first time individual and group borrowers;
- The average special credit line subloan is about $16,000 (mostly group loans) while the average general credit line subloan is about $27,000 (made to individual borrowers with adequate collateral);
- Average loan duration is 48 months;
- Average interest rate is around 22% for MDL loans;
- Types of economic activities supported include agricultural production, dairy, small-scale dairy processing, grain mills, tractors, a mechanization services cooperative, and other equipment;
- Demand for credit to support agriculture and processing activities appears to be high;
- Non-agricultural activities, such as tailoring, sewing, bakery, small-scale market infrastructure, information equipment, etc. are also being supported; and
- Demand for non-agricultural activities exists but is relatively smaller than those directly linked to agricultural sector.

PFI and portfolio monitoring will take place regularly. The National Bank, which is represented on the project Steering Committee, will issue a written confirmation semi-annually reconfirming the full compliance of PFIs with the eligibility criteria. The Technical Unit, already functioning for over five years with a commendable track record, will continue to collect pertinent information on PFIs and will convey to IDA independent verifications that each PFI fully meets the eligibility criteria.

Additional Annex 17: Overview of Banking Sector and Assessment of Potential Participating Financial Institutions
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Banking Supervision – Moldova's Achievement of International Standards

In 1991, Moldova committed itself to economic reform and has led among the other CIS countries in and transition to a market economy. With strong support from the IMF and other international organizations, the banking sector moved quickly toward international standards.

Progress over the first decade:

- 1991 Creation of the NBM as an autonomous legal entity, responsible only to the country's Parliament, resulting in an effective two-tier system. The NBM provides regulatory and supervisory control over commercial banks, and monetary policy;
- 1993 successful introduction of the Moldova lei. Today, the Moldovan lei is fully convertible, repatriatable, and has enjoyed relative stability;
- 1995 Law on Financial Institutions – provides a legal and regulatory base patterned after international standards, including key measures such as minimum capital requirements, mime liquidity, deposit-to-capital ratio, single exposure to single client group, and foreign exchange exposure. In some cases, Moldova has set stricter standards than Basle, such as the critical minimum capital, set at 12% reflecting the Basle recommendation for emerging markets, rather than the Basle minimum of 8%;
- 1996 banks moved to electronic clearing and connected to the SWIFT;
- 1997 beginning of annual on-site examinations of each bank, assigning a CAMEL rating, with the Bank Resolution Unit following up with weak banks; and
- 1998 New accounting standards for banks, approaching IAS.

In late 1998, the stability of the banking system was tested by the Russian economic crisis. However, the Moldovan banking sector had the depth to survive the crisis without any major bank collapse. The progress and stability of the sector was validated the following year by the World Bank in a comprehensive study. Attachment 1 is two summary tables from the study confirming the progress made. (Banking Sector Note, Moldova. Prepared by Sonia Bratanovic, Vince Polizatto, Hennie van Greuning, Robert Keppler, Michael Pomerleano; work concluded February 1999. Tables: Adherence to Principles for Effective Banking Supervision; Robust Banking Sector Indicators).

Development of the of the banking sector in Moldova over the last four years is characterized by the following data:

Table 1. Overall Growth of the Banking Sector in Moldova, in millions MD Lei

	12/31/98	12/31/99	12/31/00	12/31/01
Number of Banks	23	23	20	19
Total Assets	2,660.9	3,201.3	4,665.1	5,915.3
Total Capital	737.3	925.3	1,428.2	1,593.6
Total Loan Portfolio	1,771.4	1,597.6	1,635.7	3,154.8
Total Provisions	350.8	298.0	264.8	232.2
Total Deposits	1,047.7	1,587.7	2,314.3	3,437.0
Incl. From Private Individuals	474.9	617.5	888.9	1,665.1
Exchange Rate to US$, EOP	8.32	11.59	12.38	13.09

In addition to an adequate foundation of law, regulation, and supervision, there are other factors that contribute to continued growth and stability of the banking sector:

- The Moldovan banks derive the bulk of their profit from interest and fee income from traditional banking activity. Lending accounts for 53.3% of total banking assets. (Table 1 above);
- Loan portfolios and banks' lending practices are seasoned: Loss Provisions, based on Basle principles and confirmed by NBM on-site examinations and independent IAS audits by major accounting firms, decreased from 11.5% of total loans at year-end 2000 to 7.4% at year-end 2001;
- Lending skills have been sharpened in part by various credit lines from a number of donor organizations, usually including technical assistance and training. Lines varied from EBRD's micro-lending to IBRD's middle-market PSD1. The banks' prior training in lending has been apparent to the RISP team during the PPF;
- Transparency – banks publicly disclose operating results monthly on National Accounting Standards which approximate IAS; and
- There is healthy competition among banks for a diversity of individual and commercial clients.

The NBM has also a significant role in the general macroeconomic reforms, including the decreasing inflation rate, which dropped to 6.3% in 2001. With inflation and lending rates decreasing, total lending almost doubled from year-end 2000 (Table 1 above). The imminent passage in 2002 of Civil Code (mandated by IMF and World Bank as condition for continued lending), will be the next milestone in improving the business climate and lending to businesses.

While the number of credit lines and investments in banks by the international community is a positive sign, confidence in system is best illustrated by the nation's citizenry which increased deposits 48% in 2001, with deposits by individuals growing 87%.

Regulatory Increases in Minimum Capital

Banks receive one of three levels of licenses based primarily on a minimum regulatory capital. The smaller banks with a license A can operate only in domestic currency. Banks with B or C licenses can conduct international operations dealing in foreign currencies. Banks with C license may also engage in capital market and trust operations.

To strengthen the banking sector (with the support of IMF and the Bank) the NBM began a series of increases in the minimum capital requirements for each license, culminating on January 1, 2001 with the capital requirements in effect today. The regulatory increases had the desired effect, as the capital doubled over the past three years, to over $100 million sector-wide.

Capital requirements for licenses A, B, and C. As of January 1, 2000, the minimum capital requirements were MDL 24 million, MDL 32 million, and MDL 48 million, for type A, B, and C license respectively. As of July 1, 2000, the NBM effectively increased the minimum capital required by 50%, to MDL 36 million (type A license), MDL 48 million (B license), and MDL 72 million (type C license). The minimum capital requirements were further strengthened as of January 1, 2001 (a 100% increase from the January 1, 2000), when they reached MDL 48 million for A license banks, MDL 64 million for B license banks, and MDL 96 million for license C banks.

The higher capital requirements were not easy for all banks to achieve. Fincombank and Universal Bank, both potential candidates for RISP, have had difficulty achieving a B class license necessary for participation.

Challenge to NBM Authority. Following a court litigation proceeding of one of the commercial banks versus the NBM (the NBM won the case), an amendment to the Law on Financial Institutions Act was proposed in early 2002 which would allow the court to instruct the NBM to return the license. This serious infringement on the authority and autonomy of the NBM was immediately challenged by the World Bank and the IMF, and remains unresolved at the time of this paper. Representatives of the GOM reassured the IMF in its mission early in 2002 that it opposes the amendment.

Composition of the Banking Sector

Attachment 2 , "Moldovan Bank Statistics, 2001," lists all 19 commercial banks in Moldova, ranked by capital and identifying their corresponding license. Most of the banks were established between 1989 and 1994, and all are predominantly privately owned, with the exception of the savings bank (Banca de Economii).

Top Tier: The four largest banks (in both total assets and total capital) carry C-licenses and are the first four banks participating in RISP under the PPF. These four banks account for 60% of the total banking assets in the sector, and 64% of the total lending. Three of them were former state banks, privatized in 1994-1995 (AgroIndbank, Banca Sociala, Moldinconbank). Number one, Agroindbank is easily the largest, with 25% of all banking assets in the nation and 25% of all lending, it is also twice the size as number two, Victoria Bank. Of the four, only Victoria Bank was charted with new capital.

Two more banks may soon achieve a C-License: Banca de Economii, the fifth largest in total assets, and sole remaining state savings bank, almost doubled its capital between 2000 and 2001, just exceeding the 100 million lei (approx. US$7.5 million) mark. Also breaking the 100 million lei mark is Mobiasbanca, a private bank exceptionally well capitalized with less than half of the assets of the other C-license banks. Along with Victoria Bank, Mobiasbanca is the only other bank in the top six that was not originally a state bank. The two banks achieved prominence largely by focusing on exporters and emerging private enterprises, with substantial deposits in foreign exchange.

Middle Tier: The next eight B-license banks constitute a distinct second-tier. Each has capital of $5 to $6 million and assets between US$8 to $15 million. These banks generally are large enough to have multi-branch systems; and with licenses that permit them to conduct business in foreign exchange, they do provide effective competition to the top-tier. Three or four of these B-licensed banks will be considered for participation in RISP after the 2001 audits are received. (For more on RISP participating banks, see below "Selection and Monitoring of PFIs")

Bottom Tier: The remaining four banks, with A-licenses, constitute the bottom tier. Licensed to conduct business only in lei, their influence on the banking sector is insignificant, both in terms of lending and mobilization of deposits.

Foreign banks: There are no restrictions on establishment of foreign banks or branches in Moldova. Four foreign banks (Banca Comerciala Romana, Bancoop of Romania, Banca Turco-Romana of Turkey, and the Commercial bank of Greece) have established subsidiaries in the country.

Foreign Ownership: A number of banks in Moldova have foreign shareholders. The largest foreign

investors are the EBRD, the Banca Comerciala Romana, Bancoop of Romania (this bank has gone bankrupt), and Lukoil (a Russian oil business).

Lending to Agriculture

The share of the agricultural portfolio is relatively large in the total portfolio of banks. As of end-February 2002, the total lending to agricultural production and processing amounted to MDL 860.7 million (US$ 63.7 million equivalent) or about 30 percent of the total lending by banks. As the enclosed Table 2 shows, the share of agricultural lending has been stable in the overall loan portfolio of the commercial banking sector, at around 30%. The major part of agriculture-related credits is granted to the processing industry and to input suppliers, whilst credit to primary agricultural producers is very small and mostly provided to larger production units. The small emerging individual private farmers have practically no access to credit from commercial banks.

Table 2. Lending to Agriculture (Production and Processing) by Commercial banks, in millions MD Lei

	12/31/98	12/31/99	12/31/00	03/31/01	06/30/01	09/30/01	12/31/01	02/28/02
Total Loan Portfolio	1,771.4	1,597.6	2,283.7	2,379.2	2,563.0	2,826.2	3,154.8	3,124.8
Lending to Agriculture	446.1	444.3	662.8	689.9	710.7	781.4	850.6	860.7
As a % of Total Portfolio	25	28	29	29	28	28	27	28

Selection and Monitoring of Participating Financial Institutions

Careful attention has been given to the initial selection of Participating Financial Institutions (PFIs) for RISP, and to the procedures for monitoring eligibility of PFIs and for considering new candidate PFIs.

Eligibility Criteria and Initial Selection of PFIs

The specific eligibility criteria of PFIs have been included in the Rural Credit Guidelines (attached to the Negotiations minutes) and Annex 2.

Initial eligibility criteria were established in conformity with the Bank's OP8.30. Criteria under RISP is expressly set forth in the Rural Credit Guidelines, and include: General Standards (overall compliance with banking rules and regulations, annual IAS audit), Financial Standards (e.g. standards for capital, liquidity, loan loss provisioning, and profitability), and Managerial Standards (governance, internal controls, policies and procedures, information systems). The criteria used for RISP is similar to the criteria used for the nearly completed First Private Sector Development credit line (PSD1).

The establishing and monitoring of financial criteria are simplified by the significant progress of reform in the Moldovan banking sector. The norms set by the National Bank of Moldova (NBM), as well as the procedures for off-site and on-site monitoring of compliance, were patterned after Basle principles. Without exception, the financial standards imposed by the NBM are consistent with Bank & ECA guidelines. In the critical case of Minimum Capital, it should be noted that the NBM standard of 12% exceeds the Basle minimum of 8% reflecting instead the Basle (and Bank) recommendation for emerging markets.

Rural Focus: In addition to the general Bank and ECA guidelines, candidate FIs for participation in RISP must also have adequate presence and lending potential in rural communities. This eliminates a number of banks that would otherwise be viable, but which operate primarily in the city centers. To promote more lending in rural areas, the RISP team seeks to foster interest by other banks and will consider additional banks for participation (current candidates discussed in next section).

Skills Capacity: Beyond organizational and financial stability and capacity, all PFIs must demonstrate a commitment to lending and a capacity for sound lending. Moldovan banks have already demonstrated their capacity through successfully implementation of credit lines from donor organizations. All four of the commercial banks currently participating in the RISP Project Preparation Facility (PPF), as well as the two banks seeking participation, have previously implemented credit lines from donors such as IFC, EBRD, and IBRD, including the recently concluded PSD1. Donor credit lines cover a range from micro-lending (EBRD) to middle-market lending (PSD1), and virtually all were supported by technical assistance.

RISP team members have visited each bank on multiple occasions, and are satisfied with their capacity in skills and procedures. All project potential PFI submits a questionnaire on annual basis for monitoring purposes to the IDA team (these questionnaires are available on project file). Initial subprojects submitted under the PPF confirm reasonable credit analysis and structuring.

Financial Institutions Participating under the Project Preparation Facility

The chart Moldovan Bank Statistics, Dec. 31, 2002 (Annex 2), lists all 19 private banks in Moldova. The four largest banks, holding all four of the "C" licenses, are all participating in the PPF. Presently, no banks with "B" licenses (which permit dealings in foreign currencies and trade) are participating in the PPF, but two or three candidates will be considered when 2001 audits are available. Many "B" license banks do not have adequate presence and commitment to rural development (some banks eliminated from RISP did participate in PSD1). The four or five smallest banks with "A" licenses can not participate because an "A" license does not allow dealings in foreign currency.

RISP has begun under the PPF with the four largest commercial banks – **Moldova Agroindbank, Victoria Bank, Moldinconbank, Banca Sociala** – plus a non-bank, the **Rural Finance Corporation**. As noted above, the capacity of the banks to analyze and structure credits is acceptable, as all have extensive loan portfolios using their own funds and funds from other donor credit lines. 12 projects have been submitted by three PFIs – Moldinconbank (6 loans), Victoria Bank (3), and the Rural Finance Corporation (3). All loans are relatively small ($5,000 - $25,000; one is for $60,000), all are in rural areas benefiting rural economic development, and all are reasonably structured. Banca Sociala and Moldova AgroindBank, while expressing commitment, have yet to submit their initial projects.

Rural Finance Corporation: The RFC is a non-bank institution set up by the IDA initially to provide an intermediary to on-lend funds to the new Savings and Credit Associations. Along with the maturing of some SCAs and their members, RFC has also matured, and supported with TA has developed the capacity for direct lending. RFC submitted and has funded the first three loans under the PPF, and has a pipeline of over 40 subloans. RFC expects a capital injection from another donor organization (CNFA) later in 2002, and under RISP, will receive additional technical assistance and strengthening in capacity. With its extensive roots in the rural sector, RFC is a catalyst for small rural lending, and the best fit for IDA poverty alleviation.

Potential Candidate Banks

Two commercial banks – **Fincombank, Universalbank** – have formally requested participation, and will be measured against the eligibility criteria after the 2001 audits are available. Neither is a certain addition, as both have had difficulty achieving the higher capital requirements set by the NBM for B-license. The 2001 audit on Fincombank reveals a slight shortfall, while the February 2002 statement on Universalbank reveals a substantial drop in its equity to well below the B-license minimum. Capital, while perhaps the most important, is only one criteria. Fincombank, which should achieve the proper equity from retained earnings in as little as two or three months, may be eligible under IDA Guidelines to be participate on a probation basis, with a written plan for institutional strengthening. Universal is likely to be deferred indefinitely. Two other banks – **Eximbank and Unibank** – both B-license banks with adequate capital, have expressed interest and will be considered after review of their 2001 audits.

Monitoring PFI Eligibility

In accordance with Bank and ECA standards, all PFIs are monitored at least semi-annually for continued eligibility. ***Formal review of RISP PFIs will be conducted in April and May, following receipt of 2001 annual audits and management letters.***

Monitoring financial standards in Moldova is not difficult given that the eligibility criteria is defined in terms of NBM regulations, and the NBM is cooperative in confirming and reporting when banks are or are not in compliance with NBM standards. Financial monitoring is also facilitated by the relatively good accounting standards required of banks, approaching IAS, and the high degree of disclosure. All banks report financial results publicly monthly.

The Technical Unit (TU), which was set up under the PSD 1 as a bank-monitoring agency, had the responsibility of collecting periodical information on the financial and operational status of the banks for further analysis by the TU and IDA. The TU, which has been relocated to the Ministry of Finance as a separate unit, will continue functioning under the RISP, in close cooperation with IDA team. IDA team members will proactively address all findings of the accounting firms (including the Management Letters) and the NBM with the management of the banks, and focus attention on the practices, policies, and capabilities in their lending departments.

Attachment 1

Adherence to Principles for Effective Banking Supervision

	Score	Indicator
I. Licensing and Structure	S	• Controlled use of word "bank"
	S	• Permissible activities licensed and subject to supervision
	S	• Authority to set criteria for licensing
	S	• Authority to reject for not meeting standards
	S	• Licensing process includes assessment of ownership structure, directors, business plan, projected financial condition, capital base
	PS	• Operating license includes assessment of premises, management, procedures, internal controls and mgmt. information systems
	S	• Authority to review and reject proposals to transfer significant ownership
	PS	• Authority to review major acquisition or investments by banks
	PS	• Authority to effectively force exit if safety standards not met
II. Prudential Regulations	PS	• Minimum capital requirements
	S	• Capital adequacy rules
	PS	• Asset classification, loss provisions and reserves
	PS	• Limits to exposure to single borrowers/related groups
	PS	• Portfolio concentration
	S	• Limits and control of lending to affiliated parties
	PS	• Limits to currency risk exposure
	U	• Limits and capital charge on market risk
	PS	• Rules on internal controls, incl. separation of functions/delegation of authority
	S	• Promote high ethical and professional standards
III. Effective Use of Supervisory Powers	S	• Impose corrective actions when a bank fails to meet prudential requirements
	PS	• Issue cease and desist orders
	S	• Impose fines
	PS	• Replace board members and management
	S	• Initiate receivership
IV. Methods of Supervision	PS	• Independent evaluation of policies/procedures/practices for evaluating asset quality and adequacy of loss provision and reserves
	PS	• Independent evaluation of policies/procedures/practices for granting loans
	S	• Independent evaluation of lending and advances to connected parties
	PS	• Independent assessment of banks' risk management process
	S	• Regular contact with banks management
	PS	• Collection and review of prudential reports and statistical returns on an individual and group basis
	PS	• Effective analysis and use of collected information
	S	• Capacity to validate information through on-site analysis
	S	• Obligatory external audits of banks

FS - Fully Satisfactory; S - Satisfactory; PS - Partially Satisfactory;
U – Unsatisfactory; HU - Highly Unsatisfactory; NA – Not Applicable

Attachment 2

Robust Banking System Indicators

Category	Score	Indicator
Market Structure	S	• Open to qualified new entrants, including from abroad
	U	• Share of foreign participants in total assets
	PS	• Financial sector concentration ratios
	HU	• Liquid inter-bank money and capital markets
	S	• Regulations permit full range of financial instruments
	PS	• Sound/effective payment and settlement systems
	S	• Share of banking system assets held by public sector financial institutions
	PS	• Effectively enforceable exit
Supervisory/Regulatory Authority	PS	• Independent from political interference
		• Power to force disclosure, impose penalty, impose corrective actions
	S	• in principle
	PS	• in practice
		• Adequate off-and on-site supervision resources
	PS	• Conducts supervision on a consolidated basis
	S	• Verification of information on risk management and internal control systems and on asset quality by regular examinations or external audits
	PS	• Adherence to norms established by international consultative bodies (BIS, etc):
		• in principle
	S	• in practice
	PS	• Measures to address particular types of risks:
		• Evaluation of risk management systems
		• Connected lending
	PS	• Risk exposure and loan concentration
	S	• Special attention to foreign currency/interest rate risk management and exposures
	PS	• Scrutiny of asset quality/capital adequacy in face of sharp asset price movements
	U	• Strategy for addressing financial insolvency:
		• Prompt corrective actions effectively enforced
	U	• Effective exit policy in principle and practice
	PS	
	PS	
Design of the Safety Net	NA	• Explicit deposit insurance paid for by banks
	PS	• Appropriate allocation of losses among stakeholders
	PS	• Stringent conditionality for the use of public money
Stakeholder Oversight/Governance and Institutional Capacity	PS	• Capital adequacy requirements commensurate with risk
	PS	• Effective screening of ownership
	U	• Adequate oversight/governance by boards.
	U	• Replacement of management for poor performance/enforceable financial liability
		• Adequate institutional capacity, including for risk management
		• Pervasive use of effective systems of risk management and internal control
	U	
	U	
Legal and Juridical Framework	PS	• Well-defined property rights/contract law
	U	• Market contracts easily enforceable in practice
	PS	• Ability to pledge and seize collateral
	U	• Well-developed bankruptcy code
Accounting, Disclosure and Transparency	PS	• Loan valuation/asset classification/provision practices reflecting sound risk assessment
	PS	• Regular (FS) and effective (PS) external auditing mechanism
	HU	• Information on banks' creditworthiness publicly available on a regular, frequent basis
	U	• Timely publication of relevant aggregate financial data (macroeconomic indicators, reserves, banking sector statistics, etc.)
	HU	• Availability of impartial credit-rating/credit information facilities

FS - Fully Satisfactory; S - Satisfactory; PS - Partially Satisfactory;
U – Unsatisfactory; HU - Highly Unsatisfactory; NA – Not Applicable

Attachment 3

Summary of the Project PFIs
(For information on RFC, please see Annexes 5 and 19)

Agroindbank - Moldova

Ranking*:	1st largest bank in Moldova
Established:	May 1991
Type of license:	C
Operational modalities:	Operates as a commercial and savings bank performing a wide range of services and addressing all categories of customers
Branches:	43, of which 5 in Chisinau and 38 in regions
Lending Staff:	196, of which 137 in rural areas
Ownership:	100% private; approx. 20% foreign investors, the remaining 80% are held by companies and private individuals, about 4,000
Experience in working with international organizations:	♦ EBRD - credit lines of US$ 25.7 million and DEM 12.5 million, including a convertible option credit line of US$ 8 million ♦ CNFA credit line of US$ 1.2 million
Remarks:	A former state-owned bank..

Victoriabank

Ranking*:	2nd largest bank in Moldova
Established:	1989
Type of license:	C
Operational modalities:	Main focus is corporate banking, and the bank focuses on private sector companies, mainly micro- and SMEs, involved in trading and export-oriented manufacturing
Branches:	12, of which 4 in Chisinau and 8 in regions
Lending Staff:	25, of which 10 in regions
Ownership:	100% private ownership, 57% of shareholding held by foreign investors
Experience in working with international organizations:	♦ EBRD - credit lines of US$ 5 million ♦ WB - creditlines of US$ 2.27 million and DEM 2.87 million ♦ In addition, the bank has received credit lines from private commercial banks, in amount of EUR 1.36 million and US$ 10 million
Remarks:	Established as one of the first commercial bank established in the FSU. 1998 has been named by the Central European Magazine as the best bank in Moldova.

Banca Sociala

Ranking*:	3rd largest bank in Moldova
Established:	April 1991
Type of license:	C
Operational modalities:	Operates as a commercial and savings bank performing a wide range of services and addressing all categories of customers
Branches:	19, of which 4 in Chisinau and 15 in regions
Lending Staff:	77, of which 31 in regions
Ownership:	100% privately owned, with approx. 70% of shareholding held by private farms, and the remaining 30% - by private individuals.
Experience in working with international organizations:	♦ WB credit line of US$ 1.60 million and DEM 2.78 million
Remarks:	A former state-owned bank.

Moldinconbank

Ranking*:	4th largest bank in Moldova
Established:	October 1991
Type of license:	C
Operational modalities:	Operates as a commercial and savings bank through the network of branches
Branches:	19, of which 6 in Chisinau and 13 in regions
Lending Staff:	55, of which 19 in rural areas
Ownership:	100% privately owned, with approx. 970 shareholders, mixed companies and private individuals
Experience in working with international organizations:	♦ WB creditline under PSD ♦ EBRD trade financing facility of US$ 1.5 million and a micro-credit program ♦ IFC credit line of US$ 1.5 million
Remarks:	A former state-owned bank.

Additional Annex 18: Overview of the Savings and Credit Association Development
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Background

1. A pilot initiative for the creation of Savings and Credit Associations (SCAs) was started in early 1997. FIDES, an international NGO that specializes in micro-finance, provided the initial training and advice, under an agreement with GOM, the National Bank and the World Bank, with financing from various donors, including the Dutch Government, Women's World Banking, the Soros Foundation and others. The German GTZ joined the program from March 1998 with a substantial financial contribution.

2. In the spring of 1997, FIDES established 11 SCAs and provided loans to about 400 of their members for a total amount of US$ 180,000 equivalent. By the end of that year, an additional 12 SCAs were organized and had received training and support from FIDES.

The Rural Finance Project

3. Building on the experience gained from the pilot initiative, an IDA Project (LIL) with a Credit of US$ 5.0 million (SDR 3.7 million) was prepared, appraised at the end of 1997 and approved in January 1998, preceded by a PPF and by a PHRD grant to support the activities started under the pilot initiative.

4. The Project's objectives included: (a) the development of SCAs though technical assistance and training by an NGO acceptable to IDA; (b) the establishment of a regulatory body for the SCAs, and (c) the establishment of the Rural Finance Corporation (RFC), a non-bank financial institution to on-lend funds provided under the Project to legally established and licensed SCAs.

The Legal Framework for SCAs

5. The creation and operation of SCAs are governed by the "Law on Savings and Credit Associations of Citizens" adopted by Parliament in February 1998 and by the Financial Prudential Rules for SCAs based on a decision of GOM of September 1998. The principal features of the legal framework are as follows: (a) The minimum number of members of an SCA is 10; (b) SCAs do not distribute dividends in cash to their members and all net profits are transferred to reserves; (c) The maximum amount of loans to one member cannot exceed 10 percent of the total amount of outstanding loans; (d) The SCA has to create a loan insurance reserve fund, deposited in an account in a commercial bank, equal to not less than 6 percent of the amount of outstanding short-term loans and 8 percent of outstanding long-term loans.

6. Loans by SCAs to their members are unsecured and the legal framework does not provide for a mutual guarantee of members. It does not permit lending in excess of the limit mentioned in para. 5 (c) unless the loan is secured by collateral provided by the borrowing member.

7. The State Supervisory Service (Board) created by GOM pursuant to the Law on SCAs supervises the operations of SCA and is the authority to issue, suspend or cancel the licenses of SCAs.

Creation of Savings and Credit Associations

8. By March 2001, about four years after the establishment of the first SCA, the total number of SCAs was close to 300, of which about 290 are functioning; about 10 licenses have been suspended or cancelled,

generally because of violation of the prudential rules. The total number of members is nearing 26,000. It is worth noting that about 200 SCAs were created and licensed in the last two years, 1999 and 2000.

9. Two NGOs, The Moldovan Microfinance Alliance (MMA), and the Rural Development Center (RDC) are actively engaged in the creation of SCAs including the initial training of members and elected bodies, and the provision of post-creation technical assistance and advice in management, accounting and other fields related to the activities of SCAs. Both NGOs are donor-financed. MMA, which continued the activities started by FIDES, is financed by GTZ, Open Society Institute, Women's World Banking, the Soros Foundation and others. RDC, established by RFC, and spun off in 1999, is financed by CNFA.

Financing of SCAs

10. The Rural Finance Corporation (RFC) created under the First Rural Finance Project (see para 4 above) was established in late 1997 and started lending to SCAs under the Project in February 1998. It is currently the principal financing source for SCAs, providing, with Project funds, about 70 percent of total SCA financing. (see para 13 below)

11. A positive development which was not envisaged in the original Project design, was the participation of two commercial banks, at their own initiative and with their own resources, in the financing of the SCA system.

12. Agroindbank, the leading Moldovan commercial bank, started financing of SCAs in 1998 and in 1999, Agrindbank financed 58 SCAs with a total amount of MDL 6.5 million and its market share increased significantly in 2000, providing loans totaling about MDL 15.0 million to 120 SCAs. Lending terms and interest rates are equal or similar to those of RFC.

13. The other commercial bank that started to finance SCAs was Fincombank, which provided loans to 17 SCAs in 1998, based on a guarantee agreement with Austria's Raiffeisenbank and the Open Society Institute, which covered 80 percent of the lending risks. Although portfolio performance was satisfactory, Fincombank discontinued its participation in 1999.

Rural Finance Corporation (RFC)

14. As mentioned in para 4 above, the Rural Finance Corporation was created at the end of 1997 under the first IDA financed Rural Finance Project to channel Project funds to the SCA system. RFC is a non-bank financial institution, registered under the law as an open joint stock company. Currently GOM still holds about 16 percent of voting shares; the remaining shares are held by SCAs. To become eligible for borrowing from RFC, each SCA has to purchase no less than 4 shares costing MDL 50 each. Total paid up share capital as of December 31, 2001 was MDL 234,800 (equivalent to about US$ 18,000). An assumption, included in the Project design, that each SCA would invest US$ 500 in the share capital of RFC did not materialize.

15. Loans to SCAs by RFC are financed from the Credit under the Rural Finance Project. The first US$ 2.0 million equivalent were on-lent by GOM to RFC as a subordinated loan, repayable over 35 years including a 10-year grace period, bearing IDA interest rate of 0.75 percent per annum. The remaining Credit funds are repayable over 20 years, including a grace period of five years. The current interest rate, payable to the Ministry of Finance on this portion of the loan is 19 percent per annum.

16. Lending operations by RFC to SCAs started in February 1998 and during that year total sub-loan

disbursements amounted to about MDL 3.0 million for 29 SCAs with a total membership of 1,437. Lending grew rapidly in 1999 to about MDL 10.0 million for 95 SCAs and further accelerated in 2000 when total lending amounted to about MDL 30.0 million to 159 SCAs with a total membership of about 14,500. Lending in 2001 is projected at about MDL 56.0 million for about 205 SCAs with 21,000 members. By end-2001, sub-loan disbursements were about MDL 51.1 million for 200 SCAs. Loans to SCA are short-term, for a period up to one year, generally repayable in January. Accounts indicate that many loans are repaid before the agreed maturity date.

17. Currently, interest rates charged by RFC to SCAs are 24 percent, based on the interest rate of 19 percent payable by RFC on the subsidiary loan from MOF plus a margin of 5 percent for RFC. SCAs add between 4 to 5 percent to the rate payable to RFC, charging ultimate beneficiaries up to 30 percent per annum. Loan repayment to RFC is satisfactory; however, there have been minor defaults in on-time repayment of loans by members to SCAs.

18. RFC audited financial statements for December 31, 2000 show an outstanding short-term loan portfolio of about MDL 13.5 million, liquid assets of MDL 22.5 million and total assets of MDL 36.6 million. However, given the seasonality in lending, it should be noted that the amount of the outstanding short-term loan portfolio grew from MDL 9.4 million in January 2000 to a peak of MDL 30.3 million in June 2000, and gradually declined, because of loan repayments, to MDL 13.5 million by December 2000. This explains the large balance of liquid assets at end-year. By the end of March, 2001, the outstanding loan balance had already grown to MDL 47.0 million and to MDL 51.0 million by mid-April. Because of the interest-free subordinated loan, mentioned above, profitability of RFC is high and accumulated retained earnings, net of taxes, amount to MDL 4.7 million.

Prudential Rules for Lending to SCAs

19. The current prudential rules for lending to SCAs are briefly summarized below. To be eligible for borrowing, the following requirements must be met inter alia by the SCA.

(a) The SCA is registered with the Ministry of Justice and has a state registration certificate.
(b) The SCA has the respective activity license from the State Supervisory Service.
(c) The SCA strictly observes the prudential rules established for SCAs concerning the capital adequacy, liquidity, balance of maturities of assets and liabilities, risk sharing ratios, provisioning at the moment the loans are received, and guarantees observance of these rules during the entire period of the loan.
(d) The SCA has received a minimum training from MMA, RFC, or any other non-governmental organization acceptable to International Development Association.
(e) The SCA has an office with minimum necessary equipment.
(f) The SCA keeps accounting records according to established standards.
(g) The loan application and other documents are prepared in conformity to RFC standards.
(h) The SCA guarantees submission of all information requested by RFC at any moment.
(i) The SCA guarantees free access of authorized RFC staff to the SCA's records at all times.

20. The average loan amount per member lent by RFC to an SCA cannot exceed MDL 2,500 in the first year of operation of the SCA, MDL 3,500 in the second year, MDL 4,500 in the third year and MDL 5,500 thereafter. The maximum loan amount cannot exceed MDL 15,000 for an individual member and MDL 21,000 for a family. Members who have not repaid their loans on time shall not be eligible for borrowing in the following year. An SCA cannot be granted new loans before full repayment of any existing loans. The total amount of loans to one SCA shall not exceed 10 percent of the total RFC loan

portfolio.

Mobilization of Savings by SCAs

21. Since inception, insufficient attention has been paid by the NGO engaged in the creation and development of the SCA system, by the National Federation of SCAs or by RFC to promote the mobilization of savings or to link financing to the internal generation of resources. Only some 25 SCAs have started to attract savings from members and the total balance of savings mobilized by December 31, 2000 was about MDL 170,000 equivalent to US$ 13,000 or 0.3 percent of the amount borrowed by SCAs from financial institutions in 2000. However, the total equity of 293 SCAs at end of 2000 amounted to MDL 9.3 million, equivalent to 20 percent of borrowings.

Financing of SCA System under RISP

22. The SCA system is growing and additional financing will be required for the new SCAs to be established after 2001 and for new members joining existing SCAs.

23. Under the proposed micro-finance component of the Project, funds will be allocated for the SCA system. However, major emphasis will be placed on savings mobilization and shared financing between SCAs and lending institutions. Project funds will be made available to any eligible PFI interested and willing to participate in the financing of SCAs.

24. In addition to the provision of financing, the Project will focus on the strengthening of the State Supervisory Service (SSB) to ensure that SCAs strictly comply with all existing rules and regulations and to safeguard the rights of depositors. The number of staff of SSB will increase, intensive training and technical assistance will be provided and provisions will be made that would ensure regular on-site inspections of SCAs at least once every two years.

Additional Annex 19: Summary of Social Assessment
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Background

Two quantitative surveys and one qualitative social assessment (SA) were completed as part of project preparation, by a Team consisting of Moldovan NGO members led by the Team Director, Vasile Munteanu, under the supervision of the World Bank Social Scientist, Hermine G. De Soto. Stakeholders were surveyed extensively during a GAP Study of, primarily, a rural support services component (December 1998/January 1999), and were consulted again during the Social Assessment (May-August 2000) and the Baseline Farm Survey (October-November 2000).

The SA was conducted to help project managers develop the project to fit the needs of local rural residents in the project area, thereby increasing returns on investment and enhancing sustainability. The SA aimed to understand and express the needs, aspirations, and social and economic constraints and opportunities of rural people in Moldova, including levels and sources of income, living standards, consumption patterns, access to goods and services, as well as standard social and demographic characteristics.

This annex discusses the objectives and scope of the SA and the Baseline Survey, the combined findings of the SA and the Baseline Survey and implications for the project.

Social Assessment

Two research methods were used to gather data to answer the questions:

i) Focus Groups: A total of 120 rural inhabitants participated in the focus groups. Focus group discussions provided qualitative information on agricultural information flow, demographics, and social and economic conditions focusing on aspects related to: cultivation patterns, access to markets, costs of and access to agricultural inputs, access to information, income & expenditures, village infrastructure, perception of reforms in the rural areas, and participation.; and

ii) In-Depth Interviews: A total of twenty in-depth interviews were carried out with representatives of the rural population in 10 communities. The questions focused on the perception of reforms, access to information, and communication and information patterns. This methodology was used to gather more input on social aspects and to assess the responsibilities, capabilities and practices of existent groups, their relationships with the rest of the community, and their opinions on the introduction of participatory management practices.

Baseline Survey

The Baseline Survey, which focused on the new reality generated by the ongoing changes in the rural sector, was undertaken as a first step in the development of the agricultural assistance program strategy for Moldova. The survey was conducted in October-November 2000 in 80 rural communities from 14 districts representing all counties ("judets"). The survey covered 350 farm managers and 367 rural households—a total of 717 respondents.

Social Assessment and Baseline Survey Findings

The respondents are faced with several major challenges, such as insufficient income, lack of employment, lack of access to utilities and unpaid salaries. Generally, the majority of respondents perceive living standards as being at or even lower than the subsistence level. According to the Baseline Survey, electricity is practically the only utility that rural households enjoy (98% of respondents). Running water, gas, central heating, sewage, and street lighting are not available in 60-80% of households. Almost all income received from farming (80%) is used for family needs. Regardless of the findings, Moldovan private farmers remain relatively optimistic about the future: 36% expect a definite improvement.

Below is the brief description of the SA findings, as they relate to specific Project Components:

Rural Business Development Component

- Rural population. The sharp difference in land holdings between individual farms (some 500-2000 ha; most 10 ha), corporate farms (100 to 1,000 ha), and rural households (3 ha) is reflected in the fairly strong concentration of land in the largest farms.
- Demand for group formation. All individual respondents consider that a method of acquiring economic stability is land consolidation, which implies group formation.
- Constraints. The main reasons for not changing the status to private farmers are: age and health (65%), shortage of capital (52%), and aversion to risk in a highly uncertain environment.
- Social (Group) Bonds. A very positive finding is that most rural inhabitants understand that they themselves, rather than the state, must solve the problems they face and they are favorably disposed towards joining associations. People are willing to associate if necessary to solve various problems, thus, increasing the degree of cohesion in these communities.
- Summary. Farmers involved in farm organizations enjoy a considerably better economic situation than those farming on their own. Therefore, farmers comprehend the advantages of group formation

Rural Advisory Support Services Component

- Major problems. The SA revealed that the new landowners suffer from lack of information regarding prices, market requirements, access to capital, etc.
- Demand. Farmers are interested in agricultural training and advisory services.
- Access to Markets. Access to markets is the first priority of Moldovan farmers. On average, farms sell more than 40% of their output.
- Constraints. Lack of market information; lack of proper farm machinery and inputs; inadequate harvest, storage, grading, packaging, and processing equipment and facilities; little skills to perform marketing research and investment planning; private owners and neighbors do not normally associate for the purpose of deciding what crop to plant in order to market it together, the main reason being small-scale farming..
- Summary. Small farmers and rural entrepreneurs have virtually no organizations or infrastructure to serve their needs or articulate their interests.

Rural Finance Component

- Credit Experience. In 2000, 40% of farms contracted loans. Larger farms generally report a higher frequency of borrowing and larger loans than smaller farms, and borrowed from financial institutions in the form of trade credit from marketers and suppliers. The smaller individual farms, on the other hand, did not have access to trade credit, but borrowed heavily from informal sources (relatives, friends, and neighbors). Extremely few rural households have experience with

commercial credits. The respondents were fully aware of the importance of loan repayment. Respondents in the survey strongly expressed the need for assistance in preparing business plans and managing farm finances.

- Credit demand. Among farm organizations 70% intend to borrow in the future. Of the farms that borrowed in 2000, 80% expect to continue borrowing in the future, and of the farms that did not borrow in 2000, 65% intend to start borrowing. 80% of respondents reported borrowing for farm inputs and less than 15 % of farms reported borrowing for non-agricultural activities or purchase of capital stock. As for rural households, about 20% of respondents intend to borrow in the future and for 60% out of these 20% borrowing will be a new experience. These future loans will be used mainly to purchase capital assets, finance the working capital, and invest in non-farming activities.

- Constraints. The main obstacles for applying for rural credits are:
  - high interest rates
  - term structure of loans
  - typically small loan size
  - lack of reliable information
  - low evaluation of collateral
  - lack of trust in financial institutions

- Summary. The survey strongly highlighted a number of problems in the countryside and demonstrated that the rural finance component will be beneficial for the rural population. Demand is great among various stakeholders; people are favorably disposed towards using credit for productive purposes, and lending to SCAs using social collaterals is successful, but major gaps remain in the production/consumption cycle. The newly formed farmers' organizations and agribusiness clients lack the credit history normally required by the banks and, therefore, a special credit line and training would be beneficial.

Important conclusion. The SA revealed that the rural population needed to be assisted in various aspects of their agricultural activities in order to succeed. Therefore, all the components of the project should be closely interrelated, filling in the gaps and leading towards strengthening the capacities of the beneficiaries and at the same time towards establishing a strong agricultural infrastructure.

Project Implications

The Social Assessment produced a number of important results that have implications for the project design, many of which have already been incorporated into the project; others will shape the group training and support activities and provide the basis for social monitoring. The implications are discussed in terms of the "four pillars" of social assessment: context and social development issues, stakeholders and participation, institutional analysis and monitoring and evaluation.

I. Social Issues. The components of the project are designed to reduce inequity and social exclusion by increasing social capital, strengthening organizational capacity (by empowering grassroots organizations), and improving governance.

- Organizational Capacity and Social Capital. There are virtually no organizations in Moldova to serve the interests of small farmers and rural entrepreneurs. The creation of small-scale farm organizations and agribusinesses supported by advisory services will strengthen the organizational capacity in rural areas.

- Equity. Inequity has increased in the rural areas with independence, the dissolution of the sovkhoz and kolkhoz, and the transformation and/or collapse of many of the enterprises serving the large farms. The Project will decrease inequity by empowering small farmers to associate and generate higher income; by providing information about market, production, rural credit and agricultural procedures directly to farmers; and by providing access to credit to farmers and entrepreneurs who currently have no access. Access to all project components will be equitable, transparent and consistent, based on well-defined eligibility criteria rather than position and relationships.
- Social Inclusion. The project will significantly increase social inclusion by concentrating specifically on assisting small-scale farmers and rural entrepreneurs. The currently excluded groups will have access to information, training and credits.
- Governance. The group formation and training process will emphasize the importance of group bonds and shared responsibility.
- Gender. Access and use of project components will be monitored for gender differences, and group formation and training programs will be adjusted to meet gender-related demands as they emerge.

II. Stakeholders and Participation. RISP has a number of stakeholders, including individual and group farmers, agribusiness organizations, SCAs, Rural Finance Corporation (RFC), and various officials.

- Primary Stakeholders. RISP primary beneficiary stakeholders are small-scale farmers and agribusinesses, commercial banks, and RFC. Small-scale farmers and agribusinesses directly benefit from the project. As main institutional beneficiaries, RFC and commercial banks will obtain financial resources to operate and technical support to strengthen their capacity to provide credit to farmers and rural entrepreneurs in a manner that is financially sound and sustainable.

- Other Stakeholders. Officials at different levels, from the central government to villages, strongly support project objectives. Other groups, primarily local NGOs will complement the role of the project. Input and machinery suppliers see themselves both as beneficiaries, whose interests are served by increasing the quality and quantity of agricultural production and cash flows in rural areas, and as competitors who currently profit from in-kind seasonal loans to producers. The staff of the regulatory state agencies and lawyers will profit from the project's procedures since they will get direct feedback from the grassroots organizations. Finally, SCAs are likely to increase in number and assume more important roles as the result of project interventions.

- Participation. RISP is a complex project and stakeholders will be participating at various levels and stages. All components of the project are demand-driven; thus, available information to realize the potential demand is crucial. The project participation strategy will consist of five elements, which are described below:
  1. *Remove constraints.*
  2. *Involve agencies/leaders that the rural population trusts.*
  3. *Make information available.*
  4. *Train and mobilize prospective clients.*
  5. *Monitor progress and address emerging issues.*

III. Institutional Analysis. A central goal of the project is to help develop efficient institutions and organizations to sustain project activities at all levels, from the national networks to village groups and individuals, and help improve their governance.

CAPMU will focus on two essential tasks:

- *Develop links to internal and external resources.*
- *Increase institutional capacity.*

RFIs and RFC will become more effective by focusing on the following tasks:

- *Remove internal obstacles; and*
- *Reduce obstacles mentioned by clients.*

The Project will contribute to developing institutional capacity of all stakeholders by:

- Supporting the formation, management and coordination of the viable farmers' groups and new agribusiness enterprises;
- The participation of local NGOs and rural leaders in promoting farmer groups' activities;
- Development of community-driven initiatives to identify priority problems;
- Assisting the beneficiaries to establish legal status thus reducing the restrictive regulatory measures related to markets;
- Providing informational and training support to assist them with the management and the technical skills required to help them carry out their responsibilities;
- Establishment of a market infrastructure from producers to processors and export agencies.

IV. Social Impact Monitoring. Participatory Monitoring of the project's development indicators and feedback from the public and other beneficiaries will be continuous, with progress reports submitted quarterly. Indicators relevant to social development outcomes will include:

- The number of rural businesses created or strengthened and the number of their members;
- The willingness and success of communities in taking responsibility for the rural development systems;
- The measures taken to improve or build agricultural market facilities;
- Beneficiary satisfaction with the agricultural services financed under the project;
- The level of self-financing and long-term sustainability of the services provided under the project;
- The increased/decreased access to other resources, information or opportunities for groups rather than individuals;
- The impact on household income;
- The number of private farmers and rural entrepreneurs that had access to credits and their successful utilization;
- The progress from group to individual lending over time.

Additional Annex 20: GEF Agricultural Pollution Control Project Concept Note
MOLDOVA: RURAL INVESTMENT AND SERVICES PROJECT

Objectives

The overall objective of the Agricultural Pollution Control Project (APCP) is to reduce nutrient (N&P) pollution from agricultural sources in Moldova to the Danube River and Black Sea. In support of this objective, the project will assist the Government of Moldova to: (i) promote the adoption of environmentally-friendly practices in crop and livestock production and in rural agro-industries that contribute to nutrient pollution, including wetland and integrated watershed management; (ii) strengthen national policy, regulatory and institutional capacity for agricultural nutrient pollution control; and (iii) promote a broad public awareness campaign and replication strategy. The Project would be a component of the US$30million IDA-funded Rural Investment and Services Project (RISP) and will mainstream environmental concerns into agricultural practices. The proposed project would also assist the Government of Moldova in harmonizing its legislative framework with relevant European Union (EU) directives and in honoring its international commitments to reduce nutrient loads to the Danube River and Black Sea.

Sector Context and Background

Since independence, Moldova's agricultural sector has undergone significant structural changes. Former collective enterprises and farms have been reorganized into smaller farming associations and private farms. However, the new farmers and owners lack farming experience, technical skills and financial resources for sustainable farm management. The absence of on-farm environmental management is exacerbating the erosion process as well as nutrient runoff into the country's waterbodies. Currently, more than 400,000ha of the private farms and farming associations are moderately or highly degraded. The large cattle, pig and poultry farms have been mostly dismantled, and the majority of livestock is now kept privately in small and medium holdings. However, the continued lack of efficient manure management practices is having significant implications for groundwater pollution and drinking water supply for rural settlements in Moldova. Samples analysed from about 70% of shallow wells which are the main source of drinking water supply for rural communities revealed nitrogen concentrations in excess of the maximum acceptable levels. (UN/ECE. The Republic of Moldova: Environment Performance Review. Geneva, 1998)

Agricultural non-point source nutrient pollution is the most important contributor of water pollution in Moldova. Other sources are inadequately managed municipal and industrial wastewater treatment plants. Nutrient run-off to the rivers stems from: (i) environmentally unsustainable crop and soil management practices; (ii) over-exploitation and illegal cutting of forests, leading to the destruction of forest belts and buffer strips; (iii) inappropriate management, storage and disposal of animal manure and waste; (iv) over-grazing; and (v) mismanagement of wetlands. Soil erosion washes away an estimated 10 million tons of fertile soil annually. From the Prut River basin alone, approximately 12.5 thousand tons of nitrogen and 1.5-2.0 thousand tons of phosphorus are being discharged each year. Annual run-off from manure is estimated at 10.5 thousand tones for nitrogen and 2.5 thousand tones for phosphorus (Nutrient Balancer for Prut River Basin Project, 1994).

Agricultural pollution, together with over-fishing, mismanagement of game sources, poaching, draining of wetlands, excessive tree cutting have also led to the degradation of biodiversity, which has reached a severe level in the Lower Prut River Basin. Hydropower stations built upstream have

exacerbated the problem by changing the site conditions in the area. Native flora and fauna species are severely threatened and, in some cases, facing extinction.

Government Commitments

Agricultural pollution control and wetland ecosystem protection are considered priorities by the Government of Moldova as documented in the following: (i) National Program of Strategic Actions for the Environmental Protection for 1995-2020 (1995); (ii) National Environmental Action Plan for 1996-1998 (1996), which included a program of activities to reduce or prevent pollution through better environmental management and sustainable use of natural resources; (iii) Governmental Strategy of Sustainable Development of the Republic of Moldova (2000) which emphasised sound agricultural practices, restoration and rational use of natural resources, elimination of pollution sources, water quality control, and waste management as national priorities, and (iv) Biodiversity Conservation Strategy and Action Plan (2001). Moldova has committed itself internationally to reducing nutrient loads to the Danube River and the Black Sea from its territory. It is a signatory to a number of international conventions, including the Convention on Co-operation for the Protection and Sustainable Use of the Danube River (Sofia, 1994), Convention on Protection and Use of Transboundary Water Courses and International Lakes (Helsinki, 1992), the Convention on Biological Diversity (Rio de Janeiro, 1992), etc. In terms of regional agreements, Moldova is party to (i) Statement on Lower Danube Green Corridor signed by Bulgaria, Romania, Ukraine and Moldova, on 5 June, 2000, in Bucharest, Romania; (ii) Protocol on the Establishing of the Transboundary Biosphere Reserve of Danube Delta and Scientific Reserve "Prutul de Jos", signed on 27 July, 2000 between Romania and Moldova.

Project Description

The project, to be implemented over 5 years, will support the following activities:

Component 1: ***Promotion of environmentally-friendly agricultural practices.*** Activities under this may include crop rotation, conservation tillage, efficient manure management practices, promotion of organic farming, nutrient management , buffer strips along rivers, and soil and water quality monitoring. Farmers would be offered training in these techniques. Entrepreneurs/enterprises who borrow under RISP (individual farmers, farmers organizations, co-operatives and agricultural processors) and wish to invest in environmentally sustainable agricultural practices, would receive a grant from the GEF fund to offset the incremental cost of nutrient reduction investments. The eligibility criteria for the provision of GEF grant will be primarily to support those activities that will reduce the nutrient loads in water bodies. This component would also prepare and implement a wetland and integrated watershed management plan for one of the tributaries of the Prut River in the Lower Prut Basin with the objective of reducing nutrient loads into the Prut River through nutrient filtration and reduction of the erosion of nutrient containing soil, as well as biodiversity conservation.

Component 2: ***Strengthening National Policy, Regulatory and Institutional Capacity.*** This activity would focus on strengthening the national legislative, regulatory and institutional capacity of the government of Moldova for meeting European Union standards in agricultural pollution control. It would include assistance to the Moldovan Government, notably the Ministries of Agriculture and Environment, in harmonising local and national legislation with EU's directives on environmental pollution control, including the Nitrates Directive (91/676/EEC) and Dangerous Substances Directive (76/464/EEC). A Code of Good Agricultural Practices would be developed

based on codes developed for Europe and elsewhere. These activities would increase capacity of the government for addressing agricultural pollution control measures and honouring its international commitments to reduce pollution to the Danube River and Black Sea.

Component 3: ***Public Awareness Activities and Replication Strategy.*** A broad local and nationwide public information campaign will be undertaken to disseminate the benefits of proposed GEF-funded activities and achieve replicability of the same. At the local level, the main audience will be the direct stakeholders of the project (local and county officials, farmers, community groups and NGOs). The objective of the activity will be to familiarize the population and help induce the behavioral changes necessary to the success of the project (soil erosion prevention, use of manure management practices, respecting the Code of Good Agricultural Practices, etc.). The efforts at national level would concentrate on institutions and groups (Government agencies, national environmental or professional associations, academia, NGOs, etc.) and the population at large that may develop and build a general good-will for the project and its benefits, and raise the interest of potential future clients, including agricultural enterprises nation-wide. This will be achieved, in part, through national and regional workshops, field trips, visits, training, publication in international agriculture and environmental journals and other similar activities that will promote replication of project activities in other similar areas of Moldova as well as Black Sea riparian countries. The project will work closely with ongoing similar efforts in Georgia, Bulgaria, and Turkey and the exchange of experiences will result in significant reductions in the nutrient loads entering the Danube River and Black Sea.

Component 4: ***Project Management Unit.*** A Project Management Unit is being established under RISP. The GEF project would provide support for hiring relevant staff to implement APCP activities under the overall umbrella of the RISP PIU.

Global Environmental Benefits

The proposed project's objective of reducing non-point sources of pollution from agriculture is consistent with GEF Operational Program Number 8, "Waterbody Based Operational Program", which focuses mainly on seriously threatened water-bodies and the most important trans-boundary threats to their eco-systems. Under the Program, priority is accorded to projects that are aimed at "changing sectoral policies and activities responsible for the most serious root causes or needed to solve the top priority trans-boundary environmental concerns".

The proposed project would help reduce barriers to farmers' adoption of environmentally-friendly agricultural practices and would also help restore the wetland ecosystem and its biological diversity in the "Lower Prut Lakes", a Ramsar Site. The project would provide an opportunity for the GEF to be a catalyst for actions to bring about the successful integration of land and water resource management practices. Without GEF assistance, Moldova might undertake a series of small ad hoc activities in different parts of the country to address the pollution problem and in response to EU requirements for environmental concerns in agriculture. However, this approach would lack a comprehensive inter-sectoral mechanism to coordinate the financing, program efforts and geographical targeting of activities. GEF funding would provide essential resources to accelerate the program, to demonstrate the need for a holistic approach to control nutrient loads into the Black Sea and to undertake a public outreach program for the project's success. The APCP would strive to build synergies between this project, RISP as well as other projects with similar objectives.

Project Costs

The estimated cost of APCP is estimated at US$5.0million which would cover the incremental cost of nutrient reduction interventions. Additional co-financing would be provided by the Government of Moldova and local beneficiaries in cash and kind. Other donor support would also be explored during project preparation.

Benefits

The proposed project is the first instance where the Government of Moldova will mainstream environmental considerations in agricultural practices. The synergy of such an approach will bring about greater benefits globally, regionally and locally vis-à-vis independent, discrete agricultural and environmental projects.

Internationally, benefits will accrue through: (i) a continued reduction in the discharge of nutrients into Danube River and Black Sea and the accompanying improvements in the local and Black Sea water quality; (ii) broad-based stakeholder participation that will increase public awareness and demand-driven approaches for protecting the Black Sea;(iii) improving habitat for migratory birds and a variety of endangered species; and (iv) sequestering carbon in the grasslands, cropland and forests.

Nationally, the country will benefit: (i) through improvements in quality of ground and surface waters; (ii) better maintenance of productive ecosystems and critical natural habitats in the freshwater, estuarine and near shore waters along the Black Sea coast; (iii) improved agricultural productivity through better agricultural practices; (iv) progress towards compliance with EU Directives; and (v) increased capacity building of local institutions such as EPI and PHD.

The Project will also build capacity in the CAPMU to undertake the environmental reviews and ensure that the mitigation measures are followed. As a result, potential environmental impacts will be avoided or minimized by applying a set of good practices directed to farmers through the advisory Components of the RISP, such as providing guidance to clients on environmental and agricultural sustainability matters when advising on agricultural production activities.
Locally: (i) at the farm level, additional income from effective use of organic waste (manure as fertilizer), crop rotations, organic produce, and improved livestock grazing practices; (ii) in the crop sector, outcomes will include improved production efficiency through low input use and better farm management; (iii) in the health sector, there will be improvements in health and sanitation as there will be an improvement in the drinking water and general hygiene of the villages; and (iv) through terrestrial and aquatic habitat enhancement, increased populations of birds and fish species of local economic and social importance.

Value Added of GEF Support in the Project

The proposed project would help reduce barriers to farmers' adoption of environmentally-friendly agricultural practices and would also help restore the wetland ecosystem and its biological diversity in the Lower Prut Lakes, a Ramsar Site. The project would provide an opportunity for the GEF to be a catalyst for actions to bring about the successful integration of land and water resource management practices. Without GEF assistance, Moldova might undertake a series of small ad hoc activities in different parts of the country to address the pollution problem and in response to EU requirements for environmental concerns in agriculture. However, this approach would lack a comprehensive inter-sectoral mechanism to coordinate the financing, program efforts and geographical targeting of activities. GEF funding would provide essential resources to accelerate the program, to demonstrate

the need for a holistic approach to control nutrient loads into the Black Sea and to undertake a public outreach program for the project's success. The APCP would strive to build synergies between RISP and other projects with similar objectives.

Institutional and Implementation Arrangements

The Ministry of Environment, Construction and Territorial Development will have the main responsibility for implementation of the project in full collaboration with the Ministry of Agriculture. The proposed CAPMU will establish a special implementation unit with specialized technical expertise to implement this project.

MOLDOVA
RURAL INVESTMENT AND SERVICES PROJECT

RURAL FINANCE COMPONENT
- A MOLDOVA-AGROINDBANK
- S BANCA SOCIALA
- I MOLDINDCONBANK
- V VICTORIABANK
- R RURAL FINANCE CORPORATION

RURAL ADVISORY SERVICES COMPONENT
- ● SERVICE PROVIDER CENTER
- ○ LOCAL CONSULTANT

RURAL BUSINESS DEVELOPMENT COMPONENT
- ◇ RURAL BUSINESSES
- ◆ RURAL BUSINESS DEVELOPMENT MOBILE TEAMS

- ○ SELECTED CITIES AND TOWNS
- ⊙ JUDET CAPITALS
- ★ NATIONAL CAPITAL
- JUDET BOUNDARIES
- INTERNATIONAL BOUNDARIES

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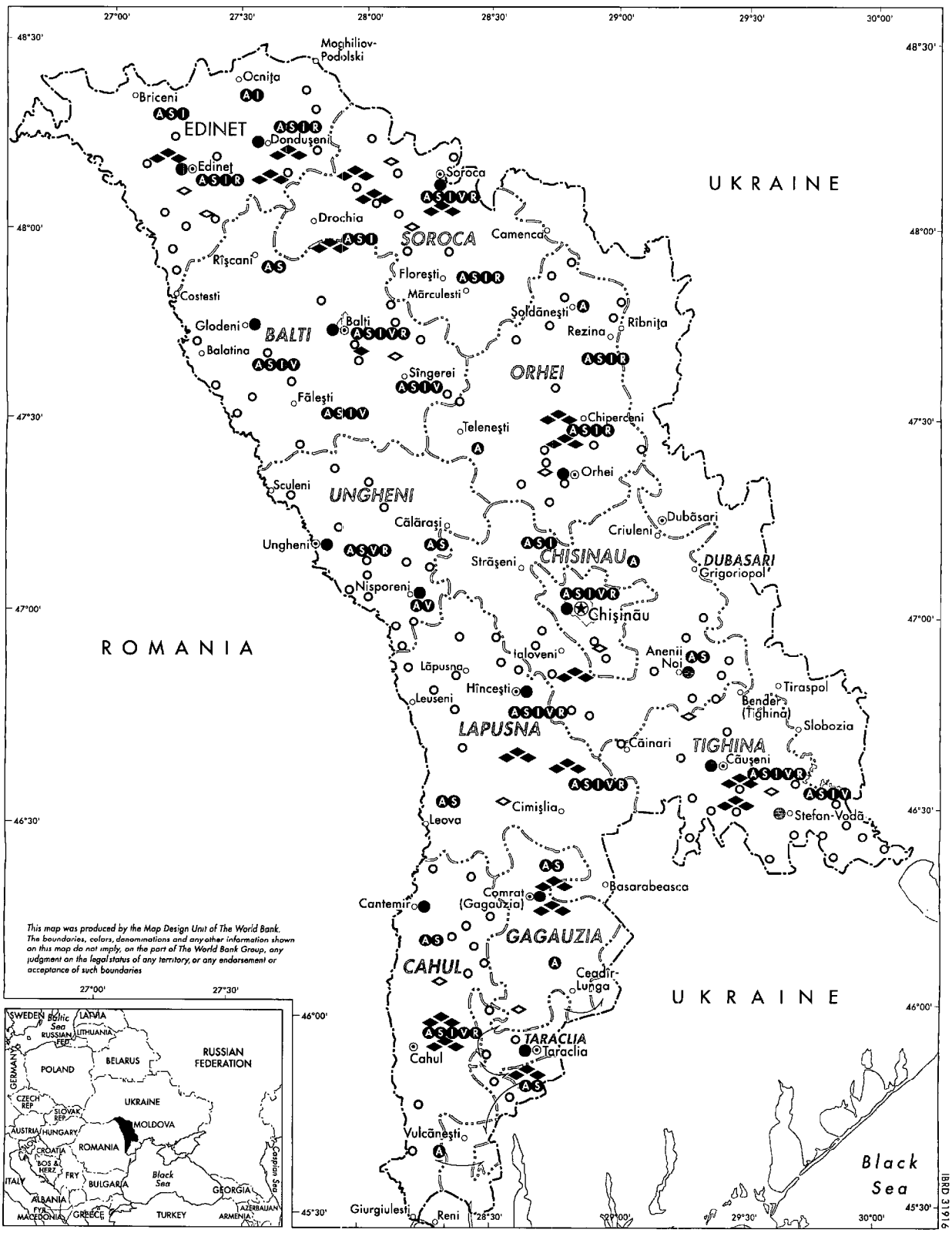

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