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TECHNICAL ANNEX

FOR AN

EMERGENCY EARTHQUAKE RECOVERY LOAN

IN THE AMOUNT OF US$252.53 MILLION

TO THE

REPUBLIC OF TURKEY

October 27, 1999

Turkey – Emergency Earthquake Recovery Loan

Currency Equivalents
(Exchange Rate Effective October 4, 1999)

Currency Unit	= Turkish Lira
TL 1	= US$ 0.0000022
US$ 1	= TL 459,516

Government Fiscal Year

January 1 – December 31

Weights and Measures

Metric System

Abbreviations and Acronyms

BAG-KUR	-	Bagimsiz Calisanlar Kurumu
CAS	-	Country Assistance Strategy
CBT	-	Central Bank of Turkey
EERL	-	Emergency Earthquake Recovery Loan
EIB	-	European Investment Bank
ES	-	Emekli Sandigi
EU	-	European Union
GDF	-	Support and Development Fund
GDP	-	Gross Domestic Product
IBRD	-	International Bank for Reconstruction and Development
IDA	-	International Development Association
IFC	-	International Finance Corporation
IMF	-	International Monetary Fund
MEER	-	Marmara Earthquake Emergency Reconstruction Project
OECF	-	Overseas Economic Cooperation Fund
PMR	-	Project Management Reports
SME	-	Small and Medium-scale Enterprises
SDR	-	Special Drawing Rights
SIS	-	State Institute of Statistics
SSF	-	Social Solidarity Fund
SSK	-	Sosyal Sigortalar Kurumu
UNDP	-	United Nations Development Program
UT	-	Undersecretariat of Treasury

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TECHNICAL ANNEX FOR AN EMERGENCY EARTHQUAKE RECOVERY LOAN TO THE REPUBLIC OF TURKEY

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A. THE MARMARA EARTHQUAKE

Country Background.

1. On August 17, 1999 a severe earthquake, rated by the U.S. Geological Survey as 7.4 on the Richter scale, produced extraordinary damage to the northwestern area of Turkey bordering the Marmara Sea. The epicenter of the earthquake was near Golcuk in the country's industrial heartland. The quake has been followed by more than 1,000 aftershocks, some as high as 5.5-6.0 on the Richter scale. The earthquake hit just as Turkey's economy was recovering from a sharp downturn in the wake of the Russia crisis. From July 1998 to June 1999, GNP contracted by 1.6 percent relative to the same period a year earlier. Starting in the second quarter of this year, however, there was clear evidence that the economy was emerging from the slump. Aside from endangering this nascent recovery, the earthquake (and additional fiscal burden that it will impose) came as the Government was implementing essential economic reforms including development of an ambitious macroeconomic stabilization program requiring strong fiscal adjustment.

Economic and Social Impact of the Earthquake.

2. Bank staff have prepared a preliminary estimate of the earthquake's impact on the Turkish economy in a reported entitled: "Marmara Earthquake Assessment" dated September 14. The key findings, updated on the basis of more recent information which indicates more extensive damage to the housing stock than initially estimated, are presented in Table 1 and summarized below. The earthquake will have serious short-term economic consequences, but these can be managed provided that the Government continues to implement its economic reform program and sufficient external support is forthcoming to help finance the emergency recovery and reconstruction effort. The area most severely hit by the earthquake accounts for about seven percent of GDP. Extensive damage to electricity power lines and a key refinery has entailed some disruption to economic activity, albeit temporary, across a large swath of an economically important region. Small- and medium-scale enterprises (SMEs) and micro-enterprises have suffered greatly. However, early indications are that the damage to larger industrial enterprises has been limited and it is likely that part of the output loss in the affected region can be made up by factories located elsewhere in Turkey.

3. Bank staff estimate that economic growth in 1999 will be 0.6 percent to 1.0 percent lower as a result of the earthquake. The economy is now projected to contract by some 1.6 percent for the year. The earthquake is expected to have a negative impact on private absorption in 1999 on the order of 1.5 percent of GNP. This would be made up in part by an increase in public absorption of about 1.0 percent of GNP due to increased public spending in response to the quake, funded in part by an inflow of foreign savings of some 0.5 percent of GNP. Provided that it can be financed, reconstruction activity related to the earthquake is expected to boost output by about one percent in 2000 resulting in projected growth of 5-6 percent. End-year CPI inflation is now projected to be 64 percent (57 percent for WPI), exceeding the 50-55 percent target set under the SMP in July. However, this is only partly attributable to the earthquake. Increased demand pressures arising from reconstruction could have an impact on inflation in 2000,

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Table 1: Impact of the Marmara Earthquake

Economic Indicators 1/	1999 $US bn	Share of GNP	2000 $US bn	Share of GNP	Total $US bn	Total GNP (%)
Direct Costs						
Wealth Loss	4 to 7	2.0% to 3.5%			4 to 7	2.0% to 3.5%
Indirect Costs						
Impact on Output	-2.0 to -1.2	-1.0% to -0.6%	1.4 to 2.4	0.6% to 1.1%		
Emergency assistance	0.4	0.2%	0.2	0.1%		
Secondary Effects						
Current account balance	-1.0	-0.5%	-2.0	-1.0%	-3.0	-1.4%
Fiscal impact	2 to 2.3	1.0% to 1.2%	1.8 to 2.3	0.8% to 1.0%	3.8 to 4.6	1.8% to 2.2%
Social Indicators						
		Average	Range 2/			
Crude death rate	(per 1000)	11.9	2.5 to 21.2			
Injury rate	(per 1000)	29.6	8.3 to 50.8			
Displaced persons			300,000-600,000			
Job losses	% of labor force	30.9	20.4 to 48.1			

1/ Updated estimates based on the most recent data including final damage estimates for housing prepared by the Ministry of Public Works and Reconstruction.
2/ Range across affected provinces.
Source: World Bank staff estimates.

4. The total fiscal burden arising from the earthquake is estimated to be in the range of US$ 3.8-4.6 billion (1.8-2.2 percent of GNP), including remedial actions to better prepare for large-scale natural disasters in the future. The largest direct cost to the budget, estimated to be in the range of US$ 740 million to US$ 1.2 billion, will be through reconstruction and repair of damage to the housing stock of the region. Costs from infrastructure replacement and rehabilitation are estimated to add a further US$ 450 million to the budget. Total damage (wealth loss) from both items significantly exceeds this amount, but the burden of reconstruction is expected to be shared with the private sector. Revenue losses and credit programs represent one third of total estimated fiscal costs of the earthquake, totaling US$ 1.3 billion. These arise from four principal sources: (i) reduced tax revenues from the region due to the negative output shock, (ii) losses from a tax payment deferral for the region announced by the Government, (iii) credit subsidies for loan refinancing and new loans to enterprises which sustained damage in the region, and (iv) postponed non-tax revenues from public enterprise privatization. Additional costs are expected from emergency assistance to the population and associated compensation for loss of life and disability totaling an estimated US$ 540 million. This includes costs for temporary shelter for the people left homeless by the quake. These figures assume that large-scale relocation of the damaged towns will not be required.

5. The current account deficit is expected to widen by some US$ 900 million in 1999 under the immediate impact of the quake and by some US$ 2 billion (one percent of GNP) in 2000 as reconstruction intensifies. The decline in production in the affected region and disruption to the İzmit port is expected to lower exports by around US$ 500

million relative to the baseline scenario in 1999 and a more modest US$ 250 in 2000. An expected drop in tourism revenues could magnify this loss by around US$ 200 million in 1999.[1] Imports, on the other hand, are projected to increase quite sharply in 2000, reflecting the positive stimulus to domestic demand from reconstruction activity. Cumulatively, these developments are projected to widen the current account deficit by 0.4 percent of GNP in 1999 and 0.8 to 1 percent of GNP in 2000. This would imply a current account deficit in the range of 2.6 percent of GNP next year assuming that the required additional external financing will be available. Otherwise, further policy actions will be needed to contain the current account deficit which would slow the reconstruction effort and possibly short-circuit the projected recovery of the economy. Provided that the Government's economic reform program stays on track, the widening of the current account deficit is expected to be temporary and concerns about sustainability should not arise. With regard to the capital account, most components are expected to remain broadly unchanged with the exception of privatization revenues which are projected to be US$ 150 million lower relative to the baseline.

6. The additional external financing required in 1999-2000 to maintain reserve accumulation as projected under the baseline is estimated at over US$ 3 billion. At some US$ 23 billion, the CBT's gross reserves are adequate to deal with most types of current account shocks, but less adequate in the event of a major capital account shock. It is expected that the additional external financing will come from official creditors and that the Turkish Lira counterpart of these funds will be used by the Government for its earthquake recovery program.

7. **The Social Dimension.** Although all of the earthquake victims are facing traumatic losses, including the loss of loved ones, injuries and disabilities, and the loss of homes and businesses, certain groups are more vulnerable than others. Logically, those who were poor and vulnerable before the earthquake will be the least likely to have financial assets after the earthquake. The poor in Turkey, who rely on labor as their primary asset, will be especially vulnerable to job losses in the self-employed, micro-enterprise and SME sectors. Those who are not enrolled in one of the three Government social insurance programs are particularly vulnerable to lost breadwinners and disability.[2] During visits to tent cities in Adapazari, victims identified uncertainty about their future as their heaviest psychological burden. This uncertainty about the future is well-merited, since it is unclear at this time how many jobs will be permanently lost owing to the earthquake. The labor market in the Marmara earthquake is more formalized than in many areas of Turkey, and more employees are likely to be covered by social insurance than is average for Turkey. However, there were vibrant self-employed, small and micro-enterprise sectors in Marmara where social insurance coverage was presumably

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[1] The Bank team has not attempted to estimate the impact of the earthquake on worker's remittances which may in fact increase in response to the disaster.

[2] The World Bank report "Turkey: Economic Reforms, Living Standards, and Social Welfare Study" under preparation will provide a detailed description of Turkey's social assistance programs and an overview of social insurance.

limited. A certain portion of these jobs may be lost irretrievably, particularly in Yalova which is unlikely to regain its appeal for local tourism.[3]

8. Before the earthquake, the Marmara region was one of the better-off areas in Turkey. Now, several hundred thousand persons have been displaced and many have lost their job or business. While a substantial share of these people have already emigrated to other parts of Turkey, a survey by the State Institute of Statistics found over 181,000 homeless people remaining in the region. Certainly, there will be a temporary increase in poverty in the affected region, but how long this will endure depends on the number of workplaces which are permanently lost. To some extent, the increase in poverty in Marmara will be offset by the increased economic activity associated with the reconstruction efforts, particularly in the year 2000. Information on deaths and injuries has been disseminated by the Government's Crisis Center through the press and world-wide web. The most recent internet information available is as of October 18, 1999.[4] Deaths numbered 17,127 and injuries were 43,953. An estimate that 30 percent of the injured will suffer disability would imply about 13,000 disabled individuals. No information was available on the age and gender distribution of deaths and injuries, so to estimate lost breadwinners, the age structure of the Turkish population was superimposed on the number of deaths. Assuming 60 percent of the adult deaths were breadwinners, this gives a total of some 4,900 estimated breadwinner losses.

The Government's Response

9. **The Initial Macroeconomic Policy Response.** While the performance of the national emergency management system in the days immediately following the earthquake has been criticized, the Government's initial macroeconomic policy response was appropriate and effective. Central Bank intervention in the days following the earthquake helped calm markets and prevent a financial panic. The Government submitted to Parliament in the days after the disaster a supplemental tax package to help meet the fiscal burden of the quake which signaled its intent to maintain fiscal discipline. The subsequent adoption and enactment of major pension reform legislation helped confirm Turkey's commitment to stabilization and reform. The Government has moved quickly with its international partners to mobilize substantial external financing for emergency relief and reconstruction. The Government is also working to organize the reconstruction effort including defining the institutional arrangements and organizational structures to support implementation of the program. Going forward, it will be critical for the authorities to sustain the momentum for stabilization and structural reform. This will provide confidence to financial markets that the increased spending needed to support recovery and reconstruction efforts will be temporary and that the budget deficit will return to a sustainable path.

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[3] Estimated job losses are given in Table 1. Available data indicate that firms with less than 10 workers accounted for 95 percent of manufacturing establishments and 35 percent of the workforce in Kocaeli province which highlights the importance of small and micro-enterprises in the region.

[4] Website of the Turkish government: http://www.deprem.gov.tr/kocaeli/info-izmit-1.htm

10. **Relief Efforts.** After some initial hesitation, relief efforts are now in full swing. The Government has established a crisis center in the Prime Ministry which is coordinating relief efforts. The Government is activating public and private sector capacities to respond to pressing needs for food, shelter and health care including psychosocial counseling for trauma victims. Major efforts are underway to clear the rubble. Large tent cities have been set up and emergency social services are being provided. The General Directorate for Children has staff in the tent cities who are working on the immediate needs of approximately 1,000 highly vulnerable children (especially orphans). Many governments, local and international agencies, and NGOs moved quickly to support relief efforts immediately after the quake and humanitarian assistance to the affected population has also been forthcoming.

11. **The Government's Earthquake Recovery Program.** The focus of the Government's efforts is now moving from relief to recovery as the components of its earthquake recovery program are put in place. At this stage, the top priority is to mobilize social protection mechanisms to help displaced persons and other vulnerable groups recover from the impact of the disaster and return to productive lives as soon as possible. The recovery program also includes additional social programs, notably longer-term care for trauma victims and job training;[5] support to affected enterprises; and a medium-term reconstruction and disaster mitigation program. The elements of the recovery program are summarized in Table 2. To supplement external support for the program, the Government intends to implement a series of revenue measures to help finance earthquake-related costs.

Table 2: Earthquake Recovery Program

Name of Program	Total Cost TL trl	Total Cost $ mil	% of GNP
Social Assistance	177	344	0.18
Accomodation assistance	108	198	0.10
Repair assistance	51	108	0.06
One-time lump sum assistance	18	38	0.02
Social Insurance Benefits 1/	13	24	0.01
Other Social Programs	15	29	0.02
Enterprise Support	118	260	0.13
Tax deferral	105	233	0.12
Direct micro-enterprise assistance	11	23	0.01
Credit programs 2/	2	4	0.00
Reconstruction and Disaster Mitigation	1,030	1,972	0.88
Housing	576	1,103	0.46
Land management and code enforcement	19	36	0.02
Infrastructure	235	450	0.22
Disaster insurance	143	273	0.15
Emergency response system	57	110	0.05
Total	1,353	2,629	1.22

Source: Treasury and staff estimates.

1/ Covers payments through end 2000. 2/ Includes only actual disbursements from GDF to date for the credit program through the state banks.

12. **Accommodation.** The most pressing social protection need is to assist the displaced population in moving out of the tent cities and into more adequate

[5] The trauma programs are described in the documentation for the MEER project and the reallocation under the Basic Education project (Loan No. 4355-TU). The job training programs are described in the documentation for the reallocation under the Employment and Training project (Loan No. 3541-TU).

accommodation as winter approaches. The authorities are following a sequenced approach to this issue with a view to relying on a mix of options that takes into account the preferences of the affected population, which are clearly in favor of moving out of the tent cities to a house or apartment as soon as possible. There are five major sources of information on earthquake victims' preferences: mission site visits, a rapid social assessment done by a team from Koc University, a survey by the State Institute of Statistics, an enterprise survey which included a household information block and another rapid survey done by a Turkish marketing firm. The Bank team made three site visits to the earthquake zone. In these site visits, earthquake victims identified uncertainty about their future, where they will live and work, as their greatest problem. Conditions in the tent cities are stark--the sanitation is primitive and many people have nothing in their tents but a few blankets and articles of donated clothing. A rapid social assessment, commissioned during preparation of the MEER project, confirmed these initial impressions from site visits. In this rapid social assessment, about 70 percent of respondents said that they planned to stay in the earthquake zone. A third source of information is a survey by SIS of the displaced population remaining in the region to determine their needs and preferences. The survey, covering over 43,000 families, indicates a strong preference for rental allowances (58 percent of respondents), a lesser demand for prefabricated housing (41 percent) and a limited preference for public buildings and recreational facilities (0.3 percent). A survey of micro- and small-to-medium enterprises was conducted by Turkish consultants with support from the Bank which included a block of questions on household information. In this survey, 90 percent of the people polled reported that they wanted to continue to live in the affected region. A separate survey was done by the Turkish marketing firm IBS where 76 percent of respondents indicated that they wanted to stay in the earthquake region.

13. In response to the preferences of earthquake victims to leave the tent cities and move to a house or apartment as soon as possible, the Government has announced an accommodation allowance program for displaced households who suffered heavy or medium damage to their homes of TL 100 million (approximately US$ 200) per month for up to one year. It is estimated that this program, to be managed through the Social Solidarity Fund (SSF), will cost TL 108 trillion (about US$ 200 million) through the year 2000. Displaced families will be able to choose to receive this cash assistance or accept free accommodation in public facilities or pre-fabricated housing as this becomes available. The Government has also announced a repair assistance program to help families who suffered light damage to their homes. Under this program, eligible families will receive a one-time grant of TL 600 million (about US$ 1,250) to help carry out repairs. This program, which will also be administered by the Social Solidarity Fund is estimated to cost TL 51 trillion (about US$ 108 million). Additionally, the Ministry of Public Works has contracted for 26,000 pre-fabricated units. However, the number of units contracted exceeds the apparent demand and these contracts are subject to a low price cap which raises concerns about quality and delivery.

14. **Implementation Arrangements.** The processing centers of the SSF for the accommodation and repair allowances in Izmit, Adapazari, and Golcuk were visited by the mission and found to be operating with an impressive degree of organization. The central SSF had sent computers to each of the processing centers (located in public buildings such as auditoriums and gymnasiums) and the local SSF had recruited a staff

primarily of volunteers as well as some temporary employees. Client waiting time was short and processing of clients was efficient. Information from the local SSF affiliates is entered into a computer system and checked for consistency and duplications, then sent to the central SSF headquarters. The SSF is in discussions with Ziraat Bank to determine whether an additional check for duplication at the payment level can be conducted.

15. **Death and Disability Benefits**. The Government is preparing a complementary package of social assistance benefits for the longer-term vulnerable among the earthquake victims, in particular families that have suffered breadwinner deaths or disabilities. As a first step, the pension legislation was amended to reduce the period of required contributions for earthquake victims in terms of their survivor benefits and disability pensions under the three social insurance programs.[6] However, there will be survivors and disabled who still do not qualify for social insurance benefits. The Government has announced a program to offer one-time lump-sum payments for each death and permanent disability regardless of social insurance coverage as was done following the 1992 Erzincan earthquake. The Government is proposing that each death be compensated by a payment of TL 750 million (US$ 1,600) and disability of the first degree (most disabled) be paid at TL 500 million, while disability of the second degree be compensated at TL 300 million. This lump-sum benefit for death and disability will be administered by the Social Solidarity Fund. Bank staff estimate that this program will cost approximately US$ 38 million. A one-time payment may not be enough, especially for households which have lost not only their home, but their self-owned business or their workplace and are unable to reintegrate into the labor market. Supplementary social assistance benefits could be considered for those victims and the need for supplementary social assistance will be assessed during the mid-term review (see below).

16. **Social Assistance Payment Levels.** The most important numeraires for assessing the level of social assistance payments are Turkey's per capita GDP (US$ 3,150) and average wage for September 1999 (US$ 270 per month). Turkey is a middle-income country and social assistance payments should reflect the general level of income and prices facing the affected population. For the accommodation allowance, the Government considered the rental market before the earthquake, and forecast the projected decline in supply (due to destruction of housing stock) and increased demand, settling on a projected rental cost of around TL 100 million per month. This forecasted amount may not be sufficient to offset rental price increases actually incurred as the rental market adjusts to the lowered supply and heightened demand. This issue will be revisited during the mid-term review with an eye to assessing the adequacy of the benefits. For the repair allowance, the level of TL 600 million (US$ 1,200) is well below the estimated unit cost for the repair of light damage given in the Earthquake Assessment of US$ 3,000. The established level takes into account that per capita incomes in the earthquake zone are higher than average in Turkey and that most households having suffered light damage will be able to contribute to the cost of repairs. On the lump-sum death allowance of TL 750 million, this amount represents a compromise between the projected loss of earnings over the lifetime of the victims as well as the government's

[6] Preliminary data suggest that the total fiscal cost for social security institutions (SSK, ES and Bag-Kur) would be TL 13 trillion (about US$ 24 million).

ability to afford compensation. The death allowance is US$ 1,500 or less than six months of the average wage, so it covers only a small fraction of the lost income resulting from death. The death allowance is less than one-half of average annual per capita income. In particular, the amount may not be high enough for families who have lost their breadwinner and potentially 10-30 years of earning capacity. The disability allowance proposed by the Government is lower than the death allowance (US$ 600-1,000) and will likely not cover anything more than the immediate costs of the disability (prothesis, medical care, etc.). It should be noted for both the death and disability allowances, the Government has followed past precedent in extending these benefits to all victims, and the amounts are approximately equal in real terms to those given after the 1992 Erzincan earthquake. The appropriateness of the death and disability allowances will also be monitored in the mid-term review.

17. **Emergency Child Protective Services.** SHÇEK is the Government agency responsible for 18,000 children at risk in Turkey. It runs a system of orphanages and boarding schools, as well as homes for the elderly and training centers. SHÇEK staff were quickly mobilized to help following the earthquake, and there are currently about 100 staff volunteers in the 22 largest tent cities in the earthquake zone where they are helping to establish kindergarterns and play centers for children, as well as food for vulnerable children.[7] SHÇEK estimated that approximately 1,000 children will be orphaned or at high risk due to the earthquake. The Government intends to provide special social benefits to these highly vulnerable children.

18. **Social Solidarity Fund.** The Social Assistance and Solidarity Encouragement Fund (SSF) was established in 1986 as an umbrella organization and financing entity for 934 regional affiliate foundations. The SSF is an extrabudgetary fund financed by earmarked taxes and administered by a State Minister. The regional affiliate foundations provide a variety of social assistance programs (usually in kind) to the needy. The needy are determined at the discretion of the regional affiliates. The SSF together with its local affiliates is the largest program of social assistance in Turkey in terms of number of beneficiaries (4.2 million from 1 July through 26 March 1999). The SSF finances the efforts of local affiliates in several areas: assistance to the needy for periodic needs, health, small-scale employment generating projects, feeding centers, education (scholarships), food & clothing, heating, and natural disaster assistance. The small scale employment generating projects are in small businesses and small agri-business, including greenhouses, poultry, carpet and tapestry-making, confectionary, small handicrafts, milk, fishing, bee-keeping, fruit, livestock breeding, vineyards, culturing mushrooms, crops, and for disabled persons. The SSF is planning to expand its employment generating activities in the earthquake region.

19. **Support to Enterprises.** The Government has announced three programs for supporting enterprises damaged by the earthquake: a tax deferral scheme, a subsidized credit program channeled through the three main state banks: Halk Bank, Ziraat Bank and Emlak Bank, and a direct program of micro-enterprise support. Details of the tax deferral and credit subsidy program have not yet been fully clarified, although the basic elements

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[7] SHÇEK staff costs (salary and other costs, including transportation) are estimated as TL 320 billion and TL 960 for 2000.

have been announced.[8] The tax scheme grants tax deferrals to businesses (and individuals) affected by the earthquake. The scheme is estimated to cost the budget TL 209.3 trillion (US$ 463.7 million) over the 1999-2000 period as only a small portion (about one-fourth) of the lost revenues are expected to be recoverable due to the loss of tax records and losses arising from severely damaged businesses.[9]

20. The credit program features: (i) rescheduling of existing debt owed by enterprises damaged by the earthquake and outstanding to the three state banks of three years with one year grace on principal and interest, and (ii) new subsidized credits (Halk Bank and Ziraat Bank only). Both the rescheduled loans and new credits are at subsidized rates equal to no more than half the applicable rate (which is already subsidized in most cases) for rescheduled loans and a flat 20 percent rate for new loans. The state banks will charge the interest rate subsidy for rescheduled loans to the budget through the duty loss system. The funding for new loans will be provided through the General Development Fund which is a budgetary fund. To date, the Government has allocated only TL 2 trillion from the budget to the credit program, although the total cost is expected to go substantially higher.[10] The high level of subsidy is a cause for concern. However, the banks are putting into place operational procedures for the new credit component of the program to ensure access by small and micro-enterprises thereby channeling part of the subsidy to them. EIB is considering funding a targeted credit scheme for small and micro-enterprises in the earthquake zone which would complement resources provided through the Government's credit program. The direct program of micro-enterprise support consists of lump-sum grants to micro-enterprises graduated on the degree of damage suffered ranging from TL 200 million (US$ 400) for light damages to TL 350 million (US$ 700) for medium damages to TL 500 million (US$ 1,000) for heavy damage. The direct program of micro-enterprise support is modest in scope, with an expected cost of US$ 23 million in total. It will be administered by the SSF. The authorities recognize the importance of ensuring coordination between the credit programs and the direct support program and they intend to take the amount provided under the direct support program into consideration when determining the credit needs of individual micro-enterprises.

21. **Reconstruction and Disaster Mitigation.** The Government's medium-term reconstruction and disaster mitigation efforts will be supported by the reallocations from existing projects and the MEER project under preparation. With regard to reconstruction, the main elements are: (i) construction of new permanent housing, (ii) rehabilitation of housing stock which suffered medium damage, and (iii) repair and reconstruction of damaged or destroyed public infrastructure. The housing construction program covers both urban and rural areas. Construction under the program will be designed to meet Turkey's seismic and environmental standards. The cost of reconstruction is estimated to

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[8] Provisions for debt rescheduling are provided in Council of Ministers' Decision No. 99/13233 of August 20, 1999. Provision on tax deferrals are provided in the Ministry of Finance circular dated September 1, 1999.

[9] Tax liabilities on business that have lost one-third or more of total assets are to be entirely forgiven according to Tax Procedure Law, Article 115.

[10] The GDF has been allocated TL 50 trillion in the 2000 budget, but the share which will go to the credit program has yet to be determined.

be approximately US$ 20,000 per housing unit. There are two elements of cost recovery under the program: repayment of zero interest loans to beneficiaries and beneficiary contributions. The housing reconstruction program will operate under the Disaster Law[11] which limits eligibility to homeowners residing in zone affected by the earthquake who do not own another undamaged residence in the same district. Assistance is provided only for the least damaged unit if the family owns more than one unit in the district. Beneficiaries must have clear title to the property. The Government is working to determine precisely how many homeowners will be eligible. The housing rehabilitation component covers buildings which suffered medium damage, defined to be structures which can be repaired for 30-50 percent of total replacement cost. The cost of rehabilitation is estimated to be US$ 9,000 per housing unit. Given the structural nature of medium damage, repair work will have to cover the entire building in most cases. The Government is working to determine cost recovery mechanisms for the rehabilitation program. The infrastructure repair component of the program covers power, telecommunications, transport, water and sewerage, health facilities and schools damaged by the earthquake.

22. Disaster mitigation efforts encompass: (a) upgrades to the national emergency management system, (b) introduction of a compulsory disaster insurance scheme to replace outdated provisions of the Disaster Law, (c) land use planning and enforcement of construction codes, and (d) cadaster renovation and land management. Actions to improve the national emergency management system aim to support the establishment of a comprehensive emergency management agency equipped with an operations center and communications and data networks, and a national earthquake mitigation plan. The national disaster insurance scheme is based on successful models in New Zealand and California. Under the scheme, a Turkish Catastrophic Insurance Pool will be established to make liquidity readily available to real estate tax paying owners of residential dwellings destroyed or damaged by an earthquake for the purpose of repair or replacement. This will reduce the fiscal exposure of the Government and the risk to the national economy of major earthquakes. The land use planning and code enforcement component will support: (i) review of ongoing modifications in the current legal system and additional modifications as required, and (ii) strengthening of municipal capacity to regulate, plan and implement disaster resistant development. Improvements to the cadaster and land management systems in the Marmara region will help provide current and reliable land information to cope with the post-earthquake situation, and update and improve obsolete registers and maps. This will also facilitate land supply operations, with emphasis on housing schemes and the overall improvement of the land market.

23. **Funding the Recovery Program.** To cope with the fiscal burden imposed by the earthquake, the Government is trying to mobilize external financing and raise domestic revenues. The authorities recognize that domestic borrowing to meet the costs of the earthquake would be very costly given the extremely high real interest rates on T-bills and resulting crowding out of private investment at a time of high credit demand. Approximately US$ 3 billion in exceptional external assistance has been tentatively identified including the World Bank, IMF, and other institutional and bilateral donors. At

[11] Law No. 7269 of May 15, 1959 as subsequently amended.

the same time, the Government has decided to impose temporary taxes on a broad range of activities to boost public revenues. The revenue package currently before Parliament includes: an additional five percent surcharge on personal and corporate income based on the declared income for 1998; one- time motor vehicle and real estate taxes; an additional 25 percent tax on cellular phone use until June 2000; and a new stamp tax on check transactions. This package is estimated to generate up to US$ 1.2 billion in additional revenue. The Government is also in the process of introducing a military service waiver scheme under which individuals born before 1973 could pay a DM 15,000 fee in order to limit their compulsory service to two months. This scheme could raise up to US$ 600 million. In summary, these two packages would generate total revenue of some US$ 1.8 billion or close to one percent of GNP.

B. TURKEY'S ECONOMIC REFORM PROGRAM

24. The Government is formulating its response to the earthquake in the context of a broader economic reform program. This program builds upon and expands on the earlier framework supported by the IMF under a staff monitored program (SMP) initiated in mid-1998. The Government agreed with the IMF on the framework of a new macroeconomic stabilization and structural reform program during Article IV discussions and review of the SMP in early July. The Government's economic reform program combines tighter macroeconomic policies, designed to lower inflationary expectations, with a package of structural reforms to underpin the fiscal adjustment, sustain a decline in real interest rates and restore growth. The program targets a decline in inflation to 25 percent by the end of 2000 and to 10 percent by the end of 2001. The program also targets a steep decline in real interest rates.

Table 3: Key Macroeconomic Indicators

			Pre-Earthquake		Post-Earthquake	
	actual		prelim.	projected	prelim.	projected
	1997	1998	1999	2000	1999	2000
GNP growth (%pa)	8.2	3.8	(0.8)	4.7	(1.6)	5.8
Inflation (%CPI eop)	99.1	69.7	58.7	25.0	64.0	25.0
Inflation (%WPI eop)	91.0	54.3	56.3	20.0	57.0	20.0
PSBR (% of GNP)	9.0	10.0	11.9	13.2	14.2	12.0
Primary Budget Balance (%GNP)	-	3.9	2.1	5.7	1.1	5.4
Budget Interest Payments/GNP	7.8	11.7	11.4	14.7	12.8	16.9
Domestic Debt/GNP	21.4	21.9	26.7	26.4	26.0	25.5
Current Account Balance ($ mio.)	(2,750.0)	1,872.0	(1,075.0)	(3,630.0)	(2,008.0)	(5,663.0)
Current Account Balance (% of GNP)	(1.4)	0.9	(0.6)	(1.7)	(1.0)	(2.6)
RER Index (1987=100)	113.6	120.6	125.3		125.3	

Source: Treasury, SPO and staff estimates.

25. Before the earthquake hit, the Government was attempting to use the remainder of 1999 to regain ground lost to looser fiscal policies during the first half of the year and initiate implementation of structural reforms. Following approval of the 1999 budget in late June, the Government announced a 20 percent increase in civil service wages for the second half of the year in line with the agreed fiscal and inflation targets. In early August, the Government increased the stamp tax by 25 percent. At the same time, there

have been some slippages, notably a stimulus package approved in late July after heavy lobbing by the business community which revises certain provisions of the 1998 tax law. Following the earthquake, the 1999 budget targets are being adjusted on the grounds that the resulting fiscal burden represents a one-time temporary shock. The consolidated central government budget is now targeted to generate a primary surplus of 1.1 percent of GNP, rather than the 2.1 percent originally programmed under the SMP (Attachment 5). The authorities plan to meet this target through approval of the revenue package currently before Parliament and the additional set of revenue measures detailed in paragraph 21. All told, these actions are expected to generate approximately one percent of GNP in additional revenue in 1999.

26. Fiscal adjustment is expected to continue in 2000 in an effort to achieve an underlying primary surplus for the consolidated public sector which is the level estimated to be consistent with stabilization of the public sector debt ratio in the absence of the inflation tax. Taking into account the fiscal impact of the earthquake, the authorities are now targeting a primary surplus for the consolidated central government of 5.4 percent of GNP which would be consistent with a primary surplus for the consolidated public sector of 4.8 percent of GNP. Achieving these targets will require a very substantial fiscal adjustment involving a combination of revenue measures and expenditure reductions.

27. To underpin its stabilization effort and restore growth, the Government is undertaking a major structural reform program covering tax policy and public expenditure management, social security, financial sector reform, agricultural policies, and deregulation and privatization. In substance, the specific reform measures foreseen by the Government are in line with the recommendations provided by the Bank and the Fund over the past several years. Importantly, given the history of aborted economic reforms in Turkey, the Government's program is front loaded and builds on recent achievements. The core component of the tax reform was adopted already last year. The new banking law, which provides for independent regulation of the financial sector, was approved by Parliament in June. Parliament adopted major new legislation to overhaul the public pension system only days after the earthquake struck. While the pension reform is not as ambitious as originally proposed by the Government, it will reduce the annual deficit of the social security system over the near term by about one percent of GNP. In agriculture, the Government has accepted the principle of replacing the existing inefficient system of price and credit subsidies with a unified program of direct income support. With respect to deregulation and privatization, the Parliament has approved a set of constitutional amendments to allow for international arbitration which is expected to revitalize Turkey's privatization program.

C. THE BANK'S RESPONSE AND STRATEGY

The Bank's Overall Response

28. Immediately after the earthquake struck on August 17, the Bank received a request from the Government of Turkey for emergency assistance. The Bank's response is being closely coordinated with the IMF. On October 13, the Fund's Board approved an emergency drawing for Turkey of SDR 361.5 million (approximately US$ 500 million) equivalent to 37.5 percent of quota. The Bank is also assisting the Government to coordinate the broader financial response of the international community to the crisis.

Bilateral donors and other multilateral agencies are already delivering humanitarian aid and pledging financial assistance for reconstruction. The international community as a whole is stepping forward to assist Turkey.

29. The Bank is implementing a four-part emergency assistance program to help Turkey respond to this crisis. The program consists of:

- Preparation of an Earthquake Assessment, circulated to the Board on September 15, which provides a preliminary assessment of the material damage, social costs and the impact on the economy.
- Reallocation of up to US$ 300 million in uncommitted funds from selected ongoing IBRD operations to redirect project activities to areas and infrastructure needs most affected by the earthquake. On September 24, the Board approved amendments of eight loan agreements reallocating a total of US$ 267.26 million under existing loans in six sectors to immediate priorities of the recovery effort (Memorandum of the President No. R99-181, dated September 17, 1999).
- Quick-disbursing financial assistance of US$ 252.53 million through financing of critical imports and budgetary needs provided under the proposed Emergency Earthquake Recovery Loan.
- New project financing for reconstruction and disaster mitigation of US$ 505 million through the proposed Marmara Earthquake Emergency Reconstruction Project (MEER) which has been prepared in parallel with the Emergency Recovery Loan.

30. In developing the emergency assistance program in response to the Marmara earthquake, Bank staff have drawn on lessons learned from the experience of previous emergency assistance to Turkey. This previous assistance includes the US$ 285 million loan for an Earthquake Rehabilitation and Reconstruction project in response to the Erzincan earthquake in 1992 and the US$ 369 million loan for an Emergency Flood and Earthquake Rehabilitation project in 1998 in response to flooding in the Western Black Sea region of Turkey and the subsequent earthquake in the Adana region. Staff have also drawn on the experience of emergency projects across the Bank including other quick-disbursing emergency loans.

Project Objectives

31. The proposed Emergency Earthquake Recovery Loan, following OP/BP 8.50 on Emergency Recovery Assistance, will assist Turkey to respond quickly and effectively to the impact of the earthquake. The main benefits will be to provide financing for incremental private sector import needs resulting from the earthquake and for budgetary expenditures related to the recovery effort including social protection. A key objective is to ensure that displaced persons and other groups made vulnerable by the earthquake receive adequate and immediate protection, particularly during the upcoming winter months, while longer-term reconstruction efforts get underway. By providing external financing for the exceptional requirements of the Government's recovery program in concert with the IMF and other international partners, the proposed operation will help the authorities keep Turkey's underlying stabilization and structural reform program on track. While this type of operation does not include conditionality linked to

macroeconomic policies, monitoring of economic developments by Bank staff in close collaboration with the IMF will help ensure adequate macroeconomic diligence on the part of the Government.

D. PROJECT DESCRIPTION

32. The proposed Emergency Recovery Loan will provide quick-disbursing support to finance a positive list of import requirements linked to the earthquake, while assisting the Government to implement its earthquake recovery program and achieve its macroeconomic objectives. The proposed loan would be quick-disbursing in order to help meet the immediate requirements arising from the earthquake and recovery effort. The loan will provide financing for a broad range of imports by the private sector, especially fuel, construction materials, construction equipment, production inputs and capital equipment, which are expected to be in demand as the recovery effort proceeds. No disbursements will be made to cover used or luxury goods, military equipment, or nuclear reactors. The Government will use the Turkish Lira counterpart of the loan funds to finance priority components of its earthquake recovery program which emphasize social protection for earthquake victims. These components, which have been agreed with the Bank, are described in Attachment 1. The loan will include limited funding for technical assistance related to implementation of the project. The proposed loan is part of a larger US$ 1 billion assistance package from the Bank which takes into account the assistance expected from the IMF, EU, and other donors (see Attachment 4 for details of the projected external support). It is designed to complement project financing for medium-term reconstruction from the reallocations under existing projects and the MEER project.

E. INSTITUTIONAL ARRANGEMENTS AND PROJECT IMPLEMENTATION

Project Organization and Management

33. The Project will be implemented by the Undersecretariat of Treasury in close collaboration with the Central Bank of Turkey. The Treasury will open a US dollar Special Account in the CBT for the loan, which will finance 100 percent of the foreign exchange costs of private sector imports on the positive list agreed with the Government.

Implementation Arrangements

34. Consistent with the emergency nature of this recovery loan, implementation arrangements have been simplified. To ensure due diligence and sound governance, the arrangements would seek to ensure: (i) that the loan proceeds are used only to finance imports of items contained in the list of imports permissible under the loan (Attachment 1), (ii) that proper procedures are established for procurement and accounting and the complete documentation of transactions; and (iii) that adequate management information is provided using suitable monitoring and audit tools. Detailed arrangements for accounting, financial management, and auditing were agreed during negotiations.

35. The Treasury and the Central Bank will sign an Implementation Agreement, satisfactory to the Bank, defining the assistance to be provided by each organization. The Treasury will:

- authorize the Central Bank to administer and execute the Project;
- approve quarterly financial management and progress reports and submit these to the Bank; and
- appoint independent auditors to carry out the final audit at completion of the project.

The Central Bank will:

- manage and operate the US Dollar Special Account (including preparing withdrawal applications), as well as a corresponding "Special Account" in Turkish Lira, and the sub-accounts for the recovery programs supported by the project;
- manage project accounts using appropriate financial management system and providing accountable and timely financial information on project financing and expenditures;
- prepare and submit quarterly financial management reports and progress reports to the Treasury for approval and submission to the Bank;
- maintain documentation in connection with eligible imports and make this documentation available to independent auditors; and
- facilitate independent audit activities.

Procurement

36. The loan proceeds will finance private sector imports against documentation evidencing that the imported goods were on the positive list of imports listed in Attachment 1. Loan proceeds will be limited to goods from eligible countries under the Bank's Procurement Guidelines (Guidelines: Procurement under IBRD Loans and IDA Credits, January 1995, revised January and August 1996, September 1997 and January 1999). No more than 50 percent of the loan will be used in the aggregate for the import of any single item on the positive list of imports. To avoid high overhead transaction costs for the Bank, financing will be restricted to contracts of US$ 100,000 or above.

37. In addition to the foregoing, the loan will finance consulting services related to implementation of the project in accordance with procedures presented in the table below.

Table 4: Procurement Arrangements

Procurement Category	Procurement Method
Commodities for private sector contracts valued at or more than US$ 5 million	Through established commodity markets, or simplified ICB as defined in Clauses 2.64 and 2.65 of IBRD Procurement Guidelines
Commodities for private sector contracts valued at less than US$ 5 million.	Based on established commercial practices.
Goods for private sector contracts valued at or more than US$ 5 million	Simplified ICB procedures under Clause 2.64 of IBRD Procurement Guidelines
Goods for private sector contracts valued at less than US$ 5 million	Based on established commercial practices
Consulting services related to implementation of the project	Based on Consultant Selection, Least-cost Selection as described under Clause 3.6, Guidelines, Selection and Employment of Consultants by World Bank Borrowers

Note: Imports valued at less than US$ 100,000 will not be eligible for financing.

38. A Country Procurement Assessment report for Turkey was prepared in November 1996. For private sector procurement, there are no national restrictions, preferences or counter-trade agreements regarding the source of imports. The private sector is free to import almost all goods and services, and total imports last year exceeded US$ 45.9 billion. Turkey entered into a customs union with the European Union in 1996. Commercial practices of private sector firms are based on open competition and are generally consistent with a competitive marketplace. Typically, firms obtain multiple quotations from traditional suppliers of the items and base their purchase decisions on the principle of best value for money. Because of this judgment that private sector importing is generally profit-oriented and therefore efficient, Bank staff have determined that current commercial practices would be acceptable without any additional stipulation. This is consistent with the decision to accept commercial practices for private sector contracts for goods up to US$ 5 million under the Export Finance Intermediation Project approved by the Board in July 1999. The thresholds for IBRD prior review are based on typical contracts of medium and large companies.

39. For technical assistance to support implementation of the project, consulting services will be procured based on the "Guidelines, Selection and Employment of Consultants by World Bank Borrowers, issued in January, 1997, revised in September, 1997 and January, 1999. The method of selection will be based on Least-Cost Selection, as described in para. 3.6 of the Guidelines.

40. The Central Bank, which in collaboration with the Treasury is the executing agency for the proposed Project, has prior experience in coordinating disbursements against imports and is capable of ensuring compliance with the agreed procurement arrangements. The Central Bank will retain all procurement documents to ensure easy retrieval for auditing or for the Bank's review.

Disbursement

41. The proceeds of the loan will be disbursed against: (i) 100 percent of the delivered cost of imports by the private sector, excluding imports duties and taxes, subject to the agreed positive list; and (ii) 100 percent of the cost of consulting services to support project implementation activities. Disbursements in respect of expenditures under private sector contracts for goods costing less than US$ 5 million equivalent and for commonly traded commodities such as petroleum, fuel products and coal will be made against Statements of Expenditures for which supporting documentation will be retained by the Central Bank and made available for review by Bank financial management and procurement specialists and project auditors. The project will be implemented over a one year period and the disbursement against imports is expected to be completed by June 30, 2000. The Closing Date for this Loan will be December 31, 2000.

42. **Retroactive Financing.** Retroactive financing in the amount of US$ 50 million, approximately 20 percent of the loan amount, will be provided to finance expenditures incurred up to four months before loan signing, which will cover the entire period since the earthquake hit on August 17.

43. **Special Account.** The Borrower may request disbursement through a US Dollar Special Account to be established in the Central Bank of Turkey, with an initial authorized allocation of US$ 50 million, approximately 20 percent of the total loan amount. The Special Account would be replenished as and when needed to ensure timely disbursements of funds to cover eligible imports.

Financial Management and Monitoring

44. **Project Accounting.** The Central Bank's Foreign Relations Department and the Accounting Department have in place an adequate financial management system to record, monitor and report on financial transactions pertaining to this operation. The financial management system would cover all project components, including project supported activities (Social Solidarity Fund and social security institutions' programs) and project expenditures on imports per agreed positive list. A Chart of Accounts was designed for the project at appraisal with the Accounting Department. The Chart of Accounts will provide consistency in the classification of financial and accounting transactions. It will also ensure sources and uses of project funds are readily matched, and that the accounts are maintained in a complete and consistent manner with respect to participating entities against which expenditures need to be accounted for in the reporting requirements established for the project. The Accounting Department will be responsible for consolidating project financial and accounting data. The Foreign Relations Department, working closely with the Accounting Department, will be responsible for the administration of the Special Accounts in US Dollars and Turkish Lira, and Sub-accounts

for each program supported by the project. All the bank accounts will be opened at the Central Bank. This arrangement will facilitate a common set of financial policies and procedures, and a common system of data classification for the project, as well as facilitate consolidation of financial data across implementing agencies. Accounting and administrative internal controls for the project are in place. To strengthen existing controls in lieu of the size of the program, accounting for the project has been centralized and flow of funds procedures streamlined. A protocol which establishes procedures for managing the flow of funds and internal reporting for the project and project supported programs has been prepared by the Borrower. The entities implementing the project and managing the project have in place adequate and qualified staff experienced in managing World Bank projects (Technical Annex, Attachment 3).

45. **Accounting and Auditing Standards.** The accounting and auditing standards in Turkey are based on Tax Procedure Law No. 213 and Turkish Trade Law No. 6762. The Central Bank is also obligated by The Central Bank Law No. 1211. Where national standards are used, the Bank requires financial statements to disclose any material departures from the International Accounting Standards, and the impact of such departure on the financial statements. The Treasury and Central Bank use double-entry accrual basis accounting.

46. **Financial Reporting.** The Foreign Relations Department will prepare consolidated Quarterly Project Management Reports (PMRs) and Progress Reports for Monitoring Indicators and submit such reports to the Undersecretariat of Treasury within 15 days of end of each calendar quarter for review. Preparation of such reports will be carried out in close collaboration with the Accounting Department to ensure consistency with accounting records and establishment of an audit trail. After review and verification of the PMRs and the Progress Report, the Treasury will submit such reports to the Bank 45 days after end of each calendar quarter. The Progress Report will assess progress towards meeting project objectives on the basis of the agreed monitoring indicators (Attachment 2). The quarterly reports contained in the system and agreed during negotiations are as follows (formats in Project File):

(a) Project Sources and Uses of Funds (Report 1-A)
(b) Project Sources and Uses of Funds (Report 1-A(2)
(Turkish Lira - Project Supported Programs)
(c) Uses of Funds by Project Activity (Report 1-B)
(d) Project Cash Withdrawals (Disbursements) (Report 1-D)
(e) Special Account Statement (Report 1-E)
(f) Summary of Project Progress (Report 2)

47. The transitional reporting requirements do not include procurement management reports because procurement of goods and commodities will be carried out by the private sector based on imports from a positive list. While procurement arrangements for contracts above US$ 5.0 million have been specified, no contracts above US$ 5.0 million for goods and US$ 5.0 million for commodities are envisaged.

48. **Auditing Arrangements.** The Undersecretariat of Treasury will select independent auditors acceptable to the Bank before the commencement of project activities. The terms

of reference (TOR) for the audit were discussed and agreed with the Borrower during negotiations, and include the following: (a) assessment of adequacy and reliability of procedures used to prepare customs certificates or similar certificates; (b) examination of customs certificates comparing the eligible expenditures (imports) to the customs certificates issued by the Turkish authorities for imported goods and commodities from the agreed positive list; (c) verification that expenditures submitted to the Bank are eligible for IBRD financing, and identification of any ineligible expenditures; (d) project financial statements including total, cumulative disbursements and expenditures for the Loan; (e) financial statements documenting the transfer of loan proceeds by the Central Bank of Turkey to the accounts of the agreed programs under Government's earthquake recovery program; (f) review of PMRs to provide the necessary degree of reassurance with respect to reporting requirements; and (g) assessment of the adequacy of accounting and internal control systems to monitor project expenditures and project supported programs.

Supervision

49. The Bank will conduct a mid-term review of the EERL during a supervision mission scheduled for February 2000. Particular attention will be paid to the monitoring of the social assistance benefits, including the accommodation and repair allowances and the lump-sum social assistance payments for death and disability. As part of the mid-term review, a beneficiary assessment will be conducted by an independent agency which will include the critical information of how the clients themselves feel about the program and to monitor the timeliness of their payments. Particular attention will be paid to the monitoring of the social assistance benefits, including the accommodation and repair allowances and the lump-sum social assistance payments for death and disability, with a view towards assessing whether the most vulnerable are adequately covered by these programs. As part of the mid-term review, a beneficiary assessment will be conducted by an independent agency which will provide critical information on how the beneficiaries themselves feel about the program and to monitor the timeliness of payments. The Bank will work with the agency selected to ensure that the interview guide will elicit the monitoring information needed. The mid-term review will also include an operational review of the earthquake recovery programs supported by the project. The objective of the operational review is to verify and assess the adequacy of procedures and systems used by the Social Solidarity Fund and social security institutions to deliver social protection to earthquake victims.

Donor Coordination

50. Since the onset of the disaster, the Bank has been working with the Government and Turkey's international partners to ensure coordination of international support. The Earthquake Assessment prepared by Bank staff has been distributed widely among multilateral and bilateral agencies, and is serving as an important reference. Several agencies, including the IMF, IFC and UNDP, collaborated in the preparation of the assessment, and a number of donors have expressed interest in co-financing or parallel financing in the framework of the Emergency Recovery Loan (in the case of balance of payments and budgetary support) or the MEER project (in the case of project financing for reconstruction). The Bank will continue to support the Government in coordinating

international assistance during the implementation phase of the Emergency Recovery Loan and MEER project.

F. ACTION PLAN

51. During negotiations, the Government delegation and Bank representatives reached agreement on the remaining details of financial management, reports, and auditing, of procurement thresholds, and disbursement procedures to be followed. A set of performance monitoring indicators was agreed (Attachment 1), selected to allow the Bank to track the impact of the project without being unduly burdensome to the Government. The Bank will conduct a mid-term review of the project with a supervision mission in February 2000. During the mid-term review, the Bank and the Borrower will assess whether the social protection programs for earthquake victims are adequate.

Effectiveness Conditions

52. Execution of the Project Implementation Agreement between the Undersecretariat of Treasury and the Central Bank of Turkey is a condition of effectiveness for the loan.

ATTACHMENT 1

Republic of Turkey
Emergency Earthquake Recovery Loan

Part I
POSITIVE LIST OF IMPORTS

Tariff code	Items
25	Salt, sulfur, earths and stone, plastering materials, lime and cement
26	Ores, slag and ash
27	Mineral fuels, mineral oils and products of their distillation, bituminous substances and mineral waxes
28	Inorganic chemicals
29	Organic chemicals
30	Pharmaceutical products
32	Tanning or dying extracts; tannins and their derivatives; dyes, pigments and other colouring matter; paints and varnishes; putty and other mastics; inks
34	Soap, organic surface-active agents, washing preparations, lubricating preparations, artificial waxes, prepared waxes, polishing or scouring preparations, candles and similar articles, modeling pastes, "dental waxes" and dental preparations with a basis of plaster
35	Albuminoidal substances; modified starches; glues; enzymes
38	Miscellaneous chemical products
39	Plastics and articles thereof
40	Rubber and articles thereof
41	Raw hides and skins (other than furskins) and leather
44	Wood and articles of wood; and wood charcoal
47	Pulp of wood or other fibrous cellulosic material; recovered (waste and scrap) paper or paperboard
48	Paper and paperboard; articles of paper pulp, of paper or paperboard
51	Wool, fine and coarse animal hair; horsehair yarn and woven fabric
52	Cotton
54	Man-made filaments
55	Man-made staple fibers
56	Wadding, felt and nonwovens; special yarns; twine, cordage, ropes cables and articles thereof
59	Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable for industrial use
68	Articles of stone, plaster, cement, mica, and asbestos or similar materials
69	Ceramic products
70	Glass and glassware
72	Iron and steel
73	Articles of iron and steel
74	Copper and articles thereof
75	Nickel and articles thereof
76	Aluminum and articles thereof
78	Lead and articles thereof
79	Zinc and articles thereof
80	Tin and articles thereof
81	Other base metals; cermets; articles thereof
83	Miscellaneous articles of base metal
84	Boilers, machinery and mechanical appliances; parts thereof 1/

1/ Excluding nuclear reactors and their parts

Tariff code	Items
85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles
86	Railway or tramway locomotives, rolling-stock and parts thereof; railway or tramway track fixtures and fittings and parts thereof; mechanical (including electro-mechanical) traffic signaling equipment of all kinds
87	Vehicles other than railway or tramway rolling-stock, and parts accessories thereof
90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and thereof
94.01 - 94.02	Medical and surgical furniture
94.06	Prefabricated constructions
96.01 - 96.13	Office equipment

PART II
Priority Programs under the Government's Earthquake Recovery Program which are Supported by the Project

1. accommodation assistance program for families in the affected region whose dwellings have collapsed or have suffered heavy or medium damage in accordance with the decision (No. B09.D.AIS.0.13.00.07/10465) of the Ministry of Public Works dated September 14, 1999 and as modified by the subsequent letters of the State Minister responsible for the Social Solidarity Fund (Nos. B 02.0 SYF/ -100-18360, 17880, and 18303) dated September 27, 1999. In accordance with this decision the accommodation assistance program will be administered by the Social Solidarity Fund;

2. repairs assistance program for eligible families in the affected region whose dwellings have suffered light damage in accordance with the above decision. The repairs assistance program will be administered by the SSF;

3. payments made by the three social security institutions (Sosyal Sigortalar Kurumu, Emekli Sandigi and Bag-Kur) to beneficiaries in the affected region on account of death benefits, survivor pensions and disability pensions which are attributable to the earthquake;

4. payment of lump-sum death and disability benefits to all families in the affected region which have suffered a death or disability (A Government decision to introduce this program will be issued before the end of October). The program will be administered by the SSF.

ATTACHMENT 2

Republic of Turkey
Emergency Earthquake Recovery Loan

Monitoring Indicators

The objective of the Emergency Earthquake Recovery Loan is to assist Turkey to respond quickly and effectively to the impact of the earthquake while keeping the Government's economic reform program on track. The main benefits will be to provide financing for incremental private sector import needs resulting from the earthquake and for budgetary expenditures related to recovery efforts including social assistance and other priorities.. The following indicators will be used to monitor the effectiveness of the project:

- Gross reserves of the Central Bank of Turkey not to fall below five months of imports of goods and services.

- The primary surplus of the consolidated Central Government not to be less than 1.0 percent of GNP in 1999.

- Accommodation assistance and Repair assistance payments to be made to all eligible recorded beneficiaries in accordance with the decision (No. B09.D.AIS.0.13.00.07/10465) of the Ministry of Public Works dated September 14, 1999 and as modified by the subsequent letters of the State Minister responsible for the Social Solidarity Fund (Nos. B 02.0 SYF/ -100-18360, 17880, and 18303) dated September 27, 1999.

- Lump-sum death and disability payments to be made to all eligible and registered beneficiaries in accordance with the Government decision to be issued by October 31, 1999. This program will be administered by the Social Solidarity Fund.

- Payments to be made by the three social insurance funds (SSK, Bag-Kur, and ES) to all eligible beneficiaries on account of death benefits, survivor pensions and disability pensions which are attributable to the earthquake.

ATTACHMENT 3

Republic of Turkey
Emergency Earthquake Recovery Loan

Financial Management Assessment

Objectives and Project Description

1. *Objective of Financial Management Assessment.* The objective of the financial management assessment was to determine whether the project has in place an adequate financial management system, including acceptable financial management and accounting controls as required by the Bank in OP/BP 10.02.

2. *Project Objectives and Project Description.* The proposed Emergency Earthquake Recovery Loan will assist the Government of Turkey to respond effectively to the August 17 earthquake in the northwestern Marmara region while keeping its economic reform program on track.

Sources and Flow of Funds

3. The proposed IBRD Loan of US$ 252.53 million will finance 100 percent of delivered cost of general imports by the private sector, excluding import duties and taxes, and subject to an agreed positive list. The IBRD Loan will be channeled through Special Accounts in US dollars and Turkish Lira to opened in the Central Bank of Turkey (the Central Bank). The Central Bank as a representative of the Undersecretariat of Treasury will have the responsibility of administering the Special Account. It will be responsible for submitting withdrawal applications for advance payment and replenishments of the Special Account to cover the IBRD Loan share of eligible imports. Upon receipt of written transfer payments order from the Undersecretariat of Treasury, the Central Bank will transfer the IBRD funds to a Special Account in Turkish Lira held at the Central Bank. The Undersecretariat of Treasury will provide the Central Bank with names of authorized signatories with authority to sign withdrawal applications.

4. Under the Special Account in local currency, Sub-accounts for the emergency earthquake recovery programs will be established within the same depository bank, and managed by the Foreign Relations Department. The Sub-accounts under the Social Solidarity Fund will service programs for families in affected regions and will support: (a) accommodation assistance;. (b) repair assistance; and (c) one-time lump sum assistance for death and disability. The Sub-accounts under Social Security Institutions will support payments made by the three social security institutions (Sosyal Sigortalar Kurumu, Emekli Sandigi and Bag-Kur) to beneficiaries in the affected region on account of death benefits, survivor pensions and disability pensions attributable to the earthquake. To streamline flow of funds and enhance transparency, all bank accounts will be held at the Central Bank and project accounting centralized. The Treasury has prepared a protocol which establishes procedures for managing the flow of funds and internal reporting for the project and project supported programs (Attachment 6).

5. **Statements of Expenditure (SOE).** Under the SOE withdrawal procedure, the Central Bank will forward to the Bank an application for reimbursement of payments already made and eligible for IBRD financing. Relevant supporting documents including customs certificates and invoices as evidence of payment will be retained by the Central Bank and made available for inspection by Bank representatives and the independent auditors.

6. ***Retroactive financing.*** Payments made after the emergency occurred and within four months prior to the expected date of loan signing are permissible for payments; to a cumulative maximum of US$ 50 million, approximately 20 percent of the loan amount.

Implementation Arrangements

7. The Project will be implemented by the Undersecretariat of Treasury in close collaboration with the Central Bank. Both the Treasury and the Central Bank will sign an 'Implementation Agreement'. The parties' obligations under the Implementation Agreement will be as follows:

(a) Undersecretariat of Treasury

(i) authorize the Central Bank to administer and execute the Project;

(ii) comply with all the contractual provisions of the Loan Agreement;

(iii) establish a Special Account in the Central Bank of the Republic of Turkey for the Loan;

(iv) approve Quarterly Financial Management Reports and Progress Reports on Monitoring Indicators for the Loan, prepared by the Central Bank, and submit such reports to the World Bank within 45 days after end of each calendar quarter; and

(v) appoint independent auditors satisfactory to the Bank to carry out the Loan final audit. The final audit will cover total, cumulative, disbursement and expenditures for the Loan. The audit will also cover: (i) financial statements documenting the transfer of the loan funds by the Central Bank to the accounts of the programs under the Government's earthquake recovery program as agreed with the Bank, and (ii) a review of the internal controls of each of the programs to which such funds are transferred.

(b) Central Bank of the Republic of Turkey (Department of Foreign Relations)

(i) prepare disbursement requests including replenishment of the Special Account, prepare records for disbursements made on basis of Statements of Expenditures;

(ii) sign and submit the disbursement requests under the Loan at least monthly;

(iii) maintain records and accounts for the Special Account (US Dollar and Turkish Lira), and open sub-accounts for each program that will be supported by the project;

(iv) establish and maintain appropriate records reflecting the transactions financed under the Loan, including all documentation in connection with eligible imports and transfer of the funds from the loan to the accounts of the programs under the Government's earthquake recovery program as agreed with the Bank, and allow access to such information to the independent auditors and representatives of the Bank whenever required;

(v) confirm the eligibility of import documents supporting disbursements under the Loan based on the positive list agreed with the Bank;

(vi) prepare Quarterly Financial Management Reports (PMRs) per agreed format, and Progress Reports of Monitoring Indicators and submit the reports to the Undersecretariat of Treasury within 15 days of end of each calendar quarter for review and submission to the Bank; and

(vii) facilitate independent audit activities including provision of records and documentation covering the import of eligible goods and commodities, and the transfer of funds from the Loan to the accounts of the programs under the Government's earthquake recovery program as agreed with the Bank.

(c) Undersecretariat of Treasury and the Central Bank of the Republic of Turkey

(i) Undersecretariat of Treasury approves quarterly reports prepared by the Central Bank of Turkey and submits said reports to the Bank within 45 days after end of each calendar quarter.

(ii) Undersecretariat of Treasury and the Central Bank of Turkey jointly prepare and submit to the Bank the Implementation Completion Report for the Loan after completion of the Project.

Financial Management and Reporting

8. *Project Accounting.* The Central Bank has in place adequate financial management system to record, monitor and report on financial transactions pertaining to this operation. The financial management system would cover all project components, including project supported activities (Social Solidarity Fund and social security institutions' programs) and project expenditures on imports per agreed positive list. The centralized Accounting Department in the Central Bank will be responsible for consolidating project financial data. A Chart of Accounts was designed for the project at appraisal, with the Accounting

Department. The Chart of Accounts will provide consistency in the classification of financial and accounting transactions. It would also ensure sources and uses of project funds are readily matched, and that the accounts are maintained in a complete and consistent manner with respect to participating entities against which expenditures need to be accounted for in the reporting requirements established for the project. The reporting and maintaining of records and accounts for the Special Account, the Turkish Lira Account and associated Sub-accounts for the programs under the emergency recovery program will be the responsibility of the Foreign Relations Department. The bank accounts will be established at the Central Bank. This arrangement would facilitate common set of financial policies and procedures, common system of data classification for the project, and facilitate consolidation of financial data across implementing agencies.

9. *Reporting.* The Quarterly Project Management Reports and Progress Reports will be prepared by the Foreign Relations Department and submitted to the Treasury for review within 15 days of end of each calendar quarter for review. Preparation of such reports will be carried out in close collaboration with the Accounting Department to ensure consistency with accounting records and establishment of audit trail. After review and verification of the reports, the Treasury will submit the reports to the Bank within 45 days after end of each calendar quarter. The Progress Report will assess progress towards meeting project objectives on the basis of the agreed monitoring indicators (Attachment 2). The quarterly reports contained in the system and agreed during technical discussions are as follows (formats in Project File):

(a) Project Sources and Uses of Funds (Report 1-A
(b) Project Sources and Uses of Funds (Report 1-A(2)
(Turkish Lira - Project Supported Programs)
(c) Uses of Funds by Project Activity (Report 1-B)
(d) Project Cash Withdrawals (Disbursements) (Report 1-D)
(e) Special Account Statement (Report 1-E)
(f) Progress Report (Report 2)

The transitional reporting requirements do not include a procurement management report. Procurement will be done by the private sector based on imports from a positive list and any contracts above US$ 5.0 million for goods and US$ 5.0 million for commodities will follow simplified procurement procedures.

Internal Controls

10. Accounting and administrative internal controls for the project are in place. To strengthen existing controls in lieu of the size of the program, the flow of funds procedures have been streamlined and managing the Special Account for the project and all related subaccounts is centralized at the Central Bank. Project accounting has been centralized and a protocol prepared which establishes procedures for managing the flow of funds and internal reporting for the project and project supported programs. The operational guidelines and procedures will be documented in the operational manual, in the format agreed with the Borrower during negotiations and included in the Action Plan.

Staffing

11. The Foreign Relations Department (PIU) and the Treasury have in place adequate and qualified staff experienced in managing World Bank projects. The project team includes a staff of eight with segregated duties.

Accounting and Auditing Standards

12. The accounting and auditing standards in Turkey are based on Tax Procedure Law No. 213 and Turkish Trade Law No. 6762. The Central Bank is also obligated by The Central Bank Law No. 1211. The national standards are not fully in compliance with international standards. Where national standards are used, the Bank requires financial statements to disclose any material departures from the International Accounting Standards, and the impact of such departure on the financial statements. The Central Bank and Treasury use double-entry accrual basis accounting.

Auditing Arrangements

13. The Treasury will select independent auditors acceptable to the Bank before the commencement of project activities. The terms of reference (TOR) for the audit were discussed and agreed during negotiations and a requirement for appointment of independent auditors included in the agreed Action Plan. The final audit will cover:

(a) total, cumulative disbursements and expenditures for the Loan;
(b) financial statements documenting the transfer of loan proceeds by the Central Bank of Turkey to the accounts of the programs under Government's earthquake recovery program as agreed with the Bank;
(c) review of internal controls of each of the programs to which such funds are transferred;
(d) Project Management Reports to provide the necessary degree of reassurance with respect to reporting under PMRs;
(e) assessment of adequacy and reliability of procedures used to prepare customs certificates or similar certificates;
(f) examination of customs certificates comparing the eligible expenditures (imports) to the customs certificates issued by the Turkish authorities for imported goods and commodities from the agreed positive list;
(g) verification that expenditures submitted to the Bank, including those submitted in the PMRs, are eligible for IBRD financing, and identification of any ineligible expenditures.

14. In addition to the financial audit, an operational review and a beneficiary assessment of the recovery programs supported by the project will be carried out by independent reviewers during the mid-term Review. The operational review will determine whether the institutions' procedures and systems are adequate to provide reasonable assurance that objectives will be achieved effectively and efficiently.

Conclusion

15. Review of financial management system, including internal controls, project accounting, quality of staff implementing and managing the project, and financial reporting capacity of the Central Bank's Foreign Relations Department indicate the project has satisfied the Bank's financial management requirements as required under OP/BP 10.02. An Action Plan to strengthen such systems was agreed during negotiations. Loan disbursements will be based on traditional disbursement procedures and not PMR-based disbursements. PMRs will be used for reporting purposes. This is in accordance with the agreement reached between the Bank and the Borrower.

ATTACHMENT 4

Republic of Turkey
Emergency Earthquake Recovery Loan

Balance of Payments, 1997-2000

		Baseline		Post-Earthquake	
	1998	1999	2000	1999	2000
Current account balance	1,872	-1,075	-3,630	-2,008	-5,663
(percent of GNP)	0.9	-0.6	-1.7	-1.0	-2.6
Trade Balance	-14,332	-12,413	-16,628	-13,113	-18,010
Exports	31,220	29,078	30,281	28,567	30,031
Imports	-45,552	-41,491	-46,909	-41,680	-48,041
Services (net)	10,477	5,476	6,899	5,243	6,248
of which, interest (net)	-2,342	-3,209	-3,066	-3,242	-3,170
Private transfers	5,568	5,480	5,707	5,480	5,707
Official transfers	159	382	392	382	392
Capital account balance	545	7,535	7,799	7,535	7,649
Direct investment	573	545	645	545	645
Portfolio investment (excl. privatization)	-6,057	450	-500	450	-500
Public Sector (incl. Central Bank of Turkey)	-1,221	1,895	5,680	1,895	5,530
Privatization	250	500	1,500	500	1,350
Borrowing (net)	-1,933	1,225	3,600	1,225	3,600
Bonds (net)	-261	1,979	4,500	1,979	4,500
Loans (net)	-1,672	-754	-900	-754	-900
Central Bank of Turkey (net)	462	170	580	170	580
Domestic Money Banks (net)	1,935	2,272	631	2,272	631
Other Private Sector (net)	5,315	2,373	1,343	2,373	1,343
Errors and Omissions	-2,197	131	0	131	0
Overall Balance and Change in Gross Reserves	220	6,591	4,169	5,658	1,986
Projected financing gap relative to the baseline	...	...	...	933	2,183
Cumulative gap					3,116
Exceptional Foreign Financing				800	2,312
World Bank				300	710
of which, EERL				100	112
IMF				500	
European Fund and EIB					931
Islamic Development Bank					300
Japan					200
Others					151
Cumulative Exceptional Foreign Financing					3,152
Memorandum items:					
Gross reserves	19,893	26,484	30,653	26,484	30,653
in months of importsof G&NFS	3.9	5.5	5.7	5.3	5.7
Gross Reserves (in percent) 1/	51.4	60.9	70.4	59.4	70.4
Short-term debt/foreign reserves	137	116	107	119	107

1/ Central bank foreign reserves divided by the end-period short-term debt plus MLT debt repayments falling due in the year.

ATTACHMENT 5

Republic of Turkey
Emergency Earthquake Recovery Loan

Table A5-1: Consolidated Central Government Budget, 1997-2000

			Without Quake 2/		With Quake	
[% of GNP]	1997	1998	1999	2000	1999	2000
Total Revenue	19.2	21.5	22.5	26.2	22.1	26.1
Tax Revenue	16.2	17.4	17.8	19.3	17.4	19.2
Direct	6.6	8.1	7.9	7.9	7.8	7.9
Indirect	9.6	9.3	9.9	11.4	9.6	11.3
Non-tax Revenue	3.0	4.1	4.7	6.9	4.7	6.9
Expenditure	26.9	29.3	33.4	37.2	33.8	37.6
Non-interest Expenditure	19.2	17.7	20.5	20.3	21.0	20.7
Personnel	7.1	7.3	8.4	8.0	8.4	8.0
Other Current	2.3	2.5	2.9	3.0	2.9	3.1
Transfers	7.8	6.0	7.7	7.5	8.0	7.7
Investment	2.0	1.9	1.6	1.8	1.7	1.9
Primary Balance	0.0	3.9	2.0	6.0	1.1	5.4
Interest Payments	7.8	11.7	12.8	16.9	12.8	16.9
Overall Balance	-7.7	-7.8	-10.9	-10.9	-11.8	-11.5
Memorandum items						
Consolidated public sector primary surplus 1/	0.1	2.5	-0.3	5.9	-1.4	4.8
PSBR	6.7	9.2	13.1	10.8	14.2	12.0

Source: Treasury, SPO and staff estimates.

1/ Housing investments and social assistance programs will be financed by extra-budgetary funds, included in consolidated public sector accounts.

2/ "Without Quake" budget figures do not correspond with "Pre-Earthquake" figures in Table 3 as underlying GNP and inflation estimates differ.

Attachment 5

Table A5-2: Fiscal Cost of Accommodation and Repair Assistance

	Number of Recipients	Eligibilty per family TL mil.	Monthly Cost TL bil	Total Cost 1999 TL bil	Total Cost 1999 $ mil	Total Cost 2000 TL bil	Total Cost 2000 $ mil	Total Cost 99-00 TL bil	Total Cost 99-00 $ mil
Accomodation Assistance									
Collapsed / Heavy damage	90,000.0	100.0	9,000.0	27,000.0	57.1	81,000.0	141.4	108,000.0	198.4
Light Damage Repair Assistance									
Light damage	85,000.0	600.0		51,000.0	107.8			51,000.0	107.8
Grand Total	175,000.0			78,000.0	164.9	81,000.0	141.4	159,000.0	306.3

Source: Social Solidarity Fund and Staff estimates.

Table A5-3: Fiscal Cost of One-Time Lump Sum Social Assistance

	Victims (person)	Eligibilty (ratio)	Allowance per person TL million	Allowance per person ($)	Total Cost 1999 TL bil	Total Cost 1999 ($ mio)
Loss of life	18,000	100%	750	1,586	13,500.0	28.5
Disabilities compensation [first degree]	6,000	100%	500	1,057	3,000.0	6.3
Disabilities compensation [second degree]	5,000	100%	300	634	1,500.0	3.2
Total	11,000				4,500.0	9.5
Grand total	29,000				18,000.0	38.1

Source: Social Solidarity Fund and Staff estimates.

Table A5-4: Fiscal Cost of Social Insurance Benefits

	Number of Recipients	Eligibilty per family TL mil.	Monthly Cost TL bil	Total Cost 1999 TL bil	Total Cost 1999 $ mil	Total Cost 2000 TL bil	Total Cost 2000 $ mil	Total Cost 99-00 TL bil	Total Cost 99-00 $ mil
Disability and survivor pension paym.	7,971		368.2	1,464.9	5.0	10,792.0	18.8	12,256.9	23.8
SSK	4,643	66.6	309.4	1,237.6	2.6	6,312.0	11.0	7,549.6	13.6
ES	2,050	108.0	221.4	885.6	1.9	3,321.0	5.8	4,206.6	7.7
Bagkur	1,278	44.5	56.8	227.3	0.5	1,159.0	2.0	1,386.3	2.5
Funeral Payment	3,852			305.5	0.6			305.5	0.6
SSK	2,650	60.0		159.0	0.3			159.0	0.3
ES	558	228.0		127.2	0.3			127.2	0.3
Bagkur	644	30.0		19.3	0.0			19.3	0.0
Total	11,823			1,770.4	5.6	10,792.0	18.8	12,562.4	24.4

Source: Social Security Institutions and Staff estimates.

Table A5-4: Fiscal Cost of Eligible Social Programs

Name of Program	Number of Recipients	Total Cost 1999 TL bil	Total Cost 1999 $ mil	Total Cost 2000 TL bil	Total Cost 2000 $ mil	Total Cost 99-00 TL bil	Total Cost 99-00 $ mil
Accomodation assistance	90,000	27,000.0	57.1	81,000.0	141.4	108,000.0	198.4
Repair assistance	85,000	51,000.0	107.8			51,000.0	107.8
One-time lump sum social assistance	29,000	18,000.0	38.1			18,000.0	38.1
Social insurance benefits	11,823	1,770.4	5.6	10,792.0	18.8	12,562.4	24.4
Total	215,823	97,770.4	208.6	91,792.0	160.2	189,562.4	368.8

Source: Social Security Institutions, Social Solidarity Fund and Staff estimates.

ATTACHMENT 6

CHART OF FLOW OF FUNDS IN PROJECT IMPLEMENTATION