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Enabling poor rural people
to overcome poverty

President's report

Proposed loan to the Federal Democratic Republic of Ethiopia for the

Pastoral Community Development Project III

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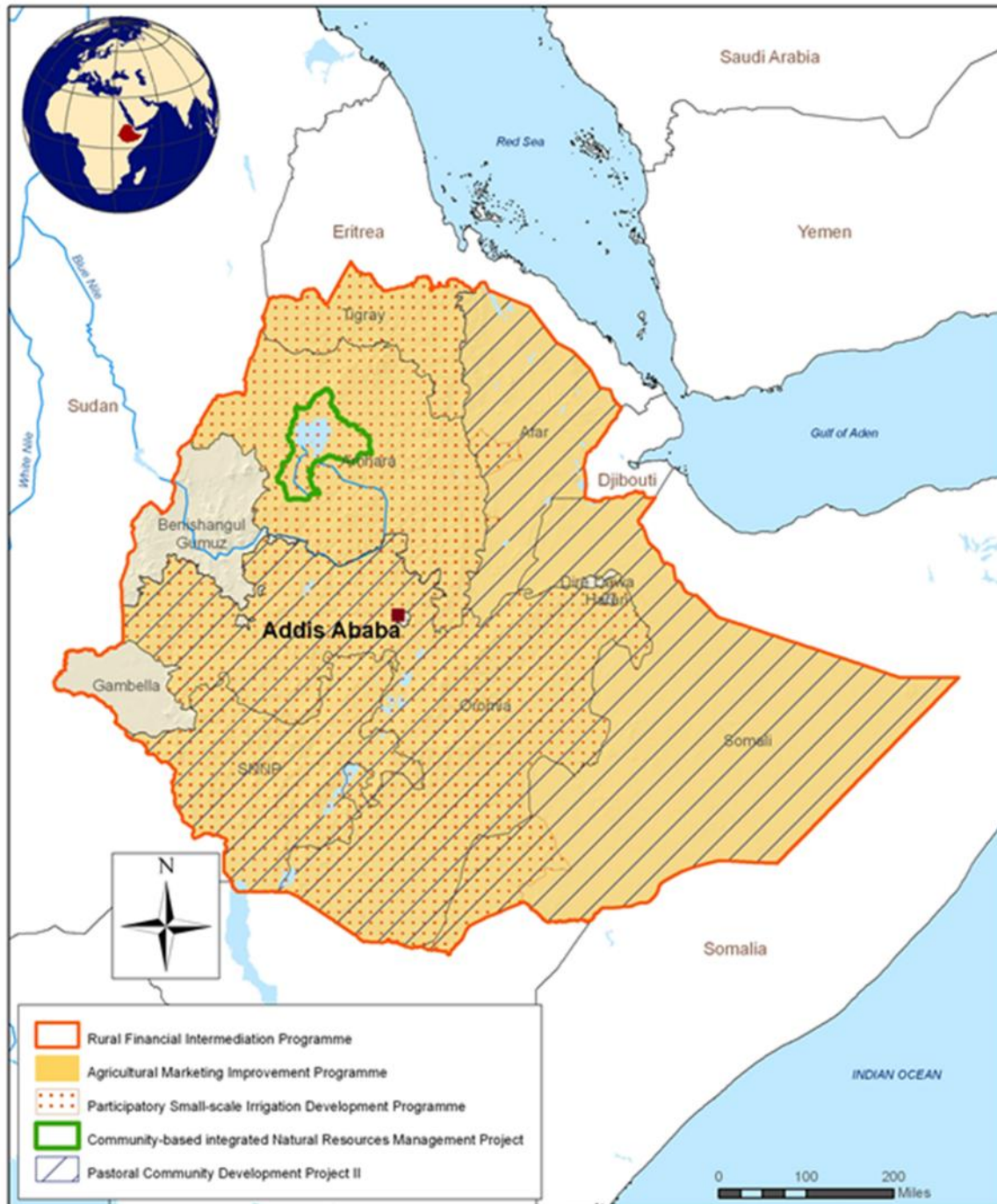
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Abbreviations and acronyms

CIF	community investment fund
COSOP	country strategic opportunities programme
FPCU	federal project coordination unit
GTP	Growth and Transformation Plan
kebele	sub-district
M&E	monitoring and evaluation
PBAS	performance-based allocation system
PCDP	Pastoral Community Development Project
RLP	Rural Livelihoods Programme
RPCU	regional project coordination unit
SACCO	rural savings and credit cooperative
woreda	district

Maps of the project area

Federal Democratic Republic of Ethiopia IFAD-funded operations



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.

Map compiled by IFAD

28-3-2011

Federal Democratic Republic of Ethiopia

Pastoral Community Development Project III



The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.
Map compiled by IFAD | 20-09-2013

Federal Democratic Republic of Ethiopia

Pastoral Community Development Project III

Financing summary

Initiating institutions:	World Bank/IFAD
Borrower:	Federal Democratic Republic of Ethiopia
Executing agency:	Ministry of Federal Affairs
Total project cost:	US\$218.2 million
Amount of IFAD loan:	SDR 55.3 million (equivalent to approximately US\$85.0 million) ¹
Terms of IFAD loan:	40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum
Cofinancier:	World Bank
Amount of cofinancing:	International Development Association: US\$100 million
Contribution of borrower:	US\$5.0 million
Contribution of beneficiaries:	US\$13.2 million
Appraising institution:	World Bank/IFAD
Cooperating institution:	World Bank

¹ The total amount of resources available under the current cycle of the performance-based allocation system (PBAS) for the Federal Democratic Republic of Ethiopia is US\$85 million, whereas IFAD's overall expected contribution to the project is US\$100 million. It is envisaged that the US\$15 million financing gap will be met in full or in part by: (i) other cofinancing sources still to be identified; and/or (ii) PBAS reallocations, which should become available by the end of 2015; and/or (iii) resources to be made available to the borrower in 2016 under the next PBAS cycle. Approval for the additional financing will be sought from the Executive Board, where appropriate.

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to the Federal Democratic Republic of Ethiopia for the Pastoral Community Development Project III, as contained in paragraph 45.

Proposed loan to the Federal Democratic Republic of Ethiopia for the Pastoral Community Development Project III

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Ethiopia is a large and diverse country with a population of 91.7 million (2012). It is a landlocked country covering an area of 1.1 million km² in the Horn of Africa. Its biophysical environment includes a variety of contrasting ecosystems, with significant differences in climate, soil properties, vegetation types, agricultural potential, biodiversity and water resources. Only 17 per cent of the population lives in urban centres, the majority in Addis Ababa. At the current annual growth rate of 2.6 per cent, Ethiopia's population is expected to reach 130 million by 2025.
2. Ethiopia has a federal, democratic government system, established in the early 1990s, with nine autonomous states (regions) and two chartered cities. Decentralization to the regional and district (*woreda*) levels of government has been actively pursued, particularly since 2003.
3. Ethiopia has experienced strong economic growth in recent years, with an average growth rate of 10.7 per cent per year from 2003/04 to 2011/12, while the regional average was 5.4 per cent. Substantial progress has also been made in social and human development over the last decade. Yet poverty remains a major challenge for the country, although high economic growth has helped reduce this in both urban and rural areas. Since 2005, 2.5 million people have been lifted out of poverty, and the share of population below the poverty line has fallen from 38.7 per cent in 2004/05 to 29.6 per cent in 2010/11 (using a poverty line of US\$0.6/day).
4. The Government of Ethiopia is currently implementing its ambitious Growth and Transformation Plan (GTP, 2010/11-2014/15), which sets the long-term goal of becoming a middle-income country by 2023 and projects growth rates of at least 11.2 per cent per year during the plan period. To achieve the GTP objectives, the Government is following a "developmental state" model in which it takes a strong role in many aspects of the economy. The GTP prioritizes key sectors such as industry and agriculture as drivers of sustained economic growth and job creation. It also reaffirms the Government's commitment to human development. Development partners have programmes that are broadly aligned with GTP priorities.
5. Lessons learned from IFAD's experiences in Ethiopia over the years are at the centre of IFAD's scaling up agenda in the country. Scaling up is largely based on tried and tested best practices, innovation and success stories. For example, lessons learned from the first phase of the Pastoral Community Development Project (PCDP) provided the basis for scaling up into PCDP II, which is being further scaled up into phase three of the project (PCDP III). This underscores the importance the Government attaches to pastoral development as means of reducing poverty among the most neglected and vulnerable rural households.

B. Rationale and alignment with government priorities and RB-COSOP

6. The results-based country strategic opportunities programme (COSOP) for Ethiopia (ending in 2015) builds on progress achieved by the country in recent years and aims to help the Government address poverty in the developing regions inhabited mainly by pastoralist and agropastoralists. In support of the GTP, PCDP III is designed to tackle the plight of the more vulnerable pastoral communities that have historically been neglected by the development agenda. Accounting for 12-15 per cent of the country's population, pastoralists live in remote and marginalized areas characterized by poor social and economic infrastructure and lack of support services. The project is scaling up the community-driven development approach to expand outreach from the baseline of about 250,000 pastoral and agropastoral households to approximately 600,000 households, representing 25-30 per cent of the total pastoral population.
7. **Socio-economic context.** Pastoralism in Ethiopia relates both to an economic livelihood system that is based primarily on extensive livestock production and to the characteristics of communities that live in the arid and semi-arid lowlands of the country. Pastoralist households can be divided into three categories: (i) the comparatively wealthy, who hold substantial livestock assets; (ii) those who have small herds and flocks and who, to some extent, depend upon cropping, petty trading or the sale of their labour (agropastoralists); and (iii) those who are gradually abandoning pastoral livelihoods. Pastoralists' success in expanding their livestock production systems can be affected by factors such as mobility, access to good rangeland, markets and services (e.g. animal health care), and the severity of climatic shocks.
8. An increase in demand for livestock, both domestically in Ethiopian markets and in neighbouring countries such as Djibouti, Kenya, Somalia and the Sudan, has been driving changes in pastoralist livelihood systems. In particular, there has been an increase in the commercialization of livestock resulting in the consolidation of herds. This has meant that, while many pastoral households have been able to improve their livestock-based livelihoods, an increasing number have been unable to maintain their traditional livelihoods as viable undertakings. As a result, a growing segment of the traditionally pastoralist population is dropping out of pastoralism, sometimes into agropastoralism and sometimes into destitution.
9. As a community, pastoralists have in the past been economically, socially and politically marginalized because of insufficient attention from policymakers. Although significant improvements have been achieved over the last ten years, pastoralists remain underserved in terms of basic social services.
10. **Target group and targeting strategy.** Community participation in the PCDP II planning process has increased from year to year, especially among women and young people in initiatives to create awareness and to prepare community action plans at the sub-*kebele* level. Engagement with women, young people and other marginal groups (for example ethnic minorities and disadvantaged groups living in remote areas) is constrained by (i) ineffective gender and targeting strategy aimed at mobilizing and including women, young people and other marginal groups; (ii) limited capacity among staff of implementing agencies at the *woreda*, *kebele* (sub-district) and sub-*kebele* levels to undertake this mobilization, coupled with a lack of awareness on gender issues among pastoral communities; and (iii) the tendency among women to participate less because of lack of time, incentives or self-confidence. PCDP III follows the modalities and principles of CDD. Gender-specific activities targeting women, as well as other vulnerable groups, are included in the project design.
11. In Phase II it was found that creation of savings and credit cooperatives (SACCOs) in pastoral areas enabled pastoral women to have access to financial services and

increased their livelihood opportunities. However, despite the high percentage of women members of SACCOs (over 50 per cent), their use of these services was limited. More needs to be done in PCDP III; the Rural Livelihoods Programme (RLP) component includes specific activities to achieve this.

II. Project description

A. Project area and target group

12. PCDP III is a national project that covers all pastoral *woredas* in Ethiopia except those in Benishangul Gumuz and Gambella. The primary target of the project is the pastoral and agropastoral population living in the arid and semi-arid areas of Ethiopia, estimated at 12 million. PCDP reached a population of 600,000 in its first phase and an additional 1.3 million in its second phase, cumulatively benefiting 1.9 million people, of whom 52 per cent are women. PCDP III should reach a further 2.8 million pastoralists in 107 pastoral and agropastoral *woredas* of Afar, Somali, Oromia and the Southern Nations, Nationalities and Peoples Regional State. During its 15-year implementation period, the project is expected to cover most pastoral and agropastoral *woredas* in the country, provide improved access to public services and support the livelihoods of about 4.7 million pastoralists and agropastoralists. It will also introduce community-driven models of service delivery that will benefit pastoral and agropastoral communities throughout the country.

B. Project development objective

13. The project development objective of PCDP III is to improve access to community-driven social and economic services for Ethiopia's pastoralists and agropastoralists. This is expected to improve the livelihoods of pastoralists and agropastoralists by increasing and stabilizing their incomes, improving their nutrition, health and education status, and expanding their empowerment and decision-making authority in local development initiatives.

C. Components/outcomes

14. The project outcomes will be measured according to the beneficiaries' increased access to public services and financial services, including agricultural and livestock production services that derive directly from PCDP III interventions and are in line with community demands and priorities. The outcomes include (i) the number of men and women household heads in project *kebeles* who use available public services addressing their livelihood priorities; (ii) the number of households undertaking viable income-generating activities supported by business plans; and (iii) the number of SACCO members as a proportion of the target community population. The project's four components are described below.
15. **Component 1: Community-driven service provision.** PCDP III will extend the CDD approach in all pastoral and agropastoral *woredas*, specifically targeting 107 pastoral and agropastoral *woredas* of Afar, Oromia, Somali and the Southern Nations, Nationalities and Peoples Regional State. Component 1 will support community sub-projects to build demand-driven social and economic infrastructure in targeted pastoral and agropastoral *kebeles*. It will provide investment funds that, together with community contributions, will help expand and improve service delivery and build infrastructure for local development. The component will also provide technical assistance to promote broad participation and community decision-making in local development. In order to strengthen the CDD process and ensure it is institutionalized, PCDP III will build community institutions able to engage in planning and resource mobilization, implement small public investment projects and provide oversight in service delivery. PCDP III will also develop community-level monitoring and learning systems by (i) introducing simple monitoring formats to be used by beneficiary communities to track project milestones, results and budget use, and to identify implementation problems and best practices; (ii) facilitating periodic structured learning forums at the *kebele*,

sub-*kebele* and *woreda* levels; and (iii) training community leaders and volunteers in managing relevant information and promoting learning from such information. It will also develop the *kebele* centres as information sharing and learning hubs. Component 1 has three sub-components: (i) community sub-projects financed through a community investment fund (CIF); (ii) institutionalization of the CDD approach through capacity-building at the *woreda* and community levels and promotion of *woreda* planning and budget development that reflects community priorities; and (iii) community-level self-monitoring and learning.

16. **Component 2: Rural Livelihoods Programme (RLP).** This component will help pastoralist and agropastoralist households to improve their livelihood systems by supporting enhanced access to financial services (through the promotion of grassroots financial institutions) and to advisory services that will enable them to identify viable investment opportunities. It will also provide households with technical support to strengthen and/or diversify their production systems and encourage innovation. Component 2 has three sub-components: (i) promotion of new pastoral SACCOs; (ii) identification and development of livelihood opportunities; and (iii) promotion of adaptive research and innovative practices.
17. **Component 3: Development learning and knowledge management.** This component will complement the community-level development focus of the first two components with policy dialogue, strategic thinking around pastoralist development issues, capacity-building of pastoral groups to enhance their ability to participate in policy dialogue, and enhanced transparency and learning within the project. The component has two sub-components: (i) policy implementation studies and knowledge management; and (ii) communication, internal learning and capacity-building for pastoral groups.
18. **Component 4: Project management and monitoring and evaluation (M&E).** PCDP III will be implemented through government offices at the federal, regional and *woreda* levels. Its implementation and oversight will be supported by project coordination units and support teams, including mobile support teams.

III. Project implementation

A. Approach

19. PCDP III will build on implementation experiences and lessons learned from PCDP I and PCDP II. This series of operations has helped expand services to pastoral and agropastoral communities in Ethiopia and has introduced the CDD approach as an effective model of local development. PCDP III will scale up these successful results geographically while also extending the CDD approach. It will help targeted communities to think through their development issues more comprehensively, proactively target the priorities of the most vulnerable sections of their population (particularly in terms of improving the livelihoods of the poorest households and those who have fallen through the traditional livestock-based livelihood systems), ensure inclusiveness in their consultation processes, promote accountability among their representatives, and support self-monitoring and learning. It will also seek to integrate the CDD modality into the Government's regular planning and budget development processes, and will include interventions to enhance the capacity of local government and community stakeholders to take over project activities.

B. Organizational framework

20. PCDP III will be implemented by existing government structures and community institutions. Implementation will be decentralized, with beneficiary communities assuming primary responsibility for most project activities. The project's core activities, particularly CIF sub-projects and RLP interventions, will be implemented through community-based institutions and teams – community groups, sub-*kebele* facilitation teams, frontline service providers, community project management and procurement committees, and community audit and supervision committees. The

kebele development committee, as the developmental arm of the Government's lowest level administration structure, will provide general implementation oversight and will liaise with and coordinate support from mobile support teams, the *woreda*, other implementing agencies and implementers of other complementary interventions (including NGOs).

21. At the federal level, the Ministry of Federal Affairs will assume overall responsibility for project implementation supported by the federal project coordination unit (FPCU). At the *woreda* level, the *woreda* development committee (WDC) – comprised of the *woreda* administrator (or his/her deputy), sectoral office heads, the head of the *woreda* finance and economic development office, and representatives of NGOs and/or microfinance institutions, where available – will have oversight of PCDP III activities within each project *woreda*. The WDC will approve all sub-projects proposed by *kebeles*, manage fund flows, monitor implementation, and ensure timely reporting on implementation progress. Each member of the WDC will also assign dedicated focal persons from their respective offices (education, health, water resources development, pastoral development or agriculture, cooperative development, microenterprise development (if available), rural roads, and women and youth affairs) to provide technical support for the implementation of the CIF and RLP. Focal persons will form a technical committee that meets at least on a monthly basis to plan coordinated visits to project *kebeles*. *Woreda* pastoral development offices will coordinate the technical support.
22. At the regional level, regional steering committees (RSCs), composed of the heads of all relevant sectors, together with the head of the finance and economic development office, and led by the pastoral development office/commission, will provide overall guidance and leadership for the project. The RSCs will meet quarterly to review performance, endorse the quarterly progress reports and provide guidance on project implementation.

C. Planning, monitoring and evaluation, and learning and knowledge management

23. Although PCDP III will be implemented through relevant government offices at the federal, regional and *woreda* levels, its implementation and oversight will be supported by project coordination units and support teams. At the federal level, a FPCU located in the Ministry of Federal Affairs will be responsible for overall management of the project. At the regional level, the pastoral development offices or commissions will house the project's regional project coordination units that will coordinate implementation and reporting on regional activities and oversee project-funded mobile support teams. Mobile support teams will provide hands-on support for implementation at the *woreda* and *kebele* levels. At the *woreda* level, a *woreda* coordinator and a finance officer will be placed in the *woreda* pastoral development and finance and economic development offices respectively to coordinate implementation, ensure the smooth flow of funds, monitor performance, and prepare timely reports (financial, procurement and performance on activities). M&E activities will include regular monitoring of implementation performance and results, independent process monitoring (including regular assessments of community-level planning and review of the effectiveness and quality of capacity-building efforts), outcome/impact evaluations at project mid-term and end, and annual thematic studies.

D. Financial management, procurement and governance

24. The design and preparation of PCDP III is informed by lessons drawn from the implementation of PCDP I and PCDP II and other similar initiatives financed by development partners to support pastoralist livelihoods in Ethiopia. PCDP III is implemented in marginalized areas where capacity for implementation and fiduciary and safeguards management is weak. On the other hand, PCDP III is the third phase of a 15-year programme. Although requiring continued attention,

mitigation measures have now been well tested and found to be effective. PCDP III will also use the country's public financial management system, several aspects of which function well – such as the budget process, budget classification system, and compliance with financial regulations. IFAD has relied substantially on fiduciary risk assessments conducted by the World Bank, whose risk assessment methodology is closely aligned with its own. Given the risks identified and the above considerations, the fiduciary risk for the project is rated "substantial" without mitigating measures, but is expected to reduce once implementation starts and the proposed risk-mitigating measures are introduced. The main weaknesses in fiduciary management arrangements continue to be high turnover and a shortage of qualified accountants and auditors (mainly at the *woreda* level), delays in reporting, and the largely ineffective internal audit function of the Government. The long process involved in producing financial reports (from the *woredas* to the regions, and from the regions to federal) may delay submission of financial reports to the development partners. The conclusion of the fiduciary assessment concluded that fiduciary management under the project meets IFAD and International Development Association (IDA) requirements.

25. **Funds flow and disbursement arrangements.** Fiduciary management arrangements for PCDP III follow the Government's fund flow mechanism whereby funds from donors flow directly to the sector ministry – in this case, the Ministry of Federal Affairs – and are overseen by the same Ministry. The FPCU will be responsible for overall fiduciary management of the project. It will be responsible for releasing funds against agreed plans, disbursing funds to all implementing levels and coordinating monitoring and financial reporting for the project as a whole. Funds from IFAD and IDA will be deposited into two separate foreign currency designated accounts to be opened at the National Bank of Ethiopia. Funds from the two separate accounts will then be transferred into pooled Birr accounts to be held by the Ministry of Federal Affairs. PCDP III will use the traditional methods of disbursement, which depend on the submission of statements of expenditure to the World Bank and replenishment of project accounts accordingly. The maximum authorized allocation will be determined for the designated accounts to avoid liquidity problems.
26. **Internal control and external audit.** Weaknesses were noted in internal audit that necessitate increasing focus on systems audit and improving management response to audit findings. Further strengthening of the internal audit function is a key challenge. One limiting factor continues to be the use of accounting standards that are not compliant with International Public Sector Accounting Standards (IPSAS); compliance with IPSAS would require disclosure of information on donor-financed projects and programmes. Overall performance of external audit has improved as a result of increased coverage and a lessening of the time needed to audit annual financial statements. Audits conducted by the Office of the Federal Auditor General generally adhere to International Organization for Supreme Audit Institutions auditing standards and focus on significant issues. Following up audit findings and applying remedies, where relevant, will be the responsibility of IFAD, in coordination with IDA.
27. **Procurement.** Procurements under PCDP III will be carried out in accordance with the World Bank Procurement Guidelines. The World Bank has reviewed the competitive bidding procedures of the Federal Government of Ethiopia and has determined that contracts for goods and works other than those to be procured under International Competitive Bidding may follow the borrower's procurement procedures. Contracts for consultancy services will be carried out in accordance with the provisions of the World Bank Consultant Guidelines.
28. **Governance and anti-corruption.** Beyond the efforts formally built into project design, such as having quarterly financial reports, annual audit reports, World Bank and IFAD supervision missions and internal audit reviews, as part of

implementation support, regional staff and citizens will be encouraged to report any cases of suspected fraud and corruption to the Federal Ethics and Anti-Corruption Commission of Ethiopia.

E. Supervision

29. Two supervision missions will be conducted each year. After each mission, risks will be measured and recalibrated accordingly. Supervision missions will be carried out with the full participation of IFAD and will include on-site visits to the various project institutions at all levels, such as FPCUs, regional project coordination units, and a sample of *woreda* finance and economic development offices and other implementing entities. These visits will include a review of controls and the overall operation of the fiduciary management system, a review of internal audit, selected transaction reviews, and sample verification of existence and ownership of assets, reviews of rural finance institutions and follow-up on actions needed.

F. Exceptions to IFAD General Conditions for Agricultural Development Financing and operational policies

30. Provisions for implementation and financial reporting, procurement, audit and use of loan proceeds for the payment of taxes will be in line with World Bank requirements. This implies a waiver of the associated sections of the IFAD General Conditions for Agricultural Development Financing in favour of World Bank (International Development Association) policies.

IV. Project costs, financing, benefits

A. Project costs

31. The total investment and incremental recurrent project costs, including physical and price contingencies, is estimated at US\$218.2 million. IFAD's current contribution to the project costs will total US\$85 million and an additional amount of US\$15 million is to be sourced by IFAD in order to close the financing gap. The project will be financed through an IFAD loan over a seven-year period starting around mid-2014, subject to the entry into force of the relevant financing agreement. The World Bank's portion of the financing is likely to close five years after the entry into force of the World Bank's agreement with the borrower, although the Bank may continue to act as the cooperating institution up to the closing of IFAD's loan to the borrower. Should this not be the case, the project would then be directly supervised by IFAD. It is also expected that during the midterm review, IFAD and the World Bank will assess implementation progress and the Bank may then decide to align its loan with IFAD's seven-year project implementation period.

B. Project financing

32. The total project financing plan for the US\$85 million is presented in table 1.

Table 1

Project financing plan (US\$85 million)
(Millions of United States dollars)

	IDA	IFAD	Government	Beneficiaries	Total	Component share (%)
Demand-driven service provision	61.85	52.45	5.00	13.20	132.50	65.20
Rural Livelihoods Programme	22.70	19.50	-	-	42.20	20.80
Development learning and knowledge management	2.45	2.05	-	-	4.50	2.20
Project management and M&E	10.30	8.70	-	-	19.00	9.40
Unallocated	2.70	2.30	-	-	5.00	2.50
Total project costs	100.00	85.00	5.00	13.20	203.20	

33. While the total amount of resources available under the current PBAS allocation for the Federal Democratic Republic of Ethiopia is US\$85 million, IFAD's overall expected contribution to the project is US\$100 million. It is envisaged that the US\$15 million financing gap will be financed in full or in part by: (i) other

cofinancing sources still to be identified; and/or (ii) PBAS reallocations, which should become available by the end of 2015; and/or (iii) resources to be made available to the borrower in 2016 under the next PBAS cycle. Approval of the additional financing will be sought from the Executive Board, where appropriate, and the resources will then be allocated on a pro-rata basis to the existing expenditure categories. Project costs, assuming the full US\$100 million IFAD contribution, are presented in table 2.

Table 2
Project financing plan (US\$100 million)
(Millions of United States dollars)

	IDA	IFAD	Government	Beneficiaries	Total	Component share (%)
Community-driven service delivery	64.92	64.92	4.91	18.43	153.18	68.50
Rural Livelihoods Programme	18.30	18.30	–	0.17	36.77	16.40
Development learning and knowledge management	2.35	2.35	–	–	4.70	2.10
Project management and M&E	9.45	9.45	–	–	18.90	8.40
Unallocated	5.00	5.00	–	–	10.00	4.50
Total project costs	100.02	100.02	4.91	18.60	223.55	

C. Summary benefit and economic analysis

34. The specific project benefits will derive from: (i) reduced transportation costs; (ii) increased volume of produce marketed due to road construction; (iii) savings in vehicle operating costs and travel time; (iv) post-harvest loss reduction; (v) better access to both educational and health facilities through improvement of roads and construction of health posts and water points; (vi) increased access to financial services; (vii) financial savings derived from the installation of water points and from the construction of health posts; and (viii) for the Government, incremental tax revenues as a result of increased volume of taxable production.
35. The construction of schools, water points and health posts contributes indirectly to increased productivity and is therefore key to sustainable socio-economic development and improved livelihoods and economic productivity in pastoral communities. Access to financial services is essential to the empowerment of pastoralist communities, especially pastoral women and young people. Improving their access to financial services through income-generating activities can raise their livelihood status and enhance their empowerment, enabling them to undertake agricultural and pastoral activities as well as other viable economic activities. The productivity of pastoral and agropastoral communities should increase as a result of interventions that improve access to health and education, which also meets IFAD's objective of increasing the productivity of smallholder farmers and pastoralists. The internal rate of return (IRR) for this project is 16 per cent. Sensitivity analysis shows that changes in key variables for the project will not negatively affect its viability. An overall cost-benefit and cost-effectiveness analysis was also carried out for the project, together with sensitivity analyses against potential increases in project costs or reductions in benefits. A 10 per cent drop in benefits will reduce the base IRR to 11 per cent while a 10 per cent increase in costs will reduce it to 12 per cent. With a two-year delay in project benefits, the project yields an IRR of 12 per cent. The project is therefore financially and economically sustainable.

D. Sustainability

36. Sustaining investments made by communities to enhance service delivery depends on *woreda* administrations taking over and operationalizing CIF sub-projects once they are completed. The experience under PCDP I and PCDP II has been that most sub-projects implemented through the CIF (over 80 per cent) have been successfully completed and handed over to *woreda* administrations. *Woredas* have in turn provided the necessary human resources and operational budgets to extend associated services. To sustain the CDD approach, capacity-building and community ownership will be needed. Once communities acquire the knowledge,

awareness and necessary skills to draw up community development plans, action plans and livelihood plans in which priority investments are identified – as well as to implement and maintain sub-projects – it is likely that the CDD approach will be taken forward, provided that financing is available. PCDP III emphasizes the need to integrate this approach into *woreda* development plans to ensure its sustainability. PCDP III financing (through the CIF) is intended to serve as a catalyst for *woredas* to engage local communities in decisions regarding the use of all public funding. Under PCDP III, *woredas* will be asked to dedicate a portion of their capital funds to be used in accordance with the CIF in order to start linking the regular *woreda* planning process to the CIF.

37. It is proposed that the RLP should promote the establishment of new community-managed financial cooperatives. At the close of the project, these cooperatives will still be in their early stages of development and will have limited capacity and scale of operation. There will be a need to continue support so that pastoral SACCOs can evolve into mature financial institutions with sufficient capacity to meet the requirements of their communities. PCDP is not well placed to provide support for the development of pastoral SACCOs because it is not specifically focused on rural financial intermediation. The project will therefore develop strong linkages with the Rural Financial Intermediation Programme (RUFIP II), which is also under the Federal Cooperative Agency and has accumulated competence and experience in this area. RUFIP II will also work towards the establishment of SACCO unions in pastoral areas and in building capacity within the regional cooperative agencies/bureaus and *woreda* offices of cooperative promotion that are expected to provide the necessary support to the pastoral SACCOs over the longer term.

V. Corporate considerations

A. Compliance with IFAD policies

38. PCDP III is consistent with key World Bank policies, which were also considered in relation to the IFAD portion of the overall financing. The project complies with IFAD policies and strategies. In particular, it is compliant with IFAD policies on targeting (Reaching the Rural Poor), rural finance, gender equality and women's empowerment, environment and natural resource management, and with the IFAD knowledge management and scaling up strategy.

B. Alignment and harmonization

39. The project is well aligned with COSOP priorities. It is also aligned with the Government's GTP and with the Development Assistance Group/Government of Ethiopia agreed programme implementation framework, both of which guide investment into joint government and donor priority areas and sectors in Ethiopia.

C. Innovations and scaling up

40. PCDP III is a scaling up of programmes tested and implemented under two previous projects (PCDP I and PCDP II) to most pastoral and agropastoral districts of Ethiopia, with the exception of those in areas not covered by the project. Given the generally satisfactory implementation experiences and the ten-year testing of programmes under PCDP I and PCDP II, such a scaling up approach is desirable. This project, and its preceding two phases (PCDP I and PCDP II), are an example of best practice in scaling up, where IFAD works in collaboration with the World Bank to reach 4.5 million direct beneficiaries (approximately 750,000 households). It is also an example of how IFAD can apply its core competency in community-driven approaches to complement the World Bank's flexible lending approach (Adaptable Program Loan).

D. Policy engagement

41. PCDP III builds on the lessons learned from PCDP I and II and provides specific actions that align phase three with relevant IFAD policies, including gender and targeting policies. The project includes activities that will fill the gaps identified in previous phases, adopts a gender and targeting strategy, and follows the CDD principles of inclusiveness, given the community-driven nature of the intervention.

VI. Legal instruments and authority

42. A project financing agreement between the Federal Democratic Republic of Ethiopia and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A copy of the negotiated financing agreement is attached as an annex.
43. The Federal Democratic Republic of Ethiopia is empowered under its laws to receive financing from IFAD.
44. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Policies and Criteria for IFAD financing.

VII. Recommendation

45. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

RESOLVED: that the Fund shall provide a loan on highly concessional terms to the Federal Democratic Republic of Ethiopia in an amount equivalent to fifty-five million three hundred thousand special drawing rights (SDR 55,300,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement: " Pastoral Community Development Project III"

(Negotiations concluded on 19 November 2013)

Loan Number:

Project Title: Pastoral Community Development Project III (the "Project")

The International Fund for Agricultural Development (the "Fund" or "IFAD")

and the

Federal Democratic Republic of Ethiopia (the "Borrower")

(each a "Party" and both of them collectively the "Parties")

hereby agree as follows:

Section A

1. The following documents collectively form this Agreement: this document, the Project Description and Implementation Arrangements (Schedule 1) and the Allocation Table (Schedule 2).

2. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, as may be amended from time to time (the "General Conditions") are annexed to this Agreement, and all provisions thereof shall apply to this Agreement except for the provisions identified in Section E paragraph 4 below. For the purposes of this Agreement the terms defined in the General Conditions shall have the meanings set forth therein.

3. The International Development Association ("IDA") has agreed to extend to the Borrower a loan in the principal amount of seventy-one million eight hundred thousand Special Drawing Rights (SDR 71 800 000) to finance the Project on terms and conditions to be set forth in an agreement between the Borrower and the IDA (the "IDA Financing Agreement").

4. The Fund shall provide a Loan to the Borrower (the "Loan"), which the Borrower shall use to implement the Project in accordance with the terms and conditions of this Agreement.

Section B

1 The amount of the Loan is fifty-five million three hundred thousand Special Drawing Rights (SDR 55 300 000).

2 The Loan is granted on highly concessional terms.

3. The Loan Service Payment Currency shall be the US dollar.

4. The first day of the applicable Fiscal Year shall be 8 July.

5. Payments of principal and service charge shall be payable on each 1 March and 1 September with payments of principal commencing on 1 March 2024.

6. There shall be a Designated Account in USD for the exclusive use of this Project in the National Bank of Ethiopia.
7. There shall be an account in Ethiopian Birr for Project operations held by the Ministry of Federal Affairs.
8. The Borrower shall provide counterpart financing for the Project in the amount of one million United States dollars (USD 1 000 000). Additionally, the Borrower shall ensure that the Project beneficiary communities provide counterpart financing for the Project in the amount of fourteen million two hundred thousand United States dollars (USD 14 200 000) for the community investment funds.

Section C

1. The Lead Project Agency shall be the Borrower's Ministry of Federal Affairs.
2. The following are designated as additional Project Parties: the National Regional State Governments of Afar, Somali, Oromia, and the Southern Nations, Nationalities and Peoples Region; the Federal Cooperative Agency; the Ethiopian Institute for Agricultural Research; and any other Party proposed by the Borrower and acceptable to the Fund.
3. The Project Completion Date shall be the seventh anniversary of the date of entry into force of this Agreement.

Section D

The Loan shall be administered by the IDA as the Cooperating Institution and the Project shall be supervised jointly by the IDA and the Fund until the Closing Date of the IDA Financing currently set at 31 December 2018, or such later date as the Fund may designate by notice to the Borrower. Thereafter, the Loan shall be administered and the Project shall be supervised by the Fund.

Section E

1. The following is designated as an additional ground for suspension of this Agreement: the IDA Financing Agreement shall have been suspended.
2. The following is designated as an additional ground for cancellation of this Agreement: the IDA Financing Agreement shall have been cancelled.
3. The following is designated as an additional general condition precedent to withdrawal: A Project Implementation Manual, including, *inter alia*, detailed Project implementation arrangements and institutional roles and responsibilities, a detailed implementation schedule, financial management and reporting, procurement, monitoring and evaluation, and procedures for implementation of the safeguards instruments for the Project, all in form and substance satisfactory to the IDA shall have been adopted by the Borrower.
4. The following provision of the General Conditions shall not apply to this Agreement:
 - (a) Section 7.05 (Procurement): for purposes of this Agreement, all goods, works and consulting services to be financed out of the proceeds of the Loan shall be subject to the IDA Financing Agreement, as may be amended from time to time;

- (b) Section 8.03 (Progress Report and Mid-Term Reviews) and Section 8.04 (Completion Report): for purposes of this Agreement, all Project reporting shall be subject to the IDA Financing Agreement, as may be amended from time to time;
 - (c) Section 9.02 (Financial Statements): for purposes of this Agreement, the delivery and audit of financial statements shall be subject to the IDA Financing Agreement, as may be amended from time to time;
 - (d) Section 9.03 (Audit of Accounts): for purposes of this Agreement, the audit of the Project shall be subject to the IDA Financing Agreement, as may be amended from time to time; and
 - (e) Section 11.01 (Taxation): for purposes of this Agreement, the use of any proceeds of the Financing to pay for taxes shall be subject to the IDA Financing Agreement, as may be amended from time to time.
5. This Agreement is subject to ratification by the Borrower.
6. The following are the designated representatives and addresses to be used for any communication related to this Agreement:

For the Borrower:
The Minister
Ministry of Finance and Economic Development
P. O. Box 1905
Addis Ababa, Ethiopia

For the Fund:
The President
International Fund for Agricultural Development
Via Paolo di Dono 44
00142 Rome, Italy

This agreement, dated _____, has been prepared in the English language in six (6) original copies, three (3) for the Fund and three (3) for the Borrower.

FEDERAL DEMOCRATIC REPUBLIC OF ETHIOPIA

Authorized Representative

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

Kanayo F. Nwanze
President

Schedule 1*Project Description and Implementation Arrangements*

1. The Project shall be the same as described in Schedule 1 of the IDA Financing Agreement, as such may be amended by the Parties thereto from time to time. The Project shall be implemented in accordance with the provisions of Sections I, II, III and V of the Schedule 2 of the IDA Financing Agreement, as such may be amended by the Parties thereto from time to time.

Schedule 2*Allocation Table*

1. *Allocation of Loan Proceeds.* (a) The Table below sets forth the Categories of Eligible Expenditures to be financed by the Loan and the allocation of the amounts of the Loan to each Category and the percentages of expenditures for items to be financed in each Category:

Category	Amount of IFAD Financing Allocated (expressed in SDR)	Percentage of Expenditures to be Financed (inclusive of Taxes)
(1) Goods, Works, Non-consulting Services, Consultants' Services, Audits, Training, and Operating Costs		
(a) (i) Project Component A	26 270 000	38% of amounts disbursed
(ii) Project Component B	8 460 000	44%
(b) Project Component C	13 010 000	44%
(c) Project Component D	1 300 000	44%
(d) Project Component E	5 860 000	44%
(2) Unallocated	400 000	
TOTAL	55 300 000	

(b) The terms used in the Table above are defined as follows:

Category 1 (a) (i) "Project Component A": Eligible Expenditures under Part A.1(a) of the Project for Sub-projects under CIF Grants as reflected in the IDA Financing Agreement as such may be amended by the Parties thereto from time to time;

Category 1 (a) (ii) "Project Component B": Eligible Expenditures under Part A.1(b), A.2 and A.3 of the Project as reflected in the IDA Financing Agreement as such may be amended by the Parties thereto from time to time;

Category 1 (b) "Project Component C": Eligible Expenditures under Part B of the Project including Grants under Part B.1 and B.3 as reflected in the IDA Financing Agreement as such may be amended by the Parties thereto from time to time;

Category 1 (c) "Project Component D": Eligible Expenditures under Part C of the Project as reflected in the IDA Financing Agreement as such may be amended by the Parties thereto from time to time;

Category 1 (d) "Project Component E": Eligible Expenditures under Part D of the Project as reflected in the IDA Financing Agreement as such may be amended by the Parties thereto from time to time.

Logical framework

Project Development Objectives (PDO)

To improve access to community demand-driven social and economic services for pastoralists and agro-pastoralists of Ethiopia.

Project Development Objective Indicators

PDO Level Results Indicators	Core	Unit of Measure	Baseline	Cumulative Target Values					Frequency	Data Source/ Methodology	Responsibility for data collection
				YR1	YR2	YR3	YR4	End Target			
Male and female household heads in project kebeles who report that available public services address their priority needs	<input type="checkbox"/>	Percentage	43% M 28% F	--	--	70% M 50% F	--	80%M 80%F	Baseline, mid-term and end of project	Survey and qualitative analysis	M&E Officer, consultants
Households undertaking a viable IGA supported by a business plan	<input type="checkbox"/>	Number	11,200	--	15,000	18,200	25,000	32,200	Annually, starting year 2.	Progress report, Case studies	M&E Officer (FPCU), consultants
Members of SACCOs as a proportion of the target community	<input type="checkbox"/>	Percentage	5.4%	--	6%	8%	9%	10%	Annually, starting year 2.	Survey and progress reports	M&E Officer, External Consultant
Direct project beneficiaries	<input checked="" type="checkbox"/>	Number	1,900,000	--	2,500,000	3,200,000	4,000,000	4,500,000	Annually, starting year 2.	Progress reports	M&E Officers (FPCU, RPCUs)
Female beneficiaries	<input checked="" type="checkbox"/>	Percentage Sub-Type Supplemental	42%	--	50%	50%	50%	50%	Annually, starting year 2.	Progress reports	M&E Officers (FPCU, RPCUs)

INTERMEDIATE RESULTS

Indicator Name	Core	Unit of Measure	Baseline	Cumulative Target Values					Frequency	Data Source/ Methodology	Responsibility for data collection
				YR1	YR2	YR3	YR4	End Target			
Component 1: Demand Driven Service Provision											
Intermediate Result 1: Community-owned investments in social and economic infrastructure within targeted communities increased and sustainably managed											
CIF sub-projects completed and fully operational	<input type="checkbox"/>	Number	3,449	--	3, 871	4,575	5,279	5,561	Annually, after mid-term. Process indicators used up to mid-term	Progress Reports	M&E Officer

Beneficiaries that feel PCDP3 investments reflect their priority needs	<input checked="" type="checkbox"/>	Percentage	0%	--	--	75%	--	85%	Baseline, mid-term and end of project	Survey	M&E Officer (FPCU), Consultants
Intermediate Result 2: CDD approaches to local level development are adopted by local governments											
Woredas targeted by the project with woreda development plans that follow a CDD planning process	<input type="checkbox"/>	Percentage	0%	--	10%	20%	30%	50%	Annually, starting year 2	Progress reports	M&E Officers
Intermediate Result 3: Increased capacity of communities to effectively engage in local development											
Sub-projects with post-project community engagement or O&M arrangements	<input checked="" type="checkbox"/>	Percentage	64%	64%	64%	70%	77%	81%	Annually, after mid-term. Process indicators used up to mid-term	Progress Report, qualitative studies	M&E Officers, consultants
Component 2: Rural Livelihoods Program											
Intermediate Result 4: Grassroots financial institutions formed among target communities											
SACCOs formed and operational	<input type="checkbox"/>	Number	448	--	--	700	900	1,110	Annually, after mid-term.	Progress reports and case studies	M&E Officers, Consultant
Intermediate Result 5: Households targeted by the project have adopted innovative practices/new technologies to strengthen livestock production or new IGAs											
Clients who have adopted an improved agriculture technology promoted by the project	<input checked="" type="checkbox"/>	Number	0	--	--	1,100	2,200	2,200	Annually, starting year 3	Progress reports	M&E Officers
Component 3: Development Learning and Knowledge Management											
Intermediate Result 6: Communities learn from local development processes											
Lessons from community discussions and experience sharing documented by KDCs/ learning and knowledge centers	<input type="checkbox"/>	Yes/No	No	No	Yes	Yes	Yes	Yes	Annually	Progress reports	M&E Officers