



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board — Sixty-Fifth Session
Rome, 2-3 December 1998

REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO

THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

FOR

THE MATALE REGIONAL ECONOMIC ADVANCEMENT PROJECT



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CURRENCY EQUIVALENTS

Currency Unit	=	Sri Lankan Rupee (LKR)
USD 1.00	=	LKR 66.0
LKR 1.00	=	USD 0.44

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m ²)	=	10.76 square feet (ft ²)
1 acre (ac)	=	0.405 ha
1 hectare (ha)	=	2.47 acres

ABBREVIATIONS AND ACRONYMS

AsDB	Asian Development Bank
AWP/B	Annual Work Programme and Budget
GTZ	German Agency for Technical Cooperation
IGA	Income-Generating Activities
IRDP	Integrated Rural Development Project
M&E	Monitoring and Evaluation
MPIPA	Ministry of Plan Implementation and Parliamentary Affairs
MSE	Micro/small Enterprise Promotion
NGO	Non-Governmental Organizations
PAB	Project Advisory Board
PEPC	Central Province Enterprise Promotion Centre
PMO	Project Management Office
RDD	Regional Development Division
REAP	Regional Economic Advancement Programme
RRDP	Regional Rural Development Project
SWC	Soil and Water Conservation
WFP	World Food Programme



GLOSSARY

Maha	Major crop season associated with north-east monsoon between October and March
Yala	Minor crop season associated with south-west monsoon between April and September

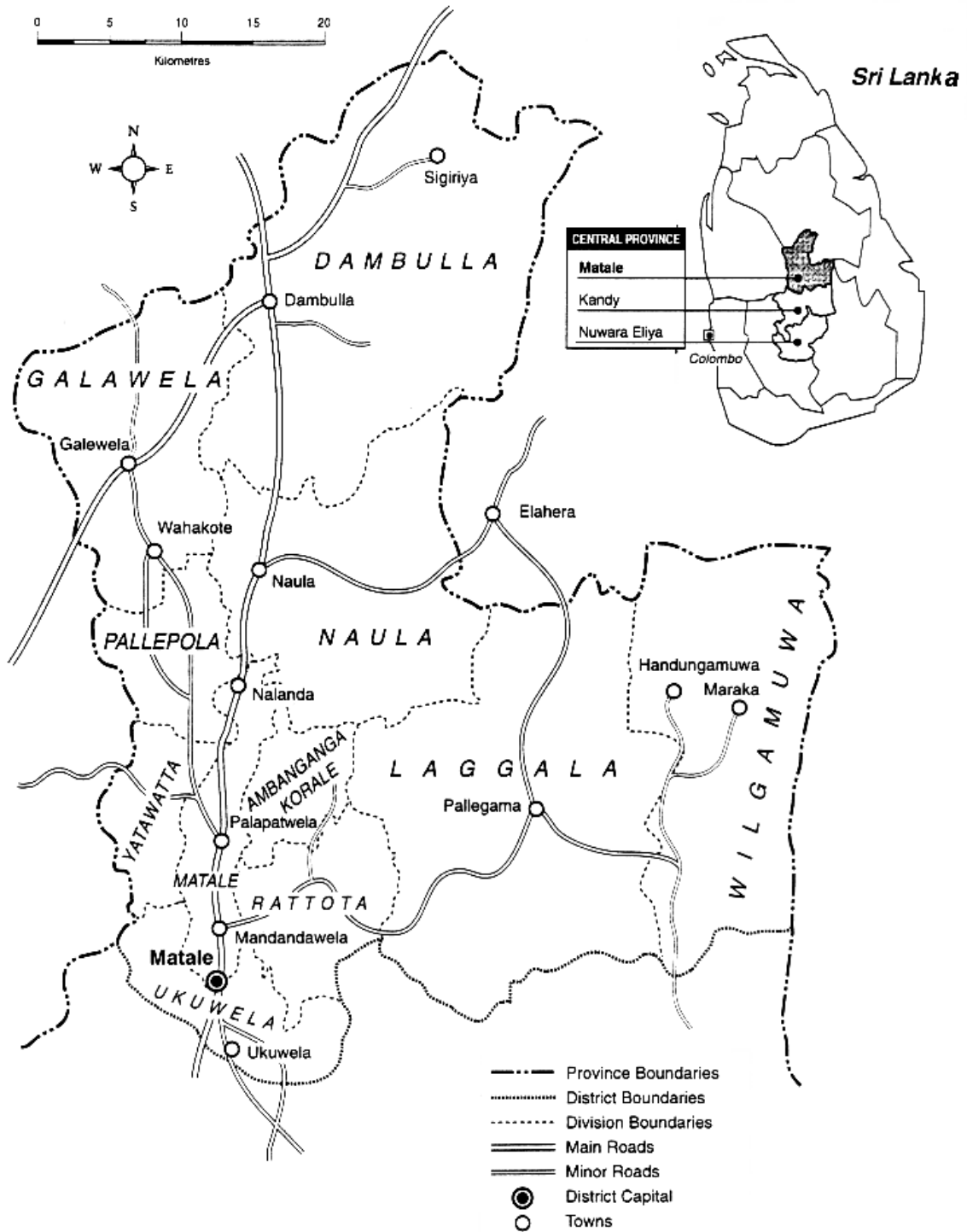
GOVERNMENT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

Fiscal Year

1 January - 31 December



MAP OF THE PROJECT AREA



Source: IFAD.

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.



DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA
MATALE REGIONAL ECONOMIC ADVANCEMENT PROJECT
LOAN SUMMARY

INITIATING INSTITUTION:	IFAD
BORROWER:	The Democratic Socialist Republic of Sri Lanka
EXECUTING AGENCY:	Ministry of Plan Implementation and Parliamentary Affairs (MPIPA)
TOTAL PROJECT COST:	USD 14.47 million
AMOUNT OF IFAD LOAN:	SDR 8.35 million (equivalent to approximately USD 11.71 million)
TERMS OF IFAD LOAN:	40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum
COFINANCIERS:	Private sector Germany World Food Programme (WFP)
AMOUNT OF COFINANCING:	Private sector: USD 0.40 million Germany: USD 0.57 million WFP: USD 0.24 million
TERMS OF COFINANCING:	Germany: Grant WFP: Grant
CONTRIBUTION OF BORROWER:	USD 1.35 million
CONTRIBUTION OF BENEFICIARIES:	USD 0.20 million
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	IFAD supervised



PROJECT BRIEF

- 1. The target group.** The primary target group is an estimated 30 000 households — 15 000 headed by women and 15 000 by men — equivalent to 26% of total households and comprising 43% of the rural households in the project area, which are the poorest. Women and youth will form a high proportion of the beneficiaries for employment, income-generating and agribusiness interventions. The primary target group has been identified on the basis of the major index for which there is reliable data and which has a significant positive relationship with poverty level, namely, illiteracy or semi-literacy, especially for women-headed households. Other indices include the extent of casual, unskilled manual labour; limited years of schooling; and child health/growth.
- 2. Reasons for poverty.** The incidence of poverty in Matale District is complicated by the diverse pattern in which families make a living: local wage labour, farming, in-district and in-country commuting for seasonal work, overseas work and remittance, *Samurdhi* (government relief) payments, village microenterprises and military service. However, the major underlying causes are: small farm holding size and poor productivity of crops and livestock; lack of planning and organization in production and in produce handling and marketing; indebtedness to informal lending sources; weak delivery of extension, credit and other support; the restricted scope, so far, of microenterprise uptake; lack of remunerative — or acceptable — employment opportunities due to limited business development in the private sector; and the inherent dependency and lack of self-reliance established by previous political-economic systems.
- 3. Project activities to benefit the target group.** The pattern of household production and incomes of poor families indicates that poverty alleviation and subsequent advancement needs to be based on a wide range of economic activities but primarily those that have real promise of expansion, uptake and improvement — and of providing consistent and remunerative returns to all participants. Participatory, village-level economic planning will enable farmers to understand their current economic status; inform them of options for improving productivity and income; and empower them to undertake simple, practical management and enterprise changes. The project will upgrade the availability and quality of seeds and planting materials to underpin on-farm improvement; enhance land productivity in irrigation and water management, soil and water conservation; improve land tenure through land titling; and assist in the commercialization of production through applied and adaptive research on technologies, husbandry and management systems and marketing initiatives. Given the limitations of the small farm sector to absorb the growing labour force, the enterprise and employment interventions will be targeted at the expansion of existing — and creation of new — businesses that will increase or create employment, especially for unemployed youth and rural women.
- 4. Project implementation.** Project organization and management has been designed in such a way as to ensure that the project directorate has the independence, flexibility and jurisdiction to amend the workplan in response to opportunities as they arise. The project director will be answerable for project progress and impact upwards to the director general of the regional development division (RDD) of the Ministry of Plan Implementation and Parliamentary Affairs (MPIPA), and downwards to the target group for project effectiveness and poverty impact. He/she will also report on technical, work planning and budgeting, and implementation issues to the project advisory board (PAB). The structure embodies channels for consultation and dialogue between management and beneficiaries both through formal liaison and directly with the business promotion and monitoring and evaluation (M&E) field staff. In this way, the project will ensure that it listens to the views, aspirations and criticisms of the beneficiaries and reports them back to the project management office (PMO) and PAB for inclusion in subsequent annual work programmes and budgets (AWP/Bs).



**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD
TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO
THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA
FOR
THE MATALE REGIONAL ECONOMIC ADVANCEMENT PROJECT**

I submit the following Report and Recommendation on a proposed loan to the Democratic Socialist Republic of Sri Lanka for SDR 8.35 million (equivalent to approximately USD 11.71 million) on highly concessional terms to help finance the Matale Regional Economic Advancement Project. The loan will have a term of 40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum. It is proposed that this IFAD-initiated project be directly supervised by the Fund in view of its innovative elements with respect to the process approach to project planning and the role of non-government organizations (NGOs) and the private sector. The main focus is on subsectors where IFAD has a developing regional strategic focus (small enterprise development, role of private sector and importance of microcredit).

PART I - THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY¹

A. The Economy and the Agricultural Sector

1. The Democratic Socialist Republic of Sri Lanka is an island state situated off the south-eastern tip of India. It is a relatively small country in Asian terms with respect to its surface area of 65 000 km² and estimated 18.5 million people (1996). The population is about 80% rural, growing at the modest rate for a developing nation of 1.4% and with a manageable density averaging 285/km² overall and 1 146/km² of cultivated land. Sri Lanka is predominantly Buddhist by religion and Sinhalese by ethnicity, but with large and important minority Tamil, Muslim and Christian communities and a notable cultural and civil history.

2. The economy has demonstrated a real growth in Gross Domestic Product (GDP) of 5.2% per annum in the 1990s and over 6% in 1997. The estimated Gross National Product per capita in current prices is of the order of LKR 52 000, or USD 804, which is a significant advance on the 1990 figures of LKR 18 800, or USD 471. The level of inflation has been relatively high — at or above 12%, and up to 20% — over the last five years, largely as a result of widening budget deficits, rapid monetary growth and the removal of subsidies. However, it has fallen from 20% in 1990 to 8.5% in 1997. Efforts to control inflationary pressures continue today. Wholesale commodity price indices show an annual increase of 8%, which tends not to be fully reflected in the selling price of agricultural produce.

3. Labour is abundant in Sri Lanka relative to the other factors of production which are tending to become increasingly scarce. Unemployment was 10.4% in late 1997, and there is a bias towards the young in its worst effects. For several years the fiscal situation has been improving: the current account deficit, which had reached 16% of GDP in 1988, came down to about 3% of GDP in 1997 as a result of favourable terms of trade for major commodities. There were also significant capital

¹ See Appendix I for additional information.



inflows and the overall balance of payments recorded a surplus of USD 163 million. At the end of 1997, official reserves were sufficient to cover 4.2 months of imports. Sri Lanka never acquired short-term capital inflows because of the war and restrictions on capital account transactions. It has therefore been relatively insulated from the worst effects of the recent East Asian crisis.

4. Both imports and exports as a share of GDP have been rising, exports markedly so, particularly since the export duty on the three major plantation crops was removed in 1992. This has produced a pattern of balance of payments which has largely reflected the trade deficit but is modified by remittance income, tourism earnings and foreign grants. Sri Lanka still imports significant quantities of basic foods, including wheat and flour, fish and, depending on the local harvest conditions, rice. According to Central Bank data, total external debt stood LKR 376 billion equivalent at the end of 1997, representing some 46% of GDP. The rupee is effectively floated against a basket of currencies of the main trading partners of Sri Lanka and has achieved a reasonable measure of stability over the last three years, although appreciating in the recent period.

5. Agriculture rebounded from negative growth of over 5% in 1996 due to better tea prices and management of estates, along with a good rice crop. The contribution of agriculture to the national economy has shown a progressive decline from 19.5% in 1990 to 15% in 1997. All the main crops show declines, but paddy, falling from 4.3% in 1990 to 2.6% in 1997, has shown the most dramatic fall, in spite of substantial support in the form of irrigation, research and seed production and tariff protection. The main cause of decline is the failure to achieve productivity gains to keep pace with the rest of the economy: the negative rate of growth of paddy output is -4.2% over the period 1990-97. National average yields of paddy reached a plateau over a decade ago and there is little sign of further gains being achievable while all the time the cost of production, particularly labour, is increasing.

B. Lessons Learned from Previous IFAD Experience in Sri Lanka

6. IFAD has so far extended 10 project loans to Sri Lanka for a total of USD 100.58 million (SDR 69.63 million) on highly concessional terms. The total amount of disbursement had reached approximately USD 60.2 million by 31 May 1998. The last project approved for Sri Lanka was the North-Central Province Participatory Rural Development Project, approved by the Executive Board in September 1995.²

7. Experience gained by IFAD in its Sri Lanka activities — and specifically the North-Western Province Dry Zone Participatory Development Project, the Second Badulla Integrated Rural Development Project and the North-Central Province Participatory Development Project, all of which are ongoing integrated rural development projects (IRDPs) — offer some pertinent lessons for the design and strategy that have been used for the present project, namely, that:

- project directors have good experience of subcontracting implementation tasks both to NGOs and the private sector; government procurement procedures support this;
- project directors are also increasingly using the AWP/B to respond to changing social and economic conditions in the project area in a flexible and responsive manner;
- the relatively slow implementation pace of IRDP projects has highlighted the need to move one step beyond social mobilization into delivering economic activities and benefits in a long-term sustainable manner to beneficiaries;
- the private sector is increasingly seen as a partner in project implementation;

² See Appendix II for the country portfolio summary.



- implementation of credit programmes has shown that group collateral is a viable methodology; and
- collaboration with the World Food Programme (WFP) is an effective means of minor tank rehabilitation, and collaborative programmes with the German Agency for Technical Cooperation (GTZ) offer comparative advantages to all parties, including the Government.

C. IFAD's Strategy for Collaboration with Sri Lanka

8. **Sri Lanka's policy for poverty eradication.** The Government has placed great emphasis on poverty alleviation and related development programmes for several decades. The Food Stamp scheme, introduced in 1979, was replaced by the Janasaviya Programme in 1989. The concept is now being modified and extended through the Samurdhi (Prosperity) Movement, the latest Government programme started in 1995, which adopts a similar philosophy but with greater emphasis on self-employment and income-generation. However, not all these efforts have been effective in reaching the poorest rural people; and even the major historical achievements of Sri Lanka in the fields of mass education and health provision are now at risk because of the deteriorating **quality** of provision.

9. In agricultural and rural development, the former policy of reliance on IRDPs has been found to be less effective than expected in the delivery of significant and sustainable benefits to the rural poor. Commercialization of non-plantation agriculture is seen as the main way forward, a theme that is reflected in the Regional Economic Advancement Programme (REAP) of RDD. This latest policy, which is being actively implemented by Government with some donor support, has four elements: promotion of market-based farm enterprise development and specialization; rural non-farm enterprise development, including entrepreneurship, credit and product development to promote rural employment; elements of social development off-farm, such as homestead development, community health and environmental conservation; and, formulation of regional development plans.

10. **The poverty eradication activities of other major donors.** There are several donor development activities covering the district although most projects are national in scope rather than specifically focused on Matale. Apart from the two Asian Development Bank (AsDB) projects for perennial crops and smallholder tea and a third recently announced on vocational training, there are other projects funded by World Bank, the Japanese International Cooperation Agency and WFP, relating to the rehabilitation of tanks and canals; by the United Nations Development Programme on women's group mobilization and microenterprise development and on upgrading of district planning capability; by the Government for minor export crops, industrial development and export development; and by *Samurdhi* in export enterprises. AsDB and the World Bank are also financing a number of watershed management projects.

11. Outside the district, there are two particularly important projects with aims and objectives relevant to the present project and whose capabilities can be engaged in its activities. The first is the Central Province Enterprise Promotion Centre (PEPC) supported by GTZ under its Regional Rural Development Project (RRDP). PEPC is intended to be a self-financing organization offering one-stop business services to the private sector. The second relevant project is the United States Agency for International Development-funded Agro-Enterprise Development Project (AgEnt), structured as a company that works closely with the private sector to promote agricultural enterprise by providing business advisory and investment services, including sectoral studies, workshops, business planning, bank financing, and agro-enterprise development grants.

12. **IFAD's strategy in Sri Lanka.** The last IFAD strategy mission in 1992 proposed that:



- area-based rural development projects should continue, but with increased emphasis on non-farm activities through microenterprise components;
- the poor be reached through community participation with associated credit delivery;
- strong emphasis be given to NGO inclusion; and
- participatory planning be developed via decentralization and devolution of development.

13. These key features were reaffirmed in the country strategy paper produced after the 1996 identification mission, which preceded the new thinking on rural development represented by REAP. The 1998 inception mission originally outlined a project concept that has led to the present design of the project. The proposed rationale and strategy, emphasizing the high poverty level, underemployment and dependency, the service contract principle and the combination of producer and private sector approaches, followed the thrusts of both REAP and IFAD's country strategy.

14. **Project rationale.** The recent and current pace of change in the traditional structure of agriculture and the rural economy generally has led to disappointment with the way the classic integrated rural development — IRDP — approach has been unable to achieve sufficient impact and sustainability. New information about the pattern of household production value and incomes of poor families indicates that poverty alleviation and subsequent advancement needs to be based on a wide range of economic activities but primarily on those that have real promise of expansion, uptake and improvement — and of providing consistent and remunerative returns to all participants. This is the underlying rationale of the Government's REAP initiative and it is one for which the Matale District economy is well suited, with: its excellent transport and communications infrastructure; the diverse nature of resource endowment; a well-established private sector involvement; and the increasing dynamism and emerging new initiatives of business growth.

15. The need has been demonstrated to be large. There are considerable numbers of families, especially those headed by women and in the more remote and less favoured Divisions, in a serious state of poverty and deprivation. However, there is also substantial scope for improvement. Agriculture and livestock enterprises in Matale are not notably productive, with mediocre yields and outputs in relation to the quality of the resource base. The missing ingredients for their improvement and realization of the proper potential are: first of all, farmer incentive, which can now only come from the market place, in terms of more certain uptake and better prices for produce; second, mitigation of risk aversion, through facilitation and simplification of access to credit by group guarantee, focused extension and assurance of marketability — by contract; and third, modernization of crop programming, handling, storage and transport methods, so as to avoid the spoilage that now occurs and depresses prices. All of these elements can be optimally provided by the alliance of producers, and their groups and associations, with the private sector trading, processing, marketing and input supply companies. This is a process that is already well-known to many Matale farmers in the vegetable, tobacco, spice and milk businesses and one which is increasingly favoured by the companies involved.

16. Outside agriculture, there is a buoyant commercial sector — particularly in the medium and small categories of business, but also in microenterprises — with considerable potential for expansion and even now an unfulfilled need for appropriately trained people. Conversely, there is a large demand for employment in non-farm work, particularly from marginal farmers, their wives and especially their (usually well educated) children. The labour force is mobile and willing to travel outside the district and even overseas for work. Many businesses, including shops, village services and specialized artisans, have proven potential to grow, but their owners tend to have similar



problems and attitudes to the small farmer and do not have the financial management, technical or marketing skills to exploit opportunities and take on more workers.

PART II - THE PROJECT

A. Project Area and Target Group

17. Matale District is the northernmost of the districts of Central Province, which, as the name suggests, lies in the middle of Sri Lanka. Its historical cultural associations, its traditional connection with the formerly prosperous plantation industry and its pivotal position in the national transport and communications network, make it one of the most economically active, well-advanced and important provinces. These features also give Matale District a strong potential to expand development and prosperity and hence improve the lot of the substantial numbers of the poor and deprived that exist in the district, notwithstanding its overall status. The terrain of the south of the district is rugged and mountainous with altitudes of up to 1 220 m and average rainfall of over 2 000 mm. Tea, cocoa and minor perennial export crops are grown, interspersed with mainly irrigated *maha* paddy production and some *yala* vegetables in the small valleys. Around Naula, the environments changes to a drier, flatter lowland with 1 500 mm rainfall, where the main activities are paddy production, other field crops such as maize, and specialist vegetable growing. The main tree crops are coconut and mango.

18. About 70% of the population derive some or most of their livelihood from **farming**. About 40 000 households consider themselves farming families, but for the majority of the poor among these households (assuming that they conform to the national pattern set out in an authoritative 1996 survey), only 35-45% have significant self-employment and crops for self-consumption from agriculture and livestock activities. For the average poor family, the main income — making up 65-70% of total household revenue — is predominantly from wage employment. *Samurdhi* and other welfare payments account for about 15% of household incomes; pensions, rents, interest and migrant remittances for 10%, although for those that do receive these (about 15% of all households), they may constitute 80-90% of income; and non-farm self-employment in microenterprises for 2-5% (although for the 5-7% of all families that engage in them, they can comprise 50-70% of all income).

19. About 14 000 families are landless but this is not synonymous with poverty as much off-farm employment exists. Nor is there the strong and direct correlation between unemployment and poverty that tends to exist in other countries. Employment is predominantly in the private sector: estimates are of 32 000 jobs in tourism, arts and crafts, trading, ceramics and rice milling; 14 000 on plantations; some 10 000 in over 6 000 microenterprises; and 24 000 in government services. Matale and Dambulla are thriving towns, the latter more recently as a result of the movement of vegetable and fruit trading from locations further north because of civil unrest.

20. The primary project target group has been identified on the basis of the major index for which there is reliable data and which has a significant positive correlation with poverty levels, namely, illiteracy or semi-literacy, especially for women-headed households. The exact pattern of prevalence and status of such families in Matale District is not available from current sources but will be established by the project baseline survey using indices of casual, unskilled manual labour; limited years of schooling; and child health/growth to select them, so that the socially oriented — as well as the enterprise development — actions of the project can be targeted.

21. Using these criteria and applying them to those among the 70 000 rural households in Matale that are poor as defined by the poverty line, indicates that at least 15 000 women-headed households will be included. Assuming, from the 1996 survey data, that a similar number of poor, men-headed households will also fit this pattern, one arrives at a total **primary target group** of the poor of some **30 000 households**, or, say, 120 000 people.



B. Project Objectives and Strategy

22. **Objectives.** The development **goal** of the project is the raising and sustaining of the incomes of poor rural and farm families permanently above the poverty line. The project **objective** that will contribute to the realization of this aim is to ensure that 30% of the target group (with an emphasis on women and youth) have access to profitable economic activities in agriculture, non-farm employment and non-farm enterprises.

23. **Strategy.** The project's strategy is to develop farming activities; off-farm but agro-related businesses; and general trade and commerce enterprises that offer self- or wage-employment to rural — and particularly poor — people in and around Matale District. Participatory economic planning, implementation and monitoring will be a feature of **the process approach** to be adopted and will set the strategic tone. Private sector participation is a crucial part of project strategy, both in project management and as implementation partners.

24. The corollary of adoption of the process approach and of reliance on the private and NGO sectors is that the project will confine its activities to the facilitation and management of services provided by contractors or **service providers**, as required, to implement various components and activities, as far as possible to be selected and contracted on the basis of competitive tendering. To ensure that the project has an identity that is clearly not solely Government, non-partisan, independent, commercially-oriented, financially sound and sustainable, it is proposed that the structure and resources that make up the core service provision and potentially the project management are transformed into a public limited company. Such a company, proposed to be named **Matale Enterprise Limited**, will be able to assume the responsibilities and functions of service providers and, ultimately, the PMO and PAB.

C. Components

25. The project will have the following components, to be implemented over a period of six years: (i) agricultural commercial development; (ii) enterprise development and employment; (iii) rural financing; and (iv) project and company management.

Agricultural Commercial Development

26. **Seed production and quality improvement.** The seed sub-component will provide technical and financial support to increased private sector involvement in seed production and strengthen seed quality control. Existing or new seed producing companies will be helped to increase production, multiplication and distribution of domestic and imported seeds. Establishment of demonstration trials, publication of the characteristics of available and suitable varieties, and the provision of extension recommendations, will be part of the promotional activities. Technical assistance and training will strengthen and streamline seed testing, certification and release of new local varieties developed by the public or private sectors.

27. **Land and water management.** Expansion of irrigation schemes will comprise rehabilitation of tanks and anicuts and agrowell development. Specialist water management advice will be secured from a service provider/consultancy for development of effective farm water management programmes; and management of the transition towards diversified and commercial agricultural practices and sustainable operation and maintenance practices. The project will support the national land regularization and titling programme through institutional support to the Provincial Land Department and the Surveyor General's Department, as has been done successfully in other IFAD projects, with special attention to the legal position of women. Beneficiaries and farmer organizations will be trained soil and water conservation (SWC) using various technologies,



including sloping agricultural land technology, as an integral part of agricultural commercialization in upland and sensitive areas.

28. **Marketing and technology development.** This sub-component will assist in the development of integrated production and marketing links for selected agricultural products by assisting farmers to develop improved methods of operation, organize themselves into viable business groups/partnerships and explore marketing opportunities. The project will provide advisory services directly or through service providers and support commercial marketing investment proposals through private investors and farmers' organizations. The services to be provided will respond to farmer and private sector requests. Provision for the upgrading of the Dambulla wholesale market is included, plus support to farmers' organizations in their own post-harvest handling, storage and transport and other localized marketing interventions.

Enterprise Development and Employment

29. **Micro/small enterprise promotion.** The micro/small enterprise (MSE) promotion and income-generating activities (IGA) will concentrate on existing enterprises, assist in the establishment or energizing of chambers of commerce or industry and initiate contacts through business forums. Support services to upgrade technologies, enhance technical and management capacity, and improve marketing practices will be provided, including organization of enterprise visits, small business management training, and business counselling services for MSEs.

30. **Rural income-generation.** This sub-component will focus on women and youth and promote non-traditional IGAs for which there are small market niches. The project will provide support packages consisting of: entrepreneurial orientation, working capital, basic skills training, and marketing assistance. The individual types of activities that are of interest and potential for the target group will emerge from the economic participatory rural appraisals.

31. **Vocational training.** Support will be provided to local training centres and programmes to improve the relevance and quality of skills training; assist youth to find wage employment in both the Colombo-based sector and the informal MSE sector; and reorient attitudes towards private sector employment, including linkages to on-the-job training. The training programmes will be also made more relevant and accessible to young women. Refresher courses will be provided for those already employed in MSEs for the purpose of upgrading the technical skills of owners and workers, linked with the introduction of new technologies and improved products/designs that will considerably improve the prospects for MSEs to expand and create new jobs. Also included will be the upgrading and commercialization of the services of the Employment Information Centre of the National Youth Services Council.

Rural Financing

32. **Enterprise development credit.** The credit facility will complement the existing rural finance system and ensure availability of loan funds for farm activities and enterprise development among the IFAD target group. Finance will be available for agricultural production and off-farm enterprises and for micro and medium general enterprise development. Any licensed bank or formal credit institution will be able to access these funds to extend credit through subsidiary lenders. Where required, social mobilization, leading to group borrowing and other systems of collateral provision in line with the model of the IFAD-assisted Small Farmers and Landless Credit Project (SFLCP), will be used. Credit funds may also be made available, if required, to Matale Enterprise Limited, as equity contribution.

33. **Discretionary funds.** Grant funds will be used to support community-based activities with the target group, including the establishment of partnerships and farmers' associations; improvement of structures and systems for input supply, marketing and credit provision; infrastructure for production



and marketing improvement; and group mobilization. A gender equity fund will provide orientation, training and educational and legal support to women and minority groups. Jurisdiction over the use of discretionary funds will rest with the project executive group according to established criteria. Discretionary funds may be provided to projects financed by GTZ and WFP that support project objectives.

Project and Company Management

34. Project management will be set up initially under the aegis of the RDD and the District and Divisional Administration, but with strong representation of the private sector and civil society — including NGOs — in PAB and PMO. The principal activities will be preparation and appraisal of subproject proposals and their incorporation into the AWP/B; activation through service contracting of the supporting expertise; liaison with provincial, district and divisional bodies; oversight of the credit organization; and, monitoring of selected indicators and service providers to assess the project's impact on the target group.

D. Costs and Financing

35. **Project costs.** Total project costs, including physical and price contingencies, are estimated at LKR 957.0 million, or USD 14.5 million over the six-year implementation period. Base costs are LKR 792.0 million, or USD 12.0 million, while physical and price contingencies are estimated to add another USD 2.4 million, or 20% of base costs, to this amount. Foreign exchange costs are equivalent to USD 5.0 million, or 35% of total project costs.

TABLE 1: SUMMARY OF PROJECT COSTS^a
(USD '000)

Components	Local	Foreign	Total	Percentage of Foreign Exchange	Percentage of Base Costs
A. Agricultural commercial development	3 032.30	448.18	3 480.56	13	29
B. Enterprise development and employment	1 845.77	62.48	1 908.25	3	16
C. Rural financing	161.10	4 184.00	4 345.10	96	36
D. Project and company management	2 073.94	241.05	2 314.99	10	19
Total base costs	7 113.19	4 935.71	12 048.90	41	100
Physical contingencies	83.48	8.37	91.85	9	1
Price contingencies	2 274.51	55.48	2 329.99	2	19
Total project costs	9 471.18	4 999.56	14 470.74	35	120

^a Discrepancies in totals are due to rounding-up of figures.



TABLE 2: FINANCING PLAN^a
(USD '000)

Components	IFAD		Private Sector		WFP		GTZ		Government		Beneficiaries		Total		Foreign Exchange	Local (Excl. Taxes)	Duties and Taxes
	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%			
1. Agricultural commercial development	3 238.88	70.9	398.31	8.7	244.63	5.4	-	-	489.03	10.7	199.27	4.4	4 570.1	31.6	484.24	3 896.9	188.94
2. Enterprise development and employment	1 787.10	70.3	-	-	-	-	570.88	22.5	184.61	7.3	-	-	2 542.5	17.6	69.23	2 473.3	-
3. Rural financing and grant funds	4 402.25	100.0	-	-	-	-	-	-	-	-	-	-	4 402.2	30.4	4 184	218.24	-
4. Project and company management	2 278.57	77.1	-	-	-	-	-	-	677.20	22.9	-	-	6 955.7	20.4	262.08	2 492.2	201.41
Total disbursement	11 706.81	80.9	398.31	2.8	244.63	1.7	570.88	3.9	1 350.85	9.3	199.27	1.4	14 470.7	100.0	4 996	9 080.8	390.35

^a Discrepancies in totals are due to rounding-up of figures.



36. **Project financing.** IFAD will finance approximately USD 11.71 million of total project costs through a loan representing 81% of total costs. IFAD financing will comprise contributions to all components, including payment of the salaries of senior PMO executives. In terms of expenditure categories, the IFAD loan will be used to finance irrigation-related civil works; for the purchase of vehicles and related costs; and for equipment and technical assistance. Training costs will be borne both by IFAD and the Government. IFAD will also finance all recurrent costs related to the PMO. The Government will finance USD 1.35 million, representing 9% of project costs, and the project beneficiaries will contribute approximately USD 0.20 million, or 1% of project costs. The private sector will contribute USD 0.40 million, or 3%. The project will have complementarity with the GTZ PEPC project, which will continue with support from the second phase of the GTZ-assisted RRDP, 1999-2004, based in Kandy. PEPC will be a core service provider to the project and will bring funding for technical assistance, both international and local, of up to USD 0.57 million. WFP will cofinance irrigation rehabilitation and contribute up to USD 0.24 million. IFAD will separately provide a Special Operations Facility grant of USD 50 000 to finance essential project start-up activities. The arrangements will include retroactive financing from 1 December 1998 and, prior to loan effectiveness, of eligible items to a maximum of USD 400 000 for financing initial core service provider contracts, community mobilization, participatory planning and baseline studies.

E. Procurement, Disbursement, Accounts and Audit

37. **Procurement** of goods and services will be in accordance with government procedures, acceptable to IFAD. The major procurement items include civil works, equipment, vehicles, inputs, training, and technical assistance. Contracts with beneficiary organizations will be in accordance with procedures and conditions adopted by the Government for participatory implementation, acceptable to IFAD. International competitive bidding is not proposed as the items and quantities concerned do not require it and representatives of major international suppliers are situated in Colombo. Contracts for goods and services costing more than USD 100 000 and contracts of over USD 50 000 for consulting firms, NGOs and individuals will be awarded after prior review by IFAD; goods and services costing between USD 50 000 and USD 100 000 by post review on the part of IFAD for all contracts, and, below USD 50 000, by selective review during supervision missions. The aim will be to ensure economy and efficiency of purchasing; equal opportunity for providing goods, works and services; and to provide an incentive for the development of local contractors and manufacturers in Sri Lanka and, in particular, Central Province. Thus, local competitive bidding will be the procurement method for the purchase of vehicles, equipment and technical assistance. To encourage the regional economy, local shopping will be used for products which are readily available and/or too cumbersome and time-consuming to put through a bidding process, such as furniture, farm and fisheries inputs and equipment and small-scale contracting services.

38. **Disbursements and accounts.** The loan will be channelled through two Special Accounts maintained in US dollars at the national level, one managed by RDD and the other by the rural credit department of the Central Bank. Following loan effectiveness, IFAD will make initial deposits of USD 900 000 and USD 200 000, respectively, corresponding to about six months' requirements. A trust account to be opened in Matale will be operated by the project director who, in turn, will transfer funds to the project implementing agencies. The closing date of the loan is 30 June 2006.

39. **Accounting and audits.** Auditing will be carried out in accordance with international auditing standards by the Auditor-General of Sri Lanka and subsequently, on company formation, by external professional accountants. The Auditor-General may appoint private auditing firms at his discretion. The PMO will submit the annual financial statements to the Auditor-General within two months of the end of the financial year. Copies of the audited financial statements will be sent to IFAD within six months of the end of the financial year.



F. Organization and Management

40. The project's organization and management structure is designed to ensure that the project directorate has the independence, flexibility and jurisdiction to adapt the AWP/B in response to opportunities as they arise. This places on them the need for accountability, upward to the PAB and RDD, but also downwards to the target group, for project effectiveness and poverty impact. The project director will be primarily accountable for financial matters and will report to PAB on technical, work planning and budgeting and implementation issues.

41. **Beneficiary participation.** Participatory economic planning, implementation and monitoring will be a feature of the process approach to be adopted. The project will not set out to prescribe a blueprint for development or for individual activities, but will consult with all participants to identify actions that can be included in the AWP/B. Thus, the latter may be tested and modified, and the *modus operandi* of execution and the nature of support required amended in the subsequent workplans. This type of participatory, village-level economic planning has the purpose of enabling farmers to understand their current status from an economic perspective; informing them of options for improving productivity and income; and empowering them to undertake simple, practical management and enterprise monitoring skills on their own and so further develop their enterprise potential.

42. **Monitoring and evaluation.** Monitoring and poverty impact assessment will start with the baseline survey and benchmark-setting exercises at project commencement. All surveys and studies to be undertaken will be designed so that follow-up will be possible by means of rapid, low-cost field investigations. Data collection for these enquiries will be confined to the significant indicators required: nutrition and mortality; basic assets; agriculture and non-farm wage-employment; and education. In all these M&E activities, the beneficiaries will be specifically invited to assist, plan and participate, so that information fed back to the AWP/B process will be reliable and consistent with the actual achievements and progress of the project on the ground. Project evaluation will take place at the mid-term review in PY3, when an interim impact assessment will be made of tasks completed, increments obtained and benefits accrued against baseline data and target; and post-project in PY7, when a completion impact assessment report will be produced.

G. Economic Justification

43. **Production, marketing and prices.** The projected yields for the crops identified for the models are modest. The expected increase in yields is 11-20% for paddy, 10-30% for maize, 30-60% for chillies, 25-30% for big onion and 20-25% for soybean. These yield increases will stabilize with the assured supply of water and with the use of high-yielding seed varieties. Project impact on output of the crops under consideration will be significant in that the net farm incomes in irrigated agriculture under minor and micro tanks are expected to increase by 20-40% — and by 60% for cultivation under rehabilitated or newly-constructed agrowells. The cultivation on rainfed upland with horticulture/export agriculture mix gives a net increase in farm income of 35%. The rate of financial return on investment from the minor and micro tanks is estimated at 16%, while that for agrowells is 36%. The rate of financial return for the upland horticultural/export agriculture mix is 22%. These results demonstrate that farming with an assured supply of water from agrowells and with a mix of high-value crops gives the maximum return. Cash flow projections indicate that the participating farmers will be able to meet the debt-servicing requirements of the seasonal loans proposed under the project.

44. **Benefits and beneficiaries.** The project's primary target group is an estimated 30 000 households (15 000 families headed by women and 15 000 headed by men), equivalent to 26% of total households and comprising 43% of the rural households in the project area, which are



the poorest. All these families will be able to benefit to some extent from project activities, for instance, in the use of improved seeds and planting material, by having their land titled, from reduced use of expensive agrochemicals, or from obtaining employment in local enterprises. Women and youth will form a high proportion of the beneficiaries of employment, income-generating and agribusiness interventions. With an average household size of four, there will thus be an estimated 120 000 beneficiaries overall. Households that will be significant or full adopters of the range of project interventions are estimated at 30% of the primary target group, or 9 000 families or 36 000 people. In addition, the proposed agribusiness, enterprise development, income-generating and training activities will impinge on an estimated 7 000 target group and client households. Since some of these will also be included in the 9 000 families of the primary target group, it is estimated that, say, 4 000 families or 16 000 people can be considered as additional beneficiaries.

45. **Economic analysis.** The economic viability of the project has been evaluated over a 25-year period, the expected economic life of the irrigation civil works with proper maintenance. Increased crop production following tank and agrowell rehabilitation and soil conservation in the upland area is an important benefit. As a result of these, total incremental crop production at full development (in PY6) is estimated at 1 539 t of paddy, 782 t of dry chillies, 816 t of maize, 740 t of big onion, and 643 t of soybean. The other quantifiable benefits include value addition from off-farm income-generating activities; efficiency gained from processing methods; and the spin-off from other agribusiness, trading and industrial activities. The overall economic rate of return of the project is estimated at 16%, which reflects the investment opportunities in the project area. The sensitivity of the expected internal rate of return to decrease in benefits or increase in costs by 10% or to benefits lagging in one and two years is limited, indicating the resilience of project activities.

H. Risks

46. As the project is taking a relatively new approach to rural development, prompted by the Government's new REAP policy, there is inevitably a heightened level of risk. Some of the more prominent risks are:

- Will the proposed participatory management system work effectively? This depends to a considerable extent on the capability of the enterprise facilitators, but Sri Lanka has many social mobilizers who can be trained to the new needs.
- Are there enough private sector companies or entrepreneurs willing to work with the project and the private sector? The Dambulla market is attracting a lot of private sector and merchant interest, also from major agribusiness companies such as Nestlé and Indian companies. The district may be most favourably placed to attract the private sector.
- Will available technology enable farmers to make the 20% leap in productivity and thus be able to compete with imported agricultural products? Provided the development of the seed business goes ahead quickly and land and water management practices are adopted, this is a reasonable target.
- Will it be possible to recruit suitable service providers to undertake the varied activities of the project? A considerable number of potential service providers have been identified, but they may be somewhat inexperienced in providing some of the needs of the sector. Experience will be built up during the course of the project.



I. Environmental Impact

47. Matale District currently has no major environmental concerns. There are some areas of hillside erosion on abandoned tea estates; and there are indications of slowly increasing runoff from watersheds and consequent earlier drying-up of seasonal streams. However, farming systems, such as the Kandyan garden system and properly-managed tea estates, are beneficial to SWC. The main environmental concern associated with the project relates to the proposed increased exploitation of groundwater resources and possible increased use of agro-chemicals as production systems are intensified. Extraction rates that exceed the natural recharge capacity of the aquifers could lead to unsustainable use of groundwater and a decline of the groundwater table. For this reason, regular groundwater level monitoring will be included in the project activities. Environmental screening will be undertaken on all subprojects and private sector-supported activities that which require increased use of agrochemicals; and the standards of best practices of the Food and Agricultural Organization of the United Nations will be applied. The main environmental benefits/impacts will be increased groundwater levels in and near tank command areas due to tank rehabilitation; reduced soil erosion through promotion of SWC measures, including increased tree plantation; and, more land regularized, thereby increasing the likelihood of investments in soil fertility and perennial crops by the farmers.

J. Innovative Features

48. The project goes further than previous IFAD projects in Sri Lanka in adopting a process approach. This is necessary because of the essential role of the private sector and need for flexibility to respond to the rapidly moving market demands facing the farmers. The second innovative feature is the use of service providers on fixed-term and limited-scope contracts, necessary to avoid top-down management by government agencies and to be able to meet changing needs — for example, tank rehabilitation in PY 1 and drip irrigation in PY6. Ultimately the service providers will provide the basis for the formation of a public limited company that will allow the sustained delivery of services and marketing facilities. The third innovative feature is the concept of the economic participatory rural appraisal. This is an essential feature of the project's design and its related participatory management system. A fourth feature is the concept of production and marketing chains, otherwise known as commodity thrusts, whereby the project will support all links of the chain and not just the production/small farmer end.

PART III - LEGAL INSTRUMENTS AND AUTHORITY

49. A loan agreement between the Democratic Socialist Republic of Sri Lanka and IFAD constitutes the legal instrument for extending the proposed loan to the borrower. A summary of the important supplementary assurances included in the negotiated loan agreement is attached as an annex.

50. The Democratic Socialist Republic of Sri Lanka is empowered under its laws to borrow from IFAD.

51. I am satisfied that the proposed loan will comply with the Agreement Establishing IFAD.



PART IV - RECOMMENDATION

52. I recommend that the Executive Board approve the proposed loan in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Democratic Socialist Republic of Sri Lanka in various currencies in an amount equivalent to eight million three hundred and fifty thousand Special Drawing Rights (SDR 8 350 000) to mature on and prior to 15 August 2038 and to bear a service charge of three fourths of one per cent (0.75%) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

Fawzi H. Al-Sultan
President



SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES INCLUDED IN THE NEGOTIATED LOAN AGREEMENT

(Loan negotiations concluded on 26 November 1998)

1. (a) The Government of the Democratic Socialist Republic of Sri Lanka (the Government) will make available to the Rural Credit Department (RCD) the amount allocated from time to time to Enterprise Development Credit under an administration agreement, acceptable to IFAD.

(b) The RCD will make the subsidiary loan available to the participatory credit institutions (PCIs) under subsidiary loan agreements, acceptable to IFAD. The terms for relending the proceeds of the subsidiary loan to the PCIs will include interest at the rate of four per cent (4%) per annum and a repayment period of five to seven (5 to 7) years, including a grace period of one (1) year.

(c) The Government will cause the RCD to make a part of the proceeds of the subsidiary loan available to Matale Enterprise Limited under a subsidiary loan agreement as an equity contribution if required.

(d) The Government will bear the foreign exchange risk under the subsidiary loan agreements.

2. The Government will cause the PMO to open and thereafter maintain in a bank, satisfactory to IFAD, a project account from its Consolidated Fund and will thereafter periodically replenish the project account by depositing the required local counterpart funds to be provided by the Government as estimated in the AWP/B. The project director will be authorized to operate the project account.

3. The Government will cause the PCIs to establish and maintain a revolving fund for the project for keeping therein the principal and interest, net of operating and other expenses, received on the credits made to farmers from the proceeds of the loan provided for Enterprise Development Credit. Amounts available in the revolving fund will be used by the PCIs for the expansion of credit facilities to the beneficiaries consistent with this agreement at least until such date as the principal of, and interest and other charges on, the loan will have been paid in full.

4. During the execution of the project, the Government and IFAD will periodically review the interest rates to be applied to the credits to be made out of the proceeds of the loan. The Government, if necessary, will take appropriate measures, consistent with its policies in order to harmonize the interest rates on credits with IFAD's policy on relending rates. In the implementation of the above, the Government will ensure that the PCIs minimize their costs in executing the Enterprise Development Credit component of the project, as it affects their margin of the interest spread.

5. The PMO will be established by the Government.

6. The project director will be appointed with qualifications and experience acceptable to IFAD and he/she will be primarily accountable for financial matters and answerable for project progress and impact to the Director-General of the RDD and accountable downwards to the target group, for project effectiveness and poverty impact. He/she will also report on technical, work planning and budgeting and implementation issues to the PAB and have the management support of the PAB in ensuring top-level cooperation from line agencies. The members of the Project Executive Group will be recruited using procedures agreed between the Government and IFAD and will have sound private and public-sector experience.



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7. The project director will be responsible for liaison with the relevant provincial, district and divisional development committees and planning offices. The development and planning bodies at all levels will be consulted in the subproject acquisition and selection process and in matters of development consistency and impact. The Project Executive Group will hold management and progress review meetings at least bi-monthly and adopt a commercially oriented approach to performance for service contracts. To such meetings will be invited the key partners involved at that time in the AWPB.

8. The PAB will be the primary source of guidance and backup to management. Its private sector-oriented composition is designed to encourage the commercial stance of the project and to enable the absorption of the PAB into the board of the proposed Matale Enterprise Limited on the formation of the said company.

9. The PAB, which will meet quarterly, will comprise nine members: three from the public sector, one from an NGO and four from the local and national private sector, plus the District Secretary as chairman. Membership of the PAB will be constituted in a manner that will facilitate its transformation into the Executive Board of Matale Enterprise Limited in due course.

10. The field presence and operational capability of the project will be centred on the Service Providers selected to initiate and oversee the establishment of the capacity for the generation of subproject proposals and for provision of all the expert inputs required to bring them to fruition. The activities of these major Service Providers will be under the control of the Project Executive Group, relevant members of the group being assigned to relevant activities, but the Service Providers will be obliged, as part of their contracts, to appoint a competent manager, who will have significant experience of rural and enterprise development management and administration and a background in the relevant technical, socio-economic and business development aspects of the project area and subject matter concerned.

11. Subsidiary contracts for specific inputs may be entrusted by the Government to core Service Providers or be tendered, at the discretion of the Project Executive Group, which will have the sole jurisdiction: (i) to nominate the short list of pre-qualified Service Providers to be invited to tender; (ii) to specify contract terms and conditions; and (iii) to allow for special assistance from discretionary funds to potential contractors having limited resources and means in order to encourage competition and optimize project effectiveness.

12. Major contracts or agreements will be required for the initiation and subsequent management of the system and mechanisms for the assessment of proposals for, and provision of assistance to, the agricultural, agribusiness and general enterprise development activities. The contracts will entail the provision of the staff, facilities and resources to undertake business planning, feasibility study and management counselling services; identify and develop opportunities of production, marketing and technology application and arrange linkages between primary producers and private-sector processing and marketing firms for their exploitation; carry out market and marketing research assignments related to business partnership development; facilitate the provision of other specialist technical, financial or legal inputs required; broker contacts between individuals, groups and companies and with financing sources; and set up and operate systems of reporting between target groups, clients and management so as to enable effective monitoring, evaluation and redirection of project activities.

13. The terms of contracts or memoranda of agreement, all acceptable to IFAD, covering all service provision or investment inputs will: encourage the project philosophy of partnership and cooperation; allow for capacity-building and strengthening of the agencies – particularly the grass-roots organizations – concerned; and require conformity with legal and human resource management norms reflecting IFAD's remit. Terms and conditions will be remunerative to Service Providers for effective



performance, but will penalize failure, delay and inadequate delivery or impact by withholding final payments and, if necessary, debarring future participation.

14. Following the contracting of initial core Service Providers, the PMO will establish the proposed methodology for the setting up of a private limited company, to be known as Matale Enterprise Limited, to subsume some or all of the Service Providers, the PMO functions and the PAB functions, so as to become the focal point for enterprise development in Matale District and, where aposite, elsewhere in Sri Lanka. The Articles of Association, acceptable to IFAD, will be formulated so as to ensure that the company is a normal, profit-making business with a social agenda in poverty alleviation, operating on a sustainable, cost-recovery basis.

15. For credit funds to flow under the enterprise development credit component of the project, the RCD will be the supervising and overall monitoring agency through its Matale regional office, in association with the rural credit officer of the PMO. Disbursements by the RCD will be based partly on forward quarterly operating plans of the PCIs and partly on the submission of actual credit requests for approved plans for farm, agribusiness and enterprise subprojects. Systems of supervision and monitoring and evaluation of credit operations, savings development and the associated management information provision will be based on the experiences of the Small Farmers and Landless Credit Project financed by IFAD (loan No. 219-SR) in Sri Lanka, adapted to take account of the commercial nature of the investments and financing agencies. A credit manual, acceptable to IFAD, giving guidelines for the operation and support of the credit facility, particularly for target group participants, will be prepared prior to start-up.

16. The Government will cause the PMO to establish a discretionary fund under the project comprising the following elements:

- (a) a grant or deferred repayment fund, oriented to farm and agribusiness development, with a contribution ceiling of 75% of the cost of infrastructural support interventions and 50% of farm/commercial interventions;
- (b) a grant/equity investment fund for enterprise development and income-generation marketing activities, with maxima of 80% of the equity or 40% of the total cost of the investment concerned, whichever is the lower; and
- (c) a gender-equity fund, for target-group women and youth education and advisory services.

17. The Government will submit to IFAD, for its review and comments, the draft AWP/B, based on the work programmes and budgets prepared by each of the implementing agencies of the project, no later than two months before the commencement of each fiscal year of the Government. The Government will consider the comments of IFAD on the said AWP/B prior to its finalization.

18. The Government will ensure that participatory economic planning, implementation and monitoring is a feature of the process approach that is adopted. The project will not set out to prescribe a blueprint for development or for individual activities, but will consult with all participants to identify actions that can be included in the AWP/B; and thus be tested, modified and the *modus operandi* of execution and the nature of support required amended in the subsequent work plans. This process will evolve a menu of potential investments and services of interest to the private sector and farmers using economic participatory rural appraisals and participatory management follow-up to highlight the needs and potentials that are most likely to lead to profitable investments. The project organization and management will ensure that the directorate and senior management have the independence, flexibility



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and jurisdiction to amend the AWP/B, in a manner acceptable to IFAD, in response to opportunities as they arise.

19. The Project Executive Group will design and ensure the operation of the systems and procedures for beneficiary, business partnership, farmers association, and Service Provider consultation and the monitoring and reporting back of progress and future plans for incorporation into the AWP/Bs. The poverty monitoring manager and team will set up similar arrangements for the progress chasing of project activities, with particular emphasis on benefits to the primary target group, and for periodic impact assessments and reviews. These will be carried out by competent external contractors, including professional and academic institutions.

20. The crucial part of the monitoring and evaluation input will be concerned with the in-depth, continuing and rigorous assessment of household income, food security, well-being and advancement of the most poor. All surveys and studies to be undertaken will be designed so that follow-up can be done by means of rapid and low-cost field investigations, using a subsample or cohort group throughout the life of the project. In all of these grass roots-level exercises, the beneficiaries will play an active part; they will be specifically invited to help plan and participate in the monitoring and evaluation surveys, so that the information that will be directly fed back into the decision making and AWP/B formulation processes is reliable and consistent with the actual achievement and progress of the project on the ground. A beneficiary evaluation workshop will be held annually in conjunction with the finalization of the AWP/B for the following year.

21. The Government will ensure that special, positive attention and support, where required, is paid to the legal and social position of women in all the processes and procedures under the project.

22. The Government will ensure that the irrigation activities under the land and water management component of the project are enterprise-driven and only executed if the request of the farmers in the project area is framed in the context of specific commercial enterprise objectives through business partnerships. The Project Executive Group will decide on the viability and approval of assistance to such schemes.

23. No withdrawals will be made in respect of payments made for expenditures for Enterprise Development Credit until:

- (a) the administration agreement shall have been executed between the Government and the RCD, acceptable to IFAD; and
- (b) the subsidiary loan agreements with the relevant PCIs shall have been executed, acceptable to IFAD.

24. The following is specified as an additional condition precedent to the effectiveness of the loan agreement:

the Government shall have appointed the project director, with qualifications and experience acceptable to IFAD.



COUNTRY DATA

SRI LANKA

Land area (km ² thousand) 1995 1/	65	GNP per capita (USD) 1996 2/	740
Total population (million) 1996 1/	18	Average annual real rate of growth of GNP per capita, 1990-96 2/	3.4
Population density (people per km ²) 1996 1/	280	Average annual rate of inflation, 1990-96 2/	10.4
Local currency	Sri Lankan Rupee	Exchange rate: USD 1 =	LKR 66.0
Social Indicators		Economic Indicators	
Population (average annual population growth rate) 1980-96 1/	1.4	GDP (USD million) 1996 1/	13 912
Crude birth rate (per thousand people) 1996 1/	19	Average annual rate of growth of GDP 1/ 1980-90	4.2
Crude death rate (per thousand people) 1996 1/	6	1990-96	4.8
Infant mortality rate (per thousand live births) 1996 1/	15	Sectoral distribution of GDP, 1996 1/	
Life expectancy at birth (years) 1996 1/	73	% agriculture	22.4
Number of rural poor (million) 1/	5	% industry	25.1
Poor as % of total rural population 1/	38.1	% manufacturing	16.0
Total labour force (million) 1996 1/	8	% services	52.4
Female labour force as % of total, 1996 1/	35.5	Consumption, 1996 1/	
Education		General government consumption (as % of GDP)	10.4
Primary school gross enrolment (% of relevant age group) 1995 1/	113.0	Private consumption (as % of GDP)	72.8
Adult literacy rate (% of total population) 1994 3/	90.1	Gross domestic savings (as % of GDP)	16.8
Nutrition		Balance of Payments (USD million)	
Daily calorie supply per capita, 1992 3/	2 275	Merchandise exports, 1996 1/	4 097
Index of daily calorie supply per capita (industrial countries=100) 1992 3/	73	Merchandise imports, 1996 1/	5 028
Prevalence of child malnutrition (% of children under 5) 1990-96 1/	37.6	Balance of merchandise trade	- 931
Health		Current account balances (USD million)	
Health expenditure, total (as % of GDP) 1990-95 1/	1.9	before official transfers, 1996 1/	-1 416
Physicians (per thousand people) 1994 1/	0.1	after official transfers, 1996 1/	- 653
Access to safe water (% of population) 1990-96 3/	57	Foreign direct investment, 1996 1/	120
Access to health service (% of population) 1990-95 3/	n.a.	Government Finance	
Access to sanitation (% of population) 1990-96 3/	63	Overall budget surplus/deficit (including grants) (as % of GDP) 1995 1/	-8.3
Agriculture and Food		Total expenditure (% of GDP) 1995 1/	29.3
Food imports as percentage of total merchandise imports 1996 1/	15.9	Total external debt (USD million) 1996 1/	7 995
Fertiliser consumption (hundreds of grams per ha of arable land) 1994-96 1/	2 270	Total external debt (as % of GNP) 1996 1/	41
Food production index (1989-91=100) 1994-96 1/	108	Total debt service (% of exports of goods and services) 1996 1/	7.3
Land Use		Nominal lending rate of banks, 1996 1/	16.3
Agricultural land as % of total land area, 1994 4/	35.9	Nominal deposit rate of banks, 1996 1/	16.0
Forest area (km ² thousand) 1995 1/	18		
Forest area as % of total land area, 1995 1/	27.8		
Irrigated land as % of cropland, 1994-96 1/	29.2		

n.a. not available.

Figures in italics indicate data that are for years or periods other than those specified.

1/ World Bank, *World Development Report*, 1998

2/ World Bank, *Atlas*, 1998

3/ UNDP, *Human Development Report*, 1997

4/ World Bank, *The World Development Indicators CD-ROM*, 1998



PREVIOUS IFAD LOANS TO SRI LANKA

Project Name	Initiating Institution	Co-operating Institution	Lending Terms	Board Approval	Loan Effectiveness	Current Closing Date	Loan/Grant Acronym	Currency	Approved Loan/Grant Amount	Disbursement (as percentage of approved amount)
Kirindi Oya Irrigation and Settlement	AsDB	AsDB	HC	12 Apr 78	03 Jul 78	30 Jun 86	L - I - 1 - SRI	USD	12 000	100%
Kirindi Oya Irrigation and Settlement	AsDB	AsDB	HC	12 Apr 78	03 Jul 78	30 Jun 86	L - I - 109 - SR	SDR	5 500	63.9%
Anuradhapura Dry Zone Agriculture	AsDB	AsDB	HC	05 Dec 80	29 Jun 81	30 Jun 89	L - I - 58 - SR	SDR	11 350	33.0%
Coconut Development	AsDB	AsDB	HC	17 Dec 81	13 Oct 82	30 Jun 88	L - I - 85 - SR	SDR	7 100	43.2%
Badulla Rural Development	IFAD	World Bank IBRD	HC	09 Dec 82	18 Jul 83	30 Nov 93	L - I - 111 - SR	SDR	12 950	81.2%
Kegalle Rural Development	IFAD	World Bank IBRD	HC	05 Dec 85	08 Jul 86	30 Jun 96	L - I - 179 - SR	SDR	7 500	83.1%
Small Farmers and Landless Credit	IFAD	UNOPS	HC	26 Apr 88	28 Mar 89	31 Dec 97	L - I - 219 - SR	SDR	4 850	86.1%
Second Badulla Integrated Rural Development	IFAD	UNOPS	HC	04 Apr 91	12 Aug 92	31 Dec 99	L - I - 283 - SR	SDR	9 900	34.1%
North-western Province Dry Zone Participatory Development	IFAD	AsDB	HC	09 Sep 92	22 Feb 93	30 Jun 01	L - I - 309 - SR	SDR	6 150	38.9%
North-Central Province Participatory Rural Development	IFAD	UNOPS	HC	13 Sep 95	09 Jan 96	31 Dec 03	L - I - 384 - LK	SDR	5 450	20.2%

LOGICAL FRAMEWORK

Project Description	Overall Verifiable Indicators	Means of Verification	Important Assumptions
<p>Goal: To raise the incomes of 9 000 households, or 36 000 people, in Matale District - at least 30% of the target group - above the poverty line on a sustainable basis</p>	<p>Per capita income in relation to the poverty line</p> <p>Families graduating from the refined Samurdhi roster</p>	<p>District statistics and tax records</p> <p>Project M&E case studies of impact</p> <p>Samurdhi returns</p>	<p>Private/public sector and beneficiary cooperation materializes in use of resources and business growth</p> <p>Commercial initiatives not undercut by Government subsidies/interference</p>
<p>Project objectives: An increased level of profitable economic activity in the district, with benefits to another 7 000 households</p> <p>Improved employment levels of young men and women</p>	<p>Output/throughput volume and value increases for produce/goods/services</p> <p>Registered job seeker numbers fall each year from PY2 onwards</p> <p>Number of youth, women finding wage or micro-enterprise self-employment</p>	<p>Farm, market, trade association and chamber records, project studies</p> <p>Unemployment statistics and employment information centre (EIC)/project M&E reports</p> <p>Business partnership and service provider/training centre records</p>	<p>Sri Lankan economy withstands low-cost Indian imports under the South Asia Preferential Trade Area</p> <p>No other internal or external shocks to the economy</p> <p>Appropriately trained people find vacancies and business opportunities</p>
<p>Summary of strategy: Foster partnership with beneficiaries, line agencies, District administration, private sector and NGOs to assemble implementation capability</p> <p>Create strong, tight, autonomous project and company management</p> <p>Adopt participatory, demand-driven process approach and replicate past IFAD/other success with competitive performance-based service provision</p>	<p>Long-term measures of output and sales of District produce and products of all kinds, underpinned by a dynamic, commercial ethos</p> <p>Cost-effective target achievement by a viable development agency/company</p> <p>Spread of uptake of interventions, growth of household food security, income and welfare status and sound competitive institutional capability</p>	<p>Initial baseline and other business partnership/ enterprise feasibility and follow-up studies; statistics of output, sales ex-farms and markets</p> <p>Project annual reports and accounts and, later, company results</p> <p>Periodic socio-economic surveys and reviews; beneficiary household and enterprise sample case studies; NGO/service provider reports/accounts</p>	<p>Political and economic stability; more effective decentralization, devolution; and continued market liberalization</p> <p>Acceptance and support of service engagement/commercial principles</p> <p>Co-operation in information sharing and mutual support of plans and operations among donors and with line agencies and Districts/Divisions</p>
<p>Outputs: agricultural commercial development New seed companies and existing planting material nurseries importing, producing, demonstrating, supplying correct inputs for production/profit</p> <p>Government seeds quality/regulatory capability enhanced</p>	<p>Four-to-five new seed companies trading and several nurseries expanded</p> <p>3 550 farming households with increased productivity and quality of produce</p> <p>Speed and efficiency of certification up to commercial standards</p>	<p>As above, plus: Project/Matale Enterprise Limited records</p> <p>Service provider, business partners and farmer association records</p> <p>Seed certification unit and company plans and reports</p>	<p>Investor interest/commitment; contract supply arranged</p> <p>Adaptive trials find appropriate packages acceptable to farmers</p> <p>New Seeds Act in place; Ministry, management/ staff compliance</p>





INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

APPENDIX III

Narrative Summary	Verifiable Indicators	Means of Verification	Important Assumptions
<p>Land and water supply provision and management improved for subprojects for business partnerships</p> <p>Land regularization/titling process speeded up</p>	<p>32 micro/ 28 minor schemes, 20 tanks and 40 canals; 400 agro-wells renovated/constructed; 450 ha upland improvement benefiting 450 households</p> <p>2 700 titles issued, mainly to project households, over three years of assistance</p>	<p>Service provider/contractor records</p> <p>Ministry of Agriculture/Department of Agrarian Services Statistics; farmer group reports and M&E case studies</p> <p>Provincial Land Department and Surveyor General progress reports</p>	<p>Farmer commitment and responsible attitude to operation and maintenance secured</p> <p>Exploitative land use restricted; water use management adopted/imposed</p> <p>Wholehearted cooperation by agencies</p>
<p>Agricultural/agribusiness enterprises established/strengthened by farmer/private sector linkages</p> <p>Systems, technologies and marketing initiatives tested/developed; effective, commercial enterprise extension available</p> <p>Market infrastructure expanded and improved</p>	<p>Business/project planning and support services operating; 500 farm households in farmer companies engaged in sole or joint venture production-marketing businesses</p> <p>Post-harvest losses reduced to < 15%; farm inputs rationalized; cropping on 2 000 ha with yield increases of 2.5% p.a.; livestock/fisheries production systems improved, commercialized</p> <p>Dambulla market modernized and expanded; other markets improved</p>	<p>As above, plus: PMO/Matale Enterprise records from business promoters and associations</p> <p>Reports from farmer associations and line agency statistics; M&E reports</p> <p>Contractor reports and market records</p>	<p>Enterprise benefits equably shared</p> <p>Improved methods and systems have farmer/trader support and customer demand</p> <p>Co-operation of traders, financiers and authorities come through as expected</p>
<p>Outputs: enterprise development and employment</p> <p>Micro/small enterprises (MSEs) assisted to overcome competence constraints in design, process and marketing with help of larger concerns</p> <p>Establishment of new chambers of commerce/industry</p>	<p>100 MSE/larger company linkages</p> <p>Advisory services to 200 MSEs operational and 10 product/sector studies done</p> <p>1 000 jobs created and 2 500 stabilized</p>	<p>As some of above, plus: Project/Matale Enterprise Limited records</p> <p>Service provider, business partners and business promoter records</p> <p>District and EIC statistics and Chamber minutes</p>	<p>Private sector, large company commitment</p> <p>Viable business ideas/plans emerge and are proved/approved</p> <p>Local private sector enthusiasm</p>
<p>Income-generating activities for rural women, youth and artisans, services and businesses with emphasis on non-traditional and niche pursuits</p> <p>Requisite expert assistance by service provider and resource person inputs</p> <p>Economic participatory rural appraisals used for identification</p>	<p>1 500 people, mostly women, with entrepreneurial orientation and 1 000 with skills training; 500 credits per year facilitated for business start-up</p> <p>60 technology/market innovations; and 1 500 self-employed businesses given improved marketing capacity</p> <p>Contacts made and meetings held in all 545 Grama Niladhari (GN) divisions</p>	<p>Training centre records and follow-up studies; individual business accounts</p> <p>Participatory credit institution (PCI)/intermediate credit institution (ICI) lending and M&E records</p> <p>Service Provider and consultant contract reports</p> <p>Divisional and planning unit records</p>	<p>Co-operation of institutions concerned</p> <p>Viable investments emerge</p> <p>Business development prospects realised</p> <p>Target group/beneficiary interest and conviction</p>
<p>Vocational training for enterprise expansion and employment made more focused and upgraded</p> <p>Selected training centres supported with methods, curricula development, equipment, and material</p>	<p>2 000 youth, women and men trained and 80% of them in employment</p> <p>500 owners/workers in MSEs with upgraded skills/business knowledge</p>	<p>Training centre, EIC and business records</p> <p>Enterprise accounts, reports; lender records</p>	<p>Institutional commitment and adequate staff performance</p> <p>Centre operator cooperation; private sector and beneficiary support</p>



Narrative Summary	Verifiable Indicators	Means of Verification	Important Assumptions
<p>Outputs: rural financing and grants Viable and accessible credit facilities available to target group and clients through banks, NGOs and informal credit agencies</p> <p>Mobilization and continued support to credit groups & administrative support to PCIs and ICIs</p> <p>Discretionary funds (for grant deferred repayment or equity assistance) for preparation and realization of farm, agribusiness and general enterprise investments and social/gender equity causes</p>	<p>Loans for 12 tank/anicut schemes, 140 agrowells and 1 000 farming improvements per year, with satisfactory repayment performance</p> <p>1 000 agribusinesses and 200 general enterprises funded per year</p> <p>Up to 2 000 applications per year approved and actioned for concessionary funding</p> <p>Orientation, education and training of women and the disadvantaged for commercial and civil involvement</p> <p>PMO and PAB - and later, Matala Enterprise Limited - operational Service providers engaged</p> <p>AWP/Bs produced, kept flexible</p> <p>Progress of subprojects on schedule</p> <p>Project strategy/policy agreed</p> <p>Orderly, timely completion of planning, services and works</p>	<p>As some of above, plus: RCD and ICI/PCI records; project M&E case studies/reports</p> <p>As above</p> <p>Executive group proceedings/reports project and service provider M&E returns</p> <p>Feedback from community NGOs</p> <p>Project records, reports, PAB minutes Company forecasts, accounts, reports Contract/procurement documents</p> <p>AWP/Bs, revisions and future plans</p> <p>Business promoter/PMO records</p> <p>PAB minutes</p> <p>Contract documents and progress reports</p>	<p>Feasible/bankable schemes and propositions emerge that require credit</p> <p>Participatory planning/consultation system is effective and worthy cases presented</p> <p>Women and young people take part in the economic participatory rural appraisals</p> <p>Commitment by IFAD, Government and district development authority to Project principles</p> <p>Participatory planning working</p> <p>Top-level Government input</p>
<p>Outputs: project and company management Responsive, cost-effective and timely delivery of project services</p> <p>Participatory AWP/B process operational at field and district level</p> <p>Efficient management achieving project targets</p>	<p>Office rented and eight senior staff recruited; vehicles and support staff provided</p> <p>Project director, contract/ procurement director execute contracts</p> <p>Director and business promoters and public relations consultant extant</p> <p>Beneficiary group/enterprise plans prepared with assistance of business promoter/community mobilization officers (JN, Samudhi, NGO)</p> <p>Subsequent appraisals and workshops and case studies by PMO/M&E</p> <p>Service Providers contracted; training, studies, baseline/benchmark surveys and support underway</p> <p>Financial institutions commissioned; credit line USD 2.8 million to draw down; systems in place for group support</p> <p>USD 1.4 million available as grant, deferred repayment or equity capital includes gender fund of USD 102000</p>	<p>Quarterly reports RDD monitoring of progress</p> <p>Quarterly reports of PMO</p> <p>Campaign, media documentation, reports</p> <p>PMO/BP and M&E records</p> <p>M&E reports, workshop proceedings</p> <p>Service provider reports PMO monitoring</p> <p>Reports of Service Providers Banks and ICI records</p> <p>Participatory monitoring M&E reports</p>	<p>Service provision satisfactory</p> <p>Qualified staff recruited</p> <p>Sufficient funds allocated</p> <p>Volition and conviction on part of target group and clients</p> <p>Business clients forthcoming with queries, problems</p> <p>Scheme remains competitive and not undercut by Government/subsidy</p> <p>Enterprises can access loans quickly to support commercial initiatives</p>



COSTS AND FINANCING

	IFAD		BENEFICIARIES PRIVATE SECTOR				WFP		GTZ		GOVERNMENT		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%			
I. Investment Costs																	
A. Civil works	775.04	44.2	199.27	11.4	398.31	22.7	244.63	13.9	-	-	136.81	7.8	1,754.06	12.1	110.62	1,506.63	136.81
B. Vehicles	73.69	35.4	-	-	-	-	-	-	-	-	134.23	64.6	207.92	1.4	73.69	-0.00	134.23
C. Equipment	83.27	67.4	-	-	-	-	-	-	-	-	40.26	32.6	123.52	0.9	59.99	23.28	40.26
D. Training	962.08	63.5	-	-	-	-	-	-	130.87	8.6	421.00	27.8	1,513.95	10.5	153.14	1,360.81	-
E. Operational & technical support	1,693.87	91.8	-	-	-	-	-	-	148.38	8.0	3.02	0.2	1,845.27	12.8	245.16	1,597.09	3.02
F. Rural finance	2,794.89	100.0	-	-	-	-	-	-	-	-	-	-	2,794.89	19.3	2,794.89	-	-
G. Service provider contacts	2,610.79	90.0	-	-	-	-	-	-	291.63	10.0	-0.00	-0.0	2,902.42	20.1	-	2,902.42	-
I. Grant fund	1,389.13	100.0	-	-	-	-	-	-	-	-	-	-	1,389.13	9.6	1,389.13	-	-
Total Investment Costs	10,382.76	82.9	199.27	1.6	398.31	3.2	244.63	2.0	570.88	4.6	735.30	5.9	12,531.15	86.6	4,826.62	7,390.23	314.31
II. Recurrent Costs																	
A. Salaries and allowances	739.89	59.3	-	-	-	-	-	-	-	-	508.39	40.7	1,248.28	8.6	-	1,248.28	-
B. O&M office supplies	304.18	80.0	-	-	-	-	-	-	-	-	76.05	20.0	380.23	2.6	172.95	131.23	76.05
C. Miscellaneous	279.98	90.0	-	-	-	-	-	-	-	-	31.11	10.0	311.09	2.1	-	311.09	-
Total Recurrent Costs	1,324.05	68.3	-	-	-	-	-	-	-	-	615.55	31.7	1,939.59	13.4	172.95	1,690.60	76.05
Total Disbursement	11,706.81	80.9	199.27	1.4	398.31	2.8	244.63	1.7	570.88	3.9	1,350.85	9.3	14,470.74	100.0	4,999.57	9,080.82	390.35

EXPENDITURE ACCOUNTS BY COMPONENTS
(USD '000)

	Agricultural Commercial Development	Enterprise Development and Employment	Rural Financing and Grant Funds	Project and Company Management	Total
I. Investment Costs					
A. Civil works	1 754.06	-	-	-	1 754.06
B. Vehicles	41.10	-	-	166.82	207.92
C. Equipment	49.36	-	-	74.17	123.52
D. Training	903.79	556.64	-	53.52	1 513.95
E. Operational and technical support	455.49	515.30	-	874.47	1 845.27
F. Rural finance	-	-	2 794.89	-	2 794.89
G. Service provider contracts	1 285.56	1 347.54	218.24	51.07	2 902.42
I. Grant fund	-	-	1 389.13	-	1 389.13
Total Investment Costs	4 489.36	2 419.49	4 402.25	1 220.04	12 531.15
II. Recurrent Costs					
A. Salaries and allowances	51.40	-	-	1 196.88	1 248.28
B. O&m office supplies	29.37	-	-	350.86	380.23
C. Miscellaneous	-	123.10	-	187.99	311.09
Total Recurrent Costs	80.76	123.10	-	1 735.73	1 939.59
Total PROJECT COSTS	4 570.12	2 542.59	4 402.25	2 955.77	14 470.74





ORGANIZATION AND MANAGEMENT

1. **Management functions.** The organization and operations structure and systems are shown in the diagrams in Figures 1 and 2. At the outset, the PMO will direct the four main categories of project activity, as illustrated in the diagrams, namely:

- facilitation of acquisition-preparation and appraisal through a single, streamlined conduit of development concepts and proposals from beneficiaries, communities, NGOs, community beneficiary organizations (CBOs), line agencies and the private sector; these will then be combined in the AWP/B, with the necessary flexibility built in;
- the contracting function - to mobilize service providers from the pool of expertise and assistance available in line agencies, NGOs and the private sector to support the establishment of subprojects;
- a liaison channel for consultation and dialogue between project management and provincial, district and divisional bodies and communities and beneficiaries so as to monitor the poverty-alleviation impact; and
- oversight and support of the credit funds flow from the RCD of the Central Bank into the project and, through the credit procedures of PCIs, to participants. The latter process will follow standard Government/Central Bank procedures, as amplified in Figure 3.

2. The organization and management structure is designed to ensure that the project directorate has the independence, flexibility and jurisdiction to amend the plan of action in response to opportunities as they arise. The project director will be primarily accountable for financial matters and answerable for project progress and impact upwards to the director general of the RDD of MPIPA; and, downwards to the target group, for project effectiveness and poverty impact. He/she will also report on technical, work planning and budgeting, and implementation issues to the PAB - and have the management support of PAB in ensuring top-level cooperation from line agencies. The management cadre below the project director will comprise a further three director-level appointments and eight advisory and field-level appointments. The structure embodies channels for consultation and dialogue between management and beneficiaries, both through formal liaison and directly with the business promotion and M&E field staff. In this way, the project will ensure that it listens to the views, aspirations and criticisms of the beneficiaries and reports these back to PMO and PAB for inclusion in subsequent AWP/Bs so that it is clear where responsibility and accountability rest.

3. **Staffing pattern.** The staffing pattern is given in the project organigram in Figure 3. The members of the project executive group will be recruited directly and competitively by the project and will have sound private-sector – as well as, preferably, some public service – experience. For Government financial regulatory reasons, it is desirable that the project director be found among senior personnel from the public service. Appointment of the project director will be subject to IFAD confirmation. The reporting and consultation/liaison relationships of the various members of the PMO cadre are illustrated in Figure 3.

4. The project director will be responsible for liaison with the relevant provincial, district and divisional development committees and planning offices. The development and planning bodies at all levels will be consulted in the subproject acquisition and selection process and in matters of development consistency and impact. The project executive group will hold management and progress review meetings at least bi-monthly and, for service contracts, adopt a commercially-oriented approach to performance.



5. The PAB will be the primary source of guidance and back-up to management. Its private sector-oriented composition is designed to encourage the commercial stance of the project and to enable the absorption of PAB into the board of Matale Enterprise Limited, once the company has been formed.

6. The PAB, which will meet quarterly, will comprise nine members: three from the public sector, one from the NGO and four from the local and national private sector, plus the district secretary as chairman. Membership of PAB will be constituted in a manner that will facilitate transformation to the executive board of Matale Enterprise Limited in due course.

7. **Field operations of service providers.** The field presence and operational capability of the project will be centred on the core service providers selected to initiate and oversee the establishment of the capacity to generate subproject proposals and provide all the expert inputs required to bring them to fruition. The activities of these major service providers will be under the control of the project executive group - relevant members of the group being assigned to relevant activities - but the service-providing organization will be obliged as part of the contract to appoint a competent manager. The latter will need to have significant experience of rural and enterprise development, management and administration, and a background in the relevant technical, socio-economic and business development aspects of the area and subject matter concerned.

8. Subsidiary contracts for specific inputs may be entrusted to core service providers or tendered at the discretion of the project executive group. The latter will have sole jurisdiction to nominate the shortlist of prequalified service providers to be invited to tender; to specify contract conditions and terms; and to allow for special assistance from discretionary funds to potential contractors of limited resources and means in order to encourage competition and optimize project effectiveness.

9. All staff – of the project, of the management of service providers and of subcontractors - will be accorded authority and accountability appropriate to their functions. All – and in particular, service provider managers – will be expected to meet explicit targets for catalysing, fostering and bringing to fruition a flow of propositions and subprojects for assistance. Final payments for contracts and incentive schemes will be retained against assessment of performance under terms that will be negotiated by the executive group for each contract, and under overall PAB guidelines.

10. **Management and service contracting.** The majority of the services required to prepare activities and undertake project actions will be acquired on a contract basis from the various sources described above, through a commercial or quasi-commercial tender system drawn up by the contracts/procurement director. Most of the investment and subproject execution will be handled by the private sector and the target group, with credit and some grant or equity assistance from the project.

11. The terms of contracts or memoranda of agreement covering all service provision or investment inputs will encourage the project philosophy of partnership and cooperation; allow for capacity-building and strengthening of the agencies - particularly the grass-roots organizations - concerned; and require conformity with legal and human resource management norms reflecting the IFAD remit. Terms and conditions will be remunerative to service providers for effective performance, but will penalize failure, delay and inadequate delivery or impact by withholding final payments and, if necessary, debarring future participation.

12. Major contracts or agreements will be required for the initiation and subsequent management of the system and mechanisms for the assessment of proposals for, and provision of assistance to, the agricultural, agribusiness and general enterprise development activities. The contracts will entail the provision of the staff, facilities and resources to undertake business planning, feasibility study and



APPENDIX VI

management counselling services; identify and develop opportunities of production, marketing and technology application, and arrange linkages between primary producers and private sector processing and marketing firms for their exploitation; carry out market and marketing research assignments related to business partnership development; facilitate the provision of other specialist technical, financial or legal inputs required; broker contacts between individuals, groups and companies and with financing sources; and set up and operate systems of reporting between target groups, clients and management so as to enable effective M&E and redirection of project activities.

13. The prime candidates for award of these contracts will be the agencies that already have a demonstrable track record in the areas concerned. These include the larger NGOs, PEPC, AgEnt, the Federation of Chambers of Commerce and Industry of Sri Lanka and certain of the banks and consulting groups. The provision of all or most of the downstream services and resources, including staff – particularly local staff – to carry out the work entailed in subproject feasibility and development will then be awarded as dictated by the emerging interest in the project.

14. The exact size and configuration of the contracts concerned will vary from subproject to subproject. This will be determined in the start-up phase by the project directorate, who together will constitute the executive group of the project and latterly of the company. In some cases, contractual packages will require that some of the specific skills be obtained from sources other than a main contractor. This is seen as an advantage, since it will ensure wider sharing of project benefits among agencies, enhance partnership and encourage cooperation which is crucial for future local development.

15. **Credit financing.** For credit funds flow, the RCD/Central Bank will be the supervising and overall monitoring agency through its Matale regional office, in association with the rural finance adviser of the PMO. Disbursements by RCD will be based partly on forward quarterly operating plans of the PCIs and partly on the submission of actual credit requests for approved plans for farm, agribusiness and enterprise subprojects. Systems of supervision and M&E of credit operations, savings development and the associated management information provision will be based on the IFAD Small Farmer and Landless Credit Project, adapted to take account of the commercial nature of the investments and the financing agencies. A credit manual with guidelines for the operation and support of the credit facility, particularly for target group participants, will be prepared prior to start-up.

16. **Work programmes and budgets.** Implementing agencies, service providers and subcontractors will be obliged as a condition of contract to prepare a periodic or annual work programme and budget in respect of their expected operations by geographical coverage or subject matter area; and for all other significant interventions such as training programmes, consultancy inputs, enterprise development and investment schemes and infrastructure construction. Other individual site or intervention AWP/Bs will be prepared by beneficiary groups, CBOs, farmer organizations or NGOs, using the menus of potential investments, submitted through the relevant front line staff of subcontractors and service providers to the project executive group and, on approval, consolidated into the work programme and budget for the project. This will be submitted to PAB for information and review in light of project progress and for transmission onwards to RDD and IFAD. Based on the Government's fiscal year of 1 January – 31 December, the project AWP/B will be submitted to PAB no later than 31 October in each year. This means that the annual planning process will have to start before June at village, division, district, provincial and sectoral - NGO and private - level.

Figure 1 – ORGANIZATIONAL STRUCTURE AND OPERATION CHART

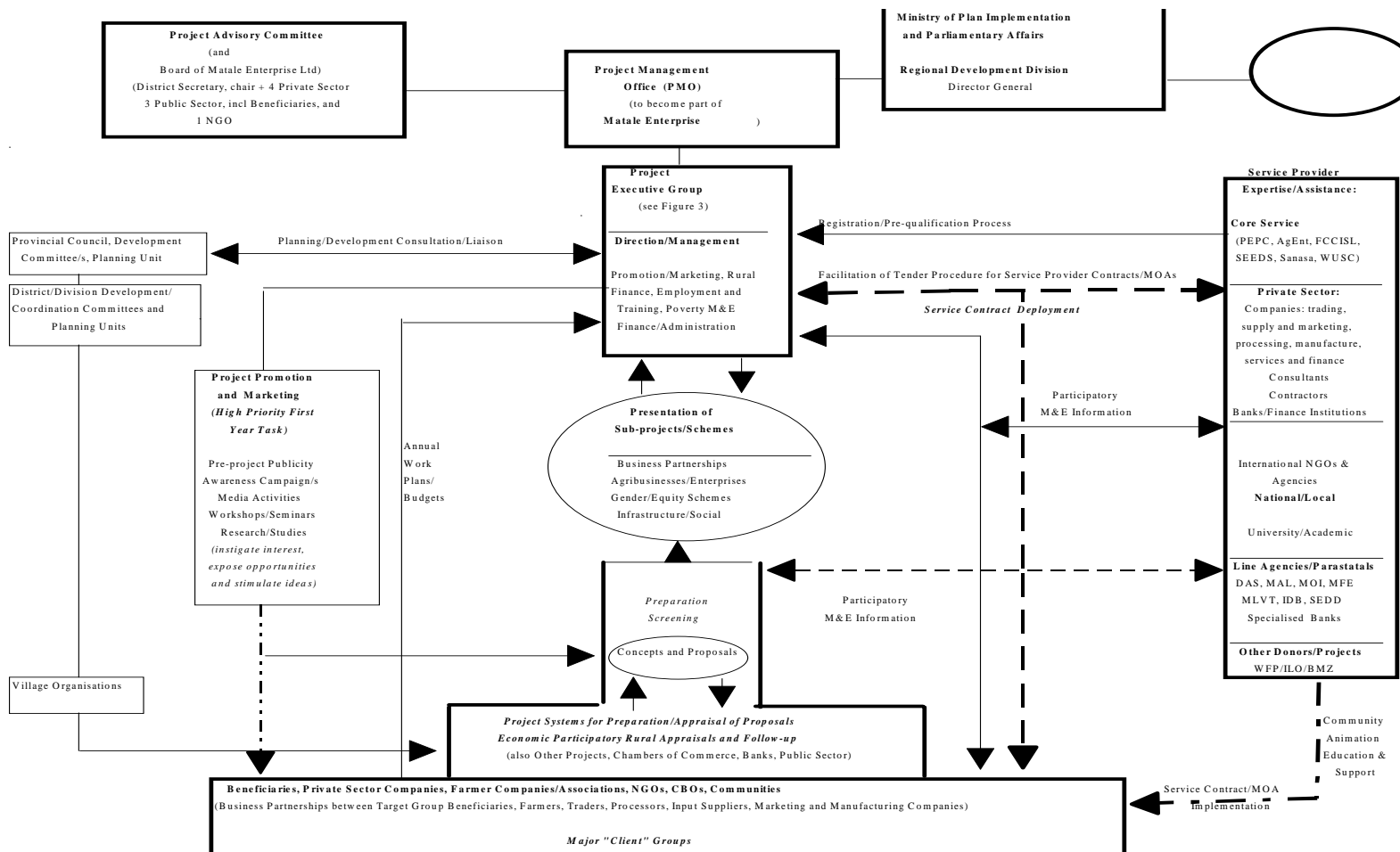


Figure 2 – IFAD/GOVERNMENT FUNDS FLOW DIAGRAM

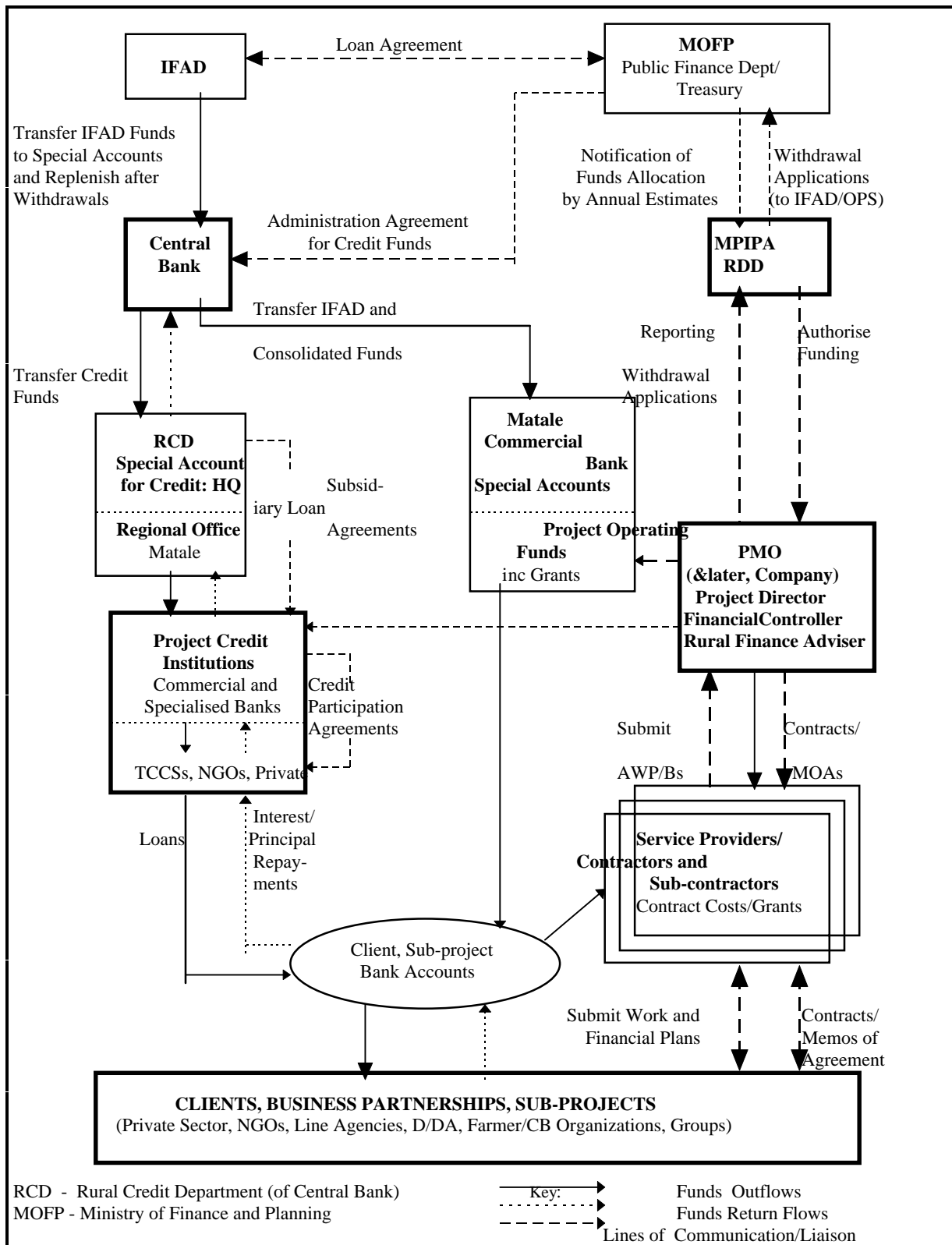
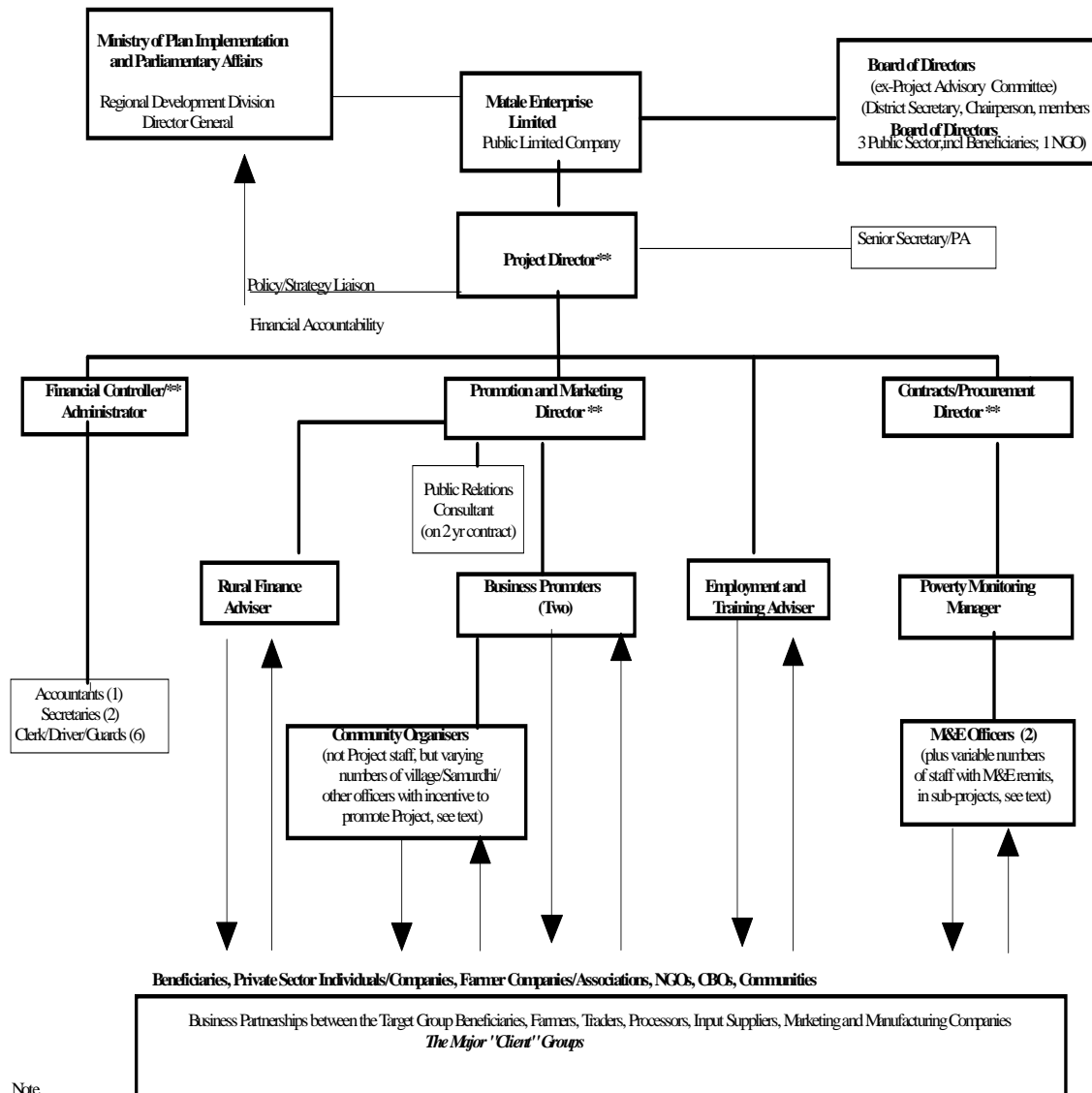




Figure 3 – PROJECT ORGANIGRAM - STAFFING CHART



Note

** Indicates members of the Project Executive.

**ECONOMIC AND FINANCIAL ANALYSIS**

17. **Project beneficiaries.** The primary target group of the project is an estimated 30 000 households – 15 000 families headed by women and 15 000 headed by men – equivalent to 26% of total households and comprising 43% of the rural households in the project area, which are the poorest. All these families will be able to benefit to some extent from project activities, for instance, in the use of improved seeds and planting material, from having their land titled, from reduced use of expensive agrochemicals, or from employment in local enterprises. With an average household size of four, there will thus be an estimated 120 000 beneficiaries overall. Households that will be significant or full adopters of the range of project interventions are estimated at 30% of the primary target group, or 9 000 families or 36 000 people.

18. Women and youth will form a high proportion of the beneficiaries for employment, income-generating and agribusiness interventions. Women already form a major part of the work force of agricultural commercial enterprises, both on-farm and in processing and marketing, and take a leading role in general enterprises such as trading, minerals processing and garment manufacture. In addition, the proposed agribusiness, enterprise development, income-generating and training activities will impinge on an estimated 7 000 target group and client households. Since some of these will be also included in the 9 000 families of the primary target group, it is estimated that, say, 4 000 families or 16 000 people can be considered as additional beneficiaries.

19. **Project benefits.** The average returns to labour are also estimated to increase by 35% for the different farm models other than for the agrowell model where it will be 100%. Incremental returns to incremental labour are estimated to be even higher. In all cases, the returns per labour day are above the prevailing nominal daily wage rate for unskilled labour of LKR 150 for men and LKR 100 for women. The large increase in the returns to labour for both the tank and agrowell models reflect the avoidance of losses in the future with-project situation as much as increases in productivity over the present situation. The returns to labour in the upland horticultural/export agriculture mix indicate the potential for realising considerable benefits through improved soil conservation, better quality seeds and more sustainable farming practices earmarked in the project.

20. The net household incomes and returns to labour, expressed in United States dollar terms, are listed below:

	Net Annual Household Income			Return to Family Labour		
	Without Project	With Project	%	Without Project	With Project	%
Tank model	338	421	25	101	116	24
Agrowell model (new)	-	478	100	-	118	100
Upland model	265	364	37	78	105	35
Enterprise model	30	150	400	86	260	202

21. The percentage increase in labour requirements for these farming models ranges between 4% and 11%. However, it is clear that the target group of 15 000 women- and 15 000 men-headed households in Matale have sufficient family numbers to meet the increased labour requirements in all cases, especially considering the lack of employment opportunities and observed underemployment of farm labour. With the commercial orientation of the farm enterprises, the seasonality of labour requirement will be decreased.



22. **Economic rate of return.** The economic viability of the project has been evaluated over a 25-year period, the expected economic life of the irrigation civil works with proper maintenance. Increased crop production following tank and agrowell rehabilitation and the soil conservation in the upland area is an important benefit. As a result, the total incremental crop production at full development - in PY6 - is estimated at 1 539 t of paddy, 782 t of dry chillies, 816 t of maize, 740 t of big onion, and 643 t of soybean. The other quantifiable benefits include value addition from off-farm income-generating activities; efficiency gained from processing methods; and the spin-off from other agribusiness, trading and industrial activities.

23. The overall economic rate of return of the project is estimated at 16%, which reflects the investment opportunities in the project area. The sensitivity of the estimated internal rate of return to decrease in benefits or increase in costs by 10% or to benefits lagging in one and two years is limited, indicating the resilience of project activities.

Base EIRR % - 16

Benefits decrease by 10%	16%
Costs increase by 10%	14%
Combined decreased in benefits and increase in costs by 10%	14%
Delay in benefits by one year	13%
Delay in benefits by two years	8%