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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE

REPUBLIC OF MOLDOVA

FOR THE

RURAL FINANCE AND SMALL ENTERPRISE DEVELOPMENT PROJECT

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CURRENCY EQUIVALENTS

Currency Unit	=	Moldavian Leu (Lei) (MDL)
USD 1.00	=	MDL 11.0
MDL 1.00	=	USD 0.09

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

CNFA	Citizens Network for Foreign Affairs
DIA	Deposit Insurance Agency
DIS	Deposit Insurance Scheme
FSU	Former Soviet Union
M&E	Monitoring and Evaluation
MTR	Mid-term Review
NAPCU	National Agricultural Project Coordinating Unit
NGOs	Non-Governmental Organizations
PCIs	Participating Credit Institutions
PIU	Project Implementation Unit
PSC	Project Steering Committee
RFC	Rural Finance Corporation
SCAs	Savings and Credit Associations
SEDF	Small-Scale Enterprise Development Fund
SSB	State Supervisory Body
USAID	United States Agency for International Development

GLOSSARY

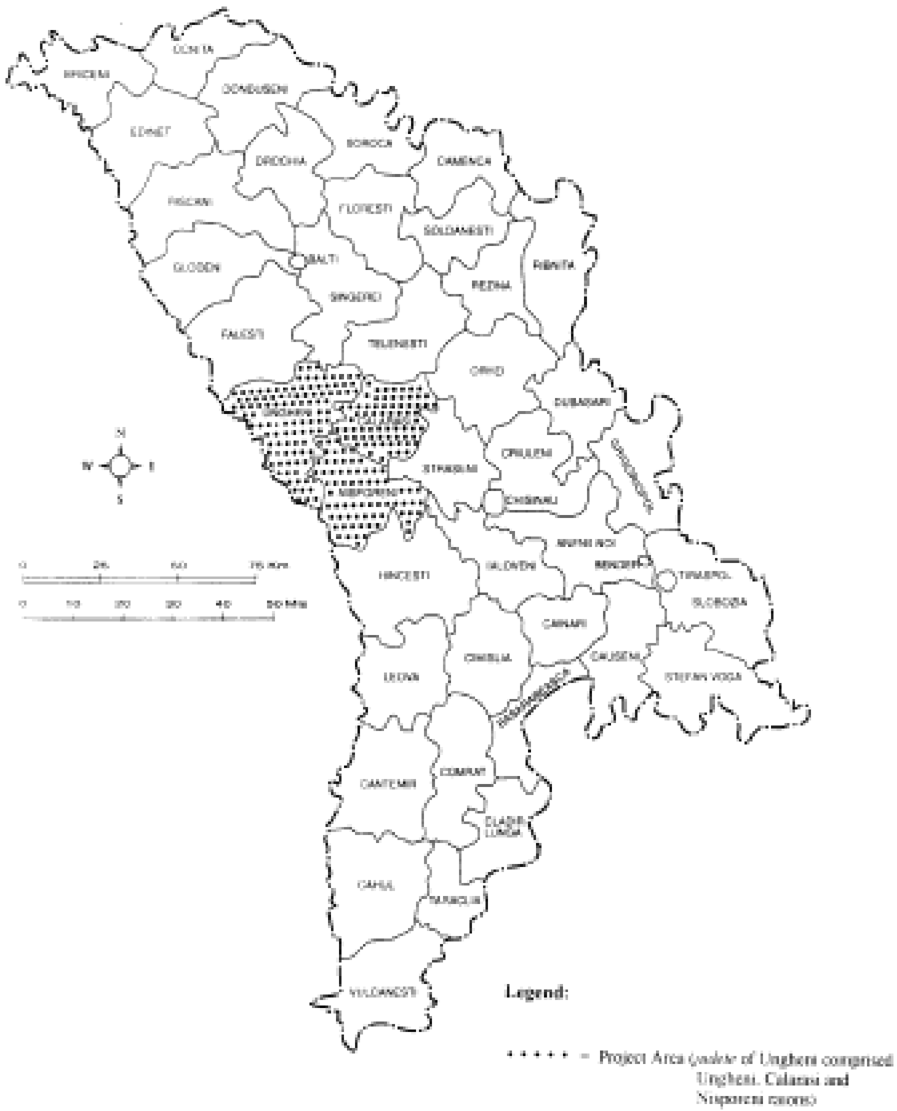
Kolkhozes	collective farms
Judete	new administrative system based on reducing the number of *raion* district
Raion	district
Sovkhozes	state-farms

GOVERNMENT OF THE REPUBLIC OF MOLDOVA

Fiscal Year

1 January - 31 December

MAP OF THE PROJECT AREA



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REPUBLIC OF MOLDOVA

RURAL FINANCE AND SMALL ENTERPRISE DEVELOPMENT PROJECT

LOAN SUMMARY

INITIATING INSTITUTION:	IFAD
BORROWER:	The Republic of Moldova
EXECUTING AGENCY:	Ministry of Agriculture
TOTAL PROJECT COST:	USD 15.06 million
AMOUNT OF IFAD LOAN:	SDR 5.80 million (equivalent to approximately USD 8.00 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
COFINANCIER:	Citizens Network for Foreign Affairs (CNFA) from the United States Agency for International Development (USAID) grant funding
AMOUNT OF COFINANCING:	USD 5.55 million
CONTRIBUTION OF BORROWER:	USD 0.54 million
CONTRIBUTION OF BENEFICIARIES:	USD 0.97 million
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	United Nations Office for Project Services (UNOPS)

PROJECT BRIEF

Project objectives. The overall project goal is to generate sustainable increases in the household incomes of the rural poor, particularly during the transition period from a centrally planned to a well-structured market economy. To achieve this goal, the project is designed to: (a) facilitate the participation of the rural poor in the commercialization of agricultural and rural development; and (b) contribute to the establishment of a responsive institutional framework for rural financial service delivery. Project activities will be geared towards building-up economic and commercial activity in the rural areas and improving access to rural services among the rural poor. The project will support the formation of a limited number of new savings and credit associations (SCAs) (about 40) in the pilot area, incorporating savings mobilization from the outset.

Profile of project beneficiaries. Rural poverty is uniformly distributed throughout the rural areas of Moldova. The comprehensive household expenditure survey, conducted in the first quarter of 1998, shows an overall mean per capita income of about USD 25 per month, or USD 300 per year. About 73% of the rural population had an average per capita monthly income of USD 26.2 or less, and 90% of the rural population had per capita incomes of USD 41.2 or less (less than USD 495 annually). About 70% of total income consisted of income in-kind. About 60% of households live below the subsistence minimum and 40% below the poverty line; of these, over 60% live in rural areas. Project activities will be targeted to benefit the members of at least 400 SCAs, implying that 40 000 beneficiaries and about 1 500 businesses could be expected to become successful applicants to the project’s small enterprise development fund.

Targeting mechanism. Project activities will make use of two sets of targeting criteria: the first will identify regions in which very few SCAs have been established and determine if there is little likelihood of clash, overlap or wasteful duplication with other ongoing donor-supported projects. The second will screen the pool of private landholders from which the target beneficiaries will be selected. The first three years of the project’s funding cycle will be implemented in an administratively delineated pilot area. The following two-year funding cycle could involve replication of the project in other areas, and the continuation and/or expansion of the activities in the first funding cycles in the same pilot area. The project's target group under the small enterprise development fund (SEDF) will be those small landowners who have withdrawn their land from the cooperative and who are not part of "associations" created to preserve previous forms of management and control.

Beneficiary participation. The community mobilization and interventions, and the establishment and functioning of SCAs constitute highly participatory activities. Two separate non-governmental organization (NGO) contracts will be established to take full advantage of NGO experience and procedures in initiating community dialogues and providing ongoing support to beneficiary households and village-based organizations. The NGO services will be provided in the context of the project's initiatives to improve the coverage, quality of and access to rural financial services.

Risks. There are two types of risk facing the project. The first are those exogenous to the project environment and for which the project will not be able, at least not directly, to mitigate their effect. This type of risk is caused by or associated with the overall economic situation in the country (such as foreign exchange rates, inflation rates, etc.) The second are those endogenous to the project environment. These include: (a) lack of confidence of the rural population in SCAs; (b) slow build-up of the SCAs’ own funds through saving mobilization; and (c) the perception among the majority of the rural population, particularly the poor, that SCAs are elite institutions. These and other risks will be mitigated through the project’s several innovative features.

REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE REPUBLIC OF MOLDOVA FOR THE RURAL FINANCE AND SMALL ENTERPRISE DEVELOPMENT PROJECT

I submit the following Report and Recommendation on a proposed loan to the Republic of Moldova for SDR 5.80 million (equivalent to approximately USD 8.0 million) on highly concessional terms to help finance the Rural Finance and Small Enterprise Development 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 will be administered by the United Nations Office for Project Services (UNOPS) as IFAD's cooperating institution.

PART I - THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY[1]

A. The Economy and Agricultural Sector

1. The Republic of Moldova is a landlocked Eastern European country that borders Romania to the west and is circled by the Ukraine on three other sides. The mid-country latitude is about 47°N, close to that of Budapest and Zurich. The country is small, and its area of 33 700 km² is similar to that of Belgium. It is the second smallest republic of the former Soviet Union (FSU), ranking ahead only of Armenia. Administratively, the national territory was originally divided into 40 districts (*raion*) and four municipalities. A new administrative structure was recently adopted this year, consisting of one municipality (Chisinau), ten *judete* and one autonomous region (Gagauzia). One *judete* (Dubasari) lies completely within the borders of Transnistria, a breakaway "republic" to the northeast, lying between the left bank of the Prut River and the Ukrainian border.

2. The population is estimated at 4.3 million, with a growth rate of less than 0.5% per year. About 54% live in some 1 500 villages and towns, of which 14 are classified as municipalities (excluding the Chisinau Municipality and Transnistria), and 842 are commune centres. The rural settlements typically range in size from 1 000 to 2 000 persons, and the majority of them are long-established communities. The quality of agricultural resources permits a relatively high population density of about 127 persons/km², the highest density of all FSU countries and about the same as for Denmark.

3. The Moldavian economy is dominated by agriculture, which accounts directly for 40% of GDP, and indirectly for a further 20% through agriculture-based manufacturing and industry. Agriculture accounts for over 70% of exports, and directly or indirectly for well over 50% of employment. From prior to independence to the present day, the Republic of Moldova has been a major supplier of agricultural products to the FSU. Russia, however, continues to be Moldova's major trading partner by far, taking about 58% its exports (by value), providing some 36% of its imports and accounting for about 40% of the overall value of external trade. Exports to the Republic of Moldova from Russia and other eastern FSU states consist largely of energy (electricity, coal, petroleum and natural gas), machinery and equipment, and chemicals. Initiatives in recent years to re-orient some of its trade flows towards Western Europe have so far had a limited effect on trade figures to date.

[1] See Appendix I for additional information.

4. Russia’s financial collapse in August 1998 had a devastating impact on the Moldovan economy. Export orders were cancelled and contracts were dishonoured. By January 1999, the total value of exports had fallen below the level reached in January 1994. Moldova's GDP figures clearly reflect the impact of the crises on the economy. After registering annual declines in GDP from 1990 to 1996, modest growth was recorded in 1997 (1.3%), and growth for 1998 had been projected at about 5%. However, the preliminary figures for 1998 show a drop in GDP of about 8.6%, due almost entirely to the effect of the Russian financial collapse. Inflation increased after August 1998, reaching a year-on-year rate of about 25% by March 1999. By May 1999, the year-on-year inflation rate had declined to less than 20%; it is projected to fall to about 11% by the end of the year. In early June 1999, the Leu/USD rate was MDL 12, compared to MDL 4.8 in September 1998. Over a twelve-month period from April 1998 to March 1999, the consumer price index (CPI) for food increased at a manageable annual rate of 14%, but the CPI for services increased by 54%, reflecting sharp increases in electricity rates for domestic users.

5. Among FSU countries, the Republic of Moldova has achieved the most notable success in breaking up state-controlled farms and distributing lands to ex-workers under full private ownership. Elimination of the state monopoly on land ownership is expected to provide a basis for the commercialization of agriculture, which is considered a fundamental requirement for successful economic reform. Prior to the reforms, state-owned land, including *sovkhozes* and enterprises, made up 32.3% of agricultural land (825 000 ha), and 59.4% of the *kolkhozes* (1.5 million ha). About 1 100 large-scale farms of these “traditional” forms existed at independence. Household plots were allocated the remaining 8.3% (212 000 ha), equivalent to some 0.2 to 0.3 ha per household.

6. Increased momentum for privatization occurred after the reform of the land code in January 1996. At that time private land owners (individuals and legal entities) were entitled to sell land specifically for active farming purposes. Prices became freely negotiable. In the first phase in 1991 and 1992, the area of household plots was increased to over 300 000 ha, or about 12% of agricultural land. Employees were subsequently given ownership rights to collective farm lands in the form of undifferentiated land shares. Certificates of allotment were provided, but locations of individual land units were not specified unless individuals withdrew from the collectivist framework. By March 1999, some 1.53 million ha of collective farm land had been allocated to over 1 million beneficiaries (over 93% of the potential beneficiaries), with an average land share of 1.48 ha. Land shares are available both to women and men, and to pensioners as former employees of a *kolkhoz*. There are now about 1 150 large-scale farms, of which 781 are considered as new form, private entities, 146 as farmer associations and the remainder as traditional units.

7. The most recent comprehensive household expenditure survey, conducted in the first quarter of 1998, shows an overall mean per capita income of about USD 25 per month, or USD 300 per year. Further analysis of rural incomes shows that about 73% of the rural population had an average per capita monthly income of USD 26.2 or less, and that 90% of the rural population had per capita incomes of USD 41.2 or less (less than USD 495 annually). The survey indicated that about 53% of the rural population received monthly incomes of USD 18.7 or less (USD 225/year). About 70% of total income for the rural areas overall consisted of income in-kind[2].

8. A tentative, quantitative definition of poverty has been established for the Republic of Moldova in terms of a “subsistence minimum” of about MDL 230 (USD 21), and a “poverty line” of some MDL 70/month (USD 6.40). This serves as a basis for developing a legislative framework for

[2] In-kind income is derived from barter transactions, household-consumed production from their own farms and gardens, and payments in-kind from ex-state farms, in lieu of cash wages and payments in-kind for services rendered.

protecting the poor. About 60% of households live below the subsistence minimum and 40% below the poverty line; of these, over 60% live in rural areas.

B. Lessons Learned from Previous IFAD Experience

9. The proposed project will be the first IFAD-financed project for the Republic of Moldova, which joined IFAD in 1996. To date, IFAD programmes in transitional economies have centred on small-scale irrigation development and the delivery of improved rural financial services. Aspects of commercialization in agricultural and rural development are featured prominently. However, managers inexperienced in the use of an entrepreneurial approach are by necessity implementing programmes. The skills needed for such an approach differ markedly from those relevant to former command systems operating under typical governmental or financial institutions. Attention needs to be paid to human resource development at an institutional level. Institutions geared to the former command economy require clear, new policies and reorientation to perform their new facilitatory and regulatory roles in a market-oriented economy. IFAD experience suggests that project designs should not be overly complex; implementation arrangements and responsibilities should be clearly specified and the project should not require complementary support from other partners, unless there is a clear and unambiguous agreement concerning roles and responsibilities. It is important to avoid overspecifying programme design at the outset in view of the unstable situation in transitional economies. A degree of flexibility in programming is warranted to permit appropriate responses when, for example, specific constraints are overcome or new opportunities arise during the course of the Government’s implementation of the reform process.

C. IFAD’s Strategy for Collaboration with the Republic of Moldova

10. **The policy of the Republic of Moldova for poverty eradication.** Once the necessary changes were made in the legal and regulatory framework pertaining to the control and ownership of land, attention was focused on the break-up of large state farms and the distribution of land to private holders. The beneficiaries of the land redistribution have been all the employees of the farms ("cooperative" members), including retirees. The land redistribution programme is being executed with exemplary efficiency and is proceeding rapidily, while donor assistance is being provided to improve the functioning of the nascent land market. Regulatory impediments have largely been removed, but the market remains thin; land mortgages have yet to be perfected as a financing tool. An open and transparent land market will ease the exit of many small land share recipients who have no interest in farming or no capacity, e.g. pensioners. The poverty eradication strategy is, in effect, an agricultural support strategy for economically active members of the small private farm subsector. It aims to enable small private farms to take full productive advantage of the resources available to them, taking into account the long-term impossibility of maintaining tens of thousands of financially viable, small, independent family farm units.

11. To date, the result has been the formation of large numbers of small private farms, but little support to enable them to reach productivity levels that prevailed a decade ago, much less their full production potential. Small farmers are struggling, no matter what sort of informal arrangements they may have made to increase production and household incomes. Those who are farming independently on their small plots can barely meet household subsistence requirements; those who formed voluntary associations with others to form larger farm units are facing constraints in transport, storage, machinery services and processing, not to mention the timely availability of basic inputs.

12. **The poverty eradication activities of other major donors.** The major grant-aid donors supporting activities and programmes of direct relevance to rural and agricultural development have been and continue to be the European Union (through its multifaceted EU-Technical Assistance for Economic Reform in the Commonwealth of Independent States Programme), Denmark, Germany, Japan, The Netherlands, Switzerland, the United Kingdom and the United States, the European Bank

for Reconstruction and Development (EBRD), the World Bank Group, International Monetary Fund and the United Nations Development Programme (UNDP). Much of the technical and financial assistance provided by the donors has been associated with the immense task of designing and introducing macroeconomic policy and legislative reforms that inevitably focused on building human resources at the national and institutional level. Another major, well-financed and well-executed series of initiatives involves the break-up and redistribution of assets of the *sovkhozes* to private ownership.

13. A number of local and international NGOs are active in the following areas: rural enterprise development; reconstruction of civil society and assistance, with the formation and strengthening of farmers' associations and a National Federation of Farmers' Association; delivery of rural financial services; initiatives to increase farmers' access to agricultural machinery services; and health, nutrition and social welfare programmes. The American NGO, Citizens Network for Foreign Affairs (CNFA), is the major contractor for the United States Agency for International Development's (USAID) large technical assistance programme for agricultural development. The CNFA has operated a successful programme in the Republic of Moldova since 1997, and has submitted a request to USAID for a follow-on (USD 20 million) to begin in September-October 1999. It will run for four years.

14. **IFAD's Strategy in the Republic of Moldova.** IFAD's overall investment strategy is to support the Government's efforts to promote agricultural transition through the sustainable development of private-sector initiatives in rural areas. IFAD has much to offer by way of its specific mandate and accumulated expertise in directing development resources to the rural poor for tackling identified needs at the local village level. The proposed project will complement the ongoing farm-restructuring process and help lay the basis for further productivity-enhancing interventions by IFAD and other donors as the reform process matures. Focusing on broadening local access to markets and opportunities for processing will create incentives for raising agricultural productivity beyond the needs of immediate household food security, thereby contributing to economic growth. The project has been designed to benefit from IFAD's strategic partnerships with other donors (for both grant and loan financing). In view of the critical need to promote both national and foreign direct investment by private-sector companies or consortia, it will seek to introduce innovative financing instruments to encourage direct private-sector financing and technical support for microenterprise/business development. It will operate in areas where basic social infrastructure needs are being met through the recently established social investment fund. Complementary locations between these programmes and the project will provide a more comprehensive basis for improving the quality of rural life.

PART II - THE PROJECT

A. Project Area and Target Group

15. The first financing cycle of the project will be implemented in an administratively defined pilot area. After careful consideration, the *judete* of Ungheni is proposed as the pilot implementation area. The area has received relatively little development attention: it has very few savings and credit associations (SCAs) and a wide range of cropping systems, thereby providing a range of small enterprise investment opportunities.

16. The Ungheni *judete* was formed from three *raions*: Ungheni, Nisporeni and Calarasi. The total physical area is 260 500 ha, of which 165 700 ha (64%) are directly used for agriculture. The population of about 275 000 constitutes approximately 15% of the rural population (excluding Transnistria). As at end of 1998, the effective privatization rate, defined as the ratio of the number of individuals who have received a physical plot in private ownership to the total number of eligible individuals, had reached 31%. It is expected to reach 60% or more by the end of 1999. At present,

there is a pool of about 30 000 small, private landholders from whom project participants could be drawn; the size of this pool is steadily increasing and could reach 50 000–60 000 by project start-up. The agricultural resources in the project area are no better than average.

17. Small private landholders constitute the pool from which the target beneficiaries will be selected. In the first type, privatization is *de facto*, that is, a state farm is privatized, usually as a joint stock company, while the old form of management is retained and a varying number of individuals entitled to land shares are persuaded not to withdraw their shares from the "farm", but allowing them to be operated cooperatively under the previous management system.

18. The second generalized type of small private landowner consists of those employees, active or retired, male or female, who upon receipt of title have fully withdrawn their land allocation from the management identified with the previous cooperative farm. Landowners in this group have adopted a number of strategies to obtain financial returns from their recently acquired assets. A range of voluntary land pooling arrangements are in operation: some are leasing their land to others; others are operating their unconsolidated small plots, mainly for home consumption; and a few have sold their land.

19. The project's target group for investment lending under the small enterprise development fund will be those small landowners who have withdrawn their land from the cooperative and who are not part of "associations" created to preserve the previous forms of management and control. Within any given community, such individuals are not difficult to identify. For the SCAs, targeting will be less restrictive and membership will be open to all small private landowners, whether or not they had actually withdrawn their land from cooperative management. However, care will be taken to prevent clandestine "pooling" of small loan funds to support a larger investment intended to benefit the "cooperative".

B. Objectives and Scope

20. **Project rationale**. The Government’s commitment to the processes of reform, the commercialization of agriculture as a major engine of economic growth and emerging policies and programmes geared towards the promotion of sustainable rural development provide both a framework and a rationale for IFAD intervention. In the agricultural sector, a major element of the reforms is the accelerating privatization of land through which poor farmers have emerged as a large, new client group for development support. Currently, the services and institutional support necessary for them to optimize the use of their newly acquired asset are either lacking or only weakly developed. Moreover, there is a increasing recognition within government circles that the dual goals of commercialization of agriculture and sustainable rural development cannot be achieved solely by a concentration on large-scale production units and an eventual revitalization of major enterprises involved in the upstream and downstream industries or services associated with agriculture. Rather, there is a need to promote business investment simultaneously on several levels: from an individual household investment in a farm or other means of self-employment, through successive scales of small to medium-scale enterprises, to large-scale, fully restructured corporate enterprises. A concentration on the small to medium-scale end of this spectrum of enterprise types gives IFAD the opportunity to assist in commercializing the approach to dealing with 30-40% of agricultural production that remains within the local economy. In addition, there is an implicit recognition in the economic reform process that development activities among the rural poor will only be sustainable if they satisfy the demands of the market place. Hence, while alternative, short-term measures may be needed to catalyse the development process among a client group unfamiliar with the needs and demands of a market economy, it will also be important to help the commercial banking sector develop confidence in smaller-scale farming and other businesses, while providing the necessary financing and investment discipline. Finally, the Government is continuing to put in place legislation and regulations that together increase the options and opportunities available for private-sector

initiative; the establishment of legislation governing rural financial services delivery and the forthcoming change in the cooperative law are specific cases in point.

21. **Scope and Design.** The proposed design telescopes the Flexible Lending Mechanism into a more typical (for IFAD) project period of five years, with a view to IFAD supporting successive follow-on projects thereafter. The arrangement will be a blend of flexible programming and financing for specified activities in a delineated pilot area within the first three-year financing cycle, to be followed with a further two-year financing cycle. The final design of the second phase of the project will be based on the findings of a mid-term review. Phase II could involve replication of the project in other areas, with appropriate modification based on Phase I lessons learned and a continuation of activities in the Phase I pilot area. Implementation will be guided by "rolling plans" to be reflected in annual work plan and budgets. Early stages of the first cycle will focus on preparatory activities and the cautious introduction of initial project components under the first financing cycle, i.e. laying the groundwork for a gradual expansion of activities and financial support.

22. **Objective.** The overall project goal is to generate sustainable increases in household incomes among the target population in rural areas during the transition to a well-structured market economy. To help achieve this goal, project investments will aim to: (a) facilitate the participation of the rural poor in the commercialization of agricultural and rural development; and (b) contribute to the establishment of a responsive institutional framework for rural financial services delivery. The project's initial post-privatization support will build upon the substantial foundation created through the ongoing Rural Financial Project, and will be consistent with and supportive of a cohesive microfinancing strategy.

C. Components

23. The project will finance activities under two major components over a five-year period.

Institutional Support

24. **Support to rural financial services.** The State Supervisory Body (SSB), the Rural Finance Corporation (RFC) and the SCAs are the operational institutions. The SSB now regulates the rural financial service network in relation to established financial and prudential rules. All microfinancing institutions are required to comply regardless of the agency responsible for their establishment. The RFC is a central financing facility and source of financial and business development training/advice for its shareholder SCAs and other SCAs on a fee-paying basis. Currently, the RFC continuously monitors the growth and operating efficiency of SCAs, including their accounts reporting. The project will support the SSB and the RFC by providing additional staff, some incremental office equipment (computers) and technical assistance. The latter will comprise the introduction of expanded and improved management information systems to enable them to cope with larger lending programmes. Support for the SCAs will be indirect and consist of training of NGOs involved in SCA formation, the preparation of improved, standardized training materials (for staff and beneficiaries) and specialized training in the introduction of the savings function to selected SCAs.

25. The project will support the formation of a limited number of new SCAs (about 40) in the pilot area, incorporating measures to promote savings from the beginning. NGO services in forming and supporting the SCAs will be grant-financed by USAID/CNFA. IFAD loan funds will cover the training of NGOs.

26. To ensure the quality of applications for small enterprise loans and screen them for viability, the RFC will develop a capacity for business development planning. The project will recruit a business development adviser (eight person/months), to be attached to RFC to build the corporation's capacity to deliver business planning advice to its clients through its regional centres. The project will

also allocate funds for: (a) incremental RFC headquarters staff (to include a business development officer and a fourth credit development officer to service SCAs in the project pilot area); (b) the establishment of three regional centres already under consideration by RFC, plus one further centre to be located in the project area; (c) specialist, short-term technical assistance in business development; (d) the provision of additional short-term local and international technical assistance as necessary; (e) local consultancy services to assist in upgrading the management information system; and (f) allocations for further in-service training of RFC professional staff, including participation in regional workshops.

27. A deposit insurance scheme (DIS) and a deposit insurance agency (DIA) will be established to serve only the SCAs. Presently, the savings function is virtually absent in the 160 SCAs that have been formed to date. The sustainability of the SCAs over the longer-term will depend on their ability to mobilize member savings in order to build up a capital base and to permit lending to members out of the SCAs' own resources (rather than relying fully on external credit funds as at present). The establishment of the DIS will alleviate one major constraint to savings within the SCAs. IFAD loan funds will be used to provide the initial funding for the deposit insurance fund until such time as it became self-supporting. Technical assistance will be provided both to prepare the draft legislation enabling the formation of the DIA and the DIS, and to assist the Government in preparing the operational details of the DIS.

28. **Project management and coordination**. A project implementation unit (PIU), headed by a project director, will be established and located in the Ministry of Agriculture. It will have full management and coordination authority over the project. The PIU will be responsible for the day-to-day management, supervision and reporting for separate and diverse activities such as financing and formation of SCAs; establishment and implementation of the SEDF; and ensuring the establishment of the DIS and its reporting thereafter.

Revolving Credit Funds

29. **Savings and credit associations (SCAs) credit fund**. The rate of expansion envisaged for SCAs nationally over the next two to three years suggests that some 600 SCAs could be operating by 2003. At April 1999, 123 SCAs had been registered and 114 were undertaking lending operations using external funds. Data for June 1999 indicates that about 160 SCAs have been formed, although all may not yet be registered. Funds for on-lending to the SCAs through the RFC are available through a World Bank-financed credit line (about USD 4.50 million at present). Some 20 SCAs received financing through three commercial banks in 1998, although they have retrenched their lending to SCAs during the current economic difficulties. It is unlikely that additional funding will be required from IFAD for the next several years. However, given the difficulty in projecting both the overall growth of the SCA movement and credit demand, half of this allocation (USD 500 000) will be made available for on-lending to SCAs through the RFC during the first financing cycle of the project. This will ensure that sufficient credit funds are available for SCAs to be established in the pilot area.

30. **Small enterprise development fund (SEDF).** An initial amount of USD 1.80 million will be provided from IFAD loan as a credit fund to support investment, up to a ceiling of USD 30 000, in small and medium-scale income-generating enterprises in the rural areas. Eligible business applications from legal entities (which could include small-scale private/family enterprises, formally established private associations or service/multipurpose cooperatives, etc.) will be required to make their own financial contribution of 10% or more of the total anticipated investment cost as a pre-condition to the consideration of their application. A matching grant could then be awarded for up to 30% or more of the investment cost (grant-aid funds), with the balance financed by a medium or long-term loan from SEDF loan funds. There will be no fixed ratio of grant-to-loan, as the level of grant support will be determined on a case-by-case basis. Loans will be repayable over a maximum of five

years depending upon the nature of the investment. Equipment purchased by the enterprise will be fully insured and considered as collateral during the period of the loan. The lending to approved enterprises will be made through participating commercial banks and/or the RFC under subsidiary loan agreements at terms and conditions acceptable to IFAD. The USAID/CNFA will be IFAD's development partner in the implementation of this component, providing grant financing for NGO participation in identifying suitable enterprises and assisting borrowing groups/associations/cooperatives. It will provide a grant element directly in support of the enterprises to be financed.

31. **Post mid-term review (MTR) project development fund**. It is difficult to estimate with any degree of accuracy the uptake of the funds and services to be provided under the project. The SEDF is a completely new initiative and it is difficult to predict the rate at which the SCA movement may grow over the coming two to three years. Therefore, IFAD loan funds amounting to USD 2.9 million have been placed in the component post mid-term review (MTR) project development fund for use in PY4 and PY5. The specific allocation of these funds will be determined after a detailed MTR, to be conducted before the close of PY3.

D. Costs and Financing

32. **Costs.** Total project costs are estimated at USD 15.06 million. The foreign exchange element is estimated at 24% of total costs. Costs include identifiable taxes, estimated at USD 0.39 million. Total costs are summarized in Table 1. Comprehensive cost details are provided in Appendix IV.

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

Components	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
A. Institutional Support					
Support to rural financial services	1 400.8	707.3	2 108.1	31	15
Project management and coordination	464.4	451.2	915.6	40	6
Subtotal	**1865.2**	**1 158.5**	**3 023.7**	34	**21**
B. Revolving Credit Funds					
SCA credit fund	500.0	-	500.0	-	4
Small enterprise development fund	2 647.5	682.5	3 330.0	20	24
Post-MTR project development fund	5 622.4	1 577.6	7 200.0	23	52
Subtotal	**8 769.9**	**2 260.1**	**11 030.0**	21	**79**
Total base costs	**10 635.1**	**3 418.6**	**14 053.7**	24	**100**
Physical contingencies	32.5	15.8	48.3	33	-
Price contingencies	748.9	214.5	963.4	22	7
Total project costs	**11 416.5**	**3 648.9**	**15 065.4**	24	**107**

[a] Discrepancies in totals are due to rounding.

TABLE 2: FINANCING PLAN[a]
(USD '000)

Components	Government		IFAD		CNFA		Beneficiaries		Total		For. Exch.	Local (Excl. Taxes)	Duties and Taxes
	Amount	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**			
A. Institutional Support													
Support to rural financial services	419.00	18	1 846.90	82	-	-	-	-	2 265.90	15	754.95	1 244.38	266.57
Project management and coordination	120.70	12	863.70	88	-	-	-	-	984.40	7	481.60	382.34	120.46
Subtotal	**539.70**	**17**	**2 710.60**	**83**	**-**	**-**	**-**	**-**	**3 250.30**	**22**	**1 236.54**	**1 626.73**	**387.04**
B. Revolving Credit Funds													
SCA credit fund	-	-	500.00	100	-	-	-	-	500.00	3	-	500.00	-
Small enterprise development fund	-	-	1 891.40	56	1 215.00	36	270.00	8	3 376.40	22	728.48	2 647.92	-
Post-MTR project development fund	-	-	2 898.00	36	4 341.00	55	699.80	9	7 938.80	53	1 683.88	6 254.92	-
Subtotal	**-**	**-**	**5 298.40**	**45**	**5 556.00**	**47**	**969.80**	**8**	**11 815.20**	**78**	**2 412.36**	**9 402.84**	**-**
Total disbursement	**539.70**	**4**	**8 000.00**	**53**	**5 556.00**	**37**	**969.80**	**6**	**15 065.50**	**100**	**3 648.90**	**11 029.57**	**387.04**

[a] Discrepancies in totals are due to rounding.

33. **Financing.** The design requires a combination of loan and grant financing from external donors, a limited contribution from the Government, beneficiary contributions towards the costs of microenterprise establishment and a share of the SEDF loan financing from own-funds of the participating banks. The financing plan is set out in Table 2. The IFAD contribution amounts to USD 8.00 million (53% of total costs). The IFAD loan will be used to contribute to costs associated with the operations of the PIU, the costs of local technical assistance (including NGOs), initial funding for the DIS and the SCA, and SEDF credit lines. Beneficiaries will contribute USD 0.97 million (cash and/or kind) towards the investment costs of enterprises eligible for SEDF credits. The USAID/CNFA will contribute a USD 5.55 million (37%) grant funding for the SEDF. The German Agency for Technical Cooperation has expressed its interest in contributing additional funding through the provision of technical assistance for the establishment of the DIS. The Government will contribute USD 0.54 million (4%) in terms of social security payroll taxes for incremental staff and in the form of taxes and duties foregone.

E. Procurement, Disbursement, Accounts and Audit

34. **Procurement.** The procurement of goods and services using IFAD loan funds will observe IFAD guidelines and technical assistance contracts will be obtained according to procedures acceptable to IFAD. All contracts for items financed by IFAD will be subject to review by the cooperating institution.

35. **Disbursement, accounts and audit.** To facilitate project implementation, a special account in United States dollars will be established by the Ministry of Finance on terms and conditions acceptable to IFAD for the disbursement of eligible expenditure. It will be replenished periodically on presentation of appropriate documentation to the cooperating institution and IFAD. The special account will be held for budget and credit fund(s) respectively. The special account will be established initially at an aggregate level of USD 800 000, equivalent to the Fund’s estimated contribution to the first six months of PY1 costs. Credit funds will be handled separately and on-lent by the Ministry of Finance under subsidiary loan agreements to specified participating credit institutions (PCIs) under terms acceptable to IFAD. A separately identifiable project account will be required for project-related expenditures at all levels, in a form that fully complies with Government accounting instructions. The PCIs (potentially including the RFC and commercial banks) will maintain separate, clearly coded accounts for administration costs and credit funds. Financial reports and accounts will be submitted regularly by implementing organizations, including contracted NGOs and PCIs, to the PIU for consolidation at the project level by the project accountant. Accounts will be subject to an annual external audit in accordance with terms and conditions to be specified in the loan agreement between the Government and IFAD and the grant financing agreement(s) of the cofinancier(s).

F. Organization and Management

36. **Pre-implementation phase.** IFAD will finance pre-implementation activities over three to six months through a Special Operating Facility grant. Activities during this period will be geared towards drafting the first year’s annual workplan and budget; installing management and coordination procedures, including a mutually acceptable system for coordination and reporting between IFAD and USAID; preparing tender documents for an initial procurement of goods and services; appointment by the Government of a director-designate for the DIA; and the establishment of a participatory monitoring system. The final operational details of the coordination agreement between IFAD and USAID will be completed during this phase. The project will conduct a start-up workshop with assistance from IFAD.

37. **Management authority** for the overall project will rest firmly with the PIU, the director having specific responsibility for the IFAD-sponsored project. The PIU will guide operations through

existing organizational structures and, to the extent possible, within the framework established under the Rural Finance Project and in close collaboration with participating NGOs. The coordination meetings will include representation from the participating credit institutions, the DIA and USAID/CNFA.

38. A project steering committee (PSC) will be formed to provide broad policy guidance and direction to the project. It will meet annually to review the proposed plan of work for the coming year and at any other time that it deems necessary. The *ex officio* chairman of the PSC will be the Minister of Finance. Other members will consist of the Minister of Agriculture and Processing Industry, the Minister of Economy and Reform, and the National Coordinator of the NAPCU.

39. **Monitoring.** The PIU will have responsibility for overall project monitoring and will focus on the principal goal and development objectives of the project as embodied in the logical framework[3]. The major instruments for monitoring progress include: (a) the records of physical progress to be prepared regularly by each agency/organization associated with the project for submission to PIU and the funding agencies; and (b) the regular financial reporting automatically built into subloan administration. The monitoring and evaluation (M&E) specialist to be attached to the PIU will work closely with the credit officers of the RFC/participating credit institution and the director of the PIU to examine existing reporting structures and develop any further requirements. Project management information software will be introduced. The PIU director, the M&E officer and the short-term M&E specialist, and the relevant staff of CNFA will design and put into operation a mutually acceptable system of sharing M&E information.

G. Economic Justification

40. Major project benefits will flow from the range of economic activities financed through the project credit facilities. Indicative enterprise budgets have been prepared to illustrate potential benefits from the seasonal and medium-term loans available from the SCAs and the types of benefits that client groups may derive from the SEDF. Analysis suggests that a range of financially robust possibilities exist for generating income that will lie within the financial means of the project client group. An internal rate of return (IRR) has been calculated for each of the components that could generate direct and indirect benefits (SCAs, SEDF, DIS) and for the project as a whole. The IRR for the entire project is about 21%, indicating that it could provide adequate returns on the total cost of project investments.

41. There are no legislative or cultural barriers to equal access by women to project credit or other benefits. At the SCA level, women represent 38% of the current membership and are well represented as chairpersons and staff of the SCA. However, the project will further promote the access of women to previously unavailable financial support through the wider availability of SCA facilities established by the project.

H. Risks

42. There are several risks associated with the technical aspects of project implementation:

(a) SCAs may be unable to survive as financing institutions due to their limited equity base and consequent inability to cushion the effects of systemic problems within the banking system. This will be mitigated by the establishment of a DIS with project support, which will help encourage savings and boost SCA membership, thereby contributing to an improved capital adequacy and greater financial resilience in an SCA.

[3] See Appendix II.

(b) Gross margins for a range of possible investments may not remain financially attractive if input/output price ratios worsen dramatically. The risk of clients being unable to repay loans through business failures will be mitigated by: project investment in strengthening microfinancing institutions through technical assistance and training; the provision of financial advisory services to prospective borrowers covering basic enterprise analysis; and the preparation of business plans and assistance to PCIs to improve loan appraisal capacity.

(c) Project loan funds will not be made available to the intended target population. Leakage of credit funds will be minimized through the following: the small size of the loans themselves (restricted in the case of SCA lending by established prudential rules and restricted by design to USD 30 000 for the SEDF), which will be relatively unattractive to larger-scale entrepreneurs; the restriction imposed on SCAs by law to operate only in their village of establishment; the eligibility criteria to be established for SEDF that are designed to ensure that investments serve the interests of the intended client population; and careful screening of loan applications.

(d) The RFC may not survive the current financial crisis in its present form, particularly if its member SCAs have difficulty in meeting their repayment commitments. The project will bolster RFC by building corporation capacity to provide business planning advice to its members and potential borrowers. The argument is a more responsive RFC will create greater confidence among its existing clientele and be more likely to attract an expanded clientele. However, to avoid overemphasizing RFC to the possible exclusion of the commercial banking sector, the project will also make dedicated credit funds available also through an eligible commercial bank(s) for lending in support of SEDF.

I. Environmental Impact

43. The overall environmental impact of project activities will range from neutral to indirectly positive. Subloans for village-based enterprises will have little or no effect on the environment. Based on the stipulated IFAD screening procedures, and taking into account the minimal disturbance to the physical setting and resources, the project will justify a Category C classification. With the exception of including necessary effluent control measures as an enterprise subloan appraisal criterion, no further environmental analysis or specific action will be required during project implementation.

J. Innovative Features

44. The project will aim to introduce four important innovative features that take advantage of the stimulation of private-sector initiative in the ongoing reform process. They respond to the priority given to promoting commercialization in agricultural and rural development in the Republic of Moldova. The innovations include:

(a) developing a synergy between funding sources through the combined use of grant aid, IFAD loan funds and the beneficiaries’ own contributions in support of small-scale commercial enterprises financed under the proposed SEDF;

(b) supporting the establishment of a DIS to promote savings mobilization by the SCAs in rural areas to assist them in becoming viable rural financial institutions;

(c) performing a brokerage role at the local level on behalf of project-area clients to link them with relevant rural services, while simultaneously enhancing access (through the SCA and SEDF credit lines) to the means to invest in order to help them take advantage of the links established; and

(d) contracting specialized technical services on behalf of village-based, self-help organizations and the enterprises that receive SEDF support.

PART III - LEGAL INSTRUMENTS AND AUTHORITY

45. A loan agreement between the Republic of Moldova 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.

46. The Republic of Moldova is empowered under its laws to borrow from IFAD.

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

PART IV - RECOMMENDATION

48. 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 Republic of Moldova in various currencies in an amount equivalent to five million eight hundred thousand Special Drawing Rights (SDR 5 800 000) to mature on and prior to 1 December 2039 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 19 November 1999)

1. The Government of the Republic of Moldova (hereinafter "the Government") through the Ministry of Finance will enter into subsidiary loan agreements with PCIs, including the RFC.

2. The PCIs will on-lend funds for small enterprise development as well as to SCAs under subsidiary loan agreements satisfactory to IFAD.

3. No later than 30 days after the effective date, the PIU will open and thereafter maintain in a bank proposed by the Government and accepted by IFAD, an account denominated in Moldovan Leu for project operations (the "Project Account"). The project director will be fully authorized to operate the Project Account.

4. The Government will ensure that sufficient resources to finance the technical assistance component are made available to the project. Should this not be possible, then the requirements of technical assistance for the project will be met from the loan. Furthermore, the technical assistance requirement of the project will be further analysed during the MTR and necessary reallocation of loan amounts will be carried out. Notwithstanding the latter, before the MTR, reallocation of loan amounts may only be made from the Unallocated Category to the categories of Civil Works, Vehicles, Equipment and Supplies, Technical Assistance, Consultancy Services and Training and Incremental Operating Costs.

5. **Conditions precedent to withdrawals**.

(a) No withdrawals shall be made with respect to the Post-MTR Development Fund until a MTR is completed to IFAD's satisfaction.

(b) No withdrawals shall be made from the Special Account nor from the Loan Account with respect to: (i) the Deposit Insurance Fund until the rules and regulations of the DIA shall have been approved by IFAD; and (ii) credit for small enterprise development and for SCAs through PCIs until the subsidiary loan agreements mentioned under paragraph 2 above, shall have been executed to IFAD's satisfaction.

6. **Conditions precedent to effectiveness**. The following are additional conditions for the effectiveness of the Project Loan Agreement:

(a) the PIU shall have been duly established and the Project Director and key project staff shall have been appointed to IFAD's satisfaction;

(b) the Memorandum of Understanding with CNFA shall have been signed;

(c) the PSC shall have been duly established to IFAD's satisfaction; and

(d) the Government shall have made an initial budgetary allocation of counterpart funds.

COUNTRY DATA – THE REPUBLIC OF MOLDOVA

Land area (km^2 thousand) 1996 1/	**33**	**GNP per capita (USD) 1997 2/**	**460**
Total population (million) 1997 1/	**4.3**	**Average annual real rate of growth of GNP per capita, 1990-97 2/**	***-10.8***
Population density (people per km^2) 1996 1/	**131**	**Average annual rate of inflation, 1990-97 2/**	**222.5**
Local currency	**Moldovan Leu (MDL)**	**Exchange rate: USD 1 =**	MDL ***ADD RATE***

Social Indicators	
Population (average annual population growth rate) 1980-97 1/	0.4
Crude birth rate (per thousand people) 1997 1/	11
Crude death rate (per thousand people) 1997 1/	10
Infant mortality rate (per thousand live births) 1997 1/	20
Life expectancy at birth (years) 1997 1/	67
Number of rural poor (million) (approximate) 1/	n.a.
Poor as % of total rural population 1/	n.a.
Total labour force (million) 1997 1/	2.1
Female labour force as % of total, 1997 1/	49
Education	
Primary school gross enrolment (% of relevant age group) 1996 1/	97
Adult literacy rate (% of total population) 1995 3/	99
Nutrition	
Daily calorie supply per capita, 1995 3/	2 522
Index of daily calorie supply per capita (industrial countries=100) 1995 3/	80
Prevalence of child malnutrition (height for age % of children under 5) 1992-97 1/	n.a.
Prevalence of child malnutrition (weight for age % of children under 5) 1992-97 1/	n.a.
Health	
Health expenditure, total (as % of GDP) 1990-97 1/	n.a.
Physicians (per thousand people) 1990-97 1/	3.6
Percentage population without access to safe water 1990-96 3/	45
Percentage population without access to health services 1990-95 3/	n.a.
Percentage population without access to sanitation 1990-96 3/	50
Agriculture and Food	
Food imports as percentage of total merchandise imports 1997 1/	8
Fertilizer consumption (hundreds of grams per ha of arable land) 1995-97 1/	652
Food production index (1989-91=100) 1995-97 1/	58.3
Land Use	
Arable land as % of land area, 1996 1/	53.8
Forest area (km^2 thousand) 1995 1/	3.6
Forest area as % of total land area, 1995 1/	10.8
Irrigated land as % of cropland, 1994-96 1/	14.1

Economic Indicators	
GDP (USD million) 1997 1/	1 872
Average annual rate of growth of GDP 1/	
1980-90	3.0
1990-97	-14.1
Sectoral distribution of GDP, 1997 1/	
% agriculture	31
% industry	35
% manufacturing	28
% services	34
Consumption, 1997 1/	
General government consumption (as % of GDP)	26
Private consumption (as % of GDP)	74
Gross domestic savings (as % of GDP)	0
Balance of Payments (USD million)	
Merchandise exports, 1997 1/	875
Merchandise imports, 1997 1/	1 164
Balance of merchandise trade	- 289
Current account balances (USD million)	
before official transfers, 1997 1/	- 373
after official transfers, 1997 1/	- 296
Foreign direct investment, 1997 1/	60
Government Finance	
Overall budget surplus/deficit (including grants) (as % of GDP) 1996 1/	n.a.
Total expenditure (% of GDP) 1996 1/	n.a.
Total external debt (USD million) 1997 1/	1 040
Present value of debt (as % of GNP) 1997 1/	52
Total debt service (% of exports of goods and services) 1997 1/	10.9
Nominal lending rate of banks, 1997 1/	33.3
Nominal deposit rate of banks, 1997 1/	23.5

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*, 1999.
2/ World Bank, *Atlas*, 1999.
3/ UNDP, *Human Development Report*, 1998.

LOGICAL FRAMEWORK

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Strategic Objective: • To contribute to poverty alleviation in general, and increases in household incomes in particular, in rural areas during the transition to a well-structured market economy.	• Increases in household income and/or expenditures; and • Increases in output levels of agricultural and other products (including total output and marketable surpluses).	• National census reports • Commerce reports • National income and expenditure surveys • Department of Statistical and Sociological Analysis - economic reviews	**Goal to IFAD Mandate:** • Political stability is maintained. • Macroeconomic stability is resumed. • Government commitment to the reform process and the stimulation of commercialization within a free market economic framework continues. • Government continues to support social and economic investment in rural areas. • Government budgetary commitments are respected.
Project Development Objectives: • To strengthen beneficiaries' capacity to organize themselves for improving access to rural technical and financial services; • To facilitate the participation of the rural poor in the commercialization of agricultural and rural development in an increasingly cash-based rural economy; • To contribute to the establishment of a stable, responsive institutional framework for rural services delivery; and • To introduce new mechanisms for attracting private-sector and grant-aid financing into commercially viable village-based, small-scale enterprises.	• Number of new village-based organizations spontaneously created and registered to pursue a commercialized approach to agricultural and rural development; • Proportion of target population involved in economic activity of any nature and their degree of reliance on cash rather than barter transactions; • Level of membership in self-help organizations; • Number and financial soundness/sustainability of rural financial institutions operating in the project area; • Degree and rate of equity formation in SCAs; and • Level of funds invested by private businesses made available by grant-aid donors in support of financially viable, village-based enterprises.	• *Primaria* reports • The Rural Finance and Small Enterprise Development Project (RFSEDP) annual progress reports • Supervision mission reports • Beneficiary assessments • SCA and RFC financial reports • RFSEDP studies and surveys • RFC/commercial bank(s) annual reports • Cofinancier/donor review meetings	**Objective to Goal:** • Members of the target population are willing and able to take advantage of opportunities made available under the project. • Financial integrity of credit line funds maintained by responsive PCIs. • Marketing opportunities for goods and services become sufficiently developed to make the profitable sale of agricultural/other products from rural enterprises possible. • Climate for wide-ranging private sector investment is improved through continued deepening of economic reforms and restructuring of industrial complexes (especially agro-industries).

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs: • Increasing number of financially rewarding rural enterprises, operating on a commercial basis, linked to a range of rural support services and increasingly able to access financing services from the commercial banking sector; • SCAs established in response to requests from newly privatized landowners, responding to local demand for financial services and demonstrating a growing capacity for financial sustainability; increased number of SCAs incorporating the savings-capitalization function; • Broad-based economic activity (private farming and other), earning opportunities and income levels raised among target population households; • Private-sector funding contributing to small-scale enterprise establishment and operation; • Diversified loan products available through RFC and/or commercial banks for village-based enterprise establishment; and • RFC self-supporting in its dual role as a responsive, refinancing institution and training/advisory body for SCAs.	• Number, category and commercial orientation of enterprises established; • Number and nature of links established/operating between self-help enterprises and rural service sources; • Number of members per SCA, rate of membership expansion, categories of loans issued and deposits taken; • Number of registered and operational SCAs; number of SCAs with savings function; number and volume of loans made from SCA internal savings; • Output levels of agricultural/other products in participating villages; • Proportion of land titleholders actively involved in cash-based, market-oriented farming; • Number, categories and estimated turnover of licensed business enterprises established; • Value of private-sector investments in and grant-aid donor support for rural enterprises; • Number and categories of loan products issued by RFC and commercial banks; • Number of loans established with commercial banks; • Financial status of RFC; • Numbers of requests received for SCA membership in RFC; and • Number and type of requests received by RFC for training advisory support.	• *Primaria* reports • RFSEDP periodic progress reports • Supervision mission reports • Contact beneficiary monitoring • SCA accounts, RFC financial reports • RFSEDP studies and surveys • Annual reports of RFC/commercial bank(s) • Government records, statistical bulletins • Reports from USAID/CNFA	**Outputs to Objectives:** • Efficient and professional implementing agencies and project partner organizations available and working within cohesive microfinancing structure; • Target population maintains confidence in SCAs as source of financial services and SCAs able to fulfil obligations under prudential financing rules and regulations; • Members deposit savings with their SCA and thereby contribute to its financial sustainability; • Barter trade minimized at all levels and interest in cash economy and the financial discipline it entails is increased; • Sufficient level of village-based entrepreneurial activity/potential to attract private industry (internal and external) interest; • Macroeconomic situation sufficiently stabilized to attract private-sector investment; • Commercial PCIs establish and maintain a competitive interest in microfinancing; and • RFC able to attract sufficient SCA shareholders to maintain its desired level of operating as a refinancing institution and as a training/ advisory body for SCAs.

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Components: • Support for lending to SCAs and SEDF	• Subcontracted NGOs and technical assistance (TA) operational; • Training and TA made available to beneficiaries; and • Recurrent expenses allocated for supervision, M&E.	• PCI records • Project AWP/Bs • Quarterly and annual progress reports	• Suitable consultants and NGOs available; • Counterpart funds made available on a timely basis; and • Grant-aid donor(s) identified.
• Support to rural financial services institutions	• TA activated and training conducted; • Vehicles and equipment supplied; • Studies and surveys conducted; and • Recurrent expenses allocated for fund administration.		
• Revolving credit funds	• SCA and SEDF credit lines disbursed; • Capital grants awarded; and • Beneficiary contributions made (cash or kind).		
• Project management and coordination	• TA activated and training conducted; • Subcontracting of technical services ongoing; and • Studies and surveys conducted.		
• **Inputs**	• Recurrent expenses • Loans made and grants awarded • Vehicles and equipment procured • Training completed • TA accepted	• PCI records • Project AWP/Bs • Quarterly and annual progress reports	

QUANTITATIVE INPUTS, TARGETS AND KEY PROGRAMME FACTORS

Objectives

The overall project goal is to generate sustainable increases in household incomes among the target population in rural areas during the transition to a well-structured market economy. To help achieve this goal, project investments will aim to: (a) facilitate the participation of the rural poor in the commercialization of agricultural and rural development; and (b) contribute to the establishment of a responsive institutional framework for rural financial services delivery. Overall investment will be geared towards ensuring a build-up in economic and commercial activity in the rural areas and improved access to rural services among the target population.

Instruments

The main instruments to be utilized in the implementation of the listed components are listed as follows:

- Support to rural financial service institution, i. e. SSB, RFC, SCA and DIS;
- Support for two revolving credit funds, i.e. SCA credit fund and SEDF;
- The SEDF credit to support investment in small rural enterprises up to USD 30 000 through participating commercial banks and/or RFC under subsidiary loan agreements;
- Provide a grant element directly in support of the enterprises to be financed;
- Support the formation of about 40 new SCAs in the pilot area;
- Support the establishment of a DIS and a DIA to serve only the SCAs; and
- Employ NGO services in forming and supporting the SCAs.

Incremental Benefits

Incremental benefits at full development:

Per beneficiary at PY5 (USD)	
• Project as a whole	60-74
• SCA component	10
• Small rural enterprise development (SRED)	830-920
Per Beneficiary at PY15 (USD)	
• Project as a whole	185-195
• SCA component	140
• SRED	830-920
Employment (full positions) at PY5	
• Project as a whole	5 070
• SCA component	220
• SRED	4 850
Employment (full positions) at PY15	
• Project as a whole	9 910
• SCA component	5 060
• SRED	4 850

Project Costs

Components		USD million	% Base Costs
A.	Development of SCAs	2.98	20
B.	Pilot development of small rural enterprises	3.37	24
C.	Post-MTR project development fund	7.52	48
D.	Programme management and coordination	1.18	8
Total including contingencies		**15.06**	**107**

Financing

	USD million	%
IFAD	8.0	53
CNFA	5.5	37
Government	0.5	4
Beneficiaries	0.9	6
Total	**15.0**	**100**

Beneficiaries

Project activities will be targeted to benefit the members of at least 400 SCAs, implying that 40 000 beneficiaries and about 1 500 businesses could become successful

Economic/financial Analysis

Financial IRR (%)	
• Project as a whole	21
• SCA component	32
• SRED	14
IFAD Financing per beneficiary(USD)	
• Project as a whole	82
• SCA component	10
• SRED	1 520-1 690
NPV@12% (USD million)	
• Project as a whole	7.6
• SCA component	7.6
• SRED	0.65

SUMMARY COST AND FINANCING TABLES

Table 1: Components Project Cost Summary

	(MDL '000)			(USD '000)			%	% Total
	Local	Foreign	Total	Local	Foreign	Total	Foreign Exchange	Base Costs
A. Development of SCAs								
1. Institutional support	18 401.4	8 130.9	26 532.3	1 600.8	707.3	2 308.2	31	16
2. SCA credit fund	5 500.0	-	5 500.0	500.0	-	500.0	-	4
Subtotal	23 901.4	8 130.9	32 032.3	2 100.8	707.3	2 808.2	25	20
B. Pilot development of small rural enterprises	29 430.6	7 511.2	36 941.9	2 647.5	682.5	3 330.0	20	24
C. Post-MTR project development fund	60 031.5	18 134.5	78 166.0	5 222.4	1 577.6	6 800.0	23	48
D. Programme management and coordination	7 636.9	5 186.6	12 823.5	664.4	451.2	1 115.6	40	8
	121 000.4	38 963.2	159 963.7	10 635.1	3 418.6	14 053.7	24	100
Physical Contingencies	374.0	182.0	556.0	32.5	15.8	48.4	33	-
Price Contingencies	44 166.3	12 606.4	56 772.7	748.9	214.5	963.4	22	7
	165 540.7	51 751.6	217 292.3	11 416.5	3 649.0	15 065.5	24	107

Table 2: Expenditures Accounts Project Cost Summary

	(MDL '000)			(USD '000)			%	% Total
	Local	Foreign	Total	Local	Foreign	Total	Foreign Exchange	Base Costs
I. Investment costs								
A. Civil works \a	43.5	31.0	74.5	3.8	2.7	6.5	42	-
B. Project equipment and goods	718.4	1 150.2	1 868.6	62.5	100.1	162.6	62	1
C. Small rural enterprise equipment, goods and services	22 275.0	7 425.0	29 700.0	2 025.0	675.0	2 700.0	25	19
D. Vehicles	388.0	819.0	1 207.0	33.8	71.3	105.0	68	1
F. TA, training and studies								
TA	10 984.6	8 625.8	19 610.5	955.6	750.4	1 706.0	44	12
Training	896.6	-	896.6	78.0	-	78.0	-	1
Studies	1 787.5	1 787.5	3 574.9	155.5	155.5	311.0	50	2
Subtotal	13 668.7	10 413.3	24 082.0	1 189.1	905.9	2 095.0	43	15
G. SCA credit and deposit insurance funds								
SCA credit line	5 500.0	-	5 500.0	500.0	-	500.0	-	4
Deposit insurance fund	4 253.2	-	4 253.2	370.0	-	370.0	-	3
Subtotal	9 753.2	-	9 753.2	870.0	-	870.0	-	6
H. Reserve SEDF expenditures and SCA credit line	60 031.5	18 134.5	78 166.0	5 222.4	1 577.6	6 800.0	23	48
Total Investment Costs	106 878.2	37 973.0	144 851.2	9 406.5	3 332.5	12 739.0	26	91
II. Recurrent Costs								
A. Salaries and allowances (contracted staff)								
Salaries	9 513.7	-	9 513.7	827.6	-	827.6	-	6
Allowances	813.8	-	813.8	70.8	-	70.8	-	1
Subtotal	10 327.6	-	10 327.6	898.4	-	898.4	-	6
B. Operation and maintenance	864.8	617.7	1 482.6	75.2	53.7	129.0	42	1
C. Other operating costs	2 929.8	372.4	3 302.3	254.9	32.4	287.3	11	2
Total Recurrent Costs	14 122.3	990.2	15 112.4	1 228.6	86.1	1 314.7	7	9
Total BASELINE COSTS	121 000.4	38 963.2	159 963.7	10 635.1	3 418.6	14 053.7	24	100
Physical Contingencies	374.0	182.0	556.0	32.5	15.8	48.4	33	-
Price Contingencies	44 166.3	12 606.4	56 772.7	748.9	214.5	963.4	22	7
Total PROJECT COSTS	165 540.7	51 751.6	217 292.3	11 416.5	3 649.0	15 065.5	24	107

\a Office refurbishment

ORGANIZATION AND MANAGEMENT

1. **Project management and coordination**. A PIU will be established under the umbrella of NAPCU located in the Ministry of Finance (MOF), with full management and coordination authority for the IFAD-sponsored project. The NAPCU will have responsibility for overall coordination of all externally assisted projects in the agricultural sector. Because the responsible ministry (MOF) is not an implementing ministry, NAPCU will have the major responsibility of ensuring cross-sectoral coordination of the projects under it, and general oversight of the implementation performance of all projects on behalf of the Government. Headed by a project director, the PIU will be responsible for the day-to-day management, supervision and reporting for separate and diverse activities such as financing and formation of SCAs; establishment and implementation of the SEDF; ensuring establishment of the DIS and reporting thereafter. The PIU will guide operations through existing organizational structures and, to the extent possible, within the framework established under RFP (and in close collaboration with participating NGOs). The coordination meetings will include representation from the PCIs, the DIA, and USAID/CNFA. The National Coordinator of NAPCU, or his designated representative, will have the standing right to attend any or all coordination meetings. Periodic meetings involving associated donor agencies with permanent representation in Moldova will be called at the discretion of the National Coordinator of NAPCU, and at a minimum during formal supervision and review missions by IFAD's cooperating institution.

2. A PSC will be formed to provide broad policy guidance and direction to the project. It will meet annually to review the proposed work plan for the coming year and at any other time that it deems necessary. The *ex officio* chairman of the PSC will be the Minister of Finance. Other members will consist of the Minister of Agriculture and Processing Industry, the Minister of Economy and Reform and the National Coordinator of the NAPCU. The NAPCU will provide secretariat services for the NAPCU.

3. Full advantage will be taken of NGO experience and procedures in initiating community dialogues and providing ongoing support to beneficiary households and village-based organizations. Two separate NGO contracts, i.e. a field services contract and a financial services contract, will be established to serve the joint area-based operations of RFSEDP and the CNFA programme.

Phasing

4. **Pre-implementation phase.** IFAD experience in other transitional economies points to the value of a preliminary phase with the use of a project preparation facility (start-up grant) as an effective means of initiating programmes in an environment where institutional development is uneven. Therefore, it is proposed that IFAD finance pre-implementation activities over three to six-months through a Special Operations Facility (SOF) grant. Activities during this period will be geared towards drafting the first year's annual work plan and budget (AWP/B); installing management and coordination procedures, including a mutually acceptable system for coordination and reporting between IFAD and USAID; preparing tender documents for an initial procurement of goods and services; appointment by the Government of a director-designate for the DIA; and the establishment of a participatory monitoring system.

5. The first AWP/B will be drawn-up by the PIU in close collaboration with the project planning adviser (PPA) and the PCIs (in the short-term, RFC and possibly one or more commercial banks), the director-designate of the DIA and representatives from the participating NGOs (provided, of course, that selection has been made). Representatives from USAID Moldova and its major in-country programme contractor will be invited to attend and actively participate. It will be necessary for the proposed position of director of the RFSEDP PIU to be filled during the pre-implementation phase in

order that the appointee be fully involved from the outset in the detailed planning of RFSEDP implementation. The position will be financed under SOF on local consultancy terms for the duration of the SOF period, with a view to the position being absorbed into the regular RFSEDP budget from the start of full implementation. It is also expected that a director-designate of the DIA be appointed during this phase. A start-up workshop, with assistance from IFAD, will be conducted immediately following completion of the SOF period to develop a full understanding of the objectives and structure of the project among associated personnel and participating agencies.

6. **Implementation phase.** The pre-implementation phase will be followed by a further six months of intensive support to begin the first full year of project implementation. The PPA will remain available to assist PIU in operationalizing the project's planning and financing approach (as outlined above) and the first year's AWP/B. Implementation of the first two funding cycles will be governed by successive, approved AWP/Bs based on project estimates adjusted to reflect changes in costs and development policies. From PY2 onwards, the AWP/Bs will incorporate field requirements emerging from the community mobilization and SCA establishment programmes and the consolidated estimates of subloans for the following year from the PCIs. They will also take into account beneficiary perspectives on the project identified through the proposed annual beneficiary assessments.

7. A CNFA/RFSEDP project coordinator will be recruited locally under RFSEDP financing, and based within the CNFA office complex. His/her main duty will be to maintain day-to-day liaison and coordination between CNFA and the PIU concerning the joint programme. He/she will be responsible for preparation of periodic progress reports covering USAID/CNFA activities related to the project as will have been previously agreed between USAID/CNFA and IFAD. He/she will also attend AWP/B workshops and coordination meetings called by the PIU. The coordinator will also have responsibility, on behalf of CNFA management, for coordinating and administering technical assistance grants made by CNFA to Moldovan NGOs in supporting SEDP activities.

8. **Project facilitation.** The PPA in PIU, with short-term input from an M&E specialist and a MIS specialist (local) will assist the director in establishing financial management, monitoring, evaluation and reporting procedures for RFSEDP satisfactory to the Government and IFAD. The report formats will be modified, as may be required, to include data from project activities financed by USAID. RFSEDP reporting and M&E will take advantage of the information collated by the SSB and the PCIs as part of their standard procedures, but be tailored to ensure that information requirements implicit in the logical framework can be met. The adviser will report administratively to the National Coordinator of the NAPCU, given the strong interest of Government in reducing the cost and demands on scarce skilled manpower for project management.

Targeting

9. **Targeting mechanism**. Project activities will make use of two sets of targeting criteria. The first will identify regions in which very few SCAs have been established to-date, and where there is little likelihood of clash, overlap or wasteful duplication with other ongoing donor-supported projects. The second will screen the pool of private landholders from which the target beneficiaries will be selected.

10. **Regional criteria**. The first financing cycle of the project will be implemented in an administratively defined pilot area. After consideration of a number of options, the *judete* of Ungheni is proposed as the pilot implementation area of first financing cycle. The area has received a relatively small amount of developmental attention and there is little likelihood of clash, overlap or wasteful duplication with other ongoing donor-supported projects. In addition, very few SCAs have been established in the area to date (only five out of a total of 123, of which all were registered in 1999). It

has a wide range of cropping systems, thereby providing a range of small enterprise investment opportunities.

11. Ungheni *judete* was formed from three *raions*: Ungheni, Nisporeni and Calarasi. The total physical area is 260 500 ha, of which 165 700 ha (64%) are directly used for agriculture. The population, about 275 000, constitutes approximately 15% of the rural population of Moldova (excluding Transnistria). As at the end of 1998, the effective privatization rate, defined as the ratio of the number of individuals who have received a physical plot in private ownership to the total number of eligible individuals, had reached 31% and is expected to reach 60% or more by the end of 1999. At present, there is a pool of about 30 000 small, private landholders from which project participants could be drawn; the size of this pool is steadily increasing and could reach 50 000 - 60 000 by the time of project start-up. The agricultural resources in the project area are no better than average. The rate of land privatization is higher than the average rate for the country as a whole, thereby creating a larger-than-average number of recently created and largely unsupported small private farms. There is no available evidence to suggest that the rural household incomes in the proposed project area are significantly different from rural incomes elsewhere in the country. Phase II could involve replication of the project in other areas as well as a continuation of activities in the Phase I pilot area.

Monitoring and Evaluation

12. Overall project monitoring will be the responsibility of the PIU and will be focused on the principal goal and development objectives of RFSEDP as embodied in the logical framework. Key requirements for achieving these aims are: that the credit mechanism must itself be viable in financial and administrative terms and remain accessible to the target beneficiaries; and that the income-generating activities/rural enterprises funded under RFSEDP must be sustainable and linked to levels of production achievable by small-scale operators. The major instruments for monitoring progress on the basis of a list of indicators include: (a) the records of physical progress to be prepared regularly by each agency/organization associated with RFSEDP for submission to PIU and the funding agencies; and (b) the regular financial reporting automatically built into subloan administration.

13. Under the established reporting regulations for SCAs/RFC, credit administration *per se* provides an adequate instrument for sound technical and financial monitoring provided that appropriate financial discipline is maintained by the SSB in overseeing adherence to the prudential rules for microfinancing institutions. Credit management through the subloan terms, the loan preparation documents and the accounting returns provide a monitoring framework that can also accommodate a range of second order information. This permits systematic assessment of the impact of the associated technical intervention on beneficiaries and provides valuable management information to facilitate project implementation and adjust procedures as necessary. The detail of information available through the loan processing systems (existing for SCAs and to be proposed for the SEDF loans) will, with minimal additional formatting and follow-up site visits, assure regular and orderly impact monitoring and permit confirmation of the achievement of the project's targeting objectives. The M&E specialist to be attached to the PIU will work closely with the credit officers of RFC/PCI and the director of the PIU to examine existing reporting structures and develop any further requirements. Project management information software (ProMIS) will be introduced.

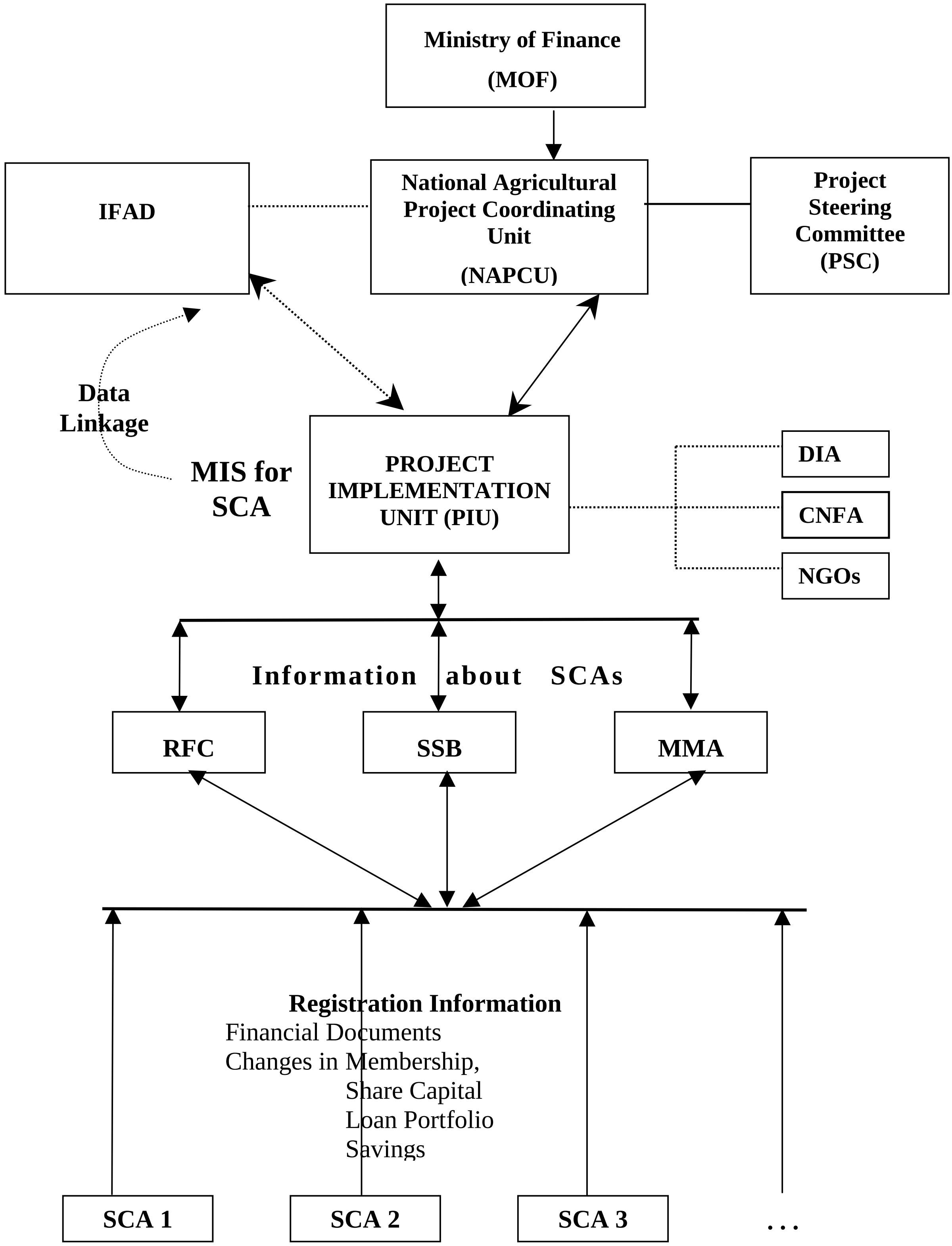
14. The PIU director, the M&E officer and the M&E specialist (short-term) and relevant staff of CNFA will design and put into operation a mutually acceptable system of sharing M&E information. This might consist of a comprehensive system implemented by the PIU, but covering the requirements of CNFA as well as IFAD.

Monitoring Indicators

Development of SCAs	• Participating NGOs contracted	Grant financier in consultation with PIU
	• Training materials prepared for NGOs and beneficiaries	PIU, training materials, TA
	• NGO staff trained in savings capitalization	PIU, NGO staff and others
	• SCAs formed and trained in pilot area	
	• Pilot area SCAs receiving external lending funds	
	• Pilot area SCAs lending from own savings	
	• Self-formed SCAs (SF/SCA) receiving assistance from NGO	
	• Retroactive assistance to existing SCAs in establishing savings-capitalization function	
	• Existing SCAs lending from own savings	
	• Access of women to SCAs services	
Small Enterprise Development	• Participating NGOs selected and contracted	CNFA, PIU is informed
	• Training materials prepared	PIU-sponsored, NGOs
	• NGO staff trained in eligibility criteria, lending procedures, enterprise screening and financial pre-appraisal, follow through support	PIU organized, with CNFA cooperation
	• Commercial banks fully briefed on overall project objectives and details, including flow of funds and lending terms and conditions	NAPCU, PIU, CNFA
	• Number and type of enterprises identified and pre-screened	NGO/Technical staff/CNFA
	• Number and type of enterprises appraised by the PCI	PCI records
	• Loans approved and disbursed by activity financed and amount	Reported by participating PCI
	• Type of borrower, e.g. household, cooperative, association, etc	Loan applications
	• Establish baseline status of borrowers to permit ex-post evaluation of impact of the financed enterprise	
	• Type and amount of grant assistance provided by cofinancier	CNFA
	• Annual financial performance of the financed enterprise	Monitoring and evaluation annual survey of borrowers
	• Debt-servicing performance	Reported by the participating PCI

DIA/Scheme	• DIA director is designated	MOF
	• TA recruited and begins work	GTZ, PIU, DIA
	• Draft legislation/regulations/ procedures prepared & approved	TA DIA; NAPCU, MOF
	• DIS introduced and explained to SCAs	DIA, RFC, SSB, PIU, Federation of SCAs
	• Number of initial participants/members is finalized	DIA, PIU, SSB, SCAs, Federation of SCAs
	• Finalize premium levels	TA DIA
	• Receive first tranche of IFAD insurance fund, receive premium payments from members	PIU, DIA, MOF
	• DIS becomes effective	DIA, PIU
	• Payments made from DIA to cover any depositor's losses	DIA records
PIU		
	• Director and staff appointed	MOF
	• Equipment procured	PIU, facilitator
	• Short-term input from project implementation adviser (start-up facilitator)	
	• Special account established	PIU
	• Basic office procedures established	PIU
	• Long-term project planning adviser recruited and begins work	
	• Short-term M&E specialist assists in design of PIU M&E system	
	• First AWP/B workshop; establish joint operational plan with CNFA	
	• Finalize AWP/B for PY1, including collaborative project with CNFA	PIU, with inputs from all participating agencies
	• Preparation of training materials and training of participating NGOs	TA, PIU, NGOs
	• Recruitment of TA for installation or improvement of MIS (PIU, RFC, SSB, DIA)	PIU
	• Submission of financial and physical progress reports from participating agencies	Agencies
	• Preparation of periodic progress reports for submission to IFAD	PIU

Programme Organizational Chart



ECONOMIC AND FINANCIAL ANALYSIS

1. The base costs for overall project coordination and management are estimated at USD 910 000 and are expected to be incurred as shown in the Table 1 below. The particulars of these expenditures may be found in the detailed cost table for the PIU. After taking into account these project management costs, the internal rate of return (IRR) for the project as a whole is estimated at 21%. Moreover, as mentioned in the introduction, this return is likely to be close lower bounds for the actual economic rate of return (ERR) to the project. Discounted at 12%, the net present value (NPV) of the project is approximately USD 7.60 million. Table 2 provides a summary of the project analysis, including impacts on benefits per beneficiary, employment and tax revenues.

Table 1: Year by Year Project Costs for Overall Coordination and Management (USD '000)

Year	2000	2001	2002	2003	2004	Total
PIU Costs	385	125	130	140	130	910

Table 2: Summary of Project Analysis

	SCAs Development	Small Rural Enterprise Development	Total Project
Direct beneficiaries	40 000	1 800 – 2 000	41 800 – 42 000
Average incremental benefit at year 5 per beneficiary (USD)	10	830 – 920	60- 74
Average incremental benefit at year 15 per beneficiary (USD)	140	830 – 920	185 - 195
IRR (%)	32	14	21
NPV @ 12% (USD million)	7.64	0.65	7.60
IFAD financing per beneficiary (USD)	10	1 520 – 1 690	82
Incremental employment at year 5 (equivalent full-time positions)	220	4 850	5 070
Incremental employment at year 15 (equivalent full-time positions)	5 060	4 850	9 910
Tax revenues generated at year 5 (USD million)	0.03	0.32	0.35
Tax revenues generated at year 15 (USD million)	0.56	0.39	0.95

Sensitivity Analysis of the Project's Expected Performance

2. Given the stability of the returns from the small rural enterprise development component, the return to the project as a whole is not critically sensitive to changes in total expected project benefits or costs.

Table 3: Sensitivity Analysis of the Total Project IRR

Change in Project Costs	Change in Incremental Project Benefits: -20%	-10%	0%	10%	20%
-20%	10.0%	17.3%	22.3%	26.5%	30.1%
-10%	9.4%	16.6%	21.6%	25.7%	29.2%
0%	8.8%	15.9%	20.9%	24.9%	28.4%
10%	8.2%	15.3%	20.2%	24.2%	27.6%
20%	7.6%	14.7%	19.6%	23.5%	26.9%

3. The switching value for total project benefits is about 13%; for costs it is approximately 190%. A one-year lag in total expected project benefits reduces project IRR to 18%. With a two-year delay in project benefits, the IRR falls to approximately 15%.

4. In conclusion, the proposed project in principle can provide adequate returns on the total costs of project investments, but close monitoring will be necessary to ensure that expected benefits are realized near project targets. To a large extent, this has been built into the project through the institutional support that will be provided to RFC, SSB, the SCAs and the PIU. The terms of reference for the NGO(s) that will be contracted to implement a programme to mobilize and coach entrepreneurs also squarely address this concern. Much, of course, will depend upon external and internal economic conditions in Moldova not deteriorating much further. The returns to enterprise development estimated in the analysis are pessimistic projections that do not assume a rapid improvement of economic prospects in the medium term. Should conditions recover more optimistically than expected the proposed project will be in an excellent position to solidify and leverage these economic gains and to ensure the access of rural households to emerging opportunities.