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IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Executive Board – Seventieth Session

Rome, 13-14 September 2000

REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON PROPOSED LOANS TO THE

AZERBAIJAN REPUBLIC

AND

GEORGIA

FOR THE

RURAL DEVELOPMENT PROGRAMME FOR MOUNTAINOUS AND HIGHLAND AREAS

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APPENDIXES

AZERBAIJAN - CURRENCY EQUIVALENTS

Currency Unit	=	Azerbaijan Manat (AZM)
USD 1.00	=	AZM 4 300
AZM 1.00	=	USD 0.0002

GEORGIA - CURRENCY EQUIVALENTS

Currency Unit	=	Georgian Lari (GEL)
USD 1.00	=	GEL 2.00
GEL 1.00	=	USD 0.50

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

ACDI/VOCA	Agricultural Cooperative Development International/ Volunteers in Overseas Cooperative Assistance
ADRA	Adventist Development and Relief Agency
AWP/B	Annual Work Plan and Budget
CARE	Cooperative for Assistance and Relief Everywhere
CI	Cooperating Institution
CUs	Credit Unions
CUDC	Credit Union Development Centre
FINCA International	International Foundation for International Community Assistance
IDPs	Internally Displaced Persons
M&E	Monitoring and Evaluation
MADA	Mountain Areas Development Agency
MAF	Ministry of Agriculture and Food
MTR	Mid-term Review
NGO	Non-Governmental Organization
PMU	Programme Management Unit
SAB	Groupement Suisse pour les Montagnes
SPF	Secours Populaire Français
TSPs	Technical Service Providers

GLOSSARY

Kolkhozes	collective farms
Raion	district
Sovkhozes	state-farms

GOVERNMENT OF THE AZERBAIJAN REPUBLIC

Fiscal Year

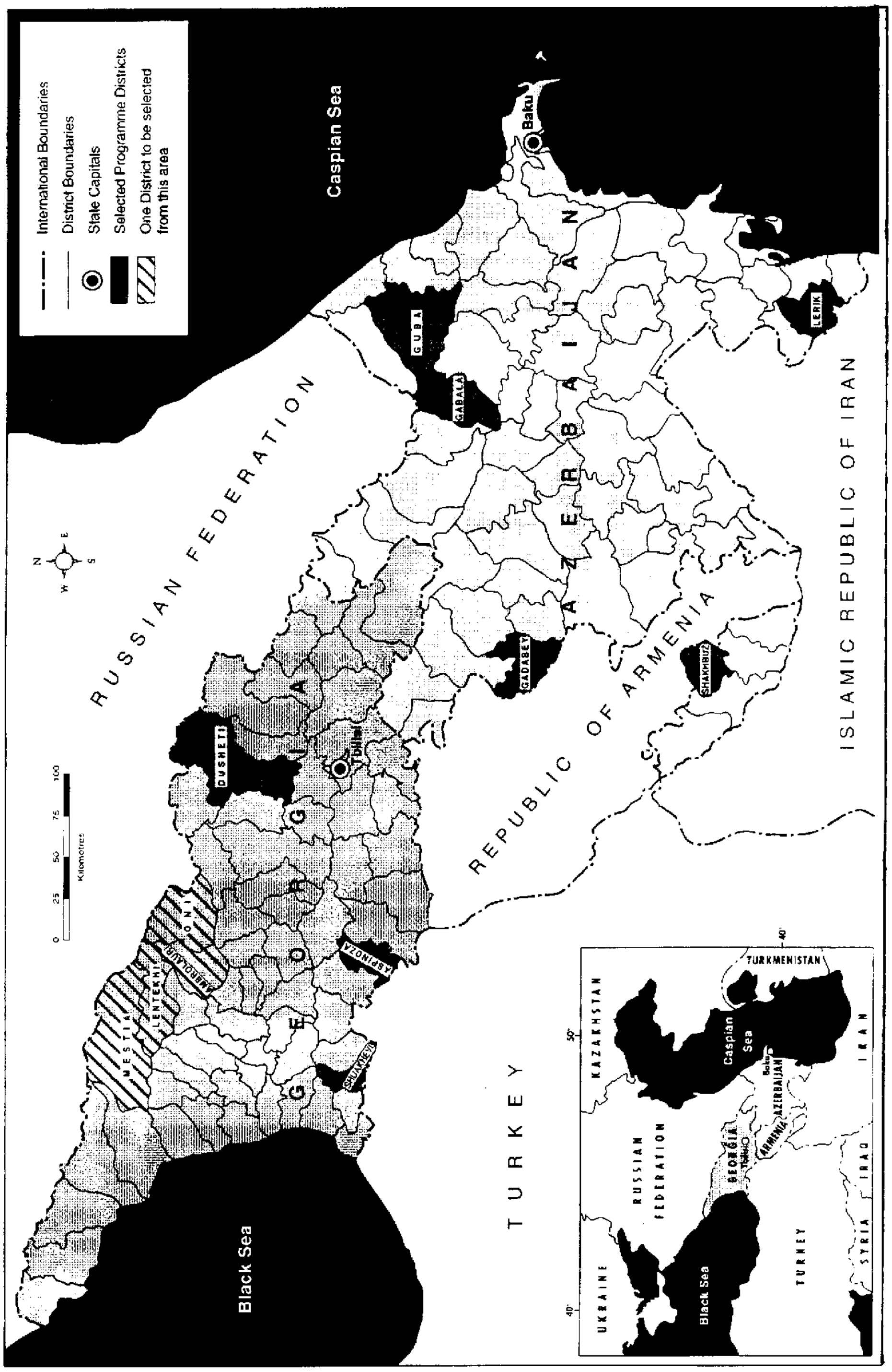
1 January - 31 December

GOVERNMENT OF GEORGIA

Fiscal Year

1 January - 31 December

MAP OF THE PROGRAMME 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.

RURAL DEVELOPMENT PROGRAMME FOR MOUNTAINOUS AND HIGHLAND AREAS

LOAN SUMMARY - AZERBAIJAN REPUBLIC

INITIATING INSTITUTION:	IFAD
BORROWER:	Azerbaijan Republic
EXECUTING AGENCY:	Office of the Cabinet of Ministers
TOTAL PROJECT COST:	USD 10.00 million
AMOUNT OF IFAD LOAN:	SDR 6.90 million (equivalent to approximately USD 9.00 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:	To be determined
AMOUNT OF COFINANCING:	To be determined
CONTRIBUTION OF BORROWER:	USD 0.40 million
CONTRIBUTION OF BENEFICIARIES:	USD 0.48 million
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	United Nations Office for Project Services (UNOPS)

RURAL DEVELOPMENT PROGRAMME FOR MOUNTAINOUS AND HIGHLAND AREAS

LOAN SUMMARY - GEORGIA

INITIATING INSTITUTION:	IFAD
BORROWER:	Georgia
EXECUTING AGENCY:	Ministry of Agriculture and Food (MAF)
TOTAL PROJECT COST:	USD 9.23 million
AMOUNT OF IFAD LOAN:	SDR 6.10 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:	To be determined
AMOUNT OF COFINANCING:	To be determined
CONTRIBUTION OF BORROWER:	USD 0.65 million
CONTRIBUTION OF BENEFICIARIES:	USD 0.50 million
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	United Nations Office for Project Services (UNOPS)

PROGRAMME BRIEF

Programme objectives. The overall goal of the joint programme between Azerbaijan and Georgia is to assist populations in mountainous and highland areas to improve their quality of life in a sustainable manner by increasing incomes while protecting the natural resource base and the environment. To achieve this goal, the programme's specific objectives will be to: (a) strengthen the beneficiaries' participation in the market economy and manage the natural resource base on which their livelihoods depends; (b) restore economic livelihoods through heightened management of the resource base and greater access to financial, technical and commercial services; (c) protect and rehabilitate the environment by developing appropriate community-based institutional mechanisms; and (d) bolster public capacity to respond to the needs of the mountain areas by establishing suitable institutional mechanisms.

Profile of programme beneficiaries. The programme will benefit around 18 800 households (8 200 in Azerbaijan and 10 600 in Georgia) from 776 settlements (340 in Azerbaijan and 436 in Georgia) through access to credit and assistance in upgrading agricultural production. The interventions will more than double beneficiaries' income in addition to improving household food security. All households except those engaged in transhumance will attain self-sufficiency in cereals and livestock products while transhumant households will achieve the greatest increase in cash income. This will enable them to cover their cereal and other basic food requirements. The present economic crisis has thrust women into a new role of greater participation in the public domain, e.g. in marketing. The programme will equip women to perform better in their new responsibilities by providing access to credit and technical support.

Targeting mechanism. The targeted area was defined taking account two key characteristics of mountain terrain – altitude and slope. Accordingly, the programme area will include districts in which more than 50% of the population live at altitudes above 500 m. Priority will be given to communities located at altitudes of 1 000 m and above, in which conditions are harshest and opportunities more limited. In total 53 districts within Azerbaijan and Georgia fall within the eligibility criteria for the programme; they represent a total population of 2.5 million in the two countries (1.2 in Azerbaijan and 1.3 in Georgia), and account for 60% of the rural population. The total number of rural households in the 20 eligible districts of Azerbaijan is estimated at 61 000, of which 56% live above 500 m and around 44% live above 1 000 m. In Georgia, the total number of rural households in the 33 eligible districts is estimated at 290 000, of which 87% live above 500 m and around 32% live above 1 000 m.

Beneficiary participation. The programme will be implemented through a flexible participatory approach, which will be adjusted and improved upon using lessons learned during implementation. Community-participation processes will underpin the prioritization and selection of programme activities. Non-governmental organizations (NGOs) will bring residents of disadvantaged communities together and explain the opportunities to assist them, individually or as communities, in identifying and implementing their development priorities. They will assist communities in forming appropriate user groups for the implementation of activities, including water user associations for irrigation, herder groups for pasture management, crop production groups for mechanized farming, marketing groups, community forest management committees for forest rehabilitation, etc.

Risks. Major risks include: (a) a slow response to the participatory approach, both from communities not yet awakened to their potential for decision-making and independent initiative, and programme management staff and technical service providers (TSPs), who must also demonstrate a vast change in attitude from past directive approaches; (b) lack of appreciation and commitment to the realities of economic change among certain sections of the Government risks taking the programme off course; and (c) the autonomy and independence of the day-to-day operations of the programme management unit (PMU) and eventually the Mountain Areas Development Agency (MADA) are not maintained.

REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD TO THE EXECUTIVE BOARD ON PROPOSED LOANS TO THE AZERBAIJAN REPUBLIC AND GEORGIA FOR THE RURAL DEVELOPMENT PROGRAMME FOR MOUNTAINOUS AND HIGHLAND AREAS

I submit the following Report and Recommendation on two proposed loans: one to the Azerbaijan Republic for SDR 6.90 million (equivalent to approximately USD 9.00 million) and the other to Georgia for SDR 6.10 million (equivalent to approximately USD 8.00 million). Both loans are on highly concessional terms to help finance the Rural Development Programme for Mountainous and Highland Areas in each country. The two loans 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. The United Nations Office for Project Services (UNOPS) will administer them as IFAD's cooperating institution.

Joint Regional Collaboration Framework

1. Despite their wide cultural and ethnic differences, Azerbaijan and Georgia share many common characteristics: similar physical environments by virtue of their location in the Caucasus Mountains; and a common historical legacy as republics of the former Soviet Union in facing common constraints in their effort to make the transition from a centrally controlled to a market-based economy. They also share many common socio-economic features: the creation of thousands of small-scale subsistence farmers as a result of the land privatization process; the collapse of most domestic industry; the lack of basic financial and commercial services and an appropriate legal framework for their development; and the absence of governance structures oriented towards the needs of a market economy. Endemic rural poverty, long masked by state control of the means of production and distribution, has resurfaced and has been exacerbated by the transitional poverty arising from the restructuring of the agricultural sector and the massive unemployment resulting from the restructuring of the domestic manufacturing industry.

2. In seeking to alleviate the disadvantages and constraints faced by their mountain area communities, the Governments of Azerbaijan and Georgia requested that IFAD finance a joint Rural Development Programme for Mountainous and Highland Areas with the objective of building on complementarities between the two countries for reinforcing the development process. This approach enables synergies to be developed in removing common constraints; facilitates policy dialogue to address mutual policy concerns; promotes the exchange of experiences and cross-fertilization in transfering proven solutions to common problems; and advances regional collaboration in proactively addressing poverty issues.

3. In pursuing this approach, formulation of the programme design was carried out in tandem in the two countries. The inception process commenced with the commissioning by IFAD of a rural poverty study of the Caucasus Mountain countries (Azerbaijan, Georgia and Armenia), followed by a needs assessment survey of the mountain communities in each country during February-March 1999. The inception process of the joint Rural Development Programme for Mountainous Areas in Azerbaijan and Georgia culminated in the development forum held in Baku in March 1999, which brought together representatives from governmental and non-governmental organizations (NGOs) in both countries. At the forum, technical specialists from the two countries collaborated in carrying out a detailed problem analysis of the mountain area communities, prioritized the problems to be addressed and identified the key interventions to be considered for inclusion in the development

programme and the conditions for success. These deliberations framed the programme design. At the forum's final session, the ministers of the respective countries endorsed the forum's findings as the basis for the design of the joint development programme in the two countries' mountainous and highland areas. The programme design was preceded by a detailed study carried out by local organizations of the key characteristics of the mountain areas in each country. Programme formulation was subsequently done in August 1999 and appraisal in January-March 2000.

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

A. The Economy and Agricultural Sector of Azerbaijan and Georgia

Azerbaijan

4. Azerbaijan is the largest of the Transcaucasian countries covering an area of 86 600 km^2. It borders on the Russian Federation and Georgia in the north, Iran to the south and Armenia to the west. The Nakhchivan Autonomous Republic is part of Azerbaijan, although separated from the rest of the country by Armenia. It provides a narrow border with Turkey. Within Azerbaijan lies the Nagorno-Karabakh region (20% of the entire Azerbaijan territory), an enclave of approximately 130 000 Armenians that has been the site of a protracted conflict between Azerbaijan and Armenia since the collapse of the Soviet Union. The country covers diverse landscapes and climatic zones. Around 43% of the area of Azerbaijan is situated above 1 000 m above sea level.

5. The population is estimated at 7.9 million (1998), out of which 1.7 million live in the capital, Baku. Azerbaijan has a high rate of urbanization with over 52% of the population living in urban areas. The population is growing at an annual rate of 1.3%. As a result of the armed conflict with Armenia, around 850 000 people or 11% of the population are refugees or internally displaced persons (IDPs).

6. Prior to independence in 1991, the economy of Azerbaijan was dominated by the oil industry and growth was higher than in any other Soviet Republic. Armed conflict and political turmoil following independence caused the worst economic collapse in the Commonwealth of Independent States. Azerbaijan was slow to tackle structural reform. Real gross domestic product (GDP) declined by more than 70% during 1992-95, by which time high inflation had eroded real incomes, the exchange rate had weakened and international reserves were nearly depleted. However, the adoption of a comprehensive stabilization programme and the signing of production-sharing agreements with foreign oil companies that led to direct foreign investment sparked economic recovery from 1996. The result was real GDP growth, reaching 8.5% per annum by 1998 and an inflation rate that declined to 4% during 1997. Nevertheless, real GDP in 1997 was still only 45% of the 1990 level. GDP per capita is estimated at USD 490 (1998). Throughout this process, the Government has attempted to ensure that a diversified economy emerges from the transition rather than one overly dependent on oil. With its oil reserves, the long-term prospects could be very positive for Azerbaijan. Nonetheless, poverty prevails and the danger looms that the poorer segments of the population might not benefit from the oil boom.

7. With its wide variety of agroclimatic zones, Azerbaijan has a very diversified agricultural sector. The main agricultural areas are in the central lowlands. Due to low rainfall levels (averaging less than 300 mm per year), 75% of the annual cropped area of 1.5 million ha is under irrigation; still irrigation systems suffer from lack of maintenance while, as a result of lack of drainage, two-thirds of the irrigated area is affected by some degree of salinity. Almost 43% of the country is subject to erosion. The major crops include wheat, barley, forage crops, cotton, tobacco and vegetables while grapes and fruit orchards are grown in the foothills. Azerbaijan is largely self-sufficient in basic foods but as in the past imports grain and many processed foods. Agriculture has traditionally been a source of export revenues from cotton, wine, fruit and vegetable exports, but the collapse of markets and the

[1] See Appendix I parts 1 and 2 for additional information.

privatization of land brought significant changes in the cropping pattern. There has been a marked shift towards staple crops (particularly wheat), partially compensating for the effects of declining yields. Areas under commercial crops have declined dramatically with grape production decreasing to 12% of its 1990 production and cotton to 20%, as the newly privatized farmers have reverted back to subsistence agriculture. Lacking access to credit to purchase inputs, their crop yields and production have fallen.

8. Although land privatization was initiated in 1992, it lagged, only gathering pace after the passing of the Law on Agrarian Reform in 1996. The effect of privatization was to create around 0.8 million small farmers with an average farm size of 1.6 ha. Various forms of cooperative and informal group farming enterprises are operating alongside individual private farmers. Livestock numbers declined after 1990 and remain well below the level prior to independence: they now comprise 1.8 million cattle and 5.2 million sheep and goats. Productivity has also shrunk. Livestock are now almost entirely privately owned.

9. There are considerable opportunities for agricultural growth and diversification. Credit markets are underdeveloped and most farmers do not have access to formal credit. There are no financial services in the mountain areas. The World Bank under the new Agricultural Development Project will be supporting the formation of credit unions (CUs) and joint-liability borrower groups, but these are likely to be mainly directed towards larger farmers in lowland areas. The present temporary regulations under the National Bank for Azerbaijan for the establishment of CUs are not conducive to the needs of resource-poor households, as a minimum share capital of USD 5 000 is required. These issues have been discussed with the Government of Azerbaijan, which agreed in principle to introduce the necessary amendments to existing regulations in order to facilitate the establishment of CUs in the mountainous areas.

Georgia

10. Georgia has a total land area of 69 700 km^2 and is bordered by Russia to the north, Azerbaijan to the east and Armenia and Turkey to the south. The country is largely mountainous, with almost 54% of the land area classified as mountains and 33% as foothills. Georgia has an estimated population of 5.4 million (1996). In 1999, Georgia ranked 85th among the 174 countries for which the United Nations Development Programme (UNDP) calculates the Human Development Index.

11. Prior to its independence in 1991, Georgia enjoyed a comparatively high standard of living due to its favourable geographic location and its unique specialization as supplier of agricultural commodities not available elsewhere in the Soviet Union. Although the Georgian economy was traditionally based on agriculture, a large-scale industrial base was artificially developed during Soviet times based on subsidized inputs and imported energy. With the demise of the Soviet Union, Georgia’s industrial production collapsed. As a result, poverty increased dramatically, real GDP fell by more than 75% between 1990 and 1995, with per capita income falling from USD 2 280 in 1990 to USD 363 in 1993; real wages fell by more than 90% and inflation increased to more than 54% per month and savings were wiped out. Most enterprises ceased operating and the country survived on Western humanitarian aid.

12. Economic transformation commenced in mid-1994 with the Government’s adoption of structural adjustment policies with the International Monetary Fund (IMF) and World Bank assistance. Inflation was brought under control, declining to 7% in 1997. Real GDP growth increased to around 9% in 1998 and gross national product (GNP) per capita rose to USD 930. However, the Georgian economy still faces severe structural problems, not least the weak tax base, which contributes to severe and increasing budget deficits and undermines the Government’s ability to finance social and welfare services.

13. Agriculture has traditionally been an important sector. In Soviet times, tea, citrus, deciduous fruits and vines were the major crops, principally for export to other Soviet republics, while wheat, sugar, milk and meat were imported. With the collapse of markets and the creation through privatization of around 1 million small farmers each with around 0.75 ha of land, the nature of agricultural production changed dramatically. Newly privatized farmers have reverted to subsistence production with wheat, maize and potatoes as the dominant crops, while the area under commercial crops has more than halved. Lacking resources to purchase inputs, crop yields have declined with wheat yields falling from 3 t/ha to 1.3 t/ha and maize from 2.5 t/ha to 1.4 t/ha. Around one-third of household land is not being used because of input, machinery and credit constraints. The policy of distributing land of different qualities among all households in the privatization process fragmented already small holdings, with an average of 3.3 plots per household. Around 33% of arable land suffers from erosion; the primary causes being non-contour ploughing on steep slopes and insufficient vegetative cover particularly at times of heavy spring rains.

14. A steep decline in livestock numbers followed the privatization of livestock due to the following: the loss of winter grazing areas in the Russian Federation; the inability of households to purchase feed to maintain animals over winter; enforced household consumption for survival and the breakdown in transhumant management systems. Past production systems placed little emphasis on forage production and relied instead on subsidized imported concentrate feed. Meadow production was not optimized by establishing more productive species. Although there are presently few problems with respect to livestock diseases, the collapse of the veterinary services is a concern; the development of a privatized system needs to be supported in view of the Government's lack of resources in maintaining effective service.

15. **Poverty Incidence in Azerbaijan and Georgia**. Prior to independence, Azerbaijan was one of the poorer republics of the Former Soviet Union, with over one-third of the population living below the official Soviet subsistence minimum. Poverty increased substantially during the 1990s as a result of the problems of transition, external shocks and internal stability. About 60% of the Azerbaijan population is below the poverty line. Regionally, the incidence of poverty is highest in Nakhchivan due to high prices caused by the economic blockade imposed by Armenia. Much of the present poverty is transitional and could be reduced as growth resumes and wages and employment improve.

16. A staggering 74% of Georgia's households have an income below the official poverty line of GEL 102 per person per month. The incidence of absolute poverty is generally lower in rural areas than in urban areas due to the greater opportunities for home consumption; unemployment or poorly remunerated employment are the major causal factors which explain the bias towards urban poverty. As important as economic considerations are the psychological factors associated with deprivation. Many people still find adapting to reduced circumstances particularly difficult and shameful. The inability to participate in social events and to provide help to relatives in need implies loss of social standing and is a major source of unhappiness and stress to many of the new poor in Georgia.

17. Households in the mountain areas have experienced a steep decline in their living standards since the collapse of the collectives. Most households are trapped at the minimum subsistence level – they have enough crop and livestock production for a meagre livelihood but are unable to generate any surplus to enable them to invest and rebuild their asset base. Many regularly dispose of young livestock due to the lack of winter-feed or to meet basic needs. Most have only the two cows, which is considered the minimum for meeting subsistence needs. This highlights their vulnerability, as any eventuality forcing them to dispose of one animal will push them into destitution. Most households have less livestock now than the number of private animals they owned during the collective period.

B. Lessons Learned from Previous IFAD Experience

18. IFAD has financed one project in Azerbaijan to date – the Farm Privatization Project – in partnership with the World Bank. The aim of the project is to mitigate the negative impact of economic reform and privatization policies on small farmers. The project covers land survey and

titling and provision of credit and business advice to newly privatized farmers. IFAD has also financed one project in Georgia – the Agricultural Development Project – also in partnership with the World Bank. Under this project, IFAD funds support the development of CUs and limited land registration activities.

19. The relevant lessons learned may be summarized as follows:

Azerbaijan

(a) Farmers have demonstrated their ability to readily understand the basic concepts of credit; however, they prefer to receive credit in cash as this enables them to obtain inputs at relatively cheaper prices.

(b) Unwieldy application, appraisal and disbursement procedures for small working capital loans increase the transaction costs to farmers and deter the uptake of credit. Emphasis on a simple demand-based system of credit provision in place of the requirement for complex farm business plans will increase farmers' interest in utilizing credit and enable the project's objectives to be achieved.

(c) Newly privatized farmers have shown a high degree of commitment, initiative and willingness to diversify into a greater variety of crops. This indicates a strong sense of private ownership and capacity for sound business management, although excessive government regulations continue to hamper the growth of private farms; and

(d) delays in the provision of the counterpart funds have negatively impacted project performance.

Georgia

(a) In order to be viable, CUs need a minimum loan portfolio. Experience indicates that the focus should be on establishing CUs with a larger membership in order to improve the prospects of becoming sustainable.

(b) Greater emphasis needs to be given to enforcing adherence to prudential standards by the CUs.

(c) The pace of establishment of CUs needs to be matched with the capacity of the promoting institution to provide the full complement of training and adequate on-site supervision to ensure that the CUs are equipped for their management responsibilities.

(d) Experience has shown that CUs need more training than had been provided for in order to be able to effectively manage their own affairs; and

(e) early indications suggest that loan repayments from CUs have been good.

C. IFAD's Strategy for Collaboration with Azerbaijan and Georgia

National Policies for Poverty Eradication

20. Since Georgia's independence in 1991, the Government has focused on restructuring and privatizing the agricultural sector. Now it is beginning to address the urgent need to provide appropriate development support for the newly emerged and impoverished small-scale farming sector in the mountain areas. The Government has taken an important step in recognizing the special needs of these communities in the enactment of the recent Law on Socio-Economic and Cultural Development of the Mountainous Regions and the establishment of a Special Commission for the Mountain Areas.

21. In Azerbaijan, there are a number of key areas in which a conducive policy framework has recently been elaborated with important implications for the rural poor. The 1998 Land Code calls for the adoption of a participatory approach with the creation of 'land protection groups' supported by a 'fund for land improvement', the application of improved agronomic practices on degraded lands and the implementation of soil conservation measures in highland areas. The recent Forest Code allows communities to lease degraded forest land for afforestation and crop development.

22. While the Government of Azerbaijan is clearly committed to developing the mountain areas, recognition of their special needs has not been reflected to date in policy or strategy formulation. Nor is there any institution that has a specific mandate to formulate a programme to promote, guide and support marginal mountain area development, although the needs of these areas are very specific and are not adequately addressed by sectoral strategies. In addition, the lack of any legal framework for microfinance activities envisaged under the programme represents a major policy issue.

Poverty Eradication Activities of other Major Donors and NGOs

23. There are considerable opportunities for agricultural growth and diversification in both Azerbaijan and Georgia. The primary constraints relate to limitations in formal credit markets, which are underdeveloped and inaccessible to most farmers, particularly in the mountain areas. In Azerbaijan, the forthcoming World Bank Agricultural Development and Credit Project will provide support to veterinary services, particularly in Nakhchivan, and will also promote new extension methodologies. Moreover, the project will support the formation of CUs and joint-liability borrower groups, but these are likely to be mainly directed towards larger farmers in lowland areas. The present temporary regulations under the National Bank for Azerbaijan for the establishment of CUs are not conducive to the needs of resource-poor households as a minimum share capital of USD 5 000 is required. These issues have been discussed with the Government, which agreed to introduce the necessary amendments to existing regulations to facilitate the establishment of CUs in the mountainous areas.

24. There are a number of international NGOs in Azerbaijan – Adventist Development and Relief Agency, Cooperative for Assistance and Relief Everywhere (CARE), Relief International and Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance (ACDI/VOCA), World Vision International – which are involved in relevant work, namely agriculture, microfinance and community development. Most efforts to date have been targeted at IDPs, but aim to broaden their remit to include other vulnerable groups. The Foundation for International Community Assistance (FINCA International) implements the most extensive microfinance programme using a village banking approach.

25. In Georgia, the establishment of CUs under the ongoing World Bank/IFAD-funded Agricultural Development Project has made a vital contribution to rebuilding trust in the financial system and demonstrating that credit discipline can be achieved. The next step is to develop mechanisms that blend establishment of financial discipline with access to the types of credit farmers need. Various NGO microfinance schemes are showing similar success, but their outreach is limited and none encompasses the mountain areas. Among these, FINCA International is operating a village banking model and small enterprise lending in urban areas, with plans to extend its operations to rural regions. Constanta (sponsored by Save the Children) has the largest programme (3 500 clients), but at present is working entirely with IDPs. However, the lack of a legal framework for microfinance activities in Georgia remains a constraint and needs to be addressed in a manner that provides flexibility for the development of alternative microfinance systems.

26. The forthcoming World Bank Agriculture Research, Extension and Training Project will fund adaptive research and technology dissemination, extension and on-farm demonstration activities (principally linked to the forthcoming World Bank-funded Irrigation and Drainage Project). The

German Agency for Technical Cooperation (GTZ) is working in partnership with CARE on potato seed trials and on the development of the marketing system for vegetables from South Georgia. CARE and Secours Populaire Français (SPF) are the two major NGOs working in agricultural development. CARE's programmes are based on a community approach and have included the promotion of farmer cooperatives. The SPF is moving from humanitarian assistance to an emphasis on pasture management, livestock, environmental issues and community organization.

IFAD’s Strategy in Azerbaijan and Georgia

27. IFAD’s overall strategy for Azerbaijan and Georgia will ensure that the transition process is efficient and effective and will sustainably raise the disposable income and family food production of small farmers by focusing on: (a) supporting the efforts of the two governments in creating a strong policy and institutional framework conducive to equitable private sector-led sustainable growth; (b) ensuring beneficiary participation in decision-making and generating community ownership and self-reliance; (c) enhancing the competitiveness of the agricultural sector; (d) improving access to rural financial services; (e) increasing the opportunities for off-farm activities; (f) ensuring women have equal access to development opportunities; and (g) encouraging NGOs to become effective catalysts in the development process. It is in this context that the proposed joint programme is designed.

28. **Programme Rationale.** The joint programme focuses decidedly on mountain area development. While there is evidence that much of the poverty in both Azerbaijan and Georgia is transient, mountain communities face special problems due to their remoteness and narrow resource base. There is less likelihood of an automatic positive response to growth in the mountainous areas and consequently a greater possibility for falling into structural poverty. Moreover, the emergent market-oriented rural economy remains fragile; the realization of its full potential to alleviate poverty in these areas will depend upon skilful resource management, appropriate and coordinated support services, diversification and producer understanding of an enterprise culture.

29. The resources presently available to mountain area communities are inadequate for generating a reasonable standard of living. Livestock numbers and productivity are low; crop yields are meagre and households lack cash or access to credit to remedy the situation. The major problems confronting small-scale farmers are: (a) lack of resources to produce and store or purchase sufficient feed and fodder to ensure livestock survival over the winter; (b) limited access to modern technologies to overcome shrinking margins resulting from cost-inefficient production of field crops; (c) poor knowledge of dryland farming technology to replace uneconomic irrigation systems; (d) undeveloped rural financial services to provide farm credit for rebuilding herds and for the uptake of newly introduced technologies; and (e) the breakdown of rural support services and infrastructure.

30. Against this background, the IFAD programme strategy is to contribute significantly in providing the institutional, financial and technical means required for developing a coherent strategy for mountain area development. The programme focuses initially on areas of development in which immediate interventions that will have a positive impact can be identified while at the same time launching activities in areas in which new technologies or institutional innovations are needed and for which testing of approaches is required. The programme design also recognizes that sectoral development approaches fail to give adequate attention to marginal mountain areas or to provide solutions that are appropriate to the needs of mountain communities that are in danger of being further marginalized in the development process. The programme will also support policy initiatives taken by the Government to involve communities in the planning and management of development activities, particularly in relation to environmental protection.

PART II - THE PROGRAMME

A. Programme Area and Target Group

31. The targeted programme area in both countries was defined to take into account the two key characteristics of mountain terrain - altitude and slope. Accordingly, it includes districts in which more than 50% of the population lives at altitudes above 500 m. This broad definition will ensure coverage of highland areas (500–1 000 m), in which steeply sloping land, rather than altitude, may represent the major constraining factor on development. Within this broad definition, the following procedure will apply:

(a) priority will be given to communities located at altitudes of 1 000 m and above; and

(b) communities at altitudes of between 501 and 1 000 m will be included on a selective basis using criteria that ensure that only the most disadvantaged communities are included. These criteria will include: (i) predominance of steeply sloping land; (ii) limited resource base for the majority of households as indicated by a small average land area and small numbers of livestock per household; (iii) low access to pasture and hay lands; and (iv) prevalence of degraded agricultural land.

32. Twenty districts in total fall into these categories in Azerbaijan and 33 districts in Georgia. They represent 1.3 million and 1.2 million people, respectively. As the present intervention is the first phase of an intended long-term IFAD-supported development programme, selection of the initial programme districts was based on building a sound foundation for replication through selecting across the spectrum of mountain districts (but with a focus on representativeness). Thus districts have been selected with the objective of testing programme activities under the range of different conditions prevailing in the mountain and highland areas in each country in order to provide the necessary experience for upscaling the activities in the programme’s later phases.

33. To this end the selection of the initial districts includes:

(a) coverage of different types of mountain terrain;
(b) diversity in livestock management and crop-production systems;
(c) diversity in climatic and agro-ecological zones; and
(d) diversity in ethnic groups.

34. For the future development of the programme, it is also essential that the performance in the initial phase is sufficiently positive to justify wider its replication. This requires a balanced approach in the selection of districts to cover those which, despite being disadvantaged, nevertheless offer good prospects for achieving success. That the programme’s approaches will work in more challenging situations is also demonstrated. The factors considered favourable to success are:

(a) wide access to markets;
(b) good communications;
(c) a physical resource base that offers potential for development;
(d) a conducive human resource base in terms of an active population with an interest in development and a supportive institutional framework (governmental/non-governmental); and
(e) scope for building on existing interventions, e.g. in the NGO sector, which will contribute to the attainment of more rapid results.

35. **Azerbaijan.** The districts selected for this first phase of the programme are Gadabey (Lesser Caucasus Mountains); Lerik (Talish Mountains); Shahbuz (Nakhchivan Autonomous Republic); and Gabala and Guba (Greater Caucasus Mountain). The total number of rural households in these

districts is estimated at around 61 600, of which more than 87% live above 500 m and around 44% live above 1 000 m. The present intervention will target around 8 200 households, representing 13% of the total rural households in these districts.

36. **Georgia.** The districts selected for this first phase of the programme are Dusheti (eastern Greater Caucasus Mountains); Aspindza (South Georgia highland plateau); Shuakhevi (Adjara mountain range); and one district in the western Greater Caucasus Mountains (Mestia, Lentekhi, Oni or Ambralouri) to be added later. The total number of rural households in these districts is estimated at around 290 000, of which more than 87% live above 500 m and around 32% live above 1 000 m. The present intervention will target around 10 600 households, representing 60% of the households within the targeted mountain areas.

37. In both countries, the target group will comprise active small private farmers operating individually or in voluntarily shared responsibility associations. Typically these will be small farmers who, following the privatization process, have less than 1 ha of homestead, crop land and hay meadows, and generally own less than 3 milking cows and less than 10 ewes. These represent the many households in the mountain areas that have experienced a steep decline in their living standards since the collapse of the collectives: they find themselves trapped at the minimum subsistence level. They have enough crop and livestock production for a meagre livelihood, but they are unable to generate any surplus to invest and to rebuild their asset base. Many are regularly disposing of young livestock due to the lack of winter-feed or to meet basic needs; this prevents them from increasing their asset base. Most have only two cows, which are considered the minimum for meeting subsistence needs: this highlights their vulnerability as any eventuality forcing them to dispose of one animal will push them over the brink into destitution. Most households have less livestock now than the number of private animals that they owned during the collective period.

38. A significant part of the target group will be the growing numbers of women who, due to the absence of male family members, are presently carrying the entire burden of farm and family. Other specific target groups will be: (a) new families established since privatization that lack land and have only the few livestock that their parents could provide to them; (b) in Georgia large families for whom resource constraints are particularly acute as land was allocated on a household basis irrespective of household size; (c) in Azerbaijan where land was allocated on a per capita basis, young families who received only a small land allocation at privatization and who now, with the subsequent arrival of children, increasingly find that they have an inadequate resource base to support their growing family; and (d) families who received marginal land in the privatization process.

B. Objectives and Scope

39. **Scope and Design.** The revival of sustainable development for the mountain areas in the two countries requires solutions to a complex web of interacting environmental, economic and social issues. Given the limited development experience and weak implementation capacity, not all these issues can be addressed simultaneously. However, over time, all need to be addressed in order to deliver sustainable development. Hence the strategy adopted will be to address these issues in a sequential manner through a long-term programme of IFAD support (12-15 years) to the mountain areas of Azerbaijan and Georgia.

40. A conscious strategy has been adopted of initially minimizing programme risks by opting for activities that are similar in Azerbaijan and Georgia. This approach enables synergies to be developed and the learning experiences to be widened and deepened by increasing the scale through coverage of both countries. A process has been put in place for capturing these experiences by introducing a separately funded regional collaboration programme that provides for collective brainstorming on key issues of mountain area development which are of crucial interest to both countries. This will occur through a series of think-tanks, thematic workshops and exchange visits to learn from best practices that have been developed under the programme. As the programme moves from Phase I to Phase II,

greater diversity on programme activities is expected, with activities becoming more specific to Azerbaijan and Georgia as basic approaches are fine-tuned to the demand from the population.

41. The present intervention represents the first tranche of IFAD funding for Phase I of the overall programme, which extends over seven years. Within this period, for each area of intervention there will be a process of pilot testing of activities prior to implementation on a broad scale. The key elements of the programme – community participation, credit delivery and technology upgrading - will be largely completed within the first three years of implementation. By the Mid-term Review (MTR) in programme year (PY)4, the major elements of a model for development of the mountain areas will be ready for replication on a wider scale within the mountainous and highland areas of the two countries. Hence, it is foreseen that preparation of a second tranche of IFAD funding for Phase II will take place in PY4. This will allow for the successful outcomes generated by Phase I to be extended to additional districts, while new issues will be addressed in the Phase I districts as part of a dynamic process that is responsive to evolving needs and changing opportunities.

42. **Objective.** The overall goal of the programme is to improve living conditions of mountain area communities in a sustainable manner by increasing incomes in a way that contributes to protecting and restoring the environment. To help achieve this goal, initial programme investments will aim to: (a) strengthen the beneficiaries' capacity to organize themselves in order to position themselves better in participating in the market economy and managing the natural resource base in a sustainable manner; (b) restore economic livelihoods through improved management of the resource base and improved access to financial, technical and commercial services; (c) protect and rehabilitate the environment by developing appropriate, community-based institutional mechanisms; and (d) fortify public capacity to identify and respond to the needs of the mountain areas by putting in place appropriate institutional mechanisms.

C. Components

43. In essence, the proposed programme will be similar in Azerbaijan and Georgia with minor variations. The programme will have four common components:

(a) **Promotion of participatory development.** The programme will engage NGOs in mobilizing communities, to assist them in prioritizing their development needs, formulating and implementing development proposals, and building appropriate community institutions (individuals/farmer/village groups) to manage implementation.

(b) **Support for income-generation.** The programme will support: (i) the establishment of sustainable community-owned and managed CUs/credit associations (CAs) to provide loans from the programme credit line to their members for investments in herd-rebuilding and expansion, fodder and pasture development, livestock-products processing, crop production and other small working capital and investment loans; (ii) support to livestock production through improved feed availability, increasing the availability of private veterinary services and restoring artificial insemination (AI) facilities on a pilot basis; (iii) support for crop production through seed production and distribution; participatory trials/demonstrations to better the productivity of existing crops, restore crop rotations and explore opportunities for crop diversification; securing yields in low rainfall areas through irrigation rehabilitation and dryland agriculture improvements through low-cost tillage technology, which helps to conserve soil moisture and increases the profitability of mechanized farming; and (iv) support to livestock and other products processing and marketing through demonstrations of improved household and village level dairy processing units and promotion of marketing groups.

(c) **Pilot community environmental improvement activities.** The programme will support the testing of community-participatory approaches to: (i) reforestation of degraded forest areas through community-forest management; and (ii) soil erosion control and land improvement measures on public and private land.

(d) **Programme management.** The programme will support the establishment in both countries of a programme management unit (PMU) within the Office of the Cabinet of Ministers of Azerbaijan and the Ministry of Agriculture and Food (MAF) of Georgia. These will later be transformed into Mountain Areas Development Agencies (MADA). Their responsibilities will be: (i) development planning, strategy development, and technology generation for long-term mountain area development; (ii) mobilization and management of funds in support of mountain area development; and (iii) provision of information and technical, financial and managerial support. The programme will also provide for a development initiatives fund to supply flexibility to move funds to areas of demand as expressed by communities through the participatory planning process and to those components where good results have been achieved.

44. **Social infrastructure rehabilitation component**. In both countries and after almost a decade without maintenance, a large part of the rural social infrastructure is in poor or very poor condition. The programme will rehabilitate this infrastructure, giving priority to drinking water supply, village roads and bridges, schools and kindergartens, and village health facilities. Two mechanisms will be used for rehabilitation, depending on the size of the works. In Georgia, implementation of larger microprojects will be contracted to the Georgian Social Investment Fund, which has already established procedures and experience. The community will contribute 20% of the total cost. No large projects will be implemented in Azerbaijan during this phase of the programme due to the absence of an equivalent experienced management agency. Small microprojects in both countries will be rehabilitated directly by the community, with it contributing a minimum of 50% of the total cost in labour and local materials.

D. Costs and Financing

45. **Azerbaijan.** The total cost of the present tranche of funding for Phase I of the programme over seven years, inclusive of contingencies, is estimated at about USD 10.00 million, of which 25% represents foreign exchange costs. Investment costs account for 85%. The overall cost for Phase I by component is summarized in Table 1A below.

Table 1A: Programme Phase I for Azerbaijan - Cost Summary (USD '000)

Components	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
A. Participatory development [a/]	907.7	275.7	1 183.5	23	13
B. Support to income-generation					
1. Development of financial services	3 651.5	263.9	3 915.4	7	42
2. Support for livestock production	295.8	270.1	565.9	48	6
3. Support for crop production	756.7	690.5	1 447.2	48	15
4. Support for marketing and processing	111.7	14.0	125.7	11	1
Subtotal support to income-generation	**4 815.7**	**1 238.4**	**6 054.2**	**20**	**64**
C. Pilot community environmental improvement activities	172.0	31.7	203.7	16	2
D. Programme management					
1. PMU	879.5	403.3	1 282.7	31	14
2. Development initiatives fund	345.0	345.0	690.0	50	7
Subtotal programme management	**1 224.5**	**748.3**	**1 972.7**	**38**	**21**
Total baseline costs	**7 119.9**	**2 294.2**	**9 414.1**	**24**	**100**
Physical contingencies	118.9	55.8	174.6	32	2
Price contingencies	296.8	111.7	408.5	27	4
Total programme costs	**7 535.6**	**2 461.6**	**9 997.2**	**25**	**106**

a/ Includes community infrastructure fund.

46. **Financing.** The IFAD loan of USD 9.00 million will finance 90% of the total programme costs (see Table 2A). Provision is made for IFAD loan funds to finance the involvement of NGOs. If in due course, international NGOs are able to offer cofinancing or cost-sharing arrangements or other bilateral grant funding is obtained, IFAD loan funds will be reallocated to other well-performing components in the course of programme implementation. The Government of Azerbaijan will make a total financial contribution (excluding tax waivers estimated at USD 0.90 million) of USD 0.40 million, or 4% of programme costs. This will cover part of the operating costs of PMU and social infrastructure rehabilitation. The programme's beneficiaries will contribute USD 0.48 million (5% of programme costs), mainly in the form of voluntary labour and local materials. Assistance from the Japanese grant programme with MAF for acquiring agricultural equipment is available for the purchase of the demonstration units for new tillage equipment.

47. **Georgia.** The total cost of the present tranche of funding for Phase I of the programme over seven years, inclusive of contingencies, is estimated at USD 9.23 million, of which 28% is for foreign exchange costs. Investment costs account for 83%. The overall cost of Phase I by component is summarized in Table 1B below.

Table 1B: Programme Phase I for Georgia - Cost Summary (USD '000)

Components	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
A. Participatory development	573.8	206.6	780.5	26	9
B. Support to income-generation					
1. Development of financial services	1 807.6	283.1	2 090.7	14	24
2. Support for livestock production	380.1	313.8	693.9	45	8
3. Support for crop production	797.7	618.1	1 415.8	44	17
4. Support for marketing and processing	136.7	10.8	147.6	7	2
Subtotal support to income-generation	**3 122.2**	**1 225.9**	**4 348.0**	**28**	**51**
C. Social infrastructure rehabilitation	677.0	255.8	932.8	27	11
D. Pilot community environmental improvement activities	177.2	34.0	211.2	16	2
E. Programme management					
1. PMU	920.2	347.2	1 267.4	27	15
2. Development initiatives fund	500.0	500.0	1 000.0	50	12
Subtotal programme management	**1 420.2**	**847.2**	**2 267.4**	**37**	**27**
Total baseline costs	**5 970.4**	**2 569.6**	**8 539.9**	**30**	**100**
Physical contingencies	127.9	75.1	203.0	37	2
Price contingencies	354.0	136.3	490.3	28	6
Total programme costs	**6 452.3**	**2 780.9**	**9 233.2**	**30**	**108**

48. **Financing.** The IFAD loan of USD 8.00 million will finance 87% of the total programme costs (see Table 2B). Provision is made for IFAD loan funds to finance the involvement of NGOs. If in due course, international NGOs are able to offer cofinancing or cost-sharing arrangements or other bilateral grant funding is obtained, IFAD loan funds will be reallocated to other well-performing components in the course of programme implementation. The Government of Georgia will make a total financial contribution (excluding an estimated USD 1.20 million in taxes waived) of USD 0.65 million, or 7% of programme costs to cover part of the operating costs of PMU and the Credit Union Development Centre (CUDC), and social infrastructure rehabilitation costs. The programme's beneficiaries will contribute USD 0.50 million (5% of programme costs), chiefly in the form of voluntary labour and local materials. Assistance from the Japanese grant programme with MAF is assumed for the purchase of agricultural tillage equipment.

Table 2A: Programme Phase I for Azerbaijan - Financing Plan[a/]
(USD '000)

Components	The Government of Azerbaijan		IFAD		Cofinancier		Beneficiaries		Total		Foreign Exch.	Local (Excl. Taxes)
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%		
A. Participatory development[b/]	235.0	18.1	831.1	63.9	-	-	235.0	18.1	1 301.1	13.0	301.5	999.6
B. Support to income-generation												
1. Development of financial services	0.0	-	3 996.2	100.0	-	-	-	-	3 996.2	40.0	284.0	3 712.2
2. Support for livestock production	17.9	2.9	598.5	97.1	-	-	-	-	616.4	6.2	292.3	324.1
3. Support for crop production	0.0	-	1 350.1	84.4	110.5	6.9	138.9	8.7	1 599.5	16.0	753.1	846.5
4. Support for marketing and processing	0.0	-	136.1	100.0	-	-	-	-	136.1	1.4	15.2	120.9
Subtotal support to income-generation	**17.9**	**0.3**	**6 080.9**	**95.8**	**110.5**	**1.7**	**138.9**	**2.2**	**6 348.2**	**63.5**	**1 344.6**	**5 003.7**
C. Pilot community environmental improvement activities	0.0	-	137.4	56.2	-	-	106.9	43.8	244.4	2.4	36.6	207.8
D. Programme management												
1. PMU	153.0	10.8	1 260.6	89.2	-	-	-	-	1 413.5	14.1	433.9	979.6
2. Development initiatives fund	-	-	690.0	100.0	-	-	-	-	690.0	6.9	345.0	345.0
Subtotal programme management	**153.0**	**7.3**	**1 950.6**	**92.7**	**-**	**-**	**-**	**-**	**2 103.5**	**21.0**	**778.9**	**1 324.6**
Total disbursement	**405.9**	**4.1**	**9 000.0**	**90.0**	**110.5***	**1.1**	**480.8**	**4.8**	**9 997.2**	**100.0**	**2 461.6**	**7 535.6**

a/ Discrepancies in totals are due to rounding.
b/ Includes community infrastructure fund.
* Discussions underway to provide this amount from the counterpart fund financed by Japan.

TABLE 2B: Programme Phase I for Georgia - Financing Plan[a/]
(USD '000)

Components	The Government of Georgia		IFAD		Cofinancier		Beneficiaries		Total		Foreign Exch.	Local (Excl. Taxes)
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%		
A. Participatory development	0.0	-	835.7	100.0	-	-	-	-	835.7	9.1	221.6	614.0
B. Support to income-generation												
1. Development of financial services	138.4	6.4	2 039.6	93.6	-	-	-	-	2 177.9	23.6	310.9	1 867.1
2. Support for livestock production	14.3	1.9	744.4	98.1	-	-	-	-	758.8	8.2	340.9	417.8
3. Support for crop production	0.0	-	1 362.4	86.5	73.7	4.7	138.9	8.8	1 575.0	17.1	680.1	894.9
4. Support for marketing and processing	0.0	-	160.7	100.0	-	-	-	-	160.7	1.7	11.8	149.0
Subtotal support to income-generation	**152.7**	**3.3**	**4 307.1**	**92.2**	**73.7**	**1.6**	**138.9**	**3.0**	**4 672.4**	**50.6**	**1 343.6**	**3 328.7**
C. Social infrastructure rehabilitation	339.9	31.8	475.4	44.4	-	-	254.5	23.8	1 069.8	11.6	296.9	772.9
D. Pilot community environmental, improvement activities	0.0	-	145.7	57.7	-	-	106.9	42.3	252.6	2.7	39.1	213.5
E. Programme management												
1. PMU	166.6	11.9	1 236.2	88.1	-	-	-	-	1 402.8	15.2	379.6	1 023.2
2. Development initiatives fund	-	-	1 000.0	100.0	-	-	-	-	1 000.0	10.8	500.0	500.0
Subtotal programme management	**166.6**	**6.9**	**2 236.2**	**93.1**	**-**	**-**	**-**	**-**	**2 402.8**	**26.0**	**879.6**	**1 523.2**
Total disbursement	**659.2**	**7.1**	**8 000.0**	**86.6**	**73.7***	**0.8**	**500.4**	**5.4**	**9 233.2**	**100.0**	**2 780.9**	**6 452.3**

a/ Discrepancies in totals are due to rounding
* Discussions underway to provide this amount from the counterpart fund financed by Japan.

49. A supplementary activity was designed to: (a) develop a framework for regional collaboration that allows for building on synergies, thus enriching the learning process and involving all stakeholders in the process; and (b) set up grass-roots lobbying organizations in each country to give a collective voice to the people in the mountain areas, enabling them to interact on more even terms and more effectively, both at the national level and within the regional collaboration framework. Specifically this will involve two major components, namely: (a) development of a regional collaborative framework; and (b) the establishment of the Caucasus Mountain Network.

50. The regional collaborative framework component will consist of: (a) strategy development; (b) exposure visits; (c) publicity and documentation; and (d) NGO management. Establishing the Caucasus Mountain component will involve: (a) construction of national chapters; (b) promotion of local NGOs; (c) technical assistance; and (d) exchange visits. The total cost of this supplementary activity is approximately USD 760 000, including contingencies.

51. IFAD, the participating countries and the bilateral donors will finance this activity. IFAD will provide a grant from its Extended Cooperation Programme (ECP) of about USD 100 000; the Governments of Azerbaijan and Georgia will each contribute about USD 30 000 from the IFAD loan for their country programmes; and the Swiss Development Cooperation has expressed its interest in providing USD 600 000 in cofinancing these activities. The implementation of these activities will be entrusted to Groupement Suisse pour les montagnes (SAB), a Swiss NGO that has a well-established record in working with mountainous communities in Switzerland since the early 1940s. The SAB has also worked in Latin America and the Balkans. It is a very active member of the International Centre on Integrated Mountain Development (ICIMOD), EuroMontana and the European Forum on Mountainous Areas.

E. Procurement, Disbursement, Accounts and Audit

52. **Procurement.** Procurement of goods and services financed by the IFAD loan will observe IFAD Procurement Guidelines. Procurement of goods and equipment worth USD 20 000 or less will be made on the basis of local shopping. Procurement of goods and equipment between USD 20 000 and 100 000 will be on the basis of local competitive bidding. For the procurement of NGO services for contracts exceeding USD 100 000, international competitive bidding will apply.

53. **Disbursement, accounts and audit.** The loans will be disbursed over a seven-year period. Disbursements by IFAD will be made against certified Statements of Expenditure, except for contracts over USD 50 000, which will require fully documented applications. A full set of accounts will be maintained by PMU in accordance with IFAD's requirements and internationally accepted accounting standards. Each service provider, including CUDC for the Microfinance Window for Mountain Areas, will maintain separate accounts. The PMU will submit consolidated financial records on a semi-annual basis to IFAD for review. Programme accounts will be audited annually by auditors acceptable to IFAD, and will include an opinion on the following: all Statements of Expenditure; the movements of the special account; and a specific opinion on the procedures of contracting to service providers and the accountability of such providers and the management of programme resources by them. The annual audit report will be submitted to the Government and to IFAD within six months of the close of the fiscal year.

54. **Reports.** Service providers will prepare and submit quarterly financial and physical progress reports to PMU. The PMU will develop reporting formats for service providers, and such reporting will form part of the conditions of the contract. The PMU will prepare and submit consolidated six-monthly financial and physical progress reports to the programme steering committee, IFAD and the cooperating institution (CI). The PMU will also prepare an annual report, copies of which will be presented to IFAD and CI within two months of the end of the financial year.

55. In the course of PY4, a MTR will be carried out jointly by the Government and IFAD. It will specifically review the following: the technical, financial and institutional progress to date; the evolution of the implementation environment; the possible need for adjustments and their justification; the efficiency of the implementation approach based on contracting service providers; the efficacy of the partnership with international NGOs; and the results of the technology upgradation trials and the readiness for the creation of MADA. Prior to MTR, PMU will prepare detailed proposals for the remainder of the Phase I period based on the experiences of the pilot stage. These will include the proposed allocation of funds from the development initiatives fund to various components, for review and finalization with the MTR mission and for submission to IFAD for approval.

56. As indicated above, it is anticipated that the preparation of Phase II of the programme could commence after the MTR of Phase I in Year 4. However, to pass from one programme phase to the next, a number of parameters need to be in place; these will function as conditions for commitment of further IFAD funding to the programme. The MTR will, therefore, also be the occasion to verify whether the conditions have been met and whether programme activities are ready for replication on a much wider scale, which will justify the preparation of Phase II to implement the core activities in additional districts.

F. Organization and Management

57. In view of the specific characteristics and needs of the mountain areas, both Governments believe that there is a need for a special institutional framework for the development of the mountainous areas. Thus, at the appropriate time the Governments of Azerbaijan and Georgia intend to establish an independent, quasi-governmental MADA in their respective countries, under which the activities of the present programme will eventually fall. The MADA will be a specialized agency that offers a clear focus on the mountain areas and combines the roles of strategy development and lobbying, ensuring a conducive enabling environment for development in the mountain legal entity. It will operate under the charter approved by Parliament, with an independent board of management with at least equal representation from the governmental and the non-governmental sectors.

58. It is, however, felt that the appropriate time for the establishment of MADA will occur once concrete experience has been gained (specifically of the appropriate interventions for mountain area communities), and the major elements of a model for development of the mountain areas are proven and ready for replication on a much wider scale. It is envisaged that this objective will be attained by PY4 of programme implementation and MADA will be established in PY5. Thus, the programme will initially be executed by MAF of Georgia and by the Cabinet of Ministers in Azerbaijan. The interim management arrangements have been developed to facilitate the easy transition to the permanent MADA structure (see Chart 1A for Azerbaijan and Chart 1B for Georgia in Appendix VI). Day-to-day management of the programme will rest with the programme director and PMU, which will report directly to the Minister of Agriculture in Georgia and to the First Prime Minister for Agrarian Reform in Azerbaijan. The respective organizational structures of PMU are shown in Charts 2A and 2B in Appendix VI. The programme will be guided in Georgia by the project steering committee, which comprises governmental and non-governmental representatives: and by the Sub-Group of the State Commission for Assistance to Private Farmers and the Programme Advisory Group representing the non-governmental sector in Azerbaijan.

59. Programme implementation will be based on contracting out to implementing partners and TSPs. Potential implementing partners will be international NGOs. Those that have expressed interest in Azerbaijan are ACDI/VOCA, ADRA, CARE, Relief International and World Vision. In Georgia, they are CARE and SPF.

60. Other TSPs will be contracted to provide support to the implementation of the various technical programmes, such as the participatory trials programme. These TSPs will be selected through open competitive bidding on the basis of the best expertise, both technical and attitudinal, and could be drawn from government research institutes, Academy of Sciences, District Agriculture Departments, NGOs, and private firms/individuals. Contracts for TSPs will give them the responsibility for procuring all materials and additional expertise required to fulfil the specified tasks. The TSPs will be monitored by the PMU/MADA staff.

61. **Monitoring and Evaluation.** One of the PMU's main responsibilities will be monitoring and evaluation (M&E) of the programme's performance and impact. Data on physical and financial progress will be submitted by international NGOs and TSPs. The PMU staff will be responsible for undertaking frequent field visits to programme villages for ongoing evaluation of the activities, and in particular to monitor the performance and standard of work of NGOs and TSPs. The programme will establish procedures to obtain feedback from its clientele on the efficacy of activities through a series of annual review workshops involving programme clientele and representatives of PMU, the NGOs and TSPs. The progress and performance of each component will be reviewed. For the purposes of impact evaluation, the PMU will contract a qualified agency to undertake a baseline survey of a sample of households in PY1 and PY2. A smaller subset of households will constitute a panel, to be followed-up annually to record their activities and progress. An independent agency will conduct a full impact evaluation survey in PY7.

62. **Dynamic Planning and Implementation Process.** In order to ensure that programme activities are able to adapt to changes in opportunities so as to remain relevant in the context of the rapidly changing environment in transitional economies, the programme will introduce a dynamic planning and implementation process. This will provide a mechanism to ensure that programme activities are responsive to needs and alert to implementation performance. The key elements in the planning framework will be the logical framework and the annual work plan and budget (AWP/B). The annual cycle of the planning process will comprise four sequential stages:

(a) **Planning.** The AWP/B will define the activities, targets, outputs and inputs in line with the objectives outlined in the logical framework. The activities will in turn be derived from the village action plans developed through the participatory planning process with communities, thereby ensuring that they reflect the needs and aspirations of the communities.

(b) **Monitoring.** This will be impact-oriented in order to capture on an ongoing basis the efficacy and continuing relevance of programme activities. This will be geared to early detection of signals allowing, where necessary, for modification of programme design.

(c) **Feedback and Reality Check.** A series of workshops at community, district, inter-district and inter-country levels provide the fora for all stakeholders to evaluate the adequacy of the overall programme design to continue meeting the needs of communities and to assess implementation performance. They will provide the opportunity for disseminating best practices and enable them to be integrated into programme design and implementation.

(d) **Fine-tuning of Programme Design.** Information gained from the previous stages will form the basis of the next round of planning, allowing for the fine-tuning of programme design, including modifications of the logical framework to bring it into line with changing circumstances and implementation experience.

G. Economic Justification

63. Around 8 200 households in Azerbaijan and 10 600 households in Georgia will benefit from the programme through heightened access to credit and assistance to upgrade agricultural production; all will more than double their incomes. The interventions will result in significant improvement in household food security. All households except those engaged in transhumance will attain self-sufficiency in cereals and livestock products, while transhumant households will achieve the greatest increase in cash income. This will enable them to cover their cereals and other basic food requirements. The present economic crisis has thrust women into a new role of greater participation in the public domain, e.g. in marketing, etc., to ensure the survival of the family. The programme will equip women to perform better in their newly acquired responsibilities by providing access to credit and technical support.

64. The environmental impact will be strongly positive as herd-rebuilding and expansion are linked to increased fodder production; all cultivation technology interventions are directed towards conservation farming and, in particular, to introducing improved cultural practices relevant to dryland agriculture. In addition, the pilot environmental improvement activities are expected to make a major contribution towards a more balanced future agricultural development from the environmental aspect.

65. The first phase of the programme will raise income and quality of life of 18 800 resource-poor households (10 600 in Georgia and 8 200 in Azerbaijan) by increasing access to credit and assistance to upgrade agricultural production. The participants in the pilot environmental and social infrastructure rehabilitation activities are assumed to overlap with the main programme participants.

66. The rates of return on the overall programmes in the two countries (including all promotional, management and support costs ranges), together with sensitivity tests are summarized in Table 3. The calculations are based on the assumption that half of farmers are full adopters of the recommended technology and the remaining half achieve 50% of the recommended technology. The rate of return is relatively high due to the very low levels of production in the without programme situation. This accounts for the high incremental production benefits that accrue in just getting back to previous production levels. In addition, the availability of feed for livestock production means that herd expansion can be accommodated through the retention of breeders.

Table 3: Basic Rate of Return and Sensitivity Tests

Country	Basic EIRR*	EIRR with 20% increase in costs	EIRR with two year delay in benefits
Azerbaijan	24 %	11%	19%
Georgia	20-33%	9-19%	15-26%

* EIRR: Economic Internal Rate of Return

67. The present economic crisis has thrust women into a new role of greater participation in the public domain to ensure the survival of the family. The programme will build on this and equip women to perform better in their newly acquired responsibilities by providing access to credit and technical support. By encouraging the appointment of women credit officers, it will be easier for women to participate in CUs, enabling them individually or as groups to access financial and technical support for whatever activity they choose to pursue. The focus on women for strenghtening dairy products processing will also provide an entry point for women into credit to take small loans for improved equipment.

H. Risks

68. The programme represents an ambitious challenge to radically change approaches to development by putting the community centre stage in driving the programme’s activities. This consequently entails a degree of risk, including: (a) a slow response to the participatory approach,

which is centre stage in driving the programme's activities, both from the communities that have yet to be awakened to their potential for decision-making and independent initiative; and among programme management staff and TSPs that also have to demonstrate a vast change in attitude from the past directive approaches with which both communities and implementers are more familiar; (b) lack of appreciation and commitment to the realities of economic change among certain sections of Government risks taking the programme off course; and (c) undermined autonomy and independence of the day-to-day operations of MADA.

69. **Special Operations Facility.** To assist with initial start-up activities of the programme in both countries, IFAD will make available to each country a Special Operations Facility of USD 80 000 (grant funding). The facility will be used mainly to engage the services of an experienced international project expediter (PE) for four months at programme commencement to assist in launching the programme and to familiarize PMU (and others) with IFAD procedures and requirements concerning reporting, establishment and maintenance of accounts, procurement, etc. The PE will also assist in negotiations with NGOs on the terms of partnership with them; recruitment of staff for PMU; recruitment of the early technical assistance inputs required, i.e. programme planning adviser, M&E specialist; and credit adviser.

I. Environmental Impact

70. The programme will have a positive environmental impact. With the significant reduction in livestock numbers compared with ten years ago, there is little pressure on summer pastures. The main constraint of winter feed supplies is addressed through the heightened productivity of hay meadows, increased cultivation of fodder crops and increased emphasis on building herder groups able to access the available winter pasture areas. This will provide a framework for ameliorating overgrazed village pastures adjacent to communities.

71. Improved crop productivity will result partly from increased fertilizer application, but the amounts applied will still be moderate. Only small increases in the use of plant protection chemicals is expected. Improved agronomic practices will be introduced into cultural practices to reduce soil erosion, while improved equipment for mechanized farming will bring along new appropriate rainfed farming techniques. These will include minimum tillage, which will contribute to moisture retention and reduction in soil erosion. Pilot activities will support these interventions to encourage farmers to adopt other protective soil conservation measures, such as terracing and gulley protection to protect vulnerable crop land. The irrigation interventions will focus chiefly on improvements to off-take structures and clearing and maintaining existing channels. Hence no negative environmental impact is expected.

72. The pilot community forestry demonstrations will in themselves have only very limited impact on restoring forest cover. Yet the main objective is to orient both communities and the Government, particularly the Department of Forest Management, to the benefits of involving the community in regenerating and protecting the forest. If this can be achieved, then a cost-effective mechanism will be in place that can have a significant future impact on reforesting degraded forest areas. The situation is such that government funds for reforestation will, for the foreseeable future, be too limited to have any significant impact on this problem.

73. Based on the above assessment, the likelihood and significance of environmental impacts are not only negligible, but indeed positive. As there will be minimal direct disturbance of the physical setting or the resources, the programme has been given a Category C classification.

J. Innovative Features

74. The innovative features of the programme can be divided between those innovative for Azerbaijan and Georgia and for IFAD.

Azerbaijan and Georgia

(a) A community participatory development approach will be emphasized to underpin all the programme activities, introducing a genuine bottom-up approach to programme design. This approach is new in the context of rural development in Georgia, and offers the opportunity to make a real contribution to building civil society at the grass-roots by empowering communities to demand and implement change.

(b) The MADA will be established as an autonomous, service-oriented institution with flexible, innovative operating modalities. This will provide a clear focal point for mountain area communities and the facility to link poor mountain area communities with a range of services. In the process, partnerships with the public and private sector will be developed. It allows for empowerment and capacity-building, and timely responsiveness to its clients.

(c) A community-owned and managed credit delivery system will be developed, which over time will build its own member-owned network of support services, including financial intermediation.

(d) Rather than establishing a non-sustainable governmental system, farmer-led extension service will be developed.

(e) A process approach will be adopted, which allows, on an ongoing basis, for piloting of activities, drawing lessons from experience and replicating on a wider scale.

(f) The development initiatives fund emphasizes the concept of flexibility inherent in the programme design, enabling funds to be directed to the areas of highest priority as expressed by the communities and to the best performing components.

IFAD

(a) The phased approach to the establishment of MADA will ensure that sufficient experience has been gained prior to the establishment of the new organization in order to ensure its operational effectiveness from the outset, thereby enhancing its credibility.

(b) A regional collaborative framework will be established to facilitate networking between the programmes in Azerbaijan and Georgia, both at the level of the programme implementers and policymakers, and through the establishment of a grass-roots organization. This will give the communities a stronger voice in decision-making in relation to the overall development of the mountain areas.

(c) A dynamic planning process will be established linking planning of programme activities with the logical framework within an institutionalized review process. This will ensure that the lessons of implementation experience are fed back into modifications in overall programme design and strategies, and thus to the logical framework that represents the programme’s template.

PART III - LEGAL INSTRUMENTS AND AUTHORITY

75. Two separate loan agreements, one between the Azerbaijan Republic and IFAD and another between Georgia and IFAD constitute the legal instruments for extending the proposed loans to the borrowers. A summary of the important supplementary assurances included in the negotiated loan agreements is attached as an annex.

76. The Azerbaijan Republic and Georgia are empowered under their respective laws to borrow from IFAD.

77. I am satisfied that the proposed loans will comply with the Agreement Establishing IFAD.

PART IV - RECOMMENDATION

78. I recommend that the Executive Board approve the proposed loans in terms of the following resolution:

> RESOLVED: that the Fund shall make a loan to the Azerbaijan Republic in various currencies in an amount equivalent to six million nine hundred thousand Special Drawing Rights (SDR 6 900 000) to mature on and prior to 1 September 2040 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.
>
> RESOLVED: that the Fund shall make a loan to Georgia in various currencies in an amount equivalent to six million one hundred thousand Special Drawing Rights (SDR 6 100 000) to mature on and prior to 1 September 2040 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 AGREEMENTS

(Loan negotiations concluded on 9 August 2000)

Azerbaijan Republic

1. **Availability of additional resources.** The Government of the Azerbaijan Republic (the Government) will make available to the PMU during the programme implementation period counterpart funds from its own resources in an aggregate amount equivalent to USD 406 000 in accordance with its customary national procedures for development assistance. For such purpose, the Government will make budgetary allocations for each fiscal year equal to the counterpart funds called for in the AWPB for the relevant programme year and make such allocations available to the PMU, through the programme account, annually in advance.

2. **Group for MADSCAPF.** The Government will establish a group for Mountain Area Development of SCAPFAPFSD (MADSCAPF) in accordance with its procedures. The First Deputy Prime Minister for Agrarian Reform will chair the group for MADSCAPF, the programme director will be its ex officio secretary and the PMU will be its secretariat.

3. **Programme management unit.** A PMU will be established within the Agency for Support to the Development of the Agricultural Private Sector (ASDAPS) in accordance with the procedures of the Government. The PMU will be under the direct supervision of the Chairman of the State Commission for Assistance to Private Farmers in Agricultural Private Farm Sector Development (SCAPFAPFSD), through ASDAPS. The staff of the PMU will be recruited locally through open competition from the public or private sector and engaged on one-year renewable contracts. The Government will provide adequate financial and other incentives to attract and retain staff of a high calibre.

4. P**rogramme director.** The Government will appoint a programme director on or before the effective date. The programme director will be recruited on a renewable contract through open competition from amongst candidates from the public and private sector. Details of the shortlisted candidates and the recommended appointee will be sent to IFAD for approval. The programme director will be appointed by the Chairman of SCAPFAPFSD, subject to the prior approval of IFAD. The programme director will be fluent in English. The programme director may only be removed by the Government after prior consultation with IFAD.

5. **Mountain Areas Development Agency.** The Government will, at a time to be agreed between the Government and IFAD, establish an autonomous MADA, with an independent board of management and representation from officials and non-officials, acceptable to IFAD. The Government and IFAD will convert the PMU into the executive team of the MADA, the programme director into its executive director and the group for MADSCAPF into its board of management. At this time, the Government will review the existing institutions created to promote mountain area development in the light of the terms of reference of MADA in order to remove duplication and to ensure a smooth transition to MADA.

6. The support to income generation component will be partly carried out by the international NGO (INGO) (with respect to the Microfinance Window for Mountain Areas (MWMA)), the participating commercial banks and other similar entities (PCEs) and the credit associations (with respect to the provision of credit) and the NGOs and private service providers (with respect to technical assistance).

7. **The PCE Subsidiary Loan Agreement.** The Government and each PCE will enter into an agreement (the PCE Subsidiary Loan Agreement), which will provide, among other things, that:

(a) the Government will transfer available funds and other resources for credit to the PCE as a loan on terms and conditions acceptable to IFAD; and

(b) the PCE will declare its commitment to the objectives and purposes of the programme as stated in the Loan Agreement and, in furtherance of such objectives and purposes, it will undertake to carry out the credit part of the support to income generation component in accordance with the Loan Agreement.

The Government will submit a draft of each PCE Subsidiary Loan Agreement to IFAD for its comments and approval before signature.

8. The Government will ensure that all programme villages conform to the criteria agreed with IFAD.

9. The Government will ensure the establishment of an independent MWMA responsible for the promotion of credit associations in the mountainous areas under the programme in accordance with operating parameters specified by the Government and IFAD.

10. Within 18 months of the effective date, the Government will put in place an appropriate legislative framework for credit associations and non-banking finance institutions which will allow for the establishment of a National Union of credit associations (NUCA), permitted to act as a financial intermediary and able to borrow from the Ministry of Finance (MOF) and commercial banks, at interest rates to be negotiated, and to on-lend to its member credit associations at interest rates which it is free to determine in order to ensure its sustainability.

11. The Government will bear the foreign exchange risk and charge no interest on the credit line for the financing of the credit associations for the first five-to-six years until the establishment of the NUCA. All repayments during this period will be credited to a revolving fund and will be used for further on-lending to meet the credit requirements under the programme.

12. With the establishment of the NUCA, a subsidiary loan agreement will be concluded between MOF and the NUCA establishing the cost of funds and maturity of the loan in a manner which ensures the sustainability of the NUCA. To this end, the Government will ensure that the rate of interest charged will only take account of the exchange rate risk and the maturity of the loan will allow the NUCA to recycle the funds at least three times before repayment to MOF.

13. **Risk fund.** The Government will establish a risk fund: to cover no more than 50% of the share capital of the credit associations with funds drawn from the loan deposited in an interest-bearing bank account specifically opened for the risk fund; to capitalize the interest; and to nominate a committee for the management of the risk fund comprising a representative of MOF, PMU and MWMA. With the establishment of the NUCA, the Government will transfer the ownership and management of the risk fund to the NUCA.

14. **INGO.** The Government will ensure that the INGO to be contracted under the programme is selected according to criteria and procedures approved by IFAD. The Government will contract the selected INGO, upon terms and conditions acceptable to IFAD, to implement the promotion of participatory development and the support to income generation components and such other components and activities as the Government and IFAD may decide, as well as to provide other technical support services as appropriate. The Government and the INGO will conclude an agreement to this effect (the INGO Agreement), acceptable to IFAD. The INGO will make a contribution of at least 20% towards the

cost of the implementation of the activities. The INGO may sub-contract all or part of those activities to local NGOs, which will be selected in accordance with criteria and procedures to be specified in the INGO Agreement.

15. In the event of other financing for the above-mentioned activities becoming available from bilateral or other donors, the proceeds of the loan allocated for these purposes will be reallocated to the Development Initiatives Fund.

16. **Tax exemption.** The Government will exempt from taxes goods, civil works and services, including contracts with NGOs, financed by the loan.

17. **Insurance of programme personnel.** The Government will insure key programme personnel against health and accident risks to the extent consistent with sound commercial practice.

18. **Additional cofinancing of the programme.** The Government will use part of the proceeds of the loan for the purpose of financing technical assistance inputs. In the event of other funding becoming available from bilateral or other donors for this purpose, the proceeds of the loan allocated for this purpose will be assigned to the Development Initiatives Fund.

19. **Regional collaborative framework.** The Government will assist in the development of a regional collaborative framework and allocate an amount of USD 30 000 from the proceeds of the loan towards the cost of the regional collaborative framework. To this end, the Government will conclude a Memorandum of Collaboration with Georgia, IFAD and other appropriate parties.

20. **Disbursement conditions.** (a) No withdrawals will be made in respect of expenditures under the support to income generation component: (i) with respect to any PCE, until a PCE Subsidiary Loan Agreement shall have been approved by IFAD in draft; a copy of such PCE Subsidiary Loan Agreement, as signed by MOF and such PCE, substantially in the form so approved and certified as true and complete by a competent officer of MOF, shall have been delivered to IFAD; the signature and performance thereof by MOF and such PCE shall have been duly authorized or ratified by all necessary corporate, administrative and governmental action; and all conditions precedent to the effectiveness thereof shall have been fulfilled; and (ii) until a law and appropriate subsidiary legislation, acceptable to IFAD, shall have been issued: (1) for the establishment and operation of an MWMA as a refinancing institution on the basis of registration with the Ministry of Justice and evidence of pending application to the National Bank of Azerbaijan for a limited banking licence; and (2) for the establishment and operation of credit associations with an initial capital base of less than USD 5 000, as well as other conditions required by IFAD, and on the basis of registration with the Ministry of Justice and evidence of pending application to the National Bank of Azerbaijan for a limited banking licence.

(b) No withdrawals will be made in respect of amounts allocated to the Development Initiatives Fund until IFAD shall have reallocated such amounts to other categories.

21. **Conditions precedent to effectiveness.** The following are the conditions precedent to the effectiveness of the Loan Agreement:

(a) the PMU shall have been duly established in accordance with the relevant procedures of the Government;

(b) the group for MADSCAPF shall have been duly established in accordance with the relevant procedures of the Government;

(c) the Loan Agreement shall have been duly signed, and the signature and performance thereof by the Government shall have been duly authorized and ratified by all necessary administrative and governmental action; and

(d) a favourable legal opinion, issued by the Minister for Justice or the Deputy Minister for Justice in form and substance acceptable to IFAD, shall have been delivered by the Government to IFAD.

Georgia

1. **Availability of additional resources.** The Government of Georgia (the Government) will make available to the PMU during the programme implementation period counterpart funds from its own resources in an aggregate amount equivalent to USD 1 800 000, of which USD 660 000 in cash contribution and USD 1 140 000 to cover taxes, in accordance with its customary national procedures for development assistance. For such purpose, the Government will make budgetary allocations for each fiscal year equal to the counterpart funds called for in the AWPB for the relevant programme year and make such allocations available to the PMU, through the programme account, quarterly in advance.

2. **Programme coordination committee.** MAF and MOF will establish a programme coordination committee (PCC), in accordance with its procedures, with responsibility for the overall coordination of the activities of the programme, providing policy guidance and ensuring the good governance of the programme. The Minister for Agriculture and Food will chair the PCC, the programme director will be its ex officio secretary and the PMU will be its secretariat.

3. **Programme management unit.** A PMU will be established by MAF and MOF as a public legal entity, with status and charter acceptable to IFAD. The PMU will be under the direct supervision of the Minister for Agriculture and Food. The staff of the PMU will be recruited locally through open competition from the public or private sector and engaged on one-year renewable contracts. The Government will provide sufficient incentives, in agreement with IFAD, so as to attract and retain staff of a high calibre.

4. P**rogramme director.** The programme director will be appointed by MAF, subject to the prior approval of IFAD, on or before the effective date. The programme director will be recruited on a renewable contract through open competition from amongst candidates from the public and private sector. Details of the shortlisted candidates and the recommended appointee will be sent to IFAD for approval. The programme director will be fluent in English. The programme director may only be removed by MAF after prior consultation with IFAD and MOF.

5. **Mountain Areas Development Agency.** The Government will, at a time to be agreed between the Government and IFAD, establish an autonomous MADA, with an independent board of management and governmental and non-governmental representation, acceptable to IFAD. The Government and IFAD will convert the PMU into the executive team of the MADA, the programme director into its executive director and the PCC into its board of management. MOF will retain its financial monitoring functions thereafter. At this time, the Government will review the existing institutions created to promote mountain area development in the light of the terms of reference of MADA in order to remove duplication and to ensure a smooth transition to MADA.

6. The support to income generation component will be carried out, through the PMU, by CUDC (with respect to the MWMA), the participating commercial banks (PCBs) and the credit unions (with respect to the provision of credit) and the NGOs and private service providers (with respect to technical assistance).

7. **The PCB Subsidiary Loan Agreement.** MOF and each PCB will enter into an agreement (the PCB Subsidiary Loan Agreement), which will provide, among other things, that:

(a) MOF will make available to the PCB, through the PMU, funds required for credit as a loan on terms and conditions, acceptable to IFAD;

(b) the PCB will declare its commitment to the objectives and purposes of the programme as stated in the Loan Agreement and, in furtherance of such objectives and purposes, it will undertake to carry out the credit part of the support to income generation component in accordance with the Loan Agreement; and

(c) all sub-loan agreements between the PCB and any customer under the programme will be approved by the PMU prior to signature.

MOF will submit a draft of each PCB Subsidiary Loan Agreement to IFAD for its comments and approval before signature.

8. The Government, through the PMU, will ensure that all programme villages conform to the criteria agreed with IFAD.

9. The Government will ensure, through the PMU, the establishment of a separate MWMA as a structure within the PMU that will be responsible for the promotion of small-scale enterprises in the mountainous areas of the programme. The CUDC, in consultation with the PMU, will be responsible for the promotion of credit unions in the mountainous areas. Both of the above will be in accordance with operating parameters specified by the Government and IFAD.

10. The Government will ensure that credit unions established under the programme are eligible to receive credit from the credit line for financing credit unions nationwide under the Agricultural Development Project, financed by IFAD (IFAD Loan No. 450-GE).

11. Within 24 months of the effective date, the Government will put in place an appropriate legislative framework for credit unions which allows for the establishment of a National Federation of credit unions (NFCU) permitted to act as a financial intermediary, and able to borrow from commercial banks and other sources, at interest rates to be negotiated, and to on-lend to its member credit unions at interest rates which it is free to determine in order to ensure its sustainability.

12. The Government will bear the foreign exchange risk and charge the same interest rate as that charged by IFAD on the loan on the credit line for the financing of the credit unions for the first five-to six years until the establishment of the NFCU. All repayments during this period will be credited to a revolving fund and would be used for further on-lending to meet the credit requirements under the programme.

13. With the establishment of the NFCU, a subsidiary loan agreement will be concluded between MOF and the NFCU establishing the cost of funds and maturity of the loan in a manner which ensures the sustainability of the NFCU. To this end, the Government will ensure that the rate of interest charged will only take account of the exchange rate risk and the maturity of the loan and, at the same time, that the interest rate is negotiated between the NFCU and MOF.

14. **Risk fund.** The Government will establish a risk fund to cover a portion of the share capital of the credit unions with funds drawn from the loan deposited in an interest-bearing bank account specifically opened by the CUDC, in consultation with the PMU, for the risk fund and to capitalize the interest. The CUDC will ensure the management and operation of the risk fund in consultation with the PMU. The coverage by the risk fund will be decided by the Government, in consultation with IFAD, but

will, in no case, exceed 50% of the share capital of the credit unions. With the establishment of the NFCU, the Government will transfer the ownership and management of the risk fund to the NFCU on terms and conditions acceptable to MOF, the NFCU and IFAD.

15. Equity and establishment grants will be provided in tranches under the programme to newly-established credit unions in mountainous areas. The maximum amount of such grants will be determined by agreement between the Government and IFAD. No further tranches of the grant will be provided until the credit union shall have demonstrated to the satisfaction of IFAD a good rate of recovery on any loans received under the programme and its good governance.

16. The Government will contract, through the PMU, NGOs, including international NGOs (INGOs), to implement the promotion of participatory development component and to provide other technical support services as appropriate and to use the proceeds of the loan for the purpose of financing the NGOs (including INGOs). In the event of other funding becoming available from bilateral or other donors for this purpose, the proceeds of the loan allocated for this purpose will be assigned to the Development Initiatives Fund. The proposals for the shortlisted NGOs (if contracted through competitive bidding) and the recommended organization will be sent to IFAD for approval.

17. The Government will ensure that all INGOs and/or local NGOs contracted under the programme are selected according to criteria agreed with IFAD.

18. All contracted parties will report to the PMU on the performance of their respective parts of the programme on a quarterly basis, as agreed in the respective contracts, and provide all relevant information thereon promptly as required.

19. **Taxes.** The Government will ensure that the proceeds of the loan are not used to pay taxes, including (but not limited to) any taxes levied on the importation, procurement or supply of any goods, civil works or services financed by the loan.

20. **Insurance of programme personnel.** The programme will insure key programme personnel against health and accident risks to the extent consistent with sound commercial practice.

21. **Additional cofinancing of the programme.** The Government will use part of the proceeds of the loan for the purpose of financing technical assistance inputs. In the event of other funding becoming available from bilateral or other donors for this purpose, the proceeds of the loan allocated for this purpose will be assigned to the Development Initiatives Fund.

22. **Regional collaborative framework.** The Government, through the PMU, will assist in the development of a regional collaborative framework and allocate an amount of USD 30 000 from the proceeds of the loan towards the cost of the regional collaborative framework.

23. **Disbursement conditions.** (a) No withdrawals will be made in respect of expenditures under the support to income generation component, with respect to any PCB, until: (i) a PCB Subsidiary Loan Agreement shall have been approved by IFAD in draft; a copy of such PCB Subsidiary Loan Agreement, as signed by MOF and the PCB, substantially in the form so approved and certified as true and complete by an authorized and competent officer of MOF, shall have been delivered to IFAD; the signature and performance thereof by MOF and such PCB shall have been duly authorized or ratified by all necessary corporate, administrative and governmental action; and all conditions precedent to the effectiveness thereof shall have been fulfilled; and (ii) the current legislation for the operation of credit unions shall have been duly amended so as to include the operations of credit unions in the mountain areas.

(b) No withdrawals will be made in respect of amounts allocated to the Development Initiatives Fund until IFAD shall have reallocated such amounts to other categories based on an evaluation carried out by IFAD and the Government.

(c) No withdrawals will be made for any fiscal year from the loan account in respect of any expenditures under the programme until the Government shall have confirmed that its counterpart fund contribution, including that to cover taxes and other counterpart contributions, for each fiscal year of the programme has been included in the Government's Budget for the said fiscal year and details of the modalities of the payment of the said counterpart contribution shall have been provided.

24. **Conditions precedent to effectiveness.** The following are the conditions precedent to the effectiveness of the Loan Agreement:

(a) the PCC shall have been duly established in accordance with the relevant procedures of the Government;

(b) the PMU shall have been duly established in accordance with the relevant procedures of the Government;

(c) the Loan Agreement shall have been duly signed, and the signature and performance thereof by the Government shall have been duly authorized and ratified by all necessary administrative and governmental action; and

(d) a favourable legal opinion, issued by the Ministry of Justice or other legal counsel approved by IFAD in form and substance acceptable to IFAD, shall have been delivered by the Government to IFAD.

COUNTRY DATA

AZERBAIJAN

Land area (km^2 thousand) 1997 1/	**87**	**GNP per capita (USD) 1998 2/**	**480**
Total population (million) 1998 1/	**7.9**	**Average annual real rate of growth of GNP per capita, 1990-98 2/**	**-12.5**
Population density (people per km^2) 1998 1/	**91**	**Average annual rate of inflation, 1990-98 2/**	**322.3**
Local currency	**Azerbaijan Manat (AZM)**	**Exchange rate: USD 1 =**	**AZM 4 300**

Social Indicators		**Economic Indicators**	
Population (average annual population growth rate) 1980-98 1/	1.4	GDP (USD million) 1998 1/	3 926
Crude birth rate (per thousand people) 1998 1/	16	Average annual rate of growth of GDP 1/	
Crude death rate (per thousand people) 1998 1/	6	1980-90	n.a.
Infant mortality rate (per thousand live births) 1998 1/	17	1990-98	-11.5
Life expectancy at birth (years) 1998 1/	71		
		Sectoral distribution of GDP, 1998 1/	
Number of rural poor (million) (approximate) 1/	n.a.	% agriculture	20.3
Poor as % of total rural population 1/	n.a.	% industry	38.7
Total labour force (million) 1998 1/	3.5	% manufacturing	22.3
Female labour force as % of total, 1998 1/	44.2	% services	41
Education		Consumption, 1998 1/	
Primary school gross enrolment (% of relevant age group) 1997 1/	*106.4*	General government consumption (as % of GDP)	11
Adult literacy rate (% of total population) 1997 3/	96.3	Private consumption (as % of GDP)	84.2
		Gross domestic savings (as % of GDP)	4.8
Nutrition			
Daily calorie supply per capita, 1996 3/	2 139	**Balance of Payments (USD million)**	
Prevalence of child malnutrition (height for age % of children under 5) 1992-98 1/	22.2	Merchandise exports, 1998 1/	678
Prevalence of child malnutrition (weight for age % of children under 5) 1992-98 1/	10.1	Merchandise imports, 1998 1/	1 724
		Balance of merchandise trade	-1 046
Health			
Health expenditure, total (as % of GDP) 1990-98 1/	7.2	Current account balances (USD million)	
Physicians (per thousand people) 1990-98 1/	3.8	before official transfers, 1998 1/	-1 429
Percentage population without access to safe water 1990-97 3/	n.a.	after official transfers, 1998 1/	-1 364
Percentage population without access to health services 1981-92 3/	n.a.	Foreign direct investment, 1998 1/	1 023
Percentage population without access to sanitation 1990-97 3/	n.a.		
		Government Finance	
Agriculture and Food		Overall budget surplus/deficit (including grants) (as % of GDP) 1997 1/	-2.2
Food imports as percentage of total merchandise imports 1998 1/	n.a.	Total expenditure (% of GDP) 1997 1/	19
Fertilizer consumption (hundreds of grams per ha of arable land) 1995-97 1/	178	Total external debt (USD million) 1998 1/	693
Food production index (1989-91=100) 1996-98 1/	60.6	Present value of debt (as % of GNP) 1998 1/	13.9
		Total debt service (% of exports of goods and services) 1998 1/	2.3
Land Use			
Arable land as % of land area, 1997 1/	19.3	Nominal lending rate of banks, 1998 1/	n.a.
Forest area (km^2 thousand) 1995 1/	9.9	Nominal deposit rate of banks, 1998 1/	n.a.
Forest area as % of total land area, 1995 1/	11.4		
Irrigated land as % of cropland, 1995-97 1/	74.9		

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*, 2000
2/ World Bank, *Atlas*, 2000
3/ UNDP, *Human Development Report*, 1999

COUNTRY DATA

GEORGIA

Land area (km^2 thousand) 1997 1/	**70**	**GNP per capita (USD) 1998 2/**	**970**
Total population (million) 1998 1/	**5.4**	**Average annual real rate of growth of GNP per capita, 1990-98 2/**	**-11.3**
Population density (people per km^2) 1998 1/	**78**	**Average annual rate of inflation, 1990-98 2/**	**709.3**
Local currency	**Georgian Lari (GEL)**	**Exchange rate: USD 1 = GEL 2.0**	

Social Indicators		**Economic Indicators**	
Population (average annual population growth rate) 1980-98 1/	0.4	GDP (USD million) 1998 1/	5 129
Crude birth rate (per thousand people) 1998 1/	9	Average annual rate of growth of GDP 1/	
Crude death rate (per thousand people) 1998 1/	7	1980-90	0.4
Infant mortality rate (per thousand live births) 1998 1/	15	1990-98	-12.8
Life expectancy at birth (years) 1998 1/	73		
		Sectoral distribution of GDP, 1998 1/	
Number of rural poor (million) (approximate) 1/	0.2	% agriculture	26
Poor as % of total rural population 1/	9.9	% industry	15.8
Total labour force (million) 1998 1/	2.7	% manufacturing	15.6
Female labour force as % of total, 1998 1/	46.6	% services	58.2
Education		Consumption, 1998 1/	
Primary school gross enrolment (% of relevant age group) 1997 1/	*88.2*	General government consumption (as % of GDP)	8.9
Adult literacy rate (% of total population) 1997 3/	99	Private consumption (as % of GDP)	97.2
		Gross domestic savings (as % of GDP)	-6.1
Nutrition			
Daily calorie supply per capita, 1996 3/	2 184	**Balance of Payments (USD million)**	
Prevalence of child malnutrition (height for age % of children under 5) 1992-98 1/	n.a.	Merchandise exports, 1998 1/	300
Prevalence of child malnutrition (weight for age % of children under 5) 1992-98 1/	n.a.	Merchandise imports, 1998 1/	1 060
		Balance of merchandise trade	- 760
Health			
Health expenditure, total (as % of GDP) 1990-98 1/	4.7	Current account balances (USD million)	
Physicians (per thousand people) 1990-98 1/	3.8	before official transfers, 1998 1/	- 599
Percentage population without access to safe water 1990-97 3/	n.a.	after official transfers, 1998 1/	- 389
Percentage population without access to health services 1981-92 3/	n.a.	Foreign direct investment, 1998 1/	50
Percentage population without access to sanitation 1990-97 3/	n.a.		
		Government Finance	
Agriculture and Food		Overall budget surplus/deficit (including grants) (as % of GDP) 1997 1/	-2.7
Food imports as percentage of total merchandise imports 1998 1/	n.a.	Total expenditure (% of GDP) 1997 1/	10
Fertilizer consumption (hundreds of grams per ha of arable land) 1995-97 1/	458	Total external debt (USD million) 1998 1/	1 674
Food production index (1989-91=100) 1996-98 1/	85.2	Present value of debt (as % of GNP) 1998 1/	24.6
		Total debt service (% of exports of goods and services) 1998 1/	7.6
Land Use			
Arable land as % of land area, 1997 1/	11.2	Nominal lending rate of banks, 1998 1/	46
Forest area (km^2 thousand) 1995 1/	29.9	Nominal deposit rate of banks, 1998 1/	17
Forest area as % of total land area, 1995 1/	42.9		
Irrigated land as % of cropland, 1995-97 1/	43.3		

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*, 2000
2/ World Bank, *Atlas*, 2000
3/ UNDP, *Human Development Report*, 1999

PREVIOUS IFAD LOANS

AZERBAIJAN

Project Id	Project Name	Lending Terms	Project Type	Financing Type	IFAD Approved Financing (USD '000)	IFAD Current Financing (USD '000)	Board Approval	Loan Signing	Loan Effectiveness	Original Closing	Current Closing	Cooperating Institution	Project Status
1033	Farm Privatization	HC	CREDIT	C	9300	9300	29 Apr 97	04 May 97	24 Jul 97	30 Jun 02	30 Jun 02	World Bank IDA	Ongoing

GEORGIA

Project Id	Project Name	Lending Terms	Project Type	Financing Type	IFAD Approved Financing (USD '000)	IFAD Current Financing (USD '000)	Board Approval	Loan Signing	Loan Effectiveness	Original Closing	Current Closing	Cooperating Institution	Project Status
1035	Agricultural Development	HC	CREDIT	C	6570	6570	30 Apr 97	15 May 97	13 Aug 97	31 Dec 02	31 Dec 02	World Bank IDA	Ongoing

LOGICAL FRAMEWORK – AZERBAIJAN/GEORGIA[a/]

Narrative Summary	Key Performance Indicators	Means of Verification	Critical Assumptions
Programme Goals To improve living conditions of mountain area communities in a sustainable manner by increasing incomes in a way that contributes to protecting and restoring the environment	• Programme area household income and expenditure patterns • Increases in output levels of agricultural products • Development of institutional capacity capable of supporting longer-term development	• Baseline and impact evaluation surveys • Annual ongoing evaluation of panel of participants • Programme completion report	• Political stability is maintained • Macroeconomic conditions continue to improve • Government committed to mountain areas development • Social and economic environments remain conducive for mountain area development and investments
Programme Purposes • To strengthen the beneficiaries' capacity to organize themselves for participating in the market economy and managing the natural resource base in a sustainable manner	• No. of credit associations (CAs)[b/] formed • No. of farmer group/community organizations formed for undertaking productive and environmental and rural infrastructure improvement	• NGO implementation reports • PMU/MADA management information system (MIS)	• Members of the target population are willing and able to take advantage of opportunities made available under the programme • Target group acknowledges the objectives of the programme and takes ownership
• To restore economic livelihoods through improved management of the resource base and improved access to financial, technical and commercial services	• Livestock numbers, condition and sales • Area of pasture and hay land under improved treatment • Crop area under optimum cultural practices, yields and sales • Adoption of improved processing technology for dairy products and improved marketing arrangements • Establishment of processing and marketing enterprises for other products	• PMU/MADA MIS • Programme performance reviews	• Effective credit management and credit discipline can be achieved • Marketing opportunities for livestock products and crop production become sufficiently developed and mountain area communities are able to successfully access markets • Communities are able to exercise independent action and initiative and develop new power structures to make participatory planning meaningful
• To protect and rehabilitate the environment by developing appropriate community-based institutional mechanisms	• Willingness to adopt soil conservation measures and forest regeneration	• Programme performance reviews	• Farmers are able to appreciate the negative impacts of environmental degradation and are willing to take necessary remedial action • Communities are able to establish community institutions to organize environmental rehabilitation works • Conducive legal framework exists to facilitate programme activities
• Strengthen public capacity to identify and respond to the needs of the mountain areas by putting in place appropriate institutional mechanisms	• Establishment of MADA • Communities' views on appropriateness of programme activities, responsiveness of MADA to expressed needs and implementation performance	• PMU/MADA MIS • Programme performance reviews	• PMU/MADA staff and staff of other implementing partners internalize the change process • PMU/MADA is able to exercise strong, autonomous management

a/ Logical Framework for Georgia analogous, with main differences indicated under programme activities/input section (for which follows the Logical Framework of Azerbaijan).
b/ Credit Associations for Azerbaijan and CUs for Georgia.

Narrative Summary	Key Performance Indicators	Means of Verification	Critical Assumptions
Outputs 1. Rural communities, both men and women, with the capability of planning, implementing and managing their own development activities	• Level of participation of community members in participatory planning process and quality of village plans • Stability, cohesiveness and managerial competence of farmer group/community organizations established for productive and social enterprises • No. of proposals submitted to PMU/MADA by communities for assistance for productive enterprises and for environmental and rural infrastructure improvement	• Programme performance reviews • PMU/MADA ongoing evaluation • PMU/MADA MIS	• Communities perceive clear distinctions between community participation under the programme and past collective organization and planning • Local authorities and elites do not dominate community-participation processes • NGO implementors have sufficient autonomy in their management of resources on behalf of PMU/MADA
2. Sustainable rural credit services available to community members through institutions demonstrating sound financial management	• Amount of loans disbursed • Repayment rates • Level of capitalization and savings • Profitability of CAs and National Federation of Credit Associations • No. and amount of loans disbursed to small and medium-scale enterprises and repayment rate	• NGO implementation reports initially and subsequently from the National Federation • PMU/MADA MIS	• Legal framework is put in place in the long-term, which will permit the operation of CAs in the proposed form • Necessary legal basis can be achieved in the short-term through presidential decrees
3. Livestock herds are rebuilt and productivity of animals is increased	• No. of households purchasing livestock and increase in livestock ownership per household • No. of trials/demonstrations in fodder/pasture improvement and no. of farmers adopting improved technology • Improvements in animal performance – improved milk and meat yields • No. of AI services provided	• PMU/MADA MIS • Comparisons of baseline and implementation performance surveys • Annual follow-up of panel of programme participants	• Technical support with adequate technical capacity and orientation to the market economy will be forthcoming to assist farmers in improving income-earning opportunities
4. Profitability of arable crop production is enhanced	• No. of trials/demonstrations of improved crop production technology • Area under improved crop technology and yield improvement achieved • No. of farmers adopting improved crop husbandry practices, e.g. crop rotation, crop diversification by end of Phase I. • Amount of improved seed produced under seed multiplication programme • Reduction in contract charges from restructuring of semi-mechanized farming system • Area of crop land benefiting from irrigation rehabilitation/construction and number of farmers benefiting	• PMU/MADA MIS • Comparisons of baseline and implementation performance surveys • Annual follow-up of panel of programme participants	• Technical support with adequate technical capacity and orientation to the market economy will be forthcoming to assist farmers in improving income-earning opportunities.

Narrative Summary	Key Performance Indicators	Means of Verification	Critical Assumptions
5. An effective farmer-to-farmer extension system is established.	• No. of farmers participating as extension contact farmers and nos. of farmers reached	• PMU/MADA MIS • Programme performance reviews	
6. An effective participatory research mechanism is established	• No. of farmers participating in trials and demonstrations • No. of proposals for research received from farmers	• PMU/MADA MIS • Programme performance reviews	
7. Community-based institutional mechanisms are established and communities are equipped to undertake environmental and rural infrastructure improvement works	• No. of farmer/community groups engaged in irrigation rehabilitation and soil conservation works and the areas covered • No. of community groups engaged in community forestry rehabilitation and adequacy of arrangements agreed with Department of Forest Management for access to benefits • Ability of communities to mobilize own contributions to the works • Satisfactory maintenance by communities of works undertaken • No. of communities establishing procedures for formulating microprojects for further financing from MADA • No. of key community members knowledgeable of essential procurement and accounting procedures	• NGO implementation reports • Programme performance reviews • Site/field inspections • Audit of accounts	• NGO implementers have sufficient autonomy in their management of resources on behalf of PMU/MADA for implementation of the micro-projects using local government technical staff where appropriate • NGO implementers adhere to programme themes and technical guidelines and adequately coordinate with PMU/MADA and each other • Suitable, transparent and enforceable benefit-sharing arrangements for forest regeneration can be worked out with the Department of Forest Management • Communities are willing and able to contribute to maintenance • Government fulfils matching expenditures where required
8. Competent, independent, institutional capacity established to attract and direct resources for the long-term development of the mountain areas	• Establishment of MADA and the scale and scope of its operations • Operations manual produced • Formulation of detailed work programmes • Policy and strategies initiatives taken • Satisfactory formulation of additional IFAD-financed intervention by Year 4 • Expansion of other donor support	• Programme performance reviews	• Personnel are hired and retained on the basis of technical qualifications, constructive attitudes and performance • Transparency of operations is achieved

Narrative Summary	Key Performance Indicators	Means of Verification	Critical Assumptions
Project Activities/Inputs 1. Participatory development a) Contracting NGOs to provide community facilitators b) Study tours for community members	▪ USD 1.2 million	• MIS • Disbursement statements • External audit	• Commitment to the programme's objectives and its implementation by the programme's implementing agencies • Counterpart funds are made available on a timely basis
2. Development of financial services a) Contract international NGO to build community credit institutions and to establish independent member-owned microfinance institution b) Training of community institutions c) Credit line for credit associations d) Credit line for small and medium-scale enterprises	• USD 3.9 million (USD 2.7 million as credit line)		▪ Suitable NGOs are available
3. Support for livestock production a) Participatory trials programme for improved pasture and fodder b) Pilot veterinary services programme c) Pilot AI programme d) Farmer-to-farmer extension	• USD 0.6 million		• Suitable TSPs are available
4. Support for crop production a) Seed production b) Small-scale irrigation c) Participatory trials programme for improved crop technology d) Improved tillage and seeding equipment	• USD 1.4 million		• Suitable TSPs are available
5. Support for marketing and processing	• USD 0.1 million		• Suitable TSPs are available • Adequate marketing opportunities for livestock products and crop production develop and mountain area communities are able to access them
6. Pilot community environmental improvement activities a) Pilot community forestry b) Pilot soil conservation	• USD 0.2 million		
7. Programme management a) PMU/establishment of the MADA b) Development initiatives fund	• USD 2.0 million (including USD 1.7 million for development initiatives fund)		

Narrative Summary	Key Performance Indicators	Means of Verification	Critical Assumptions
Project Activities/Inputs		• MIS • Disbursement statements • External audit	• Commitment to the programme's objectives and its implementation by the programme's implementing agencies • Counterpart funds are made available on a timely basis
1. Participatory development a) contracting NGOs to provide community facilitators b) study tours for community members	• USD 0.8 million		• Suitable NGOs are available
2. Development of financial services a) Contract CUDC to build community-owned credit unions b) Training of community institutions c) Establishment of independent microfinance institutions d) Credit line for credit unions c) Credit line for small and medium-scale enterprises	• USD 2.1 million (USD 0.8 million as credit line)		
3. Support for livestock production a) Participatory trials programme for pasture and fodder improvement b) Pilot veterinary services programme c) Pilot AI programme d) Farmer-to-farmer extension	• USD 0.7 million		• Suitable TSPs are available
4. Support for crop production a) Seed production b) Small-scale irrigation c) Participatory trials programme for improved crop technology d) Improved tillage and seeding equipment	• USD 1.4 million		• Suitable TSPs are available
5. Support for marketing and processing	• USD 0.1 million		• Suitable TSPs are available • Adequate marketing opportunities for livestock products and crop production develop and mountain area communities are able to access them
6. Social infrastructure rehabilitation	• USD 0.9 million		
7. Pilot community environmental improvement activities a) Pilot community forestry b) Pilot soil conservation	• USD 0.2 million		
8. Programme management a) PMU/establishment of the MADA b) Development initiatives fund	• USD 2.3 million (including USD 1.0 million Development initiatives fund)		

QUANTITATIVE INPUTS, TARGETS AND KEY PROGRAMME FACTORS

AZERBAIJAN

OBJECTIVES

The overall goal of the joint programme between Azerbaijan and Georgia is to assist populations in mountainous and highland areas in improving their quality of life in a sustainable manner by increasing incomes while protecting the natural resource base and the environment. To help achieve this goal, the programme's specific objectives will be to: (a) strengthen the beneficiaries' capacity to position themselves better for participating in the market economy and managing the natural resource base on which their livelihoods depends; (b) restore economic livelihoods through improved management of the resource base and greater access to financial, technical and commercial services; (c) protect and rehabilitate the environment through developing appropriate community-based institutional mechanisms; and (d) strengthen public capacity to respond to the needs of the mountain areas by putting in place appropriate institutional mechanisms.

INSTRUMENTS

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

- introduce community participatory planning exercise to develop village action plans, thus ensuring programme ownership by beneficiaries
- introduce and support income-generation activities through provision of medium and short-term credit for livestock, crop production and marketing and processing of produce
- support the creation of village Cas and their federation
- introduce pilot projects in feed improvement, pasture monitoring, seed production, small-scale irrigation and marketing support
- rehabilitation of basic social infrastructure through the community infrastructure fund.

Incremental Benefits

Incremental benefits at full development:

Mixed farming (cattle production):	
• Income increase (%)	160
• Return to labour/day (USD)	25
• Benefit/cost ratio	1.8
Mixed farming (milk production):	
• Income increase (%)	260
• Return to labour/day (USD)	60
• Benefit/cost ratio	4.3
Transhumance livestock grazing (cattle):	
• Income increase (%)	50
• Return to labour/day (USD)	60
• Benefit/cost ratio	2.5
Transhumance livestock grazing (sheep):	
• Income increase (%)	850
• Return to labour/day (USD)	44
• Benefit/cost ratio	6.8

PROJECT COSTS

	COMPONENTS	USD million	% Base Costs
A.	Participatory development	1.18	13
B.	Support to income-generation	6.05	64
C.	Pilot community environmental improvement activities	0.20	2
D.	Programme management	1.97	21
Total including contingencies		**9.99**	**106**

FINANCING

	USD million	%
IFAD	9.00	90.0
Government	0.40	3.7
Beneficiaries	0.48	4.3
Cofinancier	0.11	1.0
Total	**9.99**	**100.0**

BENEFICIARIES

Project activities of Phase I will be targeted to benefit the members of at least 8 200 households belonging to 340 settlements.

ECONOMIC/FINANCIAL ANALYSIS

EIRR (%)	
• Project as a whole	24
• Irrigation rehabilitation	15
• Community forestry	19
NPV@12% (USD million)	
• Project as a whole	7.4
IFAD Financing per beneficiary (USD)	
• Project as a whole	203

QUANTITATIVE INPUTS, TARGETS AND KEY PROGRAMME FACTORS

GEORGIA

OBJECTIVES	MAIN INSTRUMENTS/ACTIVITIES	Incremental Benefits
The overall goal of the joint programme between Azerbaijan and Georgia is to assist populations in mountainous and highland areas in improving their quality of life in a sustainable manner by increasing incomes while protecting the natural resource base and the environment. To help achieve this goal, the programme's specific objectives will be to: (a) strengthen the beneficiaries' capacity to position themselves better for participating in the market economy and managing the natural resource base on which their livelihoods depends; (b) restore economic livelihoods through improved management of the resource base and greater access to financial, technical and commercial services; (c) protect and rehabilitate the environment through developing appropriate community-based institutional mechanisms; and (d) strengthen public capacity to respond to the needs of the mountain areas by putting in place appropriate institutional mechanisms.	The main instruments to be utilized in the implementation of the listed components are as follows: • introduce community participatory planning exercise to develop village action plans and thus ensuring programme ownership by beneficiaries • introduce and support income-generation activities through provision of medium and short-term credit for livestock , crop production and marketing and processing of produce • support the creation of CUs and their federation • introduce pilot projects in feed improvement, pasture monitoring, seed production, small-scale irrigation and marketing support • rehabilitation of basic social infrastructure through social development fund.	Incremental benefits at full development: Mixed farming (cattle production): • Income increase (%) 350 • Return to labour/day (USD) 32 • Benefit/cost ratio 1.5 Mixed farming (draught power, cattle production): • Income increase (%) 250 • Return to labour/day (USD) 25 • Benefit/cost ratio 1.1 Transhumance livestock grazing (cattle): • Income increase (%) 280 • Return to labour/day (USD) 30 • Benefit/cost ratio 4.4 Transhumance livestock grazing (sheep): • Income increase (%) 200 • Return to labour/day (USD) 13 • Benefit/cost ratio 2.3

PROJECT COSTS

COMPONENTS	USD million	% Base Costs
A. Participatory development	0.78	9
B. Support to income-generation	4.35	51
C. Social infrastructure rehabilitation	0.93	11
D. Pilot community environmental improvement activities	0.21	2
E. Programme management	2.27	27
Total including contingencies	**9.23**	**108**

FINANCING

	USD million	%
IFAD	8.00	86.6
Government	0.65	7.1
Beneficiaries	0.50	5.4
Cofinancier	0.07	0.8
Total	**9.23**	**100.0**

BENEFICIARIES

Project activities of Phase I will be targeted to benefit the members of at least 10 600 households belonging to 436 settlements.

ECONOMIC/FINANCIAL ANALYSIS

EIRR (%)
- Project as a whole 20
- Irrigation rehabilitation 14
- Community Forestry 26

NPV@12% (USD million)
- Project as a whole 5.0

IFAD Financing per beneficiary (USD)
- Project as a whole 184

SUMMARY COST AND FINANCING TABLES

Table 1: Components Project Cost Summary – Azerbaijan

Components	(AZM Million)					(USD '000)				
	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
A. Participatory development[a/]	3 951.4	1 200.3	5 151.7	23	13	907.7	275.7	1 183.5	23	13
B. Support to income-generation										
1. Development of financial services	15 731.3	1 148.8	16 880.1	7	41	3 651.5	263.9	3 915.4	7	42
2. Support for livestock production	1 287.7	1 175.6	2 463.3	48	6	295.8	270.1	565.9	48	6
3. Support for crop production	3 294.0	3 005.8	6 299.8	48	15	756.7	690.5	1 447.2	48	15
4. Support for marketing and processing	486.2	60.8	547.0	11	1	111.7	14.0	125.7	11	1
Subtotal support to income-generation	**20 799.2**	**5 391.0**	**26 190.2**	**21**	**64**	**4 815.7**	**1 238.4**	**6 054.2**	**20**	**64**
C. Pilot community environmental improvement activities	748.7	138.2	886.9	16	2	172.0	31.7	203.7	16	2
D. Programme management										
1. PMU	3 828.5	1 755.4	5 583.9	31	14	879.5	403.3	1 282.7	31	14
2. Development initiatives fund	1 483.5	1 483.5	2 967.0	50	7	345.0	345.0	690.0	50	7
Subtotal programme management	**5 312.0**	**3 238.9**	**8 550.9**	**38**	**21**	**1 224.5**	**748.3**	**1 972.7**	**38**	**21**
Subtotal baseline costs	**30 811.3**	**9 968.4**	**40 779.7**	**24**	**100**	**7 119.9**	**2 294.2**	**9 414.1**	**24**	**100**
Physical contingencies	517.4	242.8	760.2	32	2	118.9	55.8	174.6	32	2
Price contingencies	2 697.3	1 002.4	3 699.8	27	9	296.8	111.7	408.5	27	4
Total project costs	**34 026.1**	**11 213.6**	**45 239.7**	**25**	**111**	**7 535.6**	**2 461.6**	**9 997.2**	**25**	**106**

a/ Includes community infrastructure fund.

Table 2: Expenditures Accounts Project Cost Summary – Azerbaijan

	(AZM Million)					(USD '000)				
	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
I. Investment Costs										
A. Civil works										
Survey, design & supervision	562.0	420.9	982.9	43	2	129.1	96.7	225.8	43	2
Construction materials	766.9	511.3	1 278.2	40	3	176.2	117.5	293.6	40	3
Contributed labour	1 292.5	-	1 292.5	-	3	296.9	-	296.9	-	3
Paid labour	134.4	-	134.4	-	-	30.9	-	30.9	-	-
Subtotal civil works	**2 755.8**	**932.2**	**3 688.0**	**25**	**9**	**633.1**	**214.1**	**847.2**	**25**	**9**
B. Vehicles, equipment & materials										
Vehicles	22.0	418.7	440.8	95	1	5.1	96.2	101.3	95	1
Equipment & goods	340.7	1 302.4	1 643.1	79	4	78.3	299.2	377.4	79	4
Materials	557.3	557.3	1 114.6	50	3	128.0	128.0	256.1	50	3
Subtotal vehicles, equipment & materials	**920.1**	**2 278.4**	**3 198.4**	**71**	**8**	**211.4**	**523.4**	**734.8**	**71**	**8**
C. Technical assistance (TA), contractual services and studies										
International TA	311.8	2 806.5	3 118.3	90	8	71.6	644.7	716.3	90	8
National TA	163.1	-	163.1	-	-	37.5	-	37.5	-	-
Contractual services	3 936.7	1 687.2	5 623.9	30	14	904.3	387.6	1 291.9	30	14
Studies	390.1	337.2	727.2	46	2	89.6	77.5	167.1	46	2
Subtotal TA, contractual services and studies	**4 801.7**	**4 830.8**	**9 632.5**	**50**	**24**	**1 103.1**	**1 109.7**	**2 212.8**	**50**	**24**
D. Training										
Farmer training	1 423.0	7.9	1 430.9	1	4	326.9	1.8	328.7	1	3
Staff training	517.6	59.2	576.7	10	1	118.9	13.6	132.5	10	1
Subtotal training	**1 940.6**	**67.1**	**2 007.7**	**3**	**5**	**445.8**	**15.4**	**461.2**	**3**	**5**
E. Credit lines										
CA and MWMA credit line	10 358.5	-	10 358.5	-	25	2 409.0	-	2 409.0	-	26
SME credit line	1 075.0	-	1 075.0	-	3	250.0	-	250.0	-	3
Subtotal credit lines	**11 433.5**	**-**	**11 433.5**	**-**	**28**	**2 659.0**	**-**	**2 659.0**	**-**	**28**
F. Equity grant	1 642.6	-	1 642.6	-	4	382.0	-	382.0	-	4
G. Risk fund	215.0	-	215.0	-	1	50.0	-	50.0	-	1
H. Development initiatives fund	1 483.5	1 483.5	2 967.0	50	7	345.0	345.0	690.0	50	7
Total investment costs	**25 192.7**	**9 592.0**	**34 784.7**	**28**	**85**	**5 829.2**	**2 207.7**	**8 036.9**	**27**	**85**
II. Recurrent Costs										
A. Salaries and allowances (contracted staff)										
Salaries	3 304.7	-	3 304.7	-	8	759.2	-	759.2	-	8
Allowances	531.3	-	531.3	-	1	122.0	-	122.0	-	1
Subtotal salaries and allowances (contracted staff)	**3 836.0**	**-**	**3 836.0**	**-**	**9**	**881.2**	**-**	**881.2**	**-**	**9**
B. Infrastructure maintenance	470.1	-	470.1	-	1	108.0	-	108.0	-	1
C. Operation and Maintenance (O&M)										
Vehicles O&M	462.8	198.3	661.1	30	2	106.3	45.6	151.9	30	2
Equipment O&M	114.6	114.6	229.2	50	1	26.3	26.3	52.7	50	1
Subtotal O&M	**577.4**	**312.9**	**890.3**	**35**	**2**	**132.6**	**71.9**	**204.5**	**35**	**2**
D. Office running costs	735.2	63.5	798.6	8	2	168.9	14.6	183.5	8	2
Total recurrent costs	**5 618.6**	**376.4**	**5 995.0**	**6**	**15**	**1 290.7**	**86.5**	**1 377.2**	**6**	**15**
Total baseline costs	**30 811.3**	**9 968.4**	**40 779.7**	**24**	**100**	**7 119.9**	**2 294.2**	**9 414.1**	**24**	**100**
Physical contingencies	517.4	242.8	760.2	32	2	118.9	55.8	174.6	32	2
Price contingencies	2 697.3	1 002.4	3 699.8	27	9	296.8	111.7	408.5	27	4
Total project costs	**34 026.1**	**11 213.6**	**45 239.7**	**25**	**111**	**7 535.6**	**2 461.6**	**9 997.2**	**25**	**106**

Table 1: Components Project Cost Summary – Georgia

Components	(GEL ’000)					(USD ’000)				
	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
A. Participatory development	1 190.1	428.6	1 618.7	26	9	573.8	206.6	780.5	26	9
B. Support to income-generation										
1. Development of financial services	3 659.0	587.1	4 246.1	14	24	1 807.6	283.1	2 090.7	14	24
2. Support for livestock production	788.5	650.8	1 439.3	45	8	380.1	313.8	693.9	45	8
3. Support for crop production	1 654.5	1 282.1	2 936.6	44	17	797.7	618.1	1 415.8	44	17
4. Support for marketing and processing	283.6	22.5	306.1	7	2	136.7	10.8	147.6	7	2
Subtotal support to income-generation	**6 385.5**	**2 542.5**	**8 928.0**	**28**	**51**	**3 122.2**	**1 225.9**	**4 348.0**	**28**	**51**
C. Social infrastructure rehabilitation	1 390.9	527.5	1 918.4	27	11	677.0	255.8	932.8	27	11
D. Pilot community environmental improvement activities	367.6	70.5	438.1	16	2	177.2	34.0	211.2	16	2
E. Programme management										
1. PMU	1 908.5	720.2	2 628.7	27	15	920.2	347.2	1 267.4	27	15
2. Development initiatives fund	1 000.0	1 000.0	2 000.0	50	11	500.0	500.0	1 000.0	50	12
Subtotal programme management	**2 908.5**	**1 720.2**	**4 628.7**	**37**	**26**	**1 420.2**	**847.2**	**2 267.4**	**37**	**27**
Total baseline costs	**12 242.6**	**5 289.3**	**17 532.0**	**30**	**100**	**5 970.4**	**2 569.6**	**8 539.9**	**30**	**100**
Physical contingencies	265.2	155.7	421.0	37	2	127.9	75.1	203.0	37	2
Price contingencies	3 329.3	1 252.3	4 581.6	27	26	354.0	136.3	490.3	28	6
Total project costs	**15 837.1**	**6 697.4**	**22 534.6**	**30**	**129**	**6 452.3**	**2 780.9**	**9 233.2**	**30**	**108**

Table 2: Expenditures Accounts Project Cost Summary – Georgia

	(GEL ’000)					(USD ’000)				
	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs	Local	Foreign	Total	% Foreign Exchange	% Total Base Costs
I. Investment costs										
A. Civil works										
Survey, design & supervision	349.1	209.6	558.7	38	3	169.0	101.1	270.1	37	3
Construction materials	878.5	585.7	1 464.2	40	8	425.7	283.8	709.5	40	8
Contributed labour	664.6	-	664.6	-	4	324.0	-	324.0	-	4
Paid labour	64.1	-	64.1	-	-	30.9	-	30.9	-	-
Subtotal civil works	**1 956.3**	**795.3**	**2 751.6**	**29**	**16**	**949.6**	**384.9**	**1 334.5**	**29**	**16**
B. Vehicles, equipment & materials										
Vehicles	12.6	239.4	252.0	95	1	6.1	115.4	121.5	95	1
Equipment & goods	150.9	576.0	726.9	79	4	72.8	277.7	350.5	79	4
Materials	265.1	265.1	530.2	50	3	127.8	127.8	255.6	50	3
Subtotal vehicles, equipment & materials	**428.6**	**1 080.5**	**1 509.1**	**72**	**9**	**206.7**	**520.9**	**727.6**	**72**	**9**
C. TA, contractual services and studies										
International TA	104.0	935.6	1 039.5	90	6	50.1	451.1	501.2	90	6
National TA	169.1	-	169.1	-	1	81.5	-	81.5	-	1
Contractual services	2 347.1	1 005.9	3 353.0	30	19	1 131.6	485.0	1 616.6	30	19
Studies	144.1	124.7	268.8	46	2	69.5	60.1	129.6	46	2
Subtotal TA, contractual services and studies	**2 764.2**	**2 066.2**	**4 830.4**	**43**	**28**	**1 332.7**	**996.2**	**2 328.9**	**43**	**27**
D. Training										
Farmer training	646.0	3.8	649.8	1	4	311.5	1.8	313.3	1	4
Staff training	336.9	28.2	365.1	8	2	162.4	13.6	176.0	8	2
Subtotal training	**982.9**	**32.0**	**1 014.9**	**3**	**6**	**473.9**	**15.4**	**489.3**	**3**	**6**
E. Credit lines										
CU and MWMA credit line	1 150.0	-	1 150.0	-	7	575.0	-	575.0	-	7
SME credit line	500.0	-	500.0	-	3	250.0	-	250.0	-	3
Subtotal credit lines	**1 650.0**	**-**	**1 650.0**	**-**	**9**	**825.0**	**-**	**825.0**	**-**	**10**
F. Equity grant	683.0	-	683.0	-	4	341.5	-	341.5	-	4
G. Risk fund	100.0	-	100.0	-	1	50.0	-	50.0	-	1
H. Development initiatives fund	1 000.0	1 000.0	2 000.0	50	11	500.0	500.0	1 000.0	50	12
Total investment costs	**9 565.0**	**4 973.9**	**14 538.9**	**34**	**83**	**4 679.4**	**2 417.5**	**7 096.8**	**34**	**83**
II. Recurrent costs										
A. Salaries and allowances (contracted staff)										
Salaries	1 640.1	-	1 640.1	-	9	790.8	-	790.8	-	9
Allowances	253.1	-	253.1	-	1	122.0	-	122.0	-	1
Subtotal salaries and allowances (contracted staff)	**1 893.2**	**-**	**1 893.2**	**-**	**11**	**912.8**	**-**	**912.8**	**-**	**11**
B. Infrastructure maintenance	224.0	-	224.0	-	1	108.0	-	108.0	-	1
C. O&M										
Vehicles O&M	101.7	237.3	338.9	70	2	49.0	114.4	163.4	70	2
Equipment O&M	48.0	48.0	95.9	50	1	23.1	23.1	46.3	50	1
Subtotal O&M	**149.6**	**285.2**	**434.9**	**66**	**2**	**72.2**	**137.5**	**209.7**	**66**	**2**
D. Office running costs	410.8	30.2	441.0	7	3	198.0	14.6	212.6	7	2
Total recurrent costs	**2 677.6**	**315.5**	**2 993.1**	**11**	**17**	**1 291.0**	**152.1**	**1 443.1**	**11**	**17**
Total BASELINE COSTS	**12 242.6**	**5 289.3**	**17 532.0**	**30**	**100**	**5 970.4**	**2 569.6**	**8 539.9**	**30**	**100**
Physical contingencies	265.2	155.7	421.0	37	2	127.9	75.1	203.0	37	2
Price contingencies	3 329.3	1 252.3	4 581.6	27	26	354.0	136.3	490.3	28	6
Total PROJECT COSTS	**15 837.1**	**6 697.4**	**22 534.6**	**30**	**129**	**6 452.3**	**2 780.9**	**9 233.2**	**30**	**108**

ORGANIZATION AND MANAGEMENT

A. Programme Organization and Executing Agencies

1. In view of the specific characteristics and needs of the mountain areas, both Governments of Azerbaijan and Georgia believe that there is a need for a special institutional framework for the development of the mountainous areas. Thus, at the appropriate time, both intend to establish an independent, quasi-governmental MADA under which the activities of the present programme will eventually fall. MADA will be a specialized agency, providing a clear focus on the mountain areas and combining the roles of strategy development and lobbying, ensuring a favourable enabling environment for development in the mountain areas and mobilization of financial resources for their development. The objectives and roles of MADA have already been elaborated and will be finalized in due time. MADA will be a juridical entity, operating under its charter approved by the Parliament, with an independent board of management with at least equal representation from the governmental and the non-governmental sector.

2. The appropriate time for the establishment of MADA will occur once concrete experience has been gained of the appropriate interventions for mountain area communities and the major elements of a model for development of the mountain areas have been both proven and ready for replication on a much wider scale. This will also be the appropriate time to mobilize additional funding for the adoption of the programme activities in other mountain districts in order to speed up the overall development of the mountain areas. It is envisaged that this objective will be attained by PY4 of programme implementation and MADA will be established in PY5.

3. Thus, the overall responsibility of the programme implementation will initially be with the Cabinet of Ministers in Azerbaijan and with the MAF in Georgia. However, programme implementation in the field will be contracted out to implementing partners and TSPs.

B. Management and Coordination

4. The interim management arrangements have been developed to facilitate the easy transition to the permanent MADA structure. The programme will be managed at the outset by an independent PMU to be set up in each country.

5. In Azerbaijan, PMU will report directly to the First Deputy Prime Minister for the Agrarian Reform Programme. Programme activities will be guided by a Sub-Group for Mountain Area Development of the State Commission for Assistance to Private Farmers. In addition, a programme advisory group (PAG) will be established so the programme can also draw on expertise related to mountain area development from outside of government.

6. In Georgia, PMU will report directly to MAF, and the programme activities will be guided by a PSC with equal representation from governmental and non-governmental members.

7. In both countries, it is envisaged that after PY4 (or at such time mutually agreed upon between IFAD and the respective governments of Azerbaijan and Georgia), the transformation to the MADA will take place as shown in Charts 1A and B.

8. The sub-group for Mountain Area Development in Azerbaijan will be chaired by the First Deputy Prime Minister for Agrarian Reform and will be composed of representatives from the Cabinet of Ministers, Ministry of Finance, Government of Nakchivan, National Bank of Azerbaijan, Forestry Department, Irrigation Committee and Soil and Water Conservation Department and regional/district administrators of programme districts (on rotation).

9. The PSC in Georgia will be chaired by the Minister of Agriculture and Food and will be composed of representatives from the Parliamentary Mountain Areas Committee, Ministry of Finance, the Government of Adjara Autonomous Republic, National Bank of Georgia, Department of Forest Management, regional/district administrators of programme districts (on rotation), farmers' organizations, research institutes, participating NGOs, the Georgian Chapter of the proposed Caucasus Mountain Network and women's organizations.

10. The programme director will be *ex-officio* secretary to PSC in the case of Georgia and *ex-officio* of the subgroup for Mountain Area Development in Azerbaijan. In both cases PMU will serve as the secretariat, and executive responsibility for the programme will initially be vested in PMU, headed by a full time programme director (PD). Depending on satisfactory performance, it is envisaged that PD will become the executive director (ED) of MADA, while the PMU staff will constitute the management team of MADA. The PMU will be staffed by two farming systems specialists, an economist/M&E officer, finance manager/procurement officer and accountant, plus support staff. The respective organizational structures of both PMUs are shown in Chart 2A and B. All staff in the PMU/management team will be nationals, recruited through open competition from the public or private sector, and engaged on one-year renewable contracts.

11. The main responsibilities of PD and his team will be twofold: (a) to promote the overall development of the mountainous areas and to formulate appropriate development strategies for this purpose; and (b) to provide the necessary guidance for programme implementation and to monitor the progress and performance of the development initiatives launched under the programme. The terms of reference of the programme management staff have been drafted and will be finalized during the pre-implementation phase, which will be prepared on SOF grant.

C. Implementation Arrangements and Responsibilities

12. Responsibility for implementation of programme activities within the designated districts will be contracted out to a range of private and public-sector service providers, e.g. NGOs, research institutes, farmers' organizations, private consultancy companies and individuals, district technical departments and other appropriate agencies. Alternatively, one umbrella international NGO may be found to take responsibility for implementation of all programme activities while entering into sub-contracts agreements with other NGOs or private/public-sector institutions to cover geographic or sectoral areas in which it lacks expertise. A key role of the PMU/MADA will be to contract and supervise service providers; to approve all programme expenditure; and to monitor programme performance, including the performance of service providers.

13. Service providers will be contracted to provide the following range of services. While these are described as separate activities, they can be combined depending on the interest and expertise of the potential service providers.

(a) promoting community participation in planning and implementation of programme activities and strengthening of farmer/community groups;

(b) establishing a community-based financial services system;

(c) providing technical guidance and support to communities for agricultural production, including supervising crop/pasture trials and demonstrations, irrigation rehabilitation, village veterinary services and AI services and marketing, and processing initiatives;

(d) providing support to communities for pilot environmental improvement activities in the form of community forest management and demonstration models of land improvement measures; and

(e) organizing social infrastructure rehabilitation through the community infrastructure fund.

Development of Financial Services

14. **Microfinance.** The rural financial services subcomponent in Georgia will be implemented initially by a special Microfinance Window for Mountain Areas (MWMA) within CUDC. In Azerbaijan the rural financial services subcomponent will be implemented initially by a special MWMA, established with the assistance of a specialist microfinance international NGO as an independent structure to promote the establishment of Cas. During this time an administrative bank on payment of commission in both countries will manage the line of credit.

15. Requests for loans from CUs/CAs for on-lending to their members will be screened by a credit committee, which will authorize loan disbursement to the CU/CA by the administrative bank. The CU/CA credit committees will be responsible for sanctioning short-term loans to their members and recommend members for medium-term loans. Initially this will be managed by MWMA. After around PY5, MWMA will be transformed into the National Federation of Credit Unions/Associations (NFCU/NFCA), which will take over management of the credit line; the CUs/CAs will also become responsible for disbursing medium-term loans. At this time, subsidiary loan agreements will be signed between the respective Ministries of Finance of both countries and the National Federation of Credit Unions/Associations, defining the interest rate and repayment schedule for the loan. The repayment period for short-term loans to CU members will be in line with the cash flow of the activity financed.

16. **Small and Medium Enterprises**. One or more commercial bank(s) will manage the credit line for small and medium enterprises under the terms of a subsidiary loan agreement with the Ministry of Finance (MOF); the terms and conditions of which still have to be determined. The maturity of the credit line should allow the commercial bank to recycle the proceeds several times. Repayments will be capitalized in a revolving fund. Loans will be subject to a ceiling of USD 25 000. Both the Microfinance Bank of Georgia and the Agribusiness Bank of Georgia have expressed interest in managing this credit line, depending on the terms and conditions. Similarly, the Rabita Bank and the Agri-Business Bank of Azerbaijan, both in Azerbaijan, have expressed interest in managing this credit line, depending on the terms and conditions.

17. This line of credit will be limited to: (a) individual or group small-scale enterprises that directly support the activities of target group households, e.g. processing enterprises that provide an outlet for the produce of target group households; and (b) small-scale enterprises that create additional employment and those in which workers from poor households are employed. Responsibility for the final decision on projects to be financed will be solely vested with commercial banks, which is assuming all the risk. Interest rate and collateral requirements will be determined by the bank's own policies. It is anticipated that the interest rate applied will be between 12 and 16% above inflation, but will depend on the cost of funds negotiated with MOF.

18. **Community Mobilization and Participatory Development.** NGOs will be contracted to provide these services. ACDI/VOCA, ADRA, CARE, Relief International and World Vision have all expressed interest in participating in the programme; CARE and World Vision are hopeful of being able to offer some cost-sharing arrangement. Given the lack of local NGOs experienced in community development in the rural areas, it will be advisable to benefit from the greater experience of international NGOs, at least in launching the programme.

19. **Technical Support Services.** Separate technical service providers will be contracted through open competitive tender from organizations with the best skills and experience or the umbrella NGO will directly contract these services. Two options can be considered for contracting these services: (a) contracting TSPs on a case-by-case basis in response to the requirements of individual communities as they arise; or (b) contracting one service provider for each activity area on the basis of an indefinite quantities contract, for one year initially (renewable). Work will be assigned to this provider as it arises from community action plans. Contracts for TSPs will give them responsibility

for procurement of all materials and additional expertise required to fulfil the tasks, within the cost norms for programme activities agreed with PMU/MADA and cited in the contract. Activities will be implemented on the basis of a six-monthly work plan and budget agreed with PMU/MADA. The TSP will be provided with an advance payment and will be required to submit expenditure statements in order to receive the next tranche of funding; they will be monitored by the PMU/MADA staff.

20. **Pilot Environmental Activities.** It is envisaged that the NGOs contracted for community development will also manage the pilot environmental activities. The NGO will be responsible for providing all the necessary support services (design, supervision of implementation, monitoring, etc.) and procurement of all materials required. Contractual arrangements will be as for TSPs.

21. **Social Infrastructure Rehabilitation.** The NGOs involved with community development will also assist communities in implementing small infrastructure rehabilitation projects on a participatory basis.

D. Participation Arrangements

22. The programme will be implemented through a flexible participatory process approach, which will be revised, adjusted and improved based on lessons learned from the ongoing implementation experience.

23. Community participation processes will underpin the prioritization and selection of programme activities. NGOs will bring residents of disadvantaged communities together to explain the opportunities and potentials and to assist them, individually or as communities, in identifying and implementing their development priorities. The NGOs will assist communities to form appropriate user groups for the implementation of activities, including water user associations for irrigation, herder groups for pasture management, crop production groups for mechanized farming, marketing groups, community forest management committees for forest rehabilitation, etc.

E. Monitoring and Evaluation

24. The PMU/MADA will be responsible for programme monitoring in accordance with the provisions established in the loan agreement. The monitoring programme will be focused on the rate of implementation against planned objectives as laid out in AWP/B. A set of key input and output indicators will be developed for the various programme activities. The PD and economist/M&E officer will be closely involved in the preparation of AWP/B. Thereafter, both officers will carry out systematic and regular financial monitoring against it. The service providers will provide regular monitoring reports on the progress of their activities and the economist/M&E officer will compile quarterly and annual reports analyzing programme performance and highlighting issues as a tool for improving programme management.

25. **Participatory M&E.** The programme will establish procedures that provide for periodic feedback from its clientele on the efficacy of programme activities. This feedback will be incorporated into the annual review process, which in turn will lead to adjustment and revisions of the implementation process. At least once per year, farmers of both sexes from a selection of programme villages will meet with representatives of PMU/MADA, NGOs and major TSPs to review the progress and performance of each component. They will focus on: (a) difficulties encountered; (b) degree of responsiveness of implementing agency staff; (c) usefulness of technical messages; (d) progress made in achieving objectives; and (e) outstanding problems not being adequately addressed by the programme activities. The outcome of these reviews will be incorporated into the agenda of the annual review and planning workshops held to initiate the planning process for the next year's AWP/B.

26. **Impact Evaluation.** The PMU will contract a qualified agency to undertake a base line survey to establish the base line situation of households prior to involvement in the programme. Based on the

survey, PMU will firm up the impact indicators to be used and carry out a regular programme of impact monitoring. Diagnostic studies will be conducted on specific issues as required. A full impact evaluation survey will be conducted by an independent agency in PY7.

F. Dynamic Planning and Implementation Process

27. In view of the rapidly changing environment in transitional economies, it is essential that programme activities are able to adapt to changes in opportunities in order to remain relevant. To this end, the programme will introduce a dynamic planning process to ensure that programme activities are responsive to needs and alert to implementation performance. The key elements in the planning framework will be the logical framework and AWP/B. The annual cycle of the planning process will comprise four sequential stages: planning, monitoring, feedback and reality check, and fine-tuning of the programme design. This will be reflected in planning for the subsequent year.

(a) **Planning**. The AWP/B drawn up by PMU will operationalize the logical framework by defining the activities, targets, outputs and inputs for the current year in line with the objectives outlined in the logical framework. The activities will be demand-driven being, derived from the village action plans (VAPs) developed through the participatory planning process with communities. The AWP/B will necessarily be revised periodically during the year as new communities produce their VAPs or existing communities define new needs to be addressed or identify new opportunities to be exploited. An implementation plan for the year will be drawn up that indicates the timing of the activities contained in AWP/B. This will highlight critical paths in the achievement of time-bound activities, such as crop and pasture trials and demonstrations and access to credit for crop-related investments.

(b) **Monitoring.** In a changing world, the monitoring system needs to be impact-oriented in order to capture, on an ongoing basis, the efficacy and continuing relevance of programme activities. The principal tools for monitoring the programme will be the MIS system and its associated reporting system, participatory monitoring by communities, ongoing evaluation by PMU and regular supervision by CI. The monitoring process will begin with the identification of appropriate impact-focused indicators as the basis of the MIS system. Selection of these indicators will be guided by the M&E specialist and discussed at the start-up workshop. Both progress reports from PMU and supervision missions from CI will occur on a six-monthly basis to provide a regular overview of progress. Participatory monitoring will involve communities in assessing their own progress against their plans and targets and assess the reasons for any deficiencies. The focus of ongoing evaluation by the PMU staff will be on implementation performance to highlight any corrections required in delivery performance of programme implementers.

(c) **Feedback and Reality Check.** This will comprise a series of workshops at the community, district, inter-district and inter-country levels that involve all stakeholders. They will offer a crucial opportunity for assessing progress and outcomes and comparing achievements against the logical framework and the critical performance value set for the main activities in AWP/B. They will also function as fora for evaluating the adequacy of the overall programme design to continue to meet the needs of communities in a constantly changing environment; for assessing implementation performance; and for disseminating knowledge of best practices and enabling them to be integrated into programme design. Failure to reach the critical performance values will indicate the need to fine-tune programme design and revise the logical framework. Achievement of the benchmarks will corroborate the validity of the overall programme design.

(d) **Fine-tuning of programme design.** The information gained from the previous stages will form the basis of the next round of planning in order to fine-tune programme design. If necessary this will be reflected in modifications in the logical framework to bring it into line with changing circumstances and implementation experience. It will also ensure that the activities and outputs incorporated in AWP/B for the subsequent year reflect the realities of needs and delivery capability.

28. The details of this dynamic planning process will be elaborated during the pre-implementation phase with the assistance of the project expediter and later the TA programme planning adviser and M&E specialist. The planning process relies at all stages on inputs from the various stakeholders; hence the approach will be elaborated at the start-up workshop to ensure that everyone is aware of the process. The start-up workshop will also identify the data to be collected, finalize the impact indicators to be used and define the roles and responsibilities of all stakeholders in the process.

CHART 1A: AZERBAIJAN - PROGRAMME ORGANIZATIONAL STRUCTURE

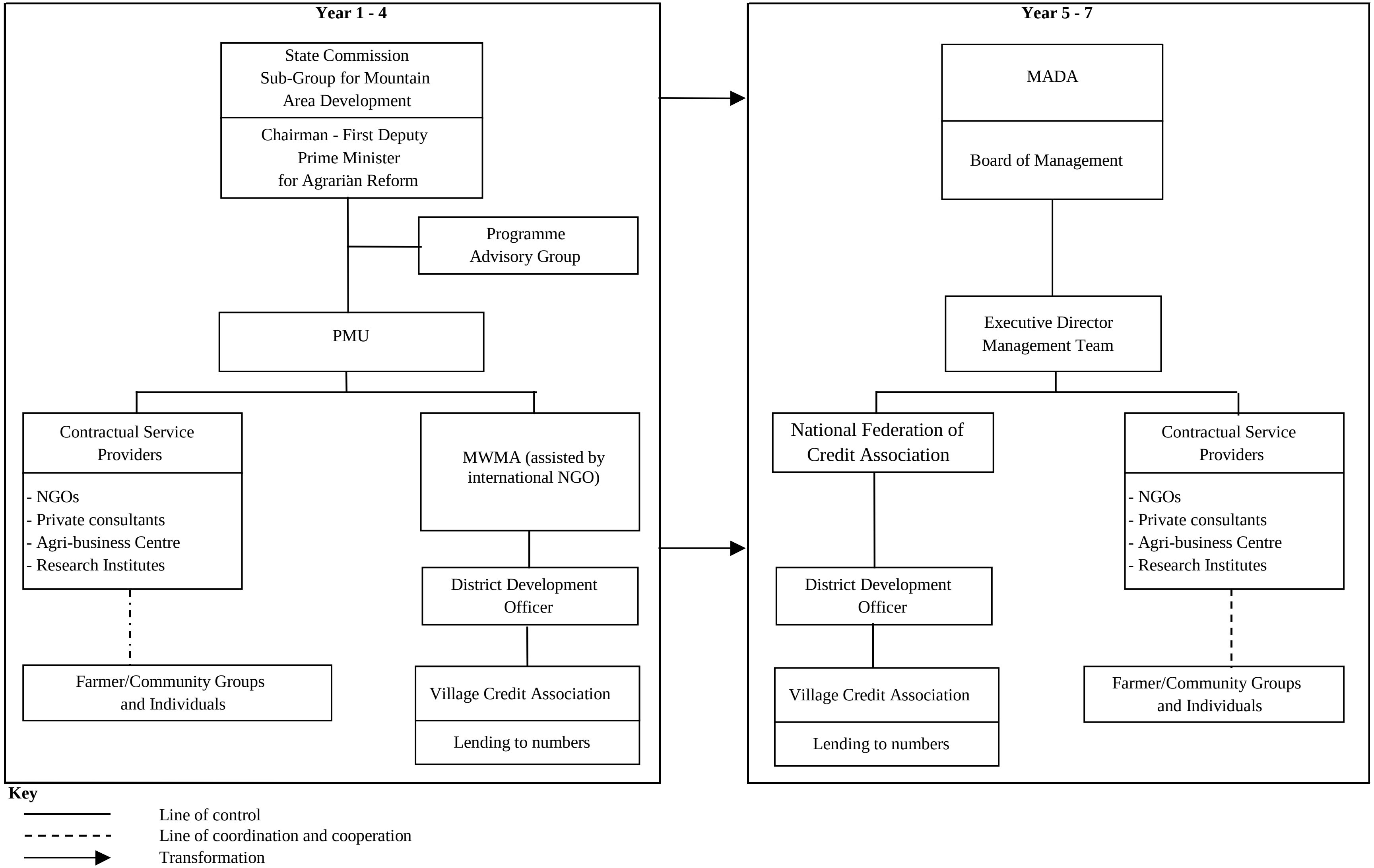
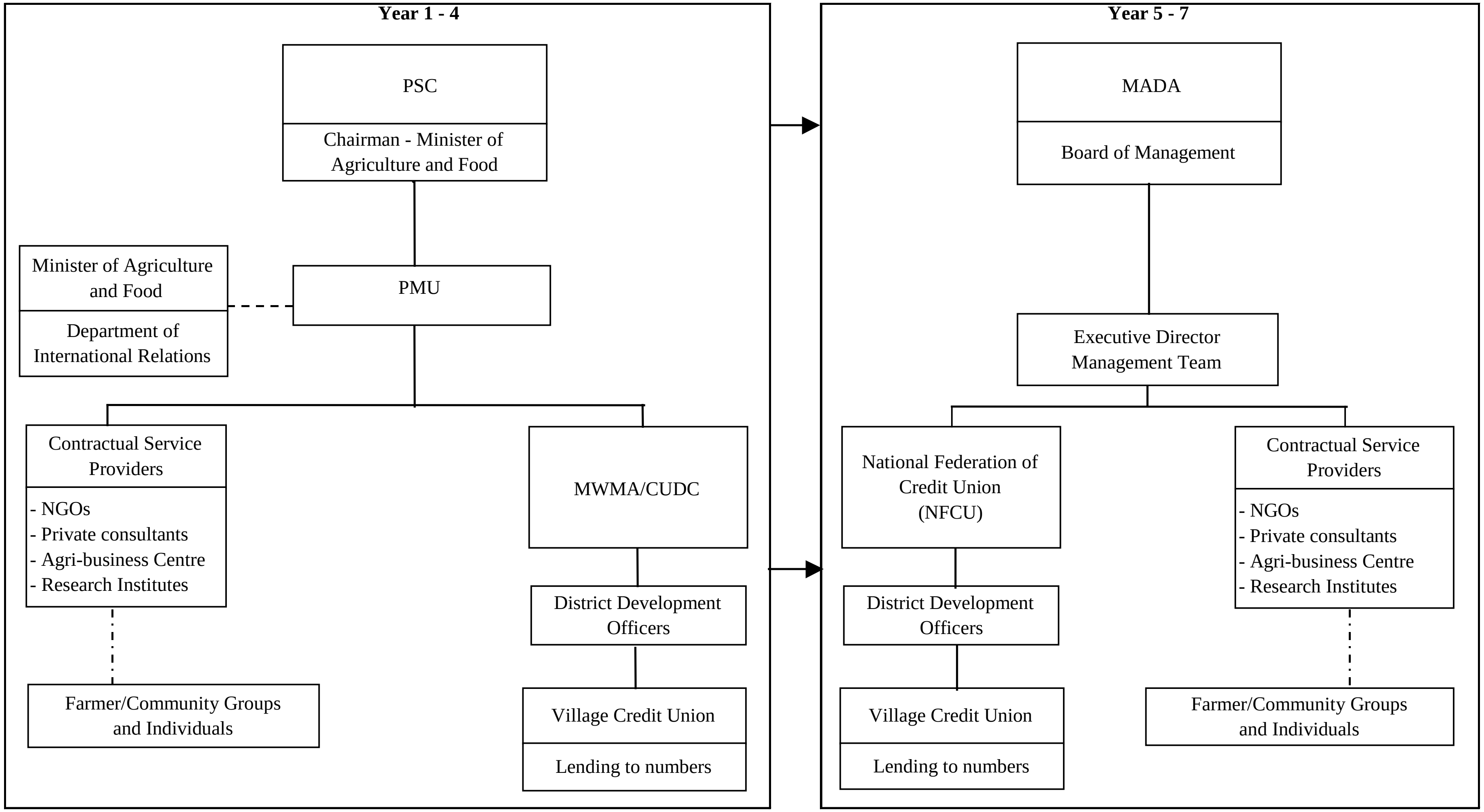


CHART 1B: GEORGIA - PROGRAMME ORGANIZATIONAL STRUCTURE



Key

Line of control
Line of coordination and cooperation
Transformation

CHART 2A: AZERBAIJAN - PROGRAMME MANAGEMENT UNIT ORGANIZATIONAL STRUCTURE

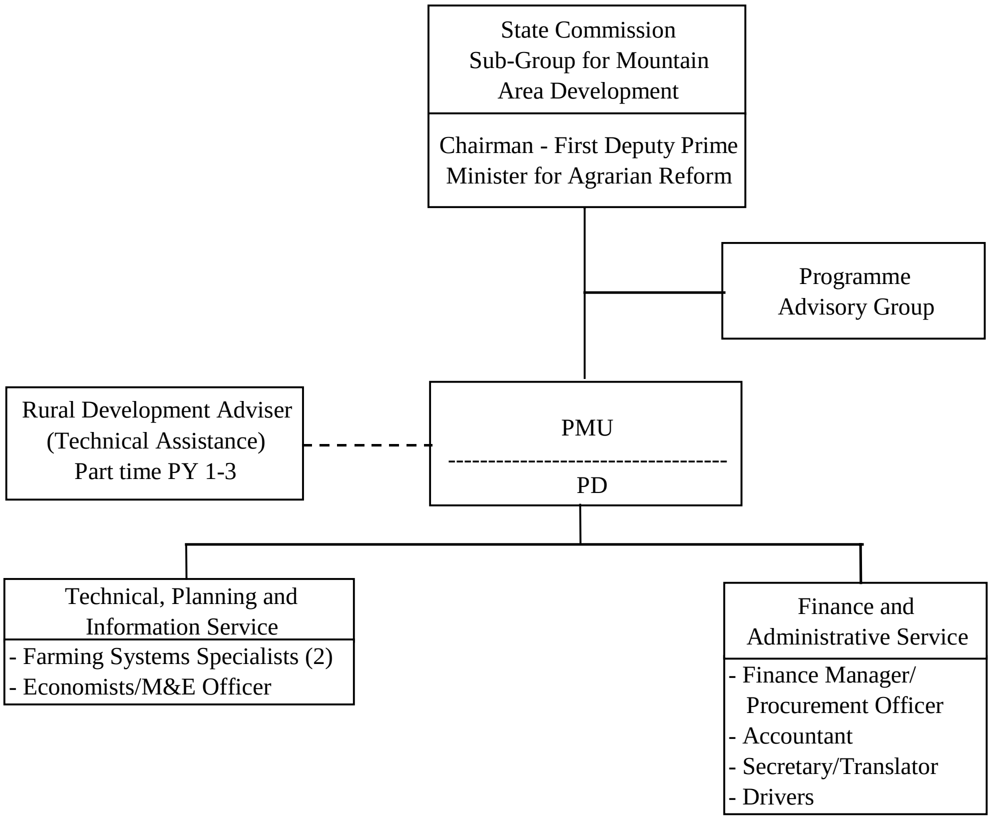
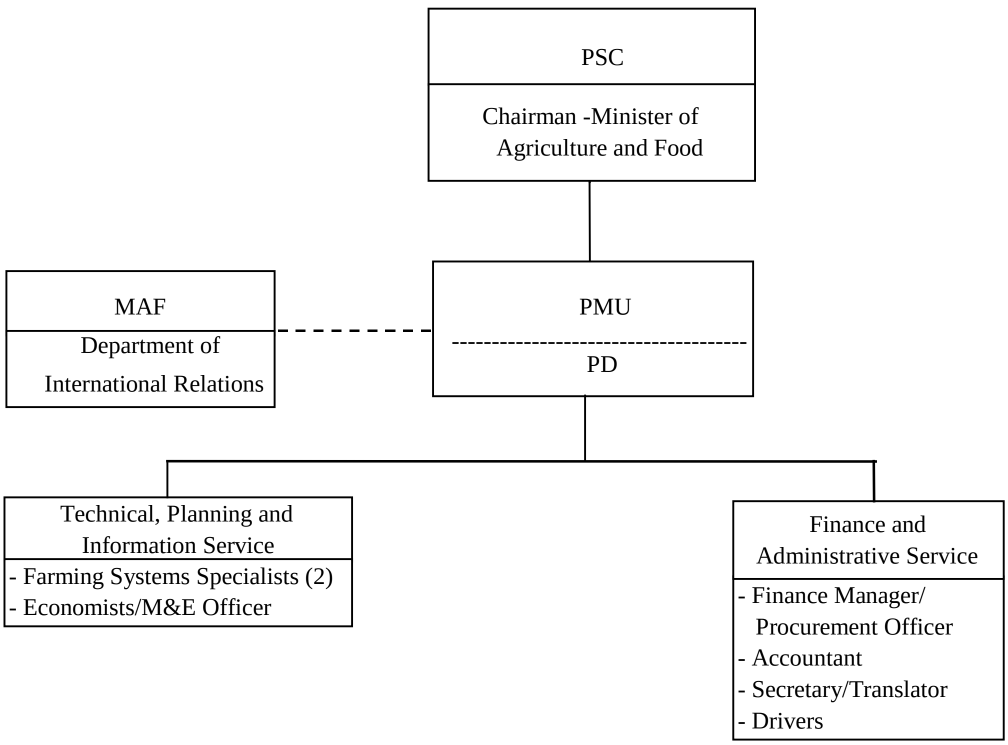


CHART 2B: GEORGIA - PROGRAMME MANAGEMENT UNIT ORGANIZATIONAL STRUCTURE



ECONOMIC AND FINANCIAL ANALYSIS

A. Financial Analysis

Crop Production Models

1. The defining characteristics of the various crop models and their financial returns are summarized in Table 1 below. Yield increases are quite large because current yields, due to a lack of inputs and appropriate technology, are very low. The majority of fields have received little inorganic fertilizer for 10 years or more. The projected yields using a well-developed cropping package generally do not exceed those achieved during the Former Soviet Union (FSU) times. The results of the financial analysis for the various livestock enterprises are also summarized in Table 1.

Table 1: Production Models: Yield Assumptions (t/ha) and Financial Returns

	Yields (t/ha)		Financial Returns		
Azerbaijan Crop Models (000'AZM/ha)	W/out	With	W/out	With	Incr. Return to Labour
Wheat – SMF/irrigated	2	4	1 031	2519	100
Barley – SMF/irrigated	2	3.5	874	1787	53
Maize – SMF/irrigated	2	5	1 272	3015	41
Alfalfa – SMF/irrigated	3.5	6.5	203	837	47
Wheat – SMF/rainfed (higher rainfall)	1.4	2.6	622	1498	64
Wheat – SMF/rainfed (lower rainfall)	0.7	1.5	86	670	53
Barley – SMF/rainfed (lower rainfall)	0.7	1.5	37	520	56
Potato – rainfed	7	18	1 654	3 565	16
Azerbaijan Livestock Models (000'AZM/ha)					
Winter stall feeding cattle (SMF)			1 328	1 762	176
Winter stall feeding cattle – milk production			1 346	4 145	319
Transhumance livestock grazing – cattle			705	2 119	303
Transhumance livestock grazing – sheep			1 164	12 667	198
Lamb fattening – local breed a/				26	5
Lamb fattening – Gzlgoyun breed				138	5
Beekeeping b/				385	385
Georgia Crop Models (GEL)					
Wheat – SMF/rainfed (Dusheti–1000 m)	1.2	3.1	195	884	29
Wheat – SMF/rainfed (Aspindza–1480 m)	1	2.6	49	627	209
Maize – SMF/rainfed (Dusheti–1000 m)	1.2	3	275	757	15
Barley – SMF/rainfed (Aspindza–1480 m)	0.9	2.1	30	432	47
Maize – DAP/rainfed (Shuakhevi)	1.2	3	280	729	14
Potato – DAP/irrigated (Shuakhevi)	10	23	1 977	4 033	13
Georgia Livestock Models (GEL)					
Winter stall feeding cattle (SMF)			474	2 484	69
Winter stall feeding cattle (DAP)			581	2 933	67
Transhumance livestock grazing – cattle			523	3 602	100
Transhumance livestock grazing – sheep			271	1 938	30
Pig breeding				1 931	80
Beekeeping				134	134

2. In Azerbaijan, the projected increases in net income are substantial for all the crops analysed, ranging from 300% for alfalfa to around 1700% for irrigated maize. The projected increases in net income in Georgia are also substantial for all the crops analysed. They range from 100% for potatoes to around 1100% for rainfed wheat. Increases in net incomes are high as machinery charges, which are common to both the with and without-programme scenarios, represent a significant share of the costs and are assumed to decline in the with project scenario, as the programme promotes more efficient agricultural machinery. Returns to labour are well above the minimum prevailing wage rate

of GEL 5 per day in Georgia and AZM 11 000 per day in Azerbaijan. Livestock models also clearly demonstrate that the opportunity to rebuild herds will make a substantial contribution to total household incomes, although it will take time: project incomes quoted above will not be achieved until year 10.

B. Impact on Household Incomes

3. In order to demonstrate the potential impact of the programme on individual farm households, six representative farm models in Azerbaijan and five in Georgia have been constructed based on the different farming systems in the programme districts and the different major agro-ecological zones. The models are based on an average household size of 5.4 persons in Azerbaijan and 4.1 persons in Georgia. These models include incremental income derived from agricultural and livestock-raising activities only and do not take account of other sources of income, e.g. remittances. In addition, income from household plot production has not been included as most of this production is consumed. The rise in farm incomes generally results from the adoption of improved technologies and increases in livestock herd sizes. A summary of the financial results is displayed in Tables 2 and 3 below.

Table 2: Azerbaijan - Impact on Household Incomes and Food Security

	SMF, Gabala, Milk Production System		SMF,Gadabey, Cattle Production System		SMF, Lerik, Cattle Production System		SMF, Shahbuz, Milk Production System		Transhumance Livestock Grazing System (Cattle)		Transhumance Livestock Grazing System (Sheep)	
	WOP	WP [a/]	WOP	WP [a/]	WOP	WP [a/]	WOP	WP [a/]	WOP	WP [a/]	WOP	WP [a/]
Farm family benefits ('000 AZM)	2 349	8 555	2192	5 394	2 156	5 720	1 567	4 537	1 028	1 563	1 363	1 3012
Return to family labour ('000 AZM)	119	259	43	79	92	107	151	164	187	259	119	196
Household food security (%) [b/]												
Wheat	200	475	13	38	213	325	100	440				
Maize												
Potato			1 050	2 700	350	1 800						
Milk products	74	494	74	189	74	189	74	494	74	222	56	826
Meat	53	225	53	107	53	107	53	225	53	150	39	407

[a/] At full development.

[b/] Self-sufficiency based on 146 kg of cereals, 67 kg of potatoes, 16.4 kg of cheese and 26 kg of meat per person per year for an average household size of 5.4 persons.

4. As Tables 2 and 3 reveal, in all the cases analysed, the potential impact of the programme in terms of increase in household incomes is substantial. In the without programme situation most households remain at subsistence level, with a small surplus of crops and dairy products representing the household's only means of raising cash for necessary expenditures. With the programme, households will generate significant surpluses of crops and livestock products, enabling them to generate cash for investment in the farm, household needs, and family needs such as health, education and social activities. However, these investments still do not restore former income levels under the collective system in which a household with two workers typically earned USD 500 per month, excluding any additional income from private livestock.

Table 3: Georgia - Impact on Household Incomes and Food Security

	SMF, Wheat/Maize, Cattle Production System		SMF, Wheat/Barley, Cattle Production System		Draught Animal Power Farming System		Transhumance Livestock Grazing System (Cattle)		Transhumance Livestock Grazing System (Sheep)	
	WOP	**WP [a]**	**WOP**	**WP [a]**	**WOP**	**WP [a]**	**WOP**	**WP [a]**	**WOP**	**WP [a]**
Farm family benefits (‘000 GEL)	835	3 735	562	3 260	1 126	3 950	1 083	4 162	831	2 498
Return to family labour (GEL)	32	64	70	78	27	50	27	61	20	26
Household food security (%) [b]										
Wheat	150	387	125	325						
Maize					70	175				
Potato					545	1 255				
Milk products	100	1 970	100	1 970	200	2 364	100	1 478	51	367
Meat	61	336	61	336	116	355	61	626	48	451

[a] At full development.

[b] Self-sufficiency based on 146 kg of cereals, 67 kg of potatoes, 16.4 kg of cheese and 26 kg of meat per person per year for an average household size of 4.1 persons.

C. Economic Analysis

5. For both countries, the analysis has assumed a 20-year period for programme benefits and included costs of all programme components. In order to model incomplete adoption of the technology packages by all farmers, it is assumed that half of the farms will achieve the full development output levels and the remaining farms will achieve 50% of the recommended technology. In both cases, the economic internal rates of return have been found to be substantial as described below, due to the very low levels of production in the without programme situation and high incremental production benefits accruing from renewed access to fertilizers and quality seeds. In addition, the availability of feed, particularly pastures, for livestock production means that herd expansion can be accommodated at low cost through retention of breeders.

6. The economic internal rate of return of the Azerbaijan portion of the programme is estimated at 24% and the sensitivity analysis indicates robustness in the economic intend rate of return (EIRR). A fall of 20% in total benefits together with a 20% increase in costs reduces EIRR to 11%. A one-year delay in benefits reduces EIRR to 21%. A two-year delay in benefits reduces it to 19%. The switching value for programme benefits is about 31%, while for programme costs it is 38%.

7. The economic analysis of the Georgia portion of the programme was based on two scenarios. In Scenario I, zero benefits are assumed from the development initiatives fund and benefits from credit are based on the incremental credit line of USD 0.58 million provided under the programme. In Scenario II, it is assumed that all resources in the development initiatives fund are utilized for credit. The EIRR for Scenario I is estimated at 20% and for Scenario II at 33%. A fall of 20% in total benefits together with a 20% increase in costs reduces EIRR to 9% for Scenario I and to 19% for Scenario II. A one-year delay in benefits reduces it to 17% for Scenario I and to 30% for Scenario II. A two-year delay in benefits reduces EIRR to 15% and 26% for Scenarios I and II, respectively. The switching value for programme benefits is about 24% for Scenario I and 40% for Scenario II, while for programme costs it is 29% for Scenario I and 47% for Scenario II.