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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED FINANCIAL ASSISTANCE TO

THE KINGDOM OF NEPAL

FOR

THE WESTERN UPLANDS POVERTY ALLEVIATION PROJECT



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CURRENCY EQUIVALENTS

Currency Unit	=	Nepalese Rupee (NPR)
USD 1.00	=	NPR 74.0
NPR 1.00	=	USD 0.013514

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

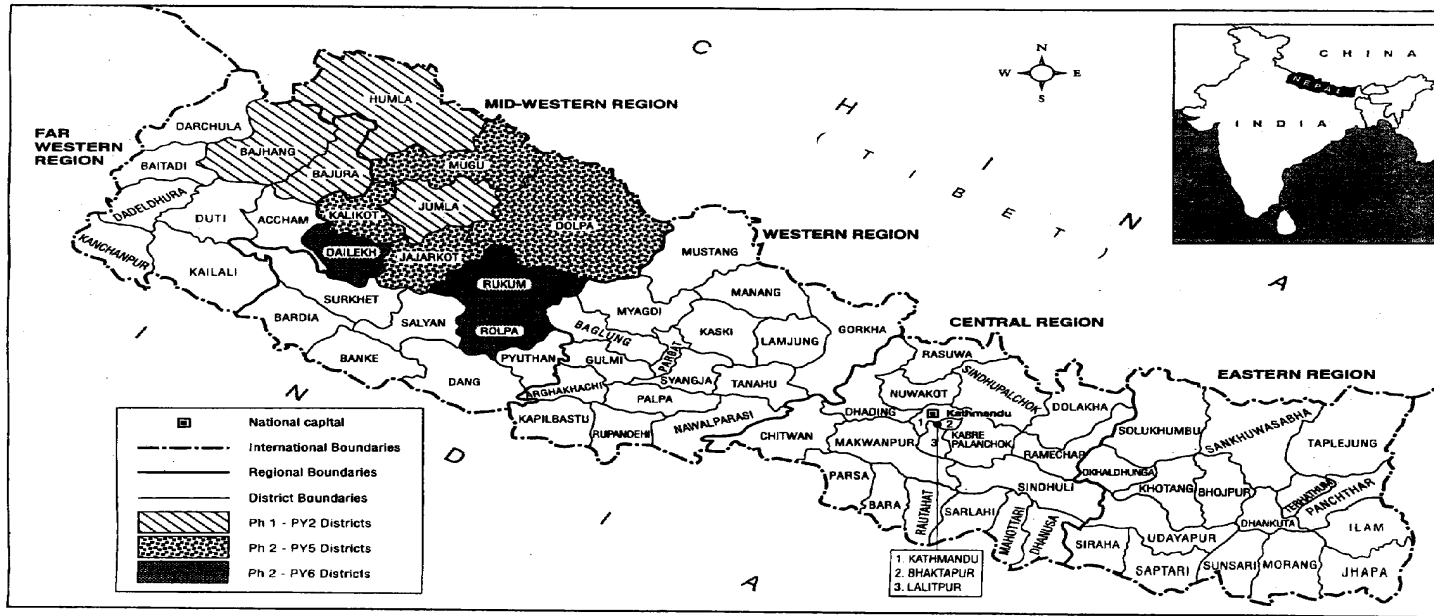
APP	Agriculture Perspective Plan
COs	Community Organizations
DADO	District Agricultural Development Office
DDC	District Development Committee
DFO	District Forest Office
DLSO	District Livestock Service Office
DOA	Department of Agriculture
DOLS	Department of Livestock Services
DPSU	District Project Support Unit
FLM	Flexible Lending Mechanism
GDP	Gross Domestic Product
LDF	Local Development Fund
LFUG	Leasehold Forest User Group
LGP	Local Governance Project
LGSP	Local Governance Strengthening Programme
M&E	Monitoring and Evaluation
MOLD	Ministry of Local Development
MOF	Ministry of Finance
MOFSC	Ministry of Forestry and Soil Conservation
NGO	Non-Governmental Organization
NPC	National Planning Commission
NTFP	Non-timber Forest Product
PCU	Project Coordination Unit
PDDP	Participatory District Development Project
RCIW	Rural Community Infrastructure Works
TA	Technical Assistance
VDC	Village Development Committee
WFP	World Food Programme

GOVERNMENT OF THE KINGDOM OF NEPAL

Fiscal Year

16 July - 15 July

MAP OF THE PROJECT AREA



Source: IFAD

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



KINGDOM OF NEPAL
WESTERN UPLANDS POVERTY ALLEVIATION PROJECT
FINANCING SUMMARY

INITIATING INSTITUTION:	IFAD
BORROWER:	Kingdom of Nepal
EXECUTING AGENCY:	Ministry of Local Development
TOTAL PROJECT COST:	USD 32.6 million
AMOUNT OF IFAD LOAN:	SDR 15.6 million (equivalent to approximately USD 20.0 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
AMOUNT OF IFAD GRANT:	SDR 290 000 million (equivalent to approximately USD 360 000)
COFINANCIERS:	World Food Programme: USD 4.0 million Private Sector: USD 36 000
CONTRIBUTION OF BORROWER:	USD 5.9 million
CONTRIBUTION OF LOCAL GOVERNMENT:	USD 2.2 million
CONTRIBUTION OF BENEFICIARIES:	USD 78 000
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	United Nations Office for Project Services (UNOPS)



PROJECT BRIEF

Who are the project beneficiaries? Project-area districts account for approximately 226 000 households, for a total of some 1.2 million people, most of whom are food-insecure because they are unable to grow sufficient food on their small and marginal holdings to feed the family for the entire year. By the end of the project period, it is expected that some 115 000 households (man and woman-headed) will have benefited from the project. The priority target group consists of the most disadvantaged members of the community (women, *dalits* (disadvantaged castes), youth, landless or semi-landless households and other minority groups). However, in view of the overall poverty prevailing in the project area, an inclusive approach to targeting will be adopted.

Why are they poor? The high incidence of poverty in the western Uplands of Nepal is attributed to a number of factors. Firstly, in terms of vulnerability, the poor live in an area characterized by extremely harsh terrain and climate. The remoteness of, and poor communications with, the districts, and the associated lack of services further exacerbate poor people's vulnerability. Secondly, in considering the institutional, legal, and policy framework that shapes the livelihoods of the poor, formal government presence is limited due to the remoteness of the project-area districts. Non-governmental organizations (NGOs) are present in the area but have very limited outreach, and donors are virtually absent. Thirdly, the target group has limited access to benefits accruing from the resource base (in particular, forestry and pasture resources). These people struggle to survive by cultivating food crops on holdings averaging less than 0.5 ha. The poor have limited access to savings and credit facilities, as NGOs have only reached a small number of rural households in the project-area districts. As far as physical capital is concerned, the most obvious indicator of underdevelopment is the lack of physical infrastructure and the associated poor links with markets.

How to benefit the target group? In addressing these livelihood constraints, the project will seek to mitigate the target group's vulnerability; improve access to essential services and resources; promote diverse livelihood components (livestock, forestry and crops); and support empowerment through mainstreaming gender and human rights activities. The target group will be reached through the following design approach: (i) in focusing on the promotion of high-value products with market potential, the project will provide access to savings and credit services at the village level, and support microenterprise development; (ii) with a view to enhancing access to and control of natural resources for the poorest (women, *dalits* and the landless), the project will support the transfer of forest and pasture management rights to beneficiaries; (iii) to provide access to markets, the project will join up with other donor programmes in building access roads and liaising with the private sector to assist in marketing; (iv) to increase the employment opportunities of the hard-core poor, and in particular women, the project will support labour-intensive community infrastructure development on a demand-driven basis; and (v) in seeking to address social justice issues, the project will promote rights-awareness activities, policy advocacy and training. Finally, to reduce women's vulnerability, project activities will be aimed at increasing their access to knowledge and technology, and control of productive resources, and at enhancing their leadership and management skills.

How will they participate in the project? Participatory development will be ensured as follows. Building on the success of the United Nations Development Programme-financed Participatory District Development Programme in Nepal, the project will support the creation of community organizations (COs) and build them up as financial intermediaries to service the poor. This will include the training of CO managers and presidents to administer savings and loan operations, and village-level specialists to provide technical support to the beneficiaries. The beneficiaries are expected to participate in CO savings and credit groups; leasehold forest-user groups; forest rehabilitation and management; demonstration programmes; training by village extension workers in crops, livestock and forestry; construction of rural infrastructure works and maintenance groups; and in the self-monitoring and impact assessment process.



**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD
TO THE EXECUTIVE BOARD ON A PROPOSED FINANCIAL ASSISTANCE TO
THE KINGDOM OF NEPAL
FOR
THE WESTERN UPLANDS POVERTY ALLEVIATION PROJECT**

I submit the following Report and Recommendation on a proposed financial assistance, comprising a loan for SDR 15.6 million (equivalent to approximately USD 20.0 million) on highly concessional terms and a grant of SDR 290 000 (equivalent to approximately USD 360 000) to help finance the Western Uplands Poverty Alleviation Project. The loan will have a term of 40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum. The financial assistance will be administered by the United Nations Office for Project Services (UNOPS).

PART I - THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY¹

A. The Economy and the Agricultural Sector

1. Nepal, is land-locked and divided into three parallel, ascending zones – the *terai* (plains), the hills and the mountains — and is one of the highest countries in the world. It has an estimated population of 22 million, and a population density of 600/km² of arable land. The economy has undergone considerable changes over the last ten years. In 1991 the Government adopted a liberal market-orientated economic policy and launched a number of reforms, including the freeing-up of trade and foreign exchange regimes, deregulation of financial markets and reduction of government control over the economy. Gross domestic product (GDP) growth averaged 5% between 1990 and 1997, and 4.6% between 1997 and 2000. While short-term macroeconomic management has been satisfactory, little progress has been made in reducing poverty and in effectively addressing the main constraints on social, economic and political development. Nepal remains one of the least developed countries in the world by all major indicators of social, economic and human development. The low per capita income of USD 225 ranks it as the ninth poorest country in the world.

2. The country's economy is characterized by a large agricultural sector and a small, but rapidly growing, informal urban economy. Although agriculture's share in GDP dropped from about 72% in 1975 to about 40% in 1999, the sector is the mainstay of the economy, employing approximately 81% of the total population. The agricultural sector is characterized by semi-feudal and subsistence agrarian regimes, high underemployment and low productivity. Most households cultivate some land but almost 70% of holdings are of less than 1 ha. Remittances play a major role both as a source of foreign exchange and of income for many households, particularly in the hill areas. Further economic growth in Nepal will depend upon: (i) exploiting the unique comparative advantages of the hills and mountains (particularly high-value products); (ii) developing social and economic infrastructure; (iii) improving administrative and institutional performance; and (iv) bringing the insurgency to a peaceful end.

¹ See Appendix I for additional information.



B. Lessons Learned from Previous IFAD Experience

3. The project design incorporates the following lessons learned from previous IFAD-supported projects in the country:

- Poor people in Nepal need the secure access to resources that will provide a measure of stability to their lives. The project will address this issue through a leasehold forestry programme targeted at the poorest.
- A pluralistic institutional approach to service provision may be more effective than relying solely on government agencies. Project design has addressed this problem by linking up with both civil society and the private sector.
- Communities of rural poor need to own project initiatives. The project will follow a demand-driven approach to addressing this issue.
- Efforts to improve livelihood systems by focusing on women have been successful and have improved overall household-level welfare. The project will mainstream gender concerns.
- Improved infrastructure is required, not least in the hills and mountains, where market links are poor. The project accordingly contains an infrastructure development component aimed at improving marketing, increasing employment opportunities and providing basic community facilities according to demand.
- Improved coordination between implementing agencies is essential. The project attempts to address this need by decentralizing project management to District-level units, which will coordinate and manage the contracting of service providers.
- Frequent staff transfers and poor staff motivation is a major constraint. This will be overcome by establishing a technical assistance (TA) team to ensure continuity in project management, and through a staff incentives programme.

C. IFAD's Strategy for Collaboration with Nepal

Nepal's Policy for Poverty Eradication

4. Poverty alleviation is major objective of the Ninth Five-Year Plan (1997-2002), which aims to reduce poverty from 42% to 32% by the end of 2002. The Plan envisages two broad strategies: integrating the moderately poor (60% of the poor population) into the mainstream of the economy; and providing special assistance to the ultra poor (40% of the poor). Agriculture was identified as the lead sector for poverty alleviation efforts, the main instrument being the 1995 Agriculture Perspective Plan (APP). The APP focuses on market-driven development supported by strategic public investment in infrastructure (notably irrigation and 'agricultural' roads) and agricultural research and extension. It focuses on agricultural transformation in the *terai* and specific, 'high-potential' areas in the hills. Other key strategies for poverty alleviation include: (i) investment in employment-intensive projects; (ii) decentralization of governance and institutional arrangements for improved access to resources and employment; and (iii) human resource development and local capacity building. In recent years, it has been recognized that, if poverty is to be addressed effectively, 'rights-based approaches' are necessary. The Poverty Reduction Strategy Paper (2000), currently under finalization, takes a commitment to such approaches, and will form the basis of the Tenth Five-Year Plan.



The Poverty Eradication Activities of other Major Donors

5. Nepal is a major recipient of foreign aid. Important donor-supported projects that offer prospects for partnerships and cross-fertilization include: (i) the Participatory District Development Project (PDDP) and the Local Governance Project (LGP), both initiated by the United Nations Development Programme (UNDP), which provide the conceptual and operational basis for the design of the current project. With the support of the Department for International Development of the United Kingdom, UNDP, the Netherlands Development Organization and other donors, His Majesty's Government of Nepal (the Government) proposes to scale up the PDDP/LGP projects into a national-scale project to be known as the Local Governance Strengthening Programme (LGSP); (ii) the World Food Programme (WFP) Rural Community Infrastructure Works (RCIW) Project, which is operating food-for-work schemes in a number of districts; (iii) the Canadian International Development Agency-supported Community-Based Economic Development Project, implemented by three national NGOs and focusing on social mobilization for the production and marketing of cash crops appropriate to the area of intervention; (iv) the Crop Diversification Project and the Third Livestock Development Project financed by the Asian Development Bank; and (v) the Danish International Development Assistance-supported Natural Resource Management Sector Assistance Project, which provides training, technical and financial support in the formation of forestry users' groups and for the preparation of its operational plans.

IFAD's Strategy in Nepal

6. Since 1978, IFAD has committed a total of USD 93.6 million for nine loans to Nepal. Six of the projects involved have closed, and another two are expected to close in December 2001. The IFAD Country Strategic Opportunities Paper for Nepal, approved in May 2000, outlined a strategy for expanding and building on the successful experiences of IFAD, other donors and NGOs in Nepal. This includes a long-term commitment to assisting the poor living in the marginal upland areas of Nepal by: (i) assisting in the self-empowerment of the most disadvantaged groups; (ii) enhancing the livelihoods of the upland people, especially those living in the most impoverished regions and districts; (iii) promoting sustainable economic growth by enabling communities to manage their natural resources in a efficient manner; (iv) addressing policy or procedural issues by building on experience gained during implementation; and (v) developing an implementation mechanism that would add value to the lives of the people by drawing on IFAD's experience in rural development, especially in conflict-prone areas in other parts of the world.

Project Rationale

7. The COSOP outlined a clear biophysical and socio-economic rationale for a project in the Western Uplands of Nepal, an characterized by its remoteness and harsh terrain, low rainfall, poor access, limited opportunities for agriculture, and the smallest agricultural landholdings in the country (0.5 ha). The populations living in these mountain areas are subject to food insecurity, with chronic malnutrition rates (60–86%) among young children, one of the highest recorded rates in the world. Virtually the entire population of the targeted districts constitute IFAD target groups. Furthermore, the area harbours the largest proportion of *dalits* in the country. Service delivery to these upland areas is very difficult, due to lack of infrastructure and understaffing of line agencies. There has been little or no donor assistance to the area and relatively few programmes have been undertaken to assist the poor. Notwithstanding these constraints, the area offers good opportunities for enhancing the incomes of the poor through livestock and forestry production. At the present time, the poor are unable to develop the available resources to their advantage, as they are not organized and lack access to services, capital and the resource base itself. The remoteness of the project area, its potential for livestock and forestry production, the concentration of the poor and their lack of access to resources all point to the need for an immediate intervention to assist the poor in the area. To that end, the



project offers the opportunity for developing a strategic partnership with other donors within the context of the LGSP. A further justification for the project is that, unless poverty is addressed, political insurgency in Nepal is likely to increase.

PART II - THE PROJECT

A. Project Area and Target Group

8. The project area covers 11 upland Districts in the far and mid-western development regions. The project-area districts contain 392 village development committees (VDCs), approximately 226 000 households and a population of approximately 1.2 million. By the end of the project, some 115 000 households (man and woman-headed) are expected to have benefited. The priority target group consists of the most disadvantaged members of the community (women, *dalits*, landless or semi-landless households and other minority groups). However, in view of the overall poverty of the project area, the project will adopt an inclusive approach to targeting for certain components and hence all community members will benefit.

9. The project-area districts are characterized by a high incidence of poverty, low human development indicators and overall deprivation. Food prices are high, government services sporadic, and the few income-earning opportunities available, in particular non-timber forest product (NTFP) production, are being managed opportunistically, further jeopardizing both the fragile ecology and people's livelihood. Due to the marginalization of people in these areas, an insurgency movement has been growing in strength over recent years. The project will be initiated in the districts least affected by the insurgency and expand to other districts based on their experience in dealing with the insurgency.

10. The project area spans three agro-ecological zones of the country: the middle hills, the high hills and the Himalaya. The climate ranges from tropical/sub-tropical, cool temperate to alpine. Livelihood systems throughout the project area are varied, characterized by the integration of crop farming, livestock, forestry and off-farm activities. Most families have very smallholdings and depend heavily on communal resources, such as waste and shrub land for grazing or forestry land for the collection of fuel wood and on NTFPs (such as fodder, fuelwood, medicines, herbs, mushrooms, litter for mulching, etc.). Covering around 50% of the total project area, forests represent a major natural resource and a vital source of supplementary income, particularly in the mountain areas where fewer agricultural opportunities exist. Agriculture is practised with limited use of farm inputs and basic equipment. Livestock provide another important source of income. Living conditions are harsh for the poor and their risk-coping strategies vary considerably. Survival strategies include agricultural labouring, out-migration, collection of NTFP, share cropping and petty trading.

B. Objectives and Scope

11. The overall goal of the project is to ensure more resilient livelihoods and to defend the basic human dignity of poor and socially disadvantaged people in the uplands of the far and mid-western regions of Nepal. The specific objective is to strengthen the capacity of poor and socially disadvantaged groups to mobilize their own resources (human, natural, physical, financial); gain access to external resources; and ensure social justice. A secondary supporting objective is to create an institutional framework in support of the primary objective, by creating dynamic grass-roots institutions that would be ultimately federated at the VDC and district development committee (DDC) levels.

12. Given that community mobilization and institution building are lengthy processes, the project will be financed under IFAD's Flexible Lending Mechanism (FLM) (see Appendix VII), which



allows for a longer project period. The project will be implemented over 11 years, in three phases. Trigger indicators to determine progression to the second and third phases will be assessed during two mid-term reviews. The first phase will last four years, during which the project will be implemented mostly in the four districts of Jumla, Humla, Bajang and Bajura, although some activities will be initiated in other districts. In the second phase, which will also last for four years, the project will expand its area coverage on the basis of the experience gained and lessons learned. A final phase of three years will concentrate on the consolidation and institutionalization of project gains.

13. Project activities will be demand-driven. Efforts will be made to mobilize communities and to persuade to outline their needs and perceived difficulties. Based on the feedback received, the project will mobilize the local administration to provide communities with the services they need. The nature of the project, the issues involved, and the need to ensure that viable district-based savings and credit institutions emerge by the end of the project period make it necessary for the project to develop its activities on a gradual basis. The project design reflects this approach and, as such, the first phase accounts for only 14% of the project costs. The exact nature of the beneficiary requests is hard to predict but, based on discussions in the field, it is anticipated that the components outlined in the following section will, by and large, address the major constraints faced by the communities.

C. Components

Labour-Intensive Infrastructure Development

14. Infrastructure facilities in the project area are grossly inadequate. While it is not intended that the project should provide sufficient funding to meet all the needs of the area, it is hoped that certain strategic activities will establish the basis for future development. Two approaches will be followed: (i) the provision of a strategic road link to provide access to markets in the area; and (ii) supporting a demand-driven, community-based small-scale infrastructure development programme.

15. Linking Jumla district to Humla district by means of a 'green road' will facilitate access from the remote northwestern districts to the *terai*. There is little doubt that construction of such a road would expedite the development of the area, render production economically viable and, more importantly, facilitate the transport of food to chronically food-deficit areas. Provision has been made for the construction of 125 km of 'green roads' at an estimated cost of USD 33 000/km. WFP, the Government and IFAD will jointly finance this project component, following procedures already developed by WFP under the RICW project. The total base cost of the roads sub-component has been estimated at USD 4.9 million, of which USD 0.9 million will be committed during the first phase of the project. This includes a provision for the initial technical feasibility study, surveys, the cost of labour for the road works, construction material, transport, material handling, the establishment of a district project support unit (DPSU), staff salaries, training, and associated TA for technical support and supervision.

16. Small-scale community-level infrastructure development will be demand-driven, and implementation will follow current procedures under the PDDP. It is difficult to predict the nature of demand, but it is thought that the sub-projects may include small-scale irrigation, foot-and-mule trails, bridge construction, water supply and sanitation, and storage facilities. The social mobilizers employed by the project will mobilize community organizations to prioritize their infrastructure needs and facilitate the processing of their requests, in partnership with the VDCs, the *Ilaka* Committee (clusters of VDCs) and the DDC. Infrastructure sub-projects will be eligible for project financing provided (i) they benefit most members of the communities, especially the poor; (ii) the VDC contributes at least 10% of the cost; (iii) communities agree to maintain the facility; (iv) communities ensure that the poorest members are employed once construction begins; and (v) the cost to the project does not exceed USD 10 000. In total, the project provides for 1 006 sub-projects at an average cost of USD 5 000 each. Each VDC will receive no more than USD 30 000 for such projects



and no further schemes will be eligible for funding unless those financed earlier have been properly maintained. The total base costs of this sub-component have been estimated at USD 5.5 million, of which about USD 0.4 million is expected to be required during the first phase.

Leasehold Forestry and NTFP Production

17. The objective of this component is to transfer productive resources to the poor and to support them in producing and marketing high-value NTFPs. Building on lessons learned from IFAD's Hills Leasehold Forestry and Forage Development Project, the component will promote the transfer of lands, on a leasehold basis, to women and the landless to enable them to: (i) undertake leasehold forestry; (ii) increase their production of fodder crops (with emphasis on the production of forage seed as an income-generating activity); and (iii) undertake NTFP production. Over a period of ten years, the project will attempt to make 22 500 ha of marginal lands available to 1 000 leasehold forest user groups (LFUGs). These lands would be available on lease for 40 years. In all, approximately 15 000 persons are expected to benefit from this activity.

18. The project will finance an initial survey to identify available areas for establishing leasehold lands in suitable clusters and the provision of services to organize new LFUGs; strengthen existing groups, prepare operational plans, and facilitate the handing over of forests and pasture areas to the target group. It will also finance the cost of contracting an NGO to work with the District Forest Office (DFO) in undertaking these tasks. Provision has been made for the training of DFO staff in leasehold concepts and implementation, NTFP and forest management, and the training of trainers. In all 44 training courses will be held in the four districts covered by the first phase of the project, when some 135 LFUGs are expected to be established and trained. Provision has also been made for initial training, exposure visits, monitoring workshops, work schedule planning and operational planning reviews.

19. The project will also finance the development and production of domesticated NTFPs that are both socio-economically viable and meet an identified market demand. In this context, the component will rely on assistance from the private sector (including the firms Dabur Nepal Ltd. and Herbal Processing and Production Ltd.) with regard to identifying suitable areas for production, providing inputs (quality saplings), transferring technology and purchasing produce. While these private companies will provide the aforementioned services at their own cost, IFAD and the Government will finance the costs of transporting saplings, training DFO staff and the beneficiaries (including the necessary travel and transport allowances for transfers to district headquarters) and of establishing nurseries. One nursery will be established for every ten LFUGs in the project area, as well as one at each District headquarters as holding nurseries to serve as demonstration sites. Women will be trained to operate the nurseries and to provide technical advice to the beneficiaries.

20. The total base costs of the forestry component are estimated at USD 3.0 million. Of this, USD 0.7 million will be disbursed during the first phase of the project, both to support 135 LFUGs and to start up activities under the project.

Crop and Livestock Production

21. The key objectives of this component are to strengthen the role of agriculture and livestock in the livelihood systems of the target group, and to improve household food security and nutrition. In addition to promoting increased production of small stock and staple food crops (new varieties of rice, maize, wheat and potatoes), the component will promote sustainable production practices (composting, proper husbandry, integration of fodder crops, introduction of legumes such as black grams and soya beans, increased livestock production through better nutrition and improved animal health); diversified kitchen gardens; nutrition training and village-based monitoring of malnutrition. To that end, the component will finance: (i) adaptive research on promising varieties through



National Agricultural Research Council stations in Jumla, Doti and Dailekh (provision has been made in the amount of USD 153 000 to conduct 100 trials and demonstrations, 24 of them during the first phase of the project); (ii) on-farm testing and demonstration of technologies by progressive farmers trained by District Agriculture Development Office/District Livestock Service Officer (DADO/DLSO) staff (provision has been made for ten demonstrations in each VDC, at a cost of NRP 5 000 per demonstration site); (iii) training of district-based agricultural and livestock staff to train village-level specialists; (iv) training/retraining and equipping of village animal health workers (two per VDC) to carry out vaccinations, simple diagnoses and treatment; (v) establishment of nurseries (one in each VDC, and one at district headquarters) to make available planting material to beneficiaries (women will be trained by DADO/DLSO staff and initially contracted to run the nurseries); and (vi) a pilot programme to increase the availability of improved breeds in short supply. The project will liaise with the International Potato Centre and the International Research Institute for the Semi-Arid Tropics to benefit from improved true potato seed and disease-resistant varieties of pigeon pea and chick pea. Total component base costs are estimated at USD 1.9 million, of which USD 0.4 million will be disbursed during the first phase.

Rural Microfinance

22. The objective of this component is to develop a viable, sustainable rural financial system through the promotion and/or strengthening of village-based community organizations (COs) to deliver savings and credit services at the village level. Savings are the cornerstone of the credit programme. COs will retail credit to their members, with the CO manager maintaining records and granting loans after suitable training. Internal auditors recruited and trained by the project will regularly audit CO accounts. COs will be required to generate and manage savings and lending from their own sources for at least six months before they become eligible to borrow project funds from the LDFs. Such funds will be granted by the project only once CO managers have demonstrated their ability to: (i) manage the operations; (ii) maintain high recovery rates from the savings funds; and (iii) keep proper records. Loans will be granted for all viable activities, including the production and marketing of NTFPs; agricultural and livestock production; and off-farm activities, including food processing, trading and marketing. The poorest members of the CO will be granted loans on a priority basis. While CO savings will be available for all members, IFAD funds will be restricted to food-deficit households. A credit risk fund will be established by the COs to cover the risk of credit defaults. In order to minimize the risk of abuse by CO managers, the following steps will be taken: (i) the scope of the internal audit will be increased to bring out cases of nepotism; (ii) the credit officers will conduct surveys among members to ensure that the managers are performing satisfactorily; (iii) the CO managers will be appointed for an initial period of three years, renewable subject to satisfactory performance as determined by the members. In order to ensure the sustainability of COs supported under the project, from the outset, social mobilizers and management will strive to promote clusters of COs at the VDC level and federations at the DDC level. The component will also finance a TA marketing specialist to liaise with the private companies, organize marketing groups — of both traders and producers — and disseminate information on prices so as to offer alternative channels to beneficiaries for marketing their produce. The total cost of the component has been estimated at USD 6.8 million, of which USD 0.2 million will be used to reach about 12 000 beneficiaries in the 40 VDCs covered under the first phase.

Institutional Support

23. Given the limitations in line agency staffing and in communications in remote areas, the development of a strong institutional framework is critical to sound project implementation. To that end, the project will finance: (i) the necessary training to build capacity at the local level, including CO and VDC staff leadership; (ii) the cost of establishing the project coordination unit (PCU) in Nepalganj and District offices to support the local development fund (LDF) in areas where such funds have not been initiated, or of incremental staff in areas where the LDFs have already been established.

In this connection, the project will finance office rental, staff salaries, purchase of equipment and furniture, the training and travel costs of staff involved, and operating costs; (iii) the cost of necessary TA and technical support mechanisms; (iv) the contracting NGOs or other service providers; (v) start-up, orientation, participatory impact monitoring workshops, and assessments of project impact; and (vi) development of the project monitoring and evaluation (M&E) system (computer equipment, staff and beneficiary training in M&E systems). In all, some 110 staff will be employed in the four districts during the first phase. The project will also finance a lump-sum allocation of USD 300 000 for poverty-alleviation activities of national importance (such as raising awareness of social justice, support for traditional medicine systems, and integration of leasehold forestry into community forestry), which will be contracted out to NGOs. The total base costs of the institutional strengthening component, including TA and all associated capacity-building, are estimated at USD 6.1 million, of which USD 1.7 million is expected to be disbursed during the first phase.

D. Costs and Financing

24. Total project costs, inclusive of contingencies, duties and taxes, are estimated at NPR 2.5 billion (USD 32.6 million), of which 11% represent foreign exchange costs. Project costs for the first phase have been estimated at NPR 347 million, or USD 4.6 million (in August 2001 prices). Physical contingencies are estimated at 1% of base costs, and foreign currency price contingencies at 2.25%. A cost summary is presented in Table 1. IFAD will provide a loan of approximately USD 20.0 million and a grant of USD 360 000. WFP's contribution is estimated at USD 4.0 million and that of the private sector at USD 36 000. The beneficiaries will contribute USD 78 000; local government bodies (DDC/VDC) USD 2.2 million; and the Government approximately USD 5.9 million. A financing plan is presented in Table 2.

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

Components	Local	Foreign	Total	% Foreign Exchange	% Base Costs
1. Labour-intensive infrastructure development					
-inter-district roads	4 412	467	4 878	10	17
-community infrastructure	4 974	541	5 515	10	20
Subtotal	9 386	1 007	10 393	10	37
2. Leasehold forestry and NTFP production	2 700	343	3 043	11	11
3. Crop and livestock production	1 302	628	1 930	33	7
4. Rural microfinance	6 719	56	6 775	1	24
Subtotal	20 106	2 034	22 140	9	78
5. Institutional support					
Project coordination	1 726	267	1 993	13	7
-Local development fund boards	2 186	763	2 949	26	10
-Capacity-building for empowerment and social justice	1 077	120	1 196	10	4
Subtotal	4 988	1 150	6 138	19	22
Total base costs	25 094	3 184	28 279	11	100
Physical contingencies	373	41	414	10	1
Price contingencies	3 380	492	3 872	13	14
Total project costs	28 847	3 717	32 565	11	115

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

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

	IFAD (Loan)		IFAD (Grant)		WFP		Private Sector		Beneficiaries		Local Government		Government (HMGN)		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%				
1. Labour-intensive infrastructure development																				
-Inter-district roads	414	6.7	-	-	4 026	65.4	-	-	25	0.4	959	15.6	728	11.8	6 152	18.9	593	5 543	16	
-Community infrastructure	4 785	73.4	-	-	-	-	-	-	53	0.8	1 242	19.1	436	6.7	6 517	20.0	639	5 866	12	
Subtotal	5 200	41.0	-	-	4 026	31.8	-	-	78	0.6	2 201	17.4	1 164	9.2	12 669	38.9	1 232	11 409	28	
2. Leasehold forestry and NTFP production	3 111	88.2	-	-	-	-	36	1.0	-	-	-	-	380	10.8	3 527	10.8	395	3 063	70	
3. Crop and livestock production	1 779	80.4	-	-	-	-	-	-	-	-	-	-	435	19.6	2 213	6.8	721	1 333	160	
4. Rural microfinance	4 433	61.8	-	-	-	-	-	-	-	-	-	-	2 743	38.2	7 177	22.0	65	7 096	15	
Subtotal	14 523	56.8	-	-	4 026	15.7	36	0.1	78	0.3	2 201	8.6	4 723	18.5	25 586	78.6	2 412	22 901	273	
5. Institutional support																				
Project coordination	1 423	65.0	360	16.5	-	-	-	-	-	-	-	-	405	18.5	2 188	6.7	295	1 827	65	
-Local development fund boards	2 605	76.5	-	-	-	-	-	-	-	-	-	-	799	23.5	3 404	10.5	871	2 332	201	
-Capacity building for empowerment and social justice	1 386	100.0	-	-	-	-	-	-	-	-	-	-	0	-	1 386	4.3	139	1 248	-	
Subtotal	5 415	77.6	360	5.2	-	-	-	-	-	-	-	-	1 204	17.2	6 978	21.4	1 305	5 407	266	
Total Disbursement	19 937	61.2	360	1.1	4 026	12.4	36	0.1	78	0.2	2 201	6.8	5 926	18.2	32 565	100.0	3 717	28 308	539	

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





E. Procurement, Disbursement, Accounts and Audit

25. **Procurement.** All procurement of goods and services from the IFAD loan will be in accordance with IFAD's procurement guidelines. The project involves no procurement suitable for international competitive bidding. Most items are readily available from domestic sources at competitive prices. Civil works for 'green road' development will be carried out on the basis of procedures currently implemented by WFP under RCIW. Equipment and off-the-shelf items of a unit cost not exceeding USD 10 000 will be procured through local shopping procedures, or through international shopping when such products are not available on the local market. TA will be recruited either on the basis of short-listing or through direct recruitment, following procedures acceptable to IFAD.

26. **Disbursement, accounts and audit.** The Government will open a Special Account in foreign exchange (with an initial deposit of USD 400 000) in the Nepal Rastra Bank in Katmandu to facilitate regular flows of funds. In addition, the Government will open: a PCU account in Nepalganj; DDC and local development fund board (LDFB) project accounts in each participating project district; and "green roads" project accounts in Humla, Jumla and Mugu. Replenishment of the Special Account will be in line with IFAD's standard procedures. Grant funds provided by IFAD for TA, training, or for supplementing staff allowances will be deposited in a separate grant account denominated in United States dollars in Nepal Rastra Bank in Katmandu. Separate records and accounts related to project expenditures will be maintained by each concerned institution, i.e. PCU, district teams, DDCs, line ministries and other service providers and COs. These accounts will be consolidated at the district level by the district teams and forwarded to the PCU for further consolidation. Accounts will be audited by the office of the auditor general. Certified copies of the audit reports and financial statements, including the auditors' opinion on the statements of expenditures, will be submitted to IFAD and the cooperating institution no later than six months after the close of the fiscal year.

F. Organization and Management

27. **Coordination.** The lead project agency will be the Ministry of Local Development (MOLD), which will have overall responsibility for project implementation. The lead project agency shall appoint a project director from the local governance or other relevant division. The Government will maintain, until the close of the project, a project steering committee, which will be chaired by the Secretary, MOLD, and comprise a representative from the Ministry of Finance (MOF), Department of Agriculture (DOA), Department of Livestock Services (DOLS), Department of Forestry (DOF) of the Ministry of Forestry and Soil Conservation (MOFSC), the Department of Local Infrastructure Development and Agricultural Roads (DOLIDAR) of MOLD, and the National Planning Commission (NPC). Participating private-sector companies will be invited to attend meetings of the project steering committee. The project coordinator (PC) will act as Secretary of the committee, which will be responsible for ensuring that project activities are carried out in accordance with the spirit of the project and in support of Government policies. To that end, the project steering committee will: review and approve annual work programmes and budgets; provide policy guidance and address issues affecting project performance; ensure that necessary support from the line ministries is forthcoming; approve procurement decisions; and review project implementation progress and its monitoring. Coordination at the district level will be handled by the LDF Board, which will be expanded to include civil society and line agency representatives. Coordination at the VDC level will take place at monthly meetings of the chairmen-managers' conference, which will be expanded to include the forest guards and the junior technical assistants (JTAs) from DOA and DOLS.

28. **Implementation.** A PCU will be established in Nepalganj, headed by a project coordinator acceptable to IFAD. A TA team comprising a project management advisor, trainer, nutritionist, research officer, gender and equity officer, marketing and microenterprise specialist, monitoring and



evaluation (M&E) specialist, and an infrastructure advisor will back up the PCU. The PCU will be responsible for day-to-day project implementation, including coordination of the activities of the district teams in each district, monitoring project performance and the viability of each credit and savings mobilization unit, maintaining close liaison with traders and the private sector, and establishing links with companies interested in contract farming. The LDF Board will be responsible for implementing the project at the district level. The LDF will be staffed by a local development fund advisor provided under the LGSP, and assurances will be sought to the effect that the advisor shall be trained and available before project inception in the districts. The advisor will support a team leader and support staff in each district.

G. Economic Justification

29. **Benefits and beneficiaries.** The project is expected to have a wide-ranging impact inasmuch as it will: (i) reach 200 VDCs, comprising 115 000 households, through infrastructure development; and (ii) form COs in 200 VDCs in the 11 districts, thereby enabling some 90 000 households in the project area to receive credit. By the end of the project, about 4 960 COs will have been formed. Some 107 000 CO members are expected to have received loans by project year 11, for an aggregate total of NPR 354 million (USD 4.8 million).

30. **Crop, livestock and associated nutritional benefits.** The project will enable poor households to improve their food security and income through incremental crop and livestock production. The adoption of intercropping of legumes, relay cropping, cultivation of forage species in the bunds, and terrace risers and improved seeds will increase the volume and diversity of food available and help to reduce seasonal malnutrition. All food-deficit households will benefit from the establishment of fruit trees, either in home gardens or on leasehold land, which will contribute to reducing vitamin deficiencies and malnutrition. The higher productivity of livestock achieved as a result of better nutrition and management will also contribute to improved household nutrition and health.

31. **Employment benefits.** The project will also generate considerable employment at the village and community levels. In all, some 10 920 specialists/managers will be trained. In addition, the project will train, and create the employment for, some 455 women as nursery operators. Furthermore, some 2.5 million man-days of employment will be generated through infrastructure. This will add considerably to family savings, with the attendant benefit of reducing seasonal malnutrition.

32. **Gender benefits.** The project will directly benefit women by providing increased access to knowledge and technology, control of productive resources, and leadership and management skills. Fifty per cent of the COs (i.e. approximately 2 480) will train women managers and women members. Each village will include at least one woman trained as an agricultural or nutrition extension specialist.

33. **Leasehold forest benefits.** About 15 000 very poor households will benefit from belonging to LFUGs through access to marginal forestland. Such households will also benefit from an assured supply of forage and fodder for livestock and of fuel wood and timber. This will substantially reduce the time and labour needed for collecting forage and fuel wood, mostly by women. These households may further benefit from NTFP production, for which there is an assured market and guaranteed floor price.

34. **Economic and financial analysis.** For obvious reasons, IFAD does not require a detailed economic and financial analysis for FLM projects. The nature of the project, with its emphasis on the demand-based provision of services, precludes any such analysis, which is problematic even for major productive components. Support requirements under these components have been estimated on the basis of trends in the demand for credit in areas benefiting from the LGP and PDDP approach to be followed under this project. Activities in the crop, livestock, NTFP and informal sectors have been identified and their financial viability rigorously evaluated. However, there is no sound basis for



aggregating these models, as the mix of activities will be demand-driven. This inhibits financial and economic analysis of these components and thus of the project as a whole. Financial analyses of the major productive activities – undertaken for livestock enterprises, NTFP cultivation, poor farm households and LFUGs – show robust financial rates of return. The financial rate of return to project investment in the establishment and support of LFUGs is estimated at 35% in the mid-hills and 28% in the high hills and mountainous areas.

H. Risks

35. The greatest risk to the project is the insurgency movement in Nepal. The project will initiate its activities in districts that are not significantly affected by the insurgency. In addition, the project will focus on empowering the poor and transferring resources to them, and on equity for disadvantaged groups, including women, thereby addressing the root causes of the insurgency. Experience with other IFAD projects in Asia suggests that, despite pressure from insurgents, women have been instrumental in ensuring the continuity of projects. IFAD hopes that the gender focus of the project will generate women's support to the project regardless of the political climate in any given VDC. Risks related to savings and credit may be summarized as follows: (i) savings may be low in the project area and the demand for credit may be below expectations. The project will attempt to overcome this eventuality by providing employment opportunities for the poorest with a view to increasing their resources. (ii) The COs may not reach the poorest households because the latter are not considered creditworthy. The project will seek to address this by sensitizing the communities to the need to assist indigent members and building incentives by providing a cash endowment to federations that have achieved a wide coverage of communities. (iii) The proposed federations may not be viable. However this is unlikely to be the case, because of the long-term nature of the project, which will allow sufficient time for building credit operations to cover the operating costs. Moreover, the project will provide training to CO leaders to ensure that viable federations emerge. The project is structured to retain a bare minimum of core staff to run the credit operations, contracting out all other activities to external agencies. However, should the federations still not prove viable, the project will have the funds earmarked to endow the federations to continue the activities until such time as additional funding can be arranged.

I. Environmental Impact

36. An Environmental Screening and Scoping Note was prepared during project formulation, in line with IFAD procedures. It classified the project as Category B, and therefore a full environmental assessment during formulation is not considered to be either necessary or appropriate.

J. Innovative Features

37. The project design contains certain innovative features new to IFAD projects in Nepal: (i) adopting a 'rights-based approach'. To tackle the high level of discrimination of marginalized groups, the project will seek to empower women, *dalits*, the landless and ethnic minorities through a combination of rights-awareness campaigns, and policy and advocacy initiatives; (ii) and, in expanding IFAD's experience with civil society in Nepal, supporting a system of financial intermediation at the village level, with management of savings and credit undertaken by the managers of COs; and (iii) building on IFAD's experience under the Hills Leasehold Forestry and Forage Development Project by providing secure access rights for the poorest to productive forest resources and, at the same time, developing these resources for NTFP production through partnerships with civil society and the private sector.



PART III - LEGAL INSTRUMENTS AND AUTHORITY

38. A financing agreement between the Kingdom of Nepal and IFAD constitutes the legal instrument for extending the proposed financial assistance to the recipient. A summary of the important supplementary assurances included in the negotiated financing agreement is attached as an annex.

39. The Kingdom of Nepal is empowered under its laws to borrow from IFAD.

40. I am satisfied that the proposed financial assistance will comply with the Agreement Establishing IFAD.

PART IV - RECOMMENDATION

41. I recommend that the Executive Board approve the proposed financial assistance in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Kingdom of Nepal in various currencies in an amount equivalent to fifteen million six hundred thousand Special Drawing Rights (SDR 15 600 000) to mature on and prior to 1 December 2041 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 FURTHER: that the Fund shall provide a grant to the Kingdom of Nepal in various currencies in an amount equivalent to two hundred ninety thousand Special Drawing Rights (SDR 290 000) and 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.

Lennart Båge
President

SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES INCLUDED IN THE NEGOTIATED FINANCING AGREEMENT

(Negotiations concluded on 30 November 2001)

1. **The financing.** The Fund agrees to extend a loan to the Government of the Kingdom of Nepal (the Government) in the principal amount of fifteen million six hundred thousand Special Drawing Rights (SDR 15 600 000), and a grant in the principal amount of two hundred ninety thousand Special Drawing Rights (SDR 290 000) for the purpose of financing the project, *provided, however*, that the amount of the loan will be reduced if and to the extent that the Government obtains grant cofinancing for the institutional support component. The Fund will promptly notify the Government of any such reduction.

2. **Project accounts.** (a) The MOLD of the Government will open and thereafter maintain in the Kathmandu Banking Office of the Nepal Rastra Bank a current account denominated in United States dollars for the purpose of receiving grant funds to partially finance the institutional support component (Grant Project Account). The project director and the project accounts officer of MOLD will each be fully authorized to jointly operate the Grant Project Account.

(b) MOLD will open and thereafter maintain in the Nepalganj branch of the Nepal Rastra Bank a current account denominated in Nepalese rupees to receive loan proceeds for PCU support (PCU Project Account). The project coordinator and the project accounts officer of MOLD will each be fully authorized to jointly operate the PCU Project Account.

(c) MOLD will cause each DDC to open in the local branch of a commercial bank two current accounts denominated in Nepalese rupees for project operations. One account will receive funds for the 'green road' sub-component (Green Road Project Account), in accordance with the relevant agreement between the MOLD and the DDC and local development fund board (LDFB) of each district (District Agreement). The other account will be used for all other project operations (DDC Project Account). The local development officer and the accounts officer of the DDC will each be fully authorized to jointly operate both the Green Road Project Account and the DDC Project Account.

(d) MOLD will cause each LDFB to open in the local branch of a commercial bank a current account denominated in Nepalese rupees to receive funds from the DDC for project operations other than activities under the green road sub-component (LDFB Project Account), in accordance with the relevant District Agreement. The executive secretary of the LDFB and the team leader of the district team will each be fully authorized to jointly operate the LDFB Project Account.

3. **Channelling of project resources.** MOLD will transfer available funds and other resources called for in the annual work plans and budgets (AWP/Bs) to each DDC and LDFB in accordance with the relevant District Agreement for project operations, *provided, however*, that MOLD will not make any such funds available to any DDC or LDFB unless and until the relevant District Agreement is signed and a copy of the signed District Agreement is delivered to the Fund and the cooperating institution.

4. **Counterpart contribution.** During the project implementation period, the Government will make available the MOLD counterpart funds in an aggregate amount of USD 5 926 000 equivalent, in accordance with its national procedures for development assistance. For such purpose, the Government will make budgetary allocations, annually in advance for each fiscal year, in an amount equal to the estimated counterpart contribution called for in the AWP/B for the relevant project year and make such allocations available to MOLD every four months in advance. The Government will also cause each

DDC to make available to the LDFB during the project implementation period counterpart funds in accordance with the relevant District Agreement.

5. **Lease availability.** The Government will: (a) make available to participants public land requested by the DFO within six months of such request, including ensuring that the Regional Forestry Division approves the DFO operational plans in a timely manner; (b) lease the land to LFUG for a period of not less than 25 years, with a provision for an additional 15 years; and (c) ensure that each DDC establishes a leasehold oversight committee to ensure that leasehold lands are made available exclusively to the target group.

6. **Cofinancing.** Within six months of the date of effectiveness, the Government shall have obtained the grant funding necessary for the entire project implementation period.

7. **Gender and equity.** The Government will ensure that the concerns of women and *dalits* are integrated into all project activities during project implementation. To this end, the Government will ensure that:

- (a) the project encourages women and *dalits* to take on leadership roles and participate in decision-making at both the family and the community levels; and
- (b) priority is given to women and *dalits* to train as social mobilizers, village specialists, office-holders and project staff, with a target of 35% women and 15% *dalits* in each position by the end of the first phase of the project.

8. **Agreements.** Within six months of the date of effectiveness, the Government will endeavour to conclude agreements with private companies for, among other things, the nursery and NTFP marketing sub-components, on terms and conditions approved by the cooperating institution.

9. **Monitoring and evaluation system.** The Government will ensure that the monitoring and evaluation system is established within six months of the date of effectiveness.

10. **Phase reviews.** The Government will ensure that the management audits and the necessary studies are conducted no later than two months prior to each phase review.

11. **Resource protection.** The Government will take all reasonable measures to ensure that existing policies and measures will be enforced to safeguard forest and wildlife resources in the project area.

12. **Microcredit by-laws.** The Government will prepare draft microcredit by-laws for the microfinance component as soon as practicable but no later than 12 months after the date of effectiveness. The microcredit by-laws will set forth procedures for lending within COs, which will be in accordance with the project implementation manual guidelines and will include, *inter alia*:

- (a) member eligibility criteria for receiving loans;
- (b) interest rates and repayment mechanisms and periods (including grace periods, if any);
- (c) lending caps to individuals and groups;
- (d) loan approval and disbursement mechanisms; and
- (e) distribution of income received from loans.

The microcredit by-laws will be approved as part of the project implementation manual.

13. **Risk fund.** The CO manager will set aside 1.5% of the spread on the funds managed to constitute a risk fund. The CO will not require any collateral for the loans to its members; however, each CO member will be jointly and severally liable for amounts unpaid by other CO members.



14. **Project coordinator.** The Government will appoint a qualified and experienced project coordinator from its civil servants, with experience in managing people-centred poverty alleviation projects. The project coordinator will be granted the authority to carry out the responsibilities under the project, and will be acceptable to the Fund. The project coordinator will serve for at least two years, and any successor thereto will be acceptable to the Fund and will have the same qualifications and experience as set forth above.

15. **Conditions precedent to effectiveness of the loan agreement:**

- (a) the Government shall have duly appointed the project coordinator;
- (b) the Government shall have appointed the LDF advisor for each first phase district;
- (c) the Government shall have duly opened the Special Account, the Grant Project Account and the PCU Project Account;
- (d) the Government shall have submitted a draft AWP/B for the first project year;
- (e) the Government shall have made the initial budgetary allocation of counterpart funds;
- (f) the Government and WFP shall have agreed in writing to enter into the WFP Agreement, pending WFP confirmation of resources committed to the Government;
- (g) the draft model District Agreement shall have been accepted by the Fund in form and substance, and a copy of the signed District Agreement for at least two of the first-phase districts shall have been delivered to the Fund and the cooperating institution, and in each such district, the DDC shall have opened the Green Road Project Account and the DDC Project Account, and the LDFB shall have opened the LDFB Project Account;
- (h) 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
- (i) the Government shall have delivered to the Fund a favourable legal opinion issued by the Ministry of Law, Justice and Parliamentary Affairs, or other legal counsel approved by the Fund, in form and substance acceptable to the Fund.

COUNTRY DATA

NEPAL

Land area (km² thousand), 1997 1/	143	GNI per capita (USD), 1999 4/	220
Total population (million), 1999 4/	23.4	Average annual real rate of growth of GNP per capita, 1990-98 2/	2.4
Population density (people per km²) 1998 1/	160	Average annual rate of inflation, 1990-98 2/	8.9
Local currency	Nepalese Rupee (NPR)	Exchange rate: USD 1 =	NPR 74.0
Social Indicators		Economic Indicators	
Population (average annual population growth rate), 1980-98 1/	2.5	GDP (USD million), 1999 4/	4 995
Crude birth rate (per thousand people), 1998 1/	34	Average annual rate of growth of GDP 1/	
Crude death rate (per thousand people), 1998 1/	11	1980-90	4.6
Infant mortality rate (per thousand live births), 1998 1/	77	1990-98	5.0
Life expectancy at birth (years), 1998 1/	58	Sectoral distribution of GDP, 1998 1/	
Number of rural poor (million) (approximate) 1/	8.9	% agriculture	40
Poor as % of total rural population 1/	44	% industry	22
Total labour force (million), 1998 1/	10.5	% manufacturing	10
Female labour force as % of total, 1998 1/	40	% services	37
Education		Consumption, 1998 1/	
Primary school gross enrolment (% of relevant age group), 1997 1/	113 a/	General government consumption (as % of GDP)	9
Adult literacy rate (% age 15 and above), 1998 3/	39	Private consumption (as % of GDP)	80
Nutrition		Gross domestic savings (as % of GDP)	
Daily calorie supply per capita, 1997 3/	2 366	Balance of Payments (USD million)	
Prevalence of child malnutrition (height for age % of children under 5), 1992-98 1/	53	Merchandise exports, 1998 1/	485
Prevalence of child malnutrition (weight for age % of children under 5), 1992-98 1/	57	Merchandise imports, 1998 1/	1 238
Health		Balance of merchandise trade	
Health expenditure, total (as % of GDP), 1990-98 1/	5.5	-753	
Physicians (per thousand people), 1990-98 1/	0.04	Current account balances (USD million)	
Percentage population without access to safe water, 1990-98 3/	29	before official transfers, 1998 1/	
Percentage population without access to health services, 1981-93 3/	90	after official transfers, 1998 1/	
Percentage population without access to sanitation, 1990-98 3/	84	Foreign direct investment, 1998 1/	
Agriculture and Food		12	
Food imports as percentage of total merchandise imports, 1998 1/	12 a/	Government Finance	
Fertilizer consumption (hundreds of grams per ha of arable land), 1995-97 1/	350	Overall budget surplus/deficit (including grants) (as % of GDP), 1997 1/	
Food production index (1989-91=100), 1996-98 1/	117.2	-3.9	
Land Use		Total expenditure (% of GDP), 1997 1/	
Arable land as % of land area, 1997 1/	20.3	16.8	
Forest area (km ² thousand), 1995 1/	48	Total external debt (USD million), 1998 1/	
Forest area as % of total land area, 1995 1/	33.7	2 646	
Irrigated land as % of cropland, 1995-97 1/	38.2	Present value of debt (as % of GNP), 1998 1/	
		Total debt service (% of exports of goods and services), 1998 1/	
		7.0	
		Nominal lending rate of banks, 1998 1/	
		14.0	
		Nominal deposit rate of banks, 1998 1/	
		8.9	

n.a. not available.

a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Report*, 20002/ World Bank, *Atlas*, 20003/ UNDP, *Human Development Report*, 20004/ World Bank, *World Development Indicators database*, 2001

PREVIOUS IFAD FINANCING TO NEPAL

Project Name	Initiating Institution	Cooperating Institution	Lending Terms	Board Approval	Loan Effectiveness	Current Closing Date	Loan /Grant Acronym	Currency	Approved Loan/Grant Amount	Disbursement (as % of Approved Amount)
Integrated Rural Development Project (Sagarmatha Zone)	AsDB	AsDB	HC	12 Dec 78	01 Nov 79	31 Dec 88	L - I - 10 - NEP	USD	13 000 000	88.7%
Small Farmer Development Project	IFAD	AsDB	HC	05 Dec 80	10 Jul 81	31 Dec 87	G - I - 64 - NE	SDR	800 000	100.0%
Small Farmer Development Project	IFAD	AsDB	HC	05 Dec 80	10 Jul 81	31 Dec 87	L - I - 57 - NE	SDR	9 800 000	100%
Command Area Development Project	AsDB	AsDB	HC	17 Dec 81	01 Oct 82	30 Sep 89	L - I - 82 - NE	SDR	9 800 000	62.0%
Second Small Farmer Development Project	IFAD	AsDB	HC	02 Apr 85	03 Mar 86	30 Jun 91	G - I - 134 - NE	SDR	110 000	56%
Second Small Farmer Development Project	IFAD	AsDB	HC	02 Apr 85	03 Mar 86	30 Jun 91	L - I - 166 - NE	SDR	15 150 000	99.7%
Aquaculture Development Project	AsDB	AsDB	HC	18 Sep 86	15 Oct 87	31 Dec 92	L - I - 191 - NE	SDR	4 200 000	14.7%
Production Credit for Rural Women Project	IFAD	UNOPS	HC	10 Sep 87	30 Nov 88	31 Dec 97	L - I - 208 - NE	SDR	4 750 000	100%
Hills Leasehold Forestry and Forage Development Project	IFAD	UNOPS	HC	07 Dec 89	18 Feb 91	31 Dec 01	L - I - 250 - NE	SDR	10 000 000	34.6%
Groundwater Irrigation and Flood Rehabilitation Project	IFAD	UNOPS	HC	19 Apr 94	01 Nov 94	31 Dec 01	L - I - 352 - NP	SDR	7 000 000	47.6%
Poverty Alleviation Project in Western Terai	IFAD	UNOPS	HC	11 Sep 97	10 Mar 98	31 Dec 04	L - I - 452 - NP	SDR	6 550 000	27.8%

AsDB Asian Development Bank
 UNOPS United Nations Office for Project Services
 HC Highly concessional



LOGICAL FRAMEWORK

Notes: (i) As the project is demand-driven, the output targets remain highly indicative and in some cases are not specified in detail; (ii) as the project is funded under the FLM, the output targets only correspond to the first phase; and (iii) the logframe should be regarded as indicative. The logframe will need to be reworked by project stakeholders during the course of implementation

NARRATIVE SUMMARY	OBJECTIVELY VERIFIED INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS AND RISKS
<p>Goal</p> <p>To ensure more resilient livelihoods and basic human dignity among poor and socially disadvantaged people in the uplands of the Mid- and Far-Western Regions of Nepal</p> <p>Purpose</p> <p>To assist in self-empowerment and in strengthening the capacity of poor and socially disadvantaged groups of people to:</p> <ul style="list-style-type: none"> • Mobilize and increase their own resources; • gain access to external resources; • claim social justice <p>A secondary project objective will be to:</p> <ul style="list-style-type: none"> • create dynamic grass-roots institutions (COs) which will ultimately be federated at the VDC and DDC levels. 	<p>At least 60% of households report considerable improvement in livelihood (gender, ethnicity, caste).</p> <p>The reported social status of 40% of households is considerably enhanced (gender, ethnicity, caste).</p> <p>The prevalence of chronic malnutrition among children less than 5 years of age is reduced by at least 10% in project-related areas (boys and girls).</p> <p>Households provided with secured rights to land, forest and pasture areas increased by 3 000 ha by the end of Phase I - Trigger Indicator for Phase II.</p> <p>(i) % increase in annual average household income (gender, ethnicity, caste); (ii) % increase in per capita income (gender, ethnicity, caste).</p> <p>No. of women, youth and <i>dalits</i> reporting increased employment opportunities, income and access to assets and natural resources; improved health (for women); economic independence (for men); more mobility and decision-making power; reduced violence and discrimination, as result of project.</p> <p>Production indicators</p> <p>% Increase in annual average household crop/livestock production.</p> <p>% increase in household leasehold forestry production (including NTFPs) (gender, ethnicity and caste).</p> <p>Consumption indicators</p> <p>Increased consumption and dietary diversification (gender, ethnicity, caste, age).</p> <p>Access to resources and services</p> <p>At least 400 COs report improved access to services at the end of first phase (by group, caste and gender).</p> <p>Social justice indicators</p> <p>No. of households reporting experience of social justice.</p> <p>% increase in CO members reporting equity/democracy in group membership composition.</p> <p>% increase in PSDP participation in COs.</p> <p>CO viability indicators</p> <p>% increase in borrowing (landed, landless, gender by household head);</p> <p>% increase in group savings with COs by PY4 (this measures both profitability and confidence in the system).</p> <p>No of clusters/federations established by the end of second phase – Trigger indicator for Phase III.</p>	<p>Population-based survey</p> <p>Population-based survey</p> <p>Anthropometric survey and rolling baseline survey, at mid term and project close.</p> <p>Rolling baseline data and participatory impact assessment.</p> <p>Comparative evaluation through longitudinal data.</p> <p>Rolling baseline data and participatory impact assessment.</p> <p>Rolling baseline survey, project M&E.</p> <p>Regular participatory impact assessment studies and monitoring.</p> <p>Participatory Impact Monitoring (PIM)</p> <p>PIM</p> <p>Annual statements of VDC accounts and statements of federated body after its formation</p>	<p>All stakeholders accept that quality of life includes both livelihoods and social justice.</p> <p>Improved capacity of local groups of PSDP leads to effective mobilization of, and access to, resources, improved services and effective claims to social justice.</p> <p>District teams (DTs), partner NGOs, government officials, line agencies and private sector adopt strategies.</p> <p>The overall situation and environment (incl. security situation) does not deteriorate to the point that the project cannot be effectively implemented.</p> <p>DTs and NGOs are willing and able to work with local groups of PSPD in a self-empowering mode.</p> <p>Local service providers have the technical know-how and the capacity to provide.</p> <p>Effective dialogue on policy may lead to policy changes.</p> <p>There is little or no interference in the credit process and relative independence of cooperatives from local elites.</p> <p>Synergy among government and village organization is enhanced and institutionalized.</p> <p>The various VDC-level bodies formed by different NGOs can be harmonized into one single federation of VDC-based cooperatives.</p> <p>There is an adequate number of NGOs in the district.</p>
Outputs/Deliverables			

3



NARRATIVE SUMMARY	OBJECTIVELY VERIFIED INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS AND RISKS
<p>IV. Rural microfinance implemented</p>	<p>Phase I 400 COs established and managing saving and credit effectively, benefiting priority target group (at least 50% women) - Phase 1-2 trigger. 800 managers/presidents trained and managing effectively. Increasing amount of beneficiary savings over time (by 80% by end of phase 1) - Phase 1-2 trigger. 40 village-level auditors trained and auditing effectively. Amount of credit from own savings disbursed as loans to disadvantaged groups. Amount of credit from LDFBs disbursed to disadvantaged. Lending to women from group savings is approx. 35% of total - Phase 1-2 trigger. 100% of COs formed have functioning savings and credit schemes within second year of establishment and are meeting regularly. Repayment rates (95%) – Phase 1-2 trigger. No. of VDC-level and District-level federations established. Jointly-produced balance sheets (savings, investments & profits etc.) at end of Phase I; No. of association/federation links with banks established at end of Phase II.</p>	<p>Progress reports and disbursement reports. Participatory M&E</p>	<p>Market trends and fluctuations do not adversely affect economic viability of on- and off- farm activities.</p> <p>Project staff properly trained and motivated.</p> <p>Willingness and ability of target groups to participate effectively.</p>
<p>V. Institutional support implemented</p> <p>Project coordination and institutional support provided. PCU and DTs functioning effectively. COs functioning effectively at the grass-roots level, with increasing membership and increasing savings per member. The secondary-level association functioning effectively at the VDC level. The tertiary-level federation of DDC-level associations emerging at the district level. Rights-based issues mainstreamed in the project developed and enforced. Gender and poverty concerns successfully mainstreamed in the project.</p>	<p>Phase I</p> <p>PCU staffed and established at Nepalgunj. District resource mapping completed and action plan prepared for each district, identifying (i) the VDCs that the project will operate in; and (ii) the service providers, their expertise and strengths and weaknesses. DTs established in four districts and functioning effectively under the LDFB Boards. Project staff recruited and trained: one PC; Professional staff at the PCU and DTs comprising a team leader, M&E officer, an accountant and selected service providers. All coordinating committees at the district level to be included in first phase established and functioning effectively. Manuals prepared. Participatory M&E system developed and operating effectively. Management information system established. Where available, NGOs contracted to provide services.</p> <p>VDC and district-level federation started up. - Phase 2 to 3 trigger. All studies and evaluation reports concluded and made available to the review missions – Phase 1-2 and 2-3 trigger.</p>	<p>Progress reports and disbursement reports. Participatory M&E Records kept by the COs.</p> <p>Regular documents maintained by the COs and VDC-level federation.</p>	<p>It is possible for project staff to develop a close working relationship with the DDC, LDF Board and line ministries.</p>



COSTS AND FINANCING

Expenditure Accounts by Components

	Institutional Support									Total	Physical								
	Labour-Intensive Infrastructure Development			Leasehold Forestry Resources And NTFP Production		Crop and Livestock Improvement		Rural Microfinance			Project Coordination		Local Development Fund Boards		Empowerment and Social Justice		Capacity Building for		
	Inter-District Roads	Community Infrastructure	-	-	-	-	-	-	-		-	-	-	-	-	-	-	-	Contingencies %
I. Investment Costs																			
A. 'Green Road' construction	4 141	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	10.0	414
B. Community infrastructure /a	-	5 030	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
C. Equipment, materials & vehicles	-	-	434	1 069	-	241	782	-	-	-	-	-	-	-	-	-	-	-	-
D. Training and workshops	6	27	473	388	98	305	732	1 196	3 224	-	-	-	-	-	-	-	-	-	-
E. Studies and research	50	-	499	158	13	116	100	-	936	-	-	-	-	-	-	-	-	-	-
F. Contract for NGO services	-	-	1 279	-	-	-	-	-	1 279	-	-	-	-	-	-	-	-	-	-
G. Credit capital	-	-	-	-	-	4 632	-	-	4 632	-	-	-	-	-	-	-	-	-	-
Total Investment Costs	4 197	5 057	2 685	1 614	4 743	661	1 613	1 196	21 768	1.9	414								
II. Recurrent Costs																			
A. Staff salaries	235	358	-	-	1 710	296	509	-	3 108	-	-	-	-	-	-	-	-	-	-
B. Field allowances	-	-	242	194	195	-	-	-	631	-	-	-	-	-	-	-	-	-	-
C. Local TA	312	-	33	9	-	737	-	-	1 090	-	-	-	-	-	-	-	-	-	-
D. Operations and maintenance	134	101	83	112	127	299	826	-	1 681	-	-	-	-	-	-	-	-	-	-
Total Recurrent Costs	681	458	358	316	2 031	1 332	1 335	1 196	6 511	1.5	414								
Total Baseline Costs	4 878	5 515	3 043	1 930	6 775	1 993	2 949	1 196	28 279	1.5	414								
Physical contingencies	414	-	-	-	-	-	-	-	414	-	-	-	-	-	-	-	-	-	-
Price contingencies	860	1 002	484	284	402	195	456	190	3 872	1.8	68								
Total Project Costs	6 152	6 517	3 527	2 213	7 177	2 188	3 404	1 386	32 565	1.5	482								
Taxes	16	12	70	160	15	65	201	-	539	-	-	-	-	-	-	-	-	-	-
Foreign exchange	593	639	395	721	65	295	871	139	3 717	1.3	48								

/a Financed 80% from IFAD loan, 10% from DDC and 10% from VDC.

Disbursement Accounts by Financiers (USD' 000)

	IFAD (Loan)		IFAD (Grant)		WFP		Private Sector		Beneficiaries		Local Government		HMGN		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%			
1. Civil works	4 754	42.3	-	-	4 026	35.8	-	-	-	-	1 789	15.9	674	6.0	11 243	34.5	1 124	10 119	-
2. Equipment, materials and vehicles	2 458	85.8	-	-	-	-	-	-	-	-	-	-	335	12.0	2 794	8.6	1 397	1 062	335
3. Transport of beneficiary inputs	-	-	-	-	-	-	-	-	-	-	-	-	73	100	73	0.2	-	73	-
4. Training and studies	4 765	100.0	-	-	-	-	-	-	-	-	-	-	0	-	4 765	14.6	476	4 288	-
5. Technical assistance	790	66.6	360	30.3	-	-	36	3.0	-	-	-	-	-	-	1 186	3.6	-	1 186	-
6. NGO services	1 498	100.0	-	-	-	-	-	-	-	-	-	-	-	-	1 498	4.6	-	1 498	-
7. Credit	4 169	90.0	-	-	-	-	-	-	-	-	-	-	463	10.0	4 632	14.2	-	4 632	-
8. Salaries and allowances	-	-	-	-	-	-	-	-	-	-	273	6.2	4 148	93.8	4 421	13.6	-	4 421	-
9. Incremental operating expenses	1 504	77.0	-	-	-	-	-	-	78	4.0	138	7.1	232	11.9	1 952	6.0	683	1 074	195
Total	19 937	61.2	360	1.1	4 026	12.4	36	0.1	78	0.2	2 201	6.8	5 926	18.2	32 565	100.0	3 681	28 353	530



IMPLEMENTATION ARRANGEMENTS AND RESPONSIBILITIES

Formation of Grass-Roots Institutions (COs)

1. The implementation arrangements for social mobilization will follow the current procedures of the PDDP. Overall responsibility for institution building at the village level will rest with the project social mobilizers (SMs), who will encourage the villages to form COs, elect presidents and managers, and ensure that they receive training under the project. At the same time, each SM will conduct a socio-economic survey to identify the target group. The CO will be a male member-based, a female member based, or a mixed male/female member-based organization. The SMs will visit the COs regularly and attend their meetings. At these meetings, the SMs will take part in the discussions and check the CO managers' record keeping. The auditors recruited and trained by the project will audit the CO accounts. Village-level specialists, trained by the line ministries and backstopped by the project and government staff at the district level, will provide technical support to the beneficiaries.

The 'Green Roads' Sub-Component

2. Costs under this sub-component include provision for an initial technical feasibility study (USD 50 000) to assess the most feasible alignment and the availability of materials, labour and costs. The roads will be built subject to the approval of the DDCs concerned. These environmentally friendly 'green roads' start off as trails and are enlarged each year until they reach the necessary width of 4.5 m. All work is done manually

3. The 'green road' will be constructed using labour-intensive techniques. RCIW will provide food, tools, material cash and training. The Government will provide engineering services and construction material. The DDC will approve projects, coordinate planning, monitor implementation, and mediate problems. Local NGOs and consultants will help to mobilize and establish the groups and train their members. User groups (UGs), comprising food-deficit families, will implement food-for-work projects. DDCs will maintain the 'green roads', with the support of VDCs and the Department of Roads, each contributing NR 12 000/km/year towards their maintenance.

4. The implementation of this sub-component, with the support of WFP, will follow existing RCIW procedures. At the district level, four institutions will be involved in the execution of RCIW activities. These are the DPSU, the DDC, the VDC and the NGO. TA to supervise and monitor the project will be provided by an NGO. The NGO's obligation will be to provide TA to MOLD and other cooperating project partners, either directly or through consultants. The NGO will advise, assist and support project partners working at all levels in the field, and strengthen the capacity of the user committee and the UGs. In line with present practice, the Government will establish a DPSU to store rice (food-for-work) and supervise road construction. The DPSU will be staffed with an engineer, three overseers, an accountant, storekeepers and security guards. The roles and responsibilities of the various participating institutions will be as follows:

- **World Food Programme.** WFP's main obligation will be to provide the specified quantity of rice on time as well as tools for construction and some office equipment. It will also provide funds to share the cost of storing and handling the rice on a 50:50 basis with the Government.
- **DDC:** At the district level, the overall responsibility for project activities will rest with the DDC, which will ensure that the roads are built in line with the district's plans, approve additional funds as necessary and monitor progress.



- **DPSU.** The main responsibilities of the DPSU are to: (i) carry out detailed designs, and cost and material estimates for roads; (ii) arrange for the storage and transport of rice; (iii) facilitate the formation of user committees; (iv) advise UGs on technical and organizational matters; (e) measure and certify work-in-progress; and (v) monitor project performance.
- **NGO technical units.** The NGO will be responsible for: (i) assisting the DPSU on programme-related matters, preparing cost estimates, organizing and conducting on-the-job training for UGs and the committees; and (ii) assisting the DPSU in technical site preparation; and certification of work-in-progress, which will be undertaken jointly with the DPSU.
- **VDC.** The VDC will facilitate project identification and provide cash for the payment of unskilled labour used during the construction phase of RCIW projects. It will also support the SM to form the user committee and identify beneficiaries to be organized into UGs.
- **UGs.** User groups will provide the labour and take over the management of the project by setting up a user committee.

Small-Scale Infrastructure Development Sub-Component

5. The small-scale infrastructure component will be implemented through the VDCs in line with present arrangements under the PDDP, with the support of the LDF and the DDCs.

6. **Scheme selection.** Beneficiary selection and the mobilization of communities will be the responsibility of the SMs recruited by the LDFB. The SMs will motivate the COs, encouraging them to identify their critical infrastructure constraints and prioritize them on the basis of eligibility criteria. The proposals will be discussed in the VDC, the *Ilaka* Committee and the DDC. Once approved by the DDC, the overseer/DDC engineer will conduct a technical feasibility study. Once the study has been undertaken, the project will be included in the annual work programme and budget (AWP/B) of the district. The proposal will then be reviewed by the SM to ensure that: (i) it benefits most members of the communities, especially the poor; (ii) the VDC will contribute the required cash contribution and deposit at least NPR 5.0 per day to the beneficiaries' savings accounts; (iii) communities ensure that the poorest members are employed once construction begins; and (iv) IFAD's contribution to the sub-project does not exceed USD 10 000.

7. Once the funding for the proposal has been evaluated, construction will be undertaken by UGs with the support of the overseer and engineers in the DDC office, who will organise UGs and help them select a user committee with the assistance of the SM. The user committee will be trained by the sub-overseers and commence work under the guidance of the overseers.

8. **Operation and maintenance.** Each CO will arrange to collect infrastructure maintenance charges from members. Each community will be required to maintain its facilities from these funds. The LDF overseer or the district engineer will train the COs in facility maintenance techniques.

Leasehold Forestry and NTFP Production Component

9. The DFOs, who will receive annual allocations from LDF to implement the agreed programme, will implement this component. The DFOs will prepare operational plans for demarcating the areas involved or contract an NGO to undertake these functions. The mobilization and training of LFUG leaders will be undertaken by the project SMs or an NGO contracted by DFOs. DFOs, who will also train the LFUG and its members in conservation-based forestry practices, will provide technical training for LFUGs. The NGO will organize the groups, prepare operational plans and arrange for them to be approved by the DFOs. Once the plans are approved, they will demarcate the LFUG lands. LFUG members will secure credit from the COs. NGOs will ensure that NTFP production follows conservation-based practices and that the benefits are distributed equally among members.



10. **Nurseries.** The project will establish one nursery for every LFUG within the land leased. This sub-component, which is targeted at women, will be implemented by an NGO with support from the private sector. In order to be eligible to enter into contracts as village nursery operators, women will be required to: (i) be heads of households; (ii) be CO members with access to credit; (iii) have experience or be trained in NTFP production; and (iv) be willing to grow species that can be propagated locally and provide a holding area for those that will only be provided by the private companies. These nurseries will be managed as follows: (i) the NGO will identify five women for training in nursery management; (ii) the women will construct and prepare seedbeds with the help of the NGOs; (iii) the private company will train the women at District headquarters; and (iv) the women will maintain the nurseries and sell the plants at a profit. The initial planting material will be provided in the form of a grant and any subsequent purchases will be made on credit.

11. **Private sector.** Liaison with private-sector companies will be maintained by the PCU marketing specialist, who will also be responsible for forming trader groups and ensuring that price information is available to the beneficiaries on timely basis. The private companies will be responsible for: (i) providing planting material at cost; (ii) training beneficiaries, DFO and NGO staff; (iii) occasionally supervising production; and (iv) purchasing produce at a stipulated floor price. The farmers will be free to sell to whomever they wish.

12. **Research on domesticated NTFP production.** The project is expected to finance research on additional plants that can be domesticated. The following procedures will be followed in granting the contracts: (i) the PCU will shortlist selected companies/NGOs that have both experience and a ready source of planting material for research purposes; (ii) short-listed companies will be invited to submit technical and financial proposals; (iii) bids will be evaluated by a tender committee; (iv) the results of that evaluation will be made available to the cooperating institution; and (v) once approved, the contract will be awarded.

Crop and Livestock Improvement Component

13. **Designation and responsibilities of project parties.** The LDF Boards will implement this component, with support from DADO and DLSO staff. The component will provide a comprehensive programme for promoting integrated farming through training and extension, demonstrations, research, supplies of planting material, improved animal health and nutrition and breed improvement.

14. **Training.** Training will be provided to line ministry staff, village specialists and persons involved in demonstrations: (i) DADO and DLSO staff will be trained by local TA recruited by the PCU, in accordance with the curricula drawn up by the training advisor with the help of the research advisor; and (ii) village specialists, who will be identified by the VDCs, will be trained by DADO and DLSO staff in sustainable agriculture farming, composting, forage production in the terrace risers and edges, and improved livestock husbandry practices, including animal health management.

15. **Extension.** This will be undertaken at demonstration sites and through farmer-to-farmer visits. Ten demonstration sites will be set up in each VDC. These sites will consist of forage and agricultural crops to show the benefits of integrated farming systems. The COs will identify farmers to establish and operate demonstration plots. The DADO and DLSO staff will train the farmers at the sites. The project will provide seed for demonstration in the form of grants. In certain cases, such as replication of the existing legume-cereal mixed cropping practices, DADO and DLSO staff will organize exposure tours. The TA research advisor in the PCU, with inputs from DADO staff, will prepare extension material and review the materials after the adaptive trials have been conducted. The material will be distributed by the LDFB to the junior assistants, junior technical assistants, village specialists and the village health workers (VAHWs).



16. **Planting material** will be provided through nurseries. One multipurpose nursery will be established for each VDC. To be eligible to enter into a contract as a village nursery operator, women will be required to: (i) be heads of households; (ii) be CO members with access to credit; (iii) have experience or be trained in NTFP production; and (iv) be willing to grow species that can be propagated locally and provide holding areas for those that can only be provided by the private companies. In consultation with the COs, the project will select two poor women or *dalits* for management of the nurseries. The nurseries will be managed as follows: (i) the identified women will be trained in nursery management; (ii) the women will build and prepare seedbeds with the help of the JTAs; and (iii) DADO and DLSO staff will train the nursery operators.

17. **Provision of animal health services** will be the responsibility of VAHWs, two of which will be trained in each VDC at the regional training centre of the district livestock service. Once these VAHWs have been trained, they will receive a start-up kit as a grant. Any subsequent replenishment of the medicine supply will be the responsibility of the VAHWs, who will be eligible to receive credit.

18. **Adaptive research trials** will be conducted by the National Agricultural Research Council (NARC) under a contractual agreement. These trials will be conducted on blast-resistant rice and hay crops in Jumla and on true seed potato production in both the hills and high-hill districts. NARC will provide seed, supervise trials and prepare periodic reports and a final report.

19. **Breed improvement** will be initiated by the project by supporting an ongoing programme for supplying breeding male goats and buffaloes. With respect to sheep, the project will improve local breeds by introducing private stud farming on a pilot basis. This will be implemented as follows. NARC will be contracted to execute this component. As part of the contract, NARC will train farmers; select the stock with the assistance of DLS staff; develop breeding plans; and supervise the farmers.

Rural Microfinance Component

20. This component will be implemented by the LDF Boards, savings and credit facilitators (SCFs), SMs, COs and auditors, in line with PDDP procedures. SMs will mobilize and support COs in the target villages. COs will retail credit to their members, with CO managers maintaining records and granting loans after training. Technical support and training will be provided through trained village specialists and by staff of line agencies (DADO, DLSO, district forestry office and NGOs). Auditors will be recruited and trained to audit CO records and accounts. LDF will provide credit to each of the COs for on-lending to CO members. The amount of funds released to the LDF will be based on the AWP/B. Funds will be released as part of the general disbursement of the Village Development Programme from MOLD. The funds will be available to the LDF on a grant basis and will be deposited in an interest-bearing account that will be managed by the team leader. The interest accrued will remain in the credit account.

21. **Credit organizations.** COs will be established in the VDCs. COs may be formed according to gender or with mixed membership, but at least 50% of the members will be women. LDF will provide credit to eligible COs based on credit plans prepared by COs and recommended by the SM/SCF. It is not required that CO should have legal status to be eligible for loans under the component. COs will be eligible to receive credit from LDF if, *inter alia*, they: (i) are at least six months old, with an excellent record in managing members' savings (ii) maintain a recovery rate of 95%; (iii) hold regular meetings attended by 90% of their members; (iv) have a manager and president who are both trained and have demonstrated capacity for maintaining accounts and book-keeping; and (v) each prospective member borrower of such COs are permanent residents of the villages and save regularly.

22. **Risk fund.** Individual borrowers under the CO will be required to contribute 1.5% of the spread on the funds managed, whether under the project or from their own funds generated from savings.



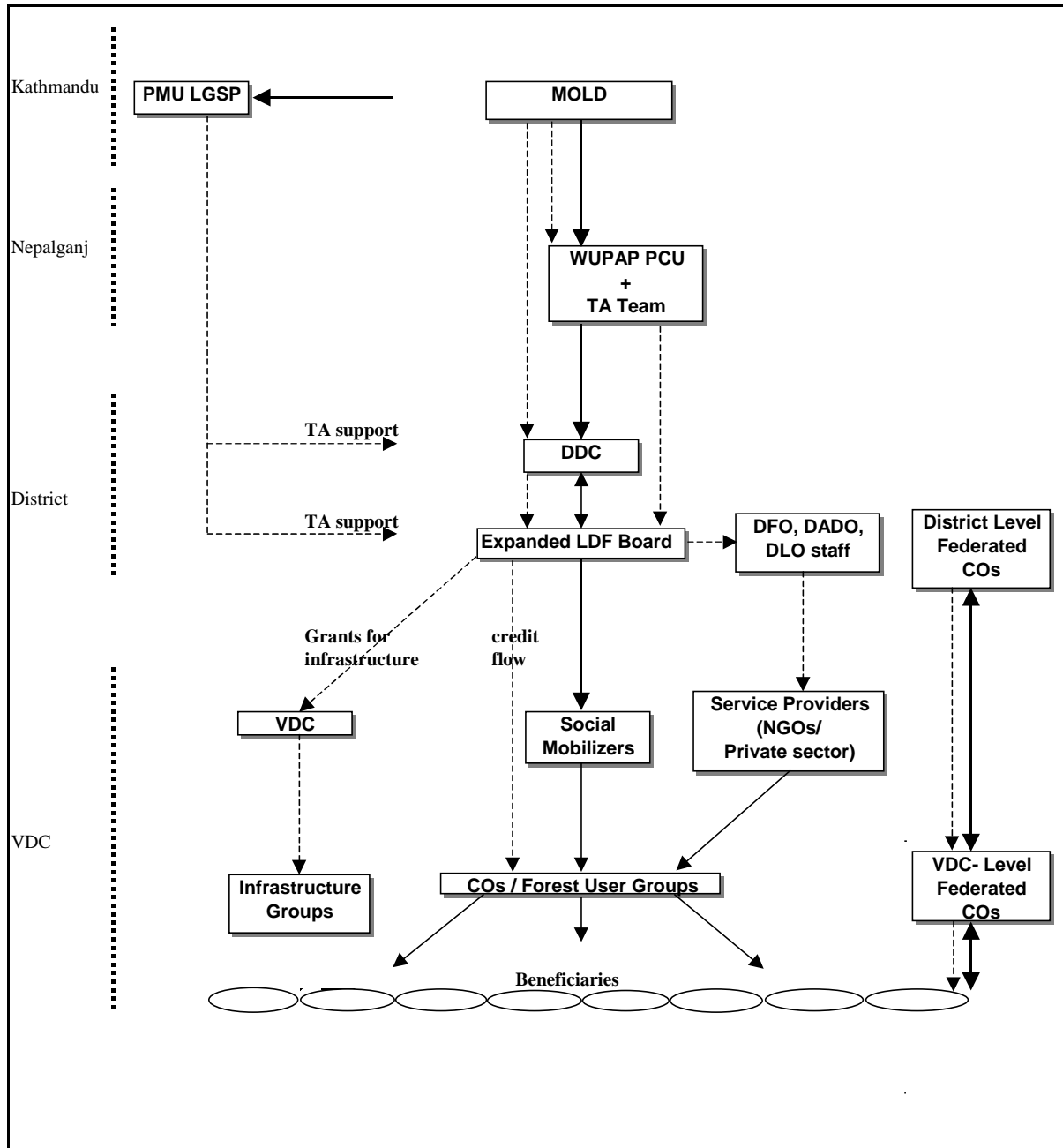
These funds will be set aside as a loan-loss provision and constitute the risk fund. No collateral other than CO joint liability will be required for loans to members.

23. **Credit by-laws.** The PCU will prepare draft credit by-laws for the component as soon as practicable but no later than 12 months after the project loan becomes effective. The credit by-laws will set forth procedures for lending within COs and will include, *inter alia*, (i) member eligibility criteria for receiving loans; (ii) lending ceilings for individuals and groups; (iii) loan approval and disbursement mechanisms; and (iv) information on the distribution of income received from loans. The PCU will submit the draft credit by-laws to the PSC for approval. Once approved by the PSC, the PCU will submit the draft credit by-laws to IFAD and the cooperating institution for comment and approval. The PSC will adopt the credit by-laws, substantially in the form approved by IFAD, for application to all credits extended to project beneficiaries that are financed (directly or indirectly) by the loan. The PCU will provide copies thereof to IFAD and the cooperating institution promptly after adoption.

24. **Equity fund.** In consultation with the cooperating institution, LDF will establish and maintain an equity fund and deposit therein all interest earned. The fund will be deposited in an interest-bearing account and will be available as equity capital to district-level federated bodies, provided all member COs have reached at least 95% of the members in their communities.

ORGANIZATIONAL CHART

Chart 1: WUPAP – Institutional Framework

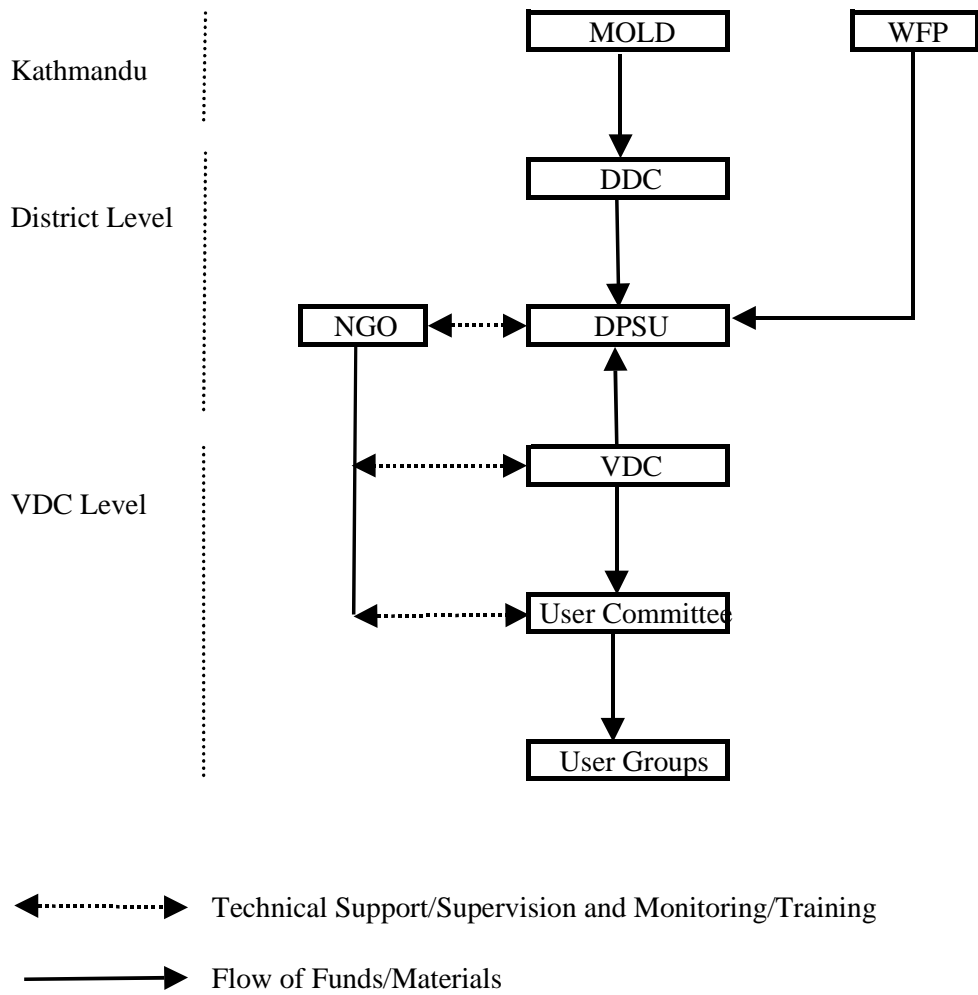


Legend

- > indicates fund flow
- > indicates lines of authority
- > indicates provision of services



Chart 2: Organization Structure for Green Roads under RCIW





FLEXIBLE LENDING MECHANISM AND CONDITIONS FOR SUBSEQUENT LENDING

1. **Flexible Lending Mechanism.** The project will be funded under the FLM. As such, it is divided into three distinct phases: (i) an initial phase of four years to establish the institutions and procedures, when activities will start in at least four Districts; (ii) an expansion phase of four years (PY 5-8); and (iii) a final phase of three years (PY 9-11), which will focus on consolidation and institutionalization of project gains. Under the FLM, a series of so-called ‘triggers’ or preconditions for deciding whether or not to proceed with, delay or cancel the subsequent phases of the project, have been developed. A joint review by the Government, IFAD and village stakeholders at the end of PY 4 and PY 8 will determine whether or not the preconditions have been met and recommend an appropriate course of action. The reviews will also recommend, where appropriate, under which disbursement or other conditions a subsequent phase should be undertaken. The decision to proceed to subsequent phases will, however, rest with IFAD management and will be a disbursement condition for all expenditures in subsequent phases.
2. **First-phase activities.** The first four years (PY 1-4) of the project will focus on: setting up the PCU, the LDFs and grass-roots-level institutions; developing the M&E system; testing the procedures for operations; training project staff and sensitizing all DDC and VDC staff and village-level specialists; establishing nurseries and distribution mechanisms; initiating NTFP production and leasehold forestry in four Districts; contracting NARC to initiate research; starting work on the Simikot-Jumla ‘green road’; and, where requested, building village infrastructure works.
3. **Triggers for proceeding from Phase I to Phase II (assessed at the end of PY 4), include:** (i) forest leases will have been made available in a timely manner and on at least 3 000 ha of land for leasehold forestry; (ii) the project will have operated on target and reached beneficiaries as planned (440 COs and 135 LFUGs formed); (iii) the project will have maintained loan recovery rates of 95%; (iv) 20 km of ‘green roads’ will have been built; (v) 75 small-scale infrastructures will have been constructed; and (vi) all studies and evaluation reports will have been concluded to IFAD’s satisfaction and made available to the review mission in PY 4. Priority will be given to women and *dalits* to train as Social Mobilizers, Village Specialists, office holders and project staff, with a target of 35% women and 15% *dalits* in each position by the end of the first phase.
4. **Triggers for proceeding from Phase II to Phase III (assessed at the end of PY 89).** It is premature to specify quantitative figures for triggers from phases II to III. However, indicators may include: (i) leases having been made available in a timely manner to at least ---- COs and --- LFUGs; (ii) the project having operated on target and reached beneficiaries as planned; (iii) all studies and evaluation reports having been concluded to IFAD’s satisfaction and made available to the review mission in PY 8 and the project having operated on target and reached beneficiaries as planned (----- CO and --- LFUGs formed); (iv) ---% women and --% *dalits* trained as SMs and village specialists, and ---% recruited under the project; (v) project maintaining loan recovery rates of 95%; (vi) all studies and evaluation reports concluded to IFAD’s satisfaction and made available to the review mission in PY 4; and (vii) there is a favourable impact on beneficiaries, especially women and *dalits*



ECONOMIC AND FINANCIAL ANALYSIS

1. IFAD does not require a detailed economic and financial analysis for FLM projects, and for obvious reasons. The nature of the project, with its emphasis on demand-based provision of services, precludes such analysis, which is problematic even for the major productive components. Activities in the crop, livestock, NTFP and informal sectors have been identified and their financial viability assessed. However, there is no sound basis for aggregating these models as the mix of activities will be demand-driven. This inhibits financial and economic analysis of these component and, thereby, of the project as a whole.
2. **Agricultural enterprises.** The livestock activities to be promoted under the project are profitable and their desirability is underlined by the large demand for credit to undertake these activities. Goat production seems to have given returns of less than one United States dollar per day. However, it is widely known that households in the project area find this activity attractive and most households have successfully borrowed for goat breeding under LGP and PDDP. The additional financial incentives necessary to encourage families to invest in honey production will derive from the incremental output of crops and fruit resulting from improved pollination.
3. **NTFP production.** A financial analysis has been undertaken for the cultivation of medicinal and aromatic plants, which are traditionally collected as NTFPs. The models show that the domestication of NTFP gives attractive returns to both capital and household labour. As the market is assured and large, and as the risks are low, there is reason to believe that the farmers will adopt domesticated NTFP production despite the high investment cost of NPR 9 500 per *ropani* (0.05 ha). The attractiveness of the investment is enhanced by the relatively low-level requirement – about 23 labour days per *ropani*.
4. **Microenterprise activities.** Sample models have been derived for some off-farm activities appropriate for landless persons. These income-generating activities are diverse and not easily comparable. In most cases, the activities are short-term in nature and sometimes seasonal. They include trading, weaving and portering. It has been assumed that financing will be provided at the prevailing interest rate of 18%. The models indicate that all identified activities will be financially profitable with benefit/cost ratios ranging from 2.1 to 8.9 (calculated as the ratio of net annual income, including finance charges, to the initial investment).
5. **Financial impact on LFUGs.** A financial analysis was conducted based on detailed analysis of data derived from the ongoing Hill Leasehold Forestry and Forage Development Project. The investment costs of USD 6 242 and USD 8 452 per LFUG in the mid- and high hills, respectively, are high and include all the incremental establishment costs (incurred by the project). Nevertheless the financial internal rates of return have been estimated at 35% and 28%, respectively.
6. **Viability and sustainability of the project.** Sustainability is a key project objective. An analysis of the Dolpa District, which is the remotest and least populated part of the project area, indicates that the costs of all the credit staff and administration should be covered by PY 11, with only 65% of the VDCs covered by the project in the District. There is little doubt that any proposed CO federation would be viable if it expanded its operation to cover the entire District. In any event, there is room for any emerging federation to increase its charges if the interest income from credit does not cover the operating costs. Sensitivity analysis indicates that the break-even year may change from PY 11 to PY 16 if the expenses increase by 50%, but the viability is not in doubt. However, to ensure sustainability, the project allows for the build-up of the capital fund of NR 6.6 million, to cushion the emerging organization against unforeseen events.