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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON PROPOSED FINANCIAL ASSISTANCE TO THE

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

FOR THE

DRY ZONE LIVELIHOOD SUPPORT AND PARTNERSHIP PROGRAMME

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CURRENCY EQUIVALENTS

Currency Unit	=	Sri Lankan Rupee (LKR)
USD 1.00	=	LKR 98.25
LKR 100.00	=	USD 1.03

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

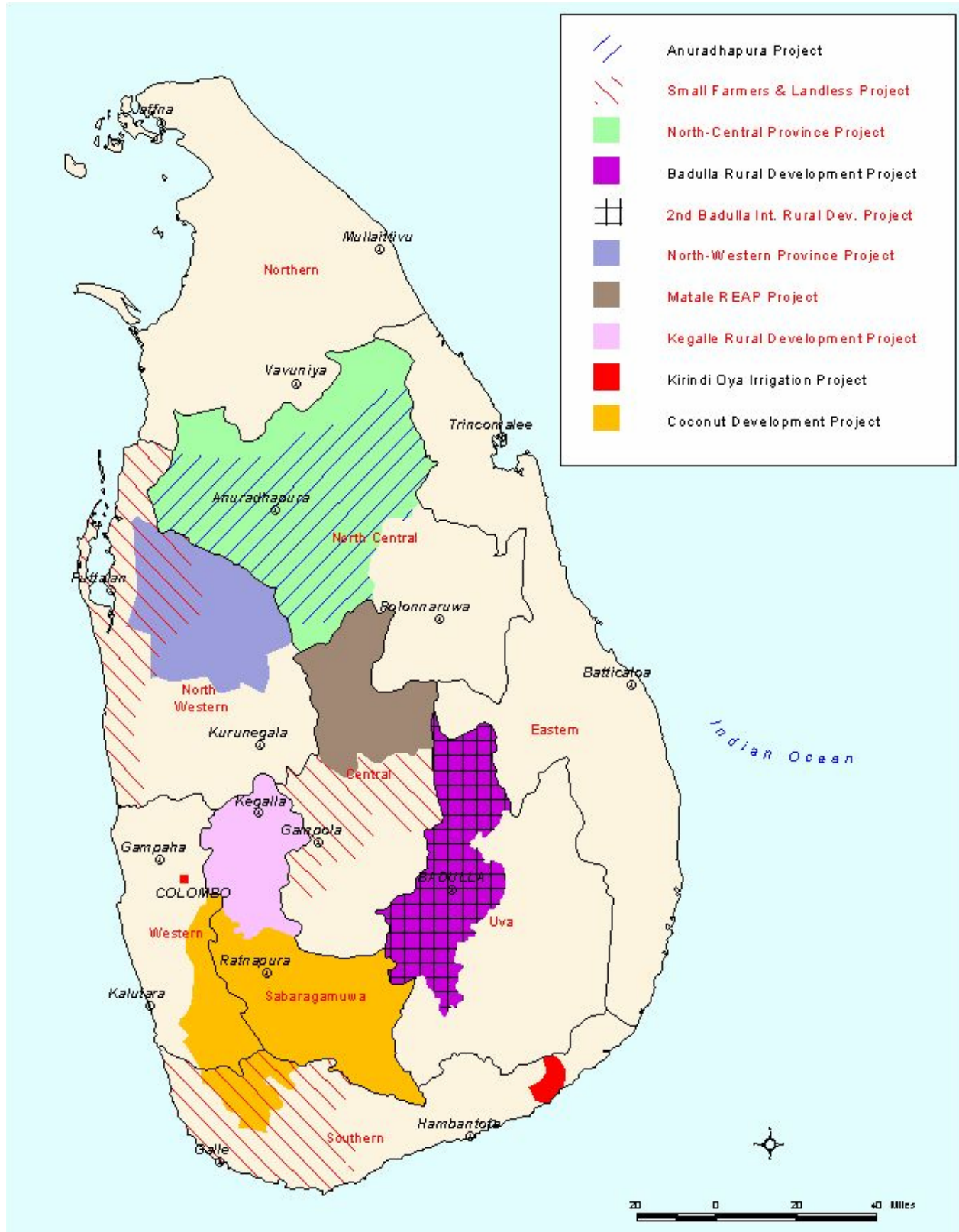
ABBREVIATIONS AND ACRONYMS

CIDA	Canadian International Development Agency
DS	District Secretary
FFS	Farmer field school
GDP	Gross domestic product
GN	Grama Nilhadari
JBIC	Japan Bank for International Cooperation
NGO	Non-governmental organization
UNDP	United Nations Development Programme
WFP	World Food Programme

GOVERNMENT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA**FISCAL YEAR**

1 January – 31 December

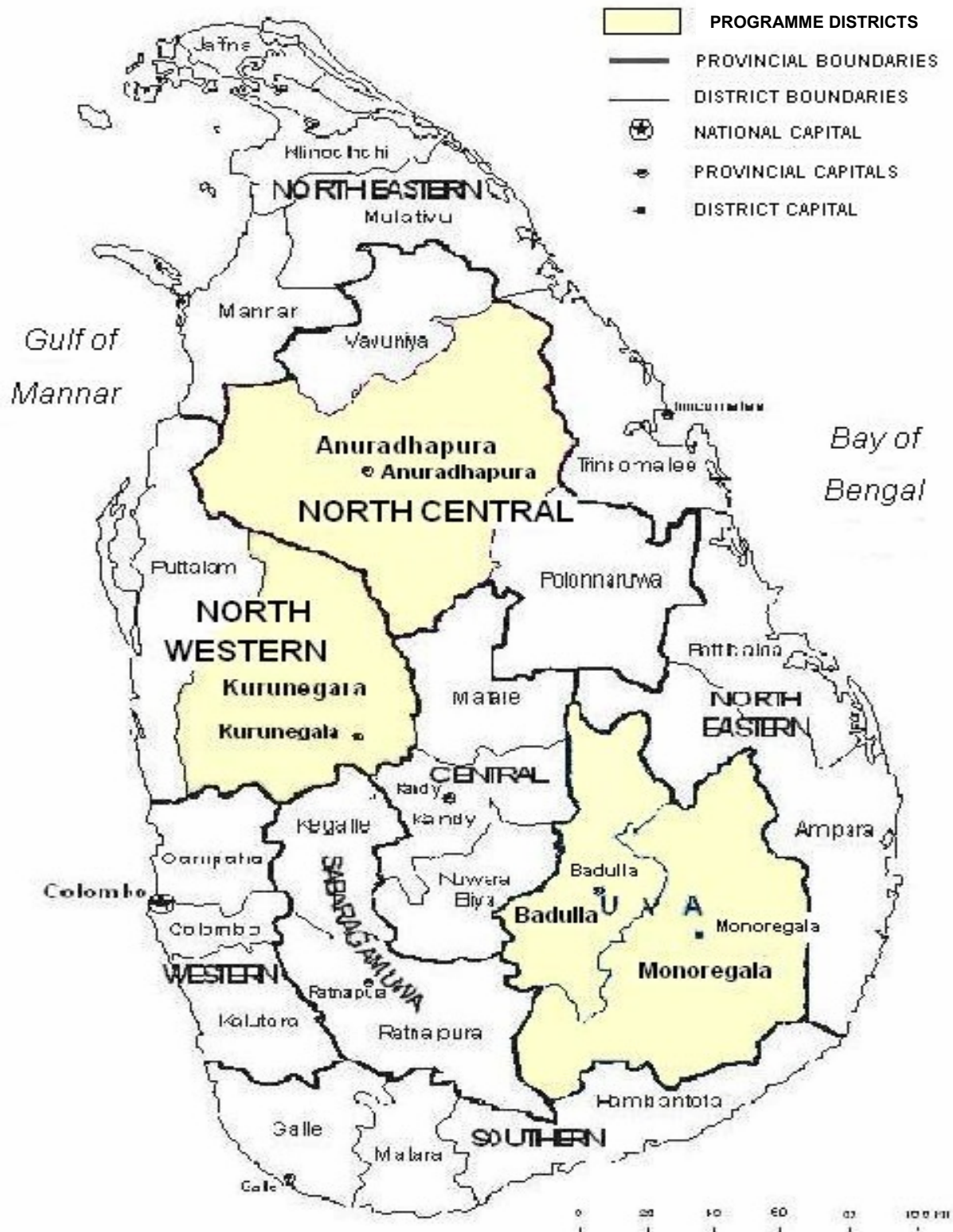
MAP OF IFAD OPERATIONS IN SRI LANKA



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.

MAP OF THE PROGRAMME AREA



Source: IFAD.

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

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA
DRY ZONE LIVELIHOOD SUPPORT AND PARTNERSHIP PROGRAMME

FINANCING SUMMARY

INITIATING INSTITUTION:	IFAD
BORROWER:	Democratic Socialist Republic of Sri Lanka
EXECUTING AGENCY:	Ministry of Agriculture, Livestock, Land and Irrigation
TOTAL PROGRAMME COST:	USD 30.40 million
AMOUNT OF IFAD LOAN:	SDR 15.10 million (equivalent to approximately USD 21.97 million)
AMOUNT OF IFAD GRANT:	SDR 240 000 (equivalent to approximately USD 339 200)
TERMS OF IFAD LOAN:	40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum
COFINANCIERS:	Canadian International Development Agency (CIDA), Japan Bank for International Cooperation (JBIC), United Nations Development Programme (UNDP), World Food Programme (WFP)
AMOUNT OF COFINANCING:	CIDA – USD 963 100 JBIC – USD 1.14 million UNDP – USD 1.50 million WFP – USD 1.06 million
TERMS OF COFINANCING:	CIDA – grant JBIC – loan with interest rate of 2.2% per annum and a repayment period of 30 years, including 10 years' grace period. UNDP – grant WFP – food aid grant
CONTRIBUTION OF BORROWER:	USD 1.73 million
CONTRIBUTION OF BENEFICIARIES:	USD 1.70 million
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	World Bank

PROGRAMME BRIEF

Who are the beneficiaries? The programme will target the rural poor in the dry zones (defined as the area with annual rainfall of up to 1 800 mm), who are those people living below the poverty line of USD 12-15 per person per month; they represent 25-32% of the national population. It will initially target poor households in four of the districts (Anuradhapura, Badulla, Kurunegala and Moneragala) with the highest concentration of poverty. An estimated 1 077 Grama Nilhadari (GN) divisions will be covered, with a total of 255 500 households. The programme will benefit 80 000 households, including: (a) those with less than 1 ac of paddy producing one crop a year and cultivating other upland and home garden crops to supplement consumption and income; (b) those with only upland fields and home gardens, in particular young or woman-headed households facing chronic labour shortages; and (c) landless households living outside villages and relying on *chena* ('shifting cultivation') on encroached land for their livelihoods. Women and youth will be a special target group in recognition of their responsibilities and capabilities in procuring the dry zone livelihoods. And particular attention will be paid to persons of low caste origin to ensure their integration in the target group.

Why are they poor? The main cause of poverty in the dry zones is low productivity due to a host of problems, including limited credit and the scarcity, or poor adoption rates, of appropriate technologies and quality seed. Other factors include the fragmentation of land holdings, post-harvest losses (estimated at 40%), inconsistent producer pricing and trade policies, and market constraints. The area is predominated by rainfed subsistence farming systems due to the limited security of access to resources (land and water), services and markets. Irrigated paddy land is limited. Paddy holdings are small and fragmented, and production is insufficient for home consumption. Those who have no paddy fields cultivate other field crops on marginal uplands, develop home gardens to supplement consumption and income, or are forced to resort to wage labour, demand for which is limited and erratic. Unemployment, especially among youth, is high, leading to seasonal or permanent migration. The situation is exacerbated in more remote areas due to the more limited access to markets, services and employment. There are also pockets of internally displaced persons directly affected by the civil conflict.

What will the programme do for them? The programme will enable the poor in the select districts to improve their incomes and living conditions sustainably through increased access to resources (land and water), services and appropriate technologies, coupled with appropriate market linkages. The capacity of grass-roots institutions will be built up so as to increase their bargaining power. Improved technologies for raising productivity on the uplands will be introduced, and the area under irrigation will be expanded. The poor will be linked to regional and national markets through partnerships between private sector operators and community organizations, coupled with improved transport infrastructure and marketing facilities. Income-generating activities and enterprise development will supplement farm incomes and generate employment, especially for women and youth. Appropriate policy dialogue with stakeholders, notably government, will help eliminate bottlenecks to the improvement of the livelihoods of the poor in the dry zone and boost the incentives to invest there.

How will they participate in the programme? The components and activities of the Dry Zone Livelihood Support and Partnership Programme have been identified through participatory analysis in selected rural communities. Its design is flexible so as to accommodate changing priorities during implementation. Beneficiaries will participate in the planning, implementation and monitoring of programme activities. In clusters of GN divisions, as a first step, a participatory assessment of constraints in rainfed and irrigated farming, from production to marketing, will be undertaken. Solutions will be reviewed in a participatory manner and piloted in beneficiary-managed farmer field schools before their dissemination to individual farmers. Community-based programme activities, like micro-tank rehabilitation and priority community infrastructure development, will be carried out only after the communities express an effective level of demand and consider maintenance priorities following a process of close participatory assessments undertaken with the help of the programme. Self-managed savings and credit schemes will support the poor, especially women, and gender equity will be achieved through the active involvement of women.

**REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD
TO THE EXECUTIVE BOARD ON PROPOSED FINANCIAL ASSISTANCE TO THE
DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA
FOR THE
DRY ZONE LIVELIHOOD SUPPORT AND PARTNERSHIP PROGRAMME**

I submit the following Report and Recommendation on a proposed financial assistance to the Democratic Socialist Republic of Sri Lanka for SDR 15.10 million (equivalent to approximately USD 21.97 million) on highly concessional terms and a grant of SDR 240 000 (equivalent to approximately USD 339 200) to help finance the Dry Zone Livelihood Support and Partnership Programme. 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 financing will be administered by the World Bank as IFAD's cooperating institution.

PART I – THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY¹

A. The Economy and Agricultural Sector

1. **The Country.** Sri Lanka is an island state situated off the south-eastern tip of India and covering an area of over 65 000 km². Its population, estimated in 2003 at 19.7 million persons, about 76.7% of whom are rural residents, is growing at 1.3% per annum. Rainfall is uneven and broadly divides the country into two main climatic zones: a wet zone in the south-west of the country with an average 2 500 mm per year and a dry zone that covers most of the remainder of the country, with precipitation levels of 1 200 to 1 800 mm. Sri Lanka is predominantly Sinhalese by ethnicity and Buddhist by religion, with important minority Tamil (generally Hindu), Muslim and Christian communities.
2. **Human development** indices of Sri Lanka are particularly favourable by developing country standards: an adult literacy rate of 92% (2001), 98% primary school enrolment rate and an average life expectancy of 73 years.
3. **Economy.** The 20-year conflict between the Liberation Tigers of Tamil Eelam and the Government has had a devastating impact on all facets of life in Sri Lanka. More than 65 000 people have been killed and as many as 800 000 displaced. The cease-fire negotiated in 2001 by the Government and the Liberation Tigers of Tamil Eelam must become consolidated into a peace agreement. Despite the escalating civil conflict and several external shocks from the global economy, Sri Lanka managed to maintain an annual growth rate in gross domestic product (GDP) of 5.3% during the 1990s before the sudden slump of 2001 and a weak recovery in 2002. In 2003, GDP per person amounted to USD 918. The driving force behind this growth performance has been the manufacturing sector, which grew at an annual average rate of 8% in 1990-2000. The agriculture sector is a significant contributor to GDP (19%), especially in view of the stimulus it provides to manufacturing (tree-crop processing) and services. Moreover, it employs over 32% of the total labour force, compared with only 17% in the manufacturing sector.

¹ See Appendix I for additional information.

4. Sri Lanka has the most liberal trade environment in all of South Asia. Quantitative controls exist for only a handful of items, for which they have been retained for security or environmental purposes. Exports are dominated by the manufacturing sector, particularly textiles and garments that generate more than 75% of total export earnings. Agriculture is gradually losing its importance in exports, having contributed an average of only 21% over the period 1997-2001, mainly because of the poor growth in the rubber and coconut sectors. Tea, including organic teas, was the leading net foreign exchange earner until the early 1990s and is performing well, representing the second largest exporting subsector and accounting for about 74% of all agricultural exports in 2001.

5. **Poverty.** Measured using a low poverty line of LKR 1 338.5 per adult per month (USD 13.6 per adult per month or USD 163.5 per adult per year), the poor population in urban areas in 2001 included 334 400 persons, or 7.6% of all urban inhabitants. In rural areas, where the poverty incidence is 26.4%, an estimated 3.8 million persons are considered poor. This means that the rural poor represent 92% of all the poor. Poverty, is thus largely a rural problem.

6. A typical poor rural household is engaged in agriculture, but has little or no access to irrigation. Therefore, poor households usually cultivate upland fields and home gardens around the home. The cultivated areas are smaller than the national average and amount to 1 or 2 ac, but crop diversity is high, not only spreading the risk of crop failure, but also providing a healthy diet. Crop production is largely for subsistence, but a significant proportion has to be sold to meet essential cash needs. Food self-sufficiency varies according to the climatic conditions, but averages six to eight months. Non-farm incomes are earned by hiring out available labour resources either to other farms, or to off-farm work through labour migration. Poverty is often due to the limited availability of labour in the household, caused by old age, separation, migration, physical or mental disabilities, etc. Women invariably contribute more labour to the household than do men. Poverty is often worsened by the problems associated with alcoholism among men and the related domestic violence.

7. **Gender.** The literacy rate among women of 87.9% is among the highest in the world, while free education has helped to reduce the gender gap in education. However, in the estate sector, the literacy rate among women is only 53%. Women's participation in the labour force is 32.1%, against 63.8% for men. Women are mostly engaged in agriculture and manufacturing, and 90% of the workers in the garment industry are women. Rural women do at least half the cultivation work. Traditionally, they cultivate drought-resistant subsistence crops in home gardens and upland fields and engage in post-harvest processing. Men concentrate on paddy cultivation and on the protection of the harvests against wild animals on irrigated land, as well as in upland fields. Yet, probably due to socio-cultural factors, government extension staff, who are mostly men, tend to disseminate new technologies and other extension messages through men farmers and ignore women farmers.

B. Lessons Learned from Previous IFAD Experience

8. Sri Lanka was the first country to benefit from an IFAD loan in April 1978. As of October 2003, the total commitments of the Fund to the country amounted to USD 112.3 million of highly concessionary loans for ten interventions.

9. A number of IFAD-supported projects in the dry zone have demonstrated the viability and potential of technologies and methodologies for upland dry-zone agriculture and water-resource development in the form of tank rehabilitation and agro-well development. These have been shown to have an important potential to add to the productive base and to provide activities grounded on adding value to products. To be beneficial and sustainable among the poor in these areas, this type of support needs to be clearly in line with market demands, as often there have been production gluts and disappointments in the lack of follow-up. Also the emphasis during implementation has to shift from infrastructure to capacity-strengthening among user groups in operation and maintenance so as to ensure sustainability.

10. Projects have shown the success of small-group revolving-loan mechanisms, especially those run by women and relying on multiple-use loans, as stepping stones to more commercial levels of credit or as a safety net. In addition, the beneficiaries have reported greater empowerment as a result of grass-roots savings and credit institutions. In both the IFAD projects in Anuradhapura and Badulla districts, the participatory approach has led to the establishment of organizations managed by the village stakeholders. Federations have been created at the District Secretary (DS) division and district levels. Such institutions are operating savings and loan schemes for their members. They have enabled IFAD operations directly to assist the poor by avoiding the multiple and often confusing layers of authority at the divisional, district, province and central levels that have been the consequence of several attempts at decentralization and devolution of power. Future IFAD programmes should build on and further strengthen the sustainability of human and institutional assets.

C. IFAD's Strategy for Collaboration with Sri Lanka

11. **Government Poverty Reduction Policy and IFAD's Contribution.** Sri Lanka's poverty reduction strategy is based on six main thrusts, namely: (a) the building of a supportive macroeconomic environment; (b) the reduction of conflict-related poverty; (c) the creation of opportunities for poor and marginalized communities to participate in economic growth through investments in rural infrastructure and the promotion of structural changes in the rural economy from low input-output production systems to commercially oriented development; (d) investment in people so as to build up the human resources through increased access to quality social services; (e) empowerment among the poor and the strengthening of governance so as to improve accountability, transparency, predictability and popular participation; and (f) effective monitoring and evaluation, using well-defined targets and indicators linked to the Millennium Development Goals. The poverty reduction strategy reflects common traits with similar strategies in other countries in that it advocates "pro-poor growth", though it lacks the effective instruments to ensure that growth reaches the poor in ways other than through an (assumed) trickle-down effect, and in that it does not seem to provide resources to the sector where most of the poor are engaged, that is, agriculture. Therefore, the IFAD programme supports the strategy by making up for its lack of the actual transfer of resources to the poor so as to raise their productivity and by sharpening its "pro-poor growth" expectations by geographically targeting poor, remote and post-conflict bordering areas.

12. **IFAD's Operational Strategy in Sri Lanka.** A number of critical criteria have been used to prioritize IFAD interventions in Sri Lanka. They include the assignment of priority to operations with the following characteristics: (a) operations with a reasonably tangible impact on the livelihoods of the poor; (b) the fostering of the sustainability of initiatives through the full empowerment of local communities so that they become responsible for the management and maintenance of their own investments; (c) a focus on women and the least favoured areas of Sri Lanka; and (d) operations with a high degree of innovation and a potentially catalytic role.

13. Based on further analysis using the above criteria in 2002 during the process revolving around the country strategic opportunities paper, three sectors emerged as niche areas for IFAD operations. The first is the **dry zone**, where three of IFAD's ten operations have been located. Furthermore, the majority of the rural residents who are structurally poor, including near landless farmers in marginal uplands and marginalized woman-headed households, are reported to be found in these areas. The second is the **estate sector and surrounding villages**, where pockets of chronic and extreme poverty are encountered among estate workers and smallholder tea producers who are poorly linked to markets. The third is the **coastal zone and surrounding hinterland**, where poor fishermen and other poor people eke out a living, notably in the conflict areas of the north and north-east. While these communities are often only considered conflict poor (as opposed to structurally poor), it is obvious that they will need support in the careful and balanced management of the natural resources (fish in particular) around them, now that the conflict (that may have inadvertently protected these resources) has virtually come to an end.

14. Of the three sectors considered, the country strategic opportunities paper recommended that top priority should be accorded to the programme in the dry zones, then to the programme to support the

smallholder estate sector and finally the resource-management operation in the coastal zones. The Dry Zone Livelihood Support and Partnership Programme therefore represents the first IFAD operation to carry out the strategy in the country strategy for Sri Lanka endorsed by the Executive Board during its session in April 2003.

15. **The Poverty Eradication Activities of Other Major Donors.** The Government of Japan, the Asian Development Bank and the World Bank, the largest donors to Sri Lanka, tend to concentrate on macroeconomic policy and structural reform, large infrastructure projects and budgetary support interventions, although they also support some pro-poor interventions in the rural sector. Significant assistance is also provided by United Nations agencies and several bilateral donors, including Australia, Canada, the European Union, Germany, Norway, The Netherlands, Sweden, the United Kingdom and the United States. Some of these tend, however, to focus more on the reduction of conflict-related poverty, on pro-poor governance and empowerment issues and on social services. IFAD continues to play a leading role in agriculture and rural development in the poorest regions of the country and for the poorest segments of society. During the design of the Dry Zone Livelihood Support and Partnership Programme, several donor agencies, including, notably, the World Bank, WFP, CIDA, JBIC, United Nations Development Programme, the German Agency for Technical Cooperation and the United Kingdom Department for International Development, have been consulted and their experiences and expertise have been taken into account in the selection of programme activities. Possibilities for cofinancing or parallel financing have been explored and realized with the first four agencies.

16. **Programme Rationale.** The dry zone constitutes a niche for IFAD support because it contains the majority of the rural poor and because it allows the Fund to build on its previous experience. The Government and IFAD have agreed to develop a programme covering the whole zone that will focus on the poorest and more remote areas, where few or no development-support programmes are present. However, even such areas maintain commercial relations with economic centres, and these will constitute the basis for the strengthening and further expansion of the activities to be supported.

17. In the absence of the proposed programme, remote and poor communities would eventually raise their standards of living only as a result of the trickle-down effect of overall macroeconomic growth. Thus, deprivation would only gradually be reduced. The rationale of the programme, consequently, is to support a focused set of priority activities that will enable poor households in these remote areas to improve their situations in a sustainable manner in a shorter time span. The programme will help to set up a national-level institutional capacity for the funding, planning and monitoring of development activities in the dry zone. This will allow the adoption of a coordinated programme approach towards dry zone development and avoid the need for discrete area development projects.

PART II – THE PROGRAMME

A. Programme Area and Target Group

18. **Programme Area.** The selection criteria for the identification of the programme area were: location in the dry zone, incidence of poverty and vulnerability and previous and recent IFAD presence. On this basis, four districts were identified: Anuradhapura, Kurunegala, Monaragala and Badulla. Within each district, the programme will cover the DS division that has been selected on the basis of the vulnerability assessments carried out by the World Food Programme. This analysis, based on food security indicators, geographic information system data, stakeholder interviews and informal group discussions, determines the degree of food security vulnerability in DS divisions. In addition, DS divisions that were part of the previous IFAD projects have been included. Thus, the programme will cover a total of 44 DS divisions. Within each DS division, the poorest half of all Grama Nilhadari divisions will be selected on the basis of poverty and remoteness indicators.

19. **Target Group.** The programme target group includes all persons living in the selected poor and remote GN divisions. Within these GN divisions, the programme will focus on the needs and capabilities

of the poorest, without excluding the more prosperous members of these communities. Women are an integral part of the target group, but some activities, such as microfinance and support for income-generating activities, following actual practice, are expected to be undertaken nearly exclusively among women. Particular attention will also be paid to persons of low caste origin, and the programme will ensure their integration in the target group. It has been estimated that the total household population in the programme GNs is about 255 500 households (or about one million persons in view of an average household size of just over four persons).

B. Objectives and Scope

20. **Goal.** The programme goal is the sustainable increase in the incomes and improvement in the living conditions of poor women and men in about 80 000 households in the dry zone.

21. **Objectives.** The purpose of the programme is to put in place a mechanism for the mobilization of resources and services that will sustainably increase production and add value to the produce in the dry zones of the country in order to achieve the overall programme goal. Therefore, the programme's immediate objectives, which reflect the anticipated outputs of each component, will include the following: (a) rainfed upland farm productivity improved and increased; (b) irrigated crop production increased through the rehabilitation and operation of the necessary infrastructure; (c) marketing opportunities and linkages expanded and value added in the agricultural production in rainfed and irrigated areas; (d) sources of income for the poor, especially women, diversified through expanded microfinance services; and (e) priority community infrastructure realized and used to effect.

C. Components

22. The programme is composed of six components, namely: (a) rainfed upland agricultural development; (b) marketing and enterprise development; (c) irrigation rehabilitation; (d) microfinance and income-generating activities; (e) priority community infrastructure development; and (f) programme management. The components are presented below.

Rainfed Upland Agricultural Development

23. Effective extension services for rainfed upland farming are sparse, largely because of resource constraints at the local level and the focus on irrigated paddy cultivation. Previous IFAD projects for the financing of upland extension services have demonstrated the positive impact of such advisory services. The programme will therefore support extension activities for the rainfed upland and home-garden farming of field crops, fruits and vegetables. A participatory approach will be applied for the identification of the main issues to be addressed, using the approach of Farmer field schools (FFSs). Issues may range from soil and water conservation to cropping techniques, including organic farming, and from harvesting to storage and marketing. As little experience with this approach exists, especially with the participatory approach and with the farmer management of the FFSs, the initial two years will be considered as a pilot exercise during which training and methodological support will be provided. At the end of the period, a detailed review of the results obtained will be undertaken by IFAD and the Government to determine the modalities for the possible adjustment and expansion of the approach. It has been estimated that about 480 FFSs will be implemented in the first two years, and, if viable, a total of 3 600 FFSs would be established thereafter, benefiting a total of 72 000 farmers during the course of the programme. Not less than 50% of the participants will be women.

Marketing and Enterprise Development

24. **Marketing.** The marketing sub-component will promote two instruments to add value to produce: forward sales contracts and inventory credit schemes. A **forward sale contract** is a legal arrangement whereby a farmer agrees in advance, generally at planting time, to sell a certain quantity of his/her future crop exclusively to a certain buyer at an agreed price. For this, the programme will build on the relevant

successful experience of the Regional Development Department of the Central Bank of Sri Lanka. A total of 40 000 families, including 3 000 **organic farmers**, will benefit. A private sector operator will facilitate the activities under the technical supervision of the department. The special ‘window’ for organic farming will be implemented, with the involvement of a specialized operator. An **inventory credit scheme** is a mechanism whereby stored crops are used as collateral for commercial loans. At harvest time, farmers store part of their crop instead of selling it at low prices and use it as collateral for bank loans to satisfy their cash needs. The department will assume overall responsibility for the implementation of the pilot phase, expected to reach some 400 farmers.

25. **Microenterprise Development.** The programme will support new and existing micro and small enterprises through training, technology transfer, the identification of market linkages, diagnostic studies, productivity development, research and product development and other activities. Eligible enterprises will have a capital base (excluding land and buildings) of more than LKR 50 000, but less than LKR 5 million, be located in the programme area and be engaged in the value-added processing of rural raw materials or in service provision. The minimum target for women’s participation is 50%.

Irrigation Rehabilitation

26. The rehabilitation of minor-tanks will support the enhancement of incomes of an estimated 10 200 families in the programme districts and will help to reinforce market-driven agriculture. Women’s participation will be at least 30%. The close coordination of the component with marketing and extension activities under the programme will be maintained. Investments will be made in the rehabilitation of approximately 780 minor-tanks and 330 *anicuts* (‘weirs’) with command areas of up to 80 ha. Irrigation improvement will cover an area of about 6 600 ha in the *maha* season, and this will increase the effective irrigated area of the *yala* season by about 30%. Farmers will contribute 10% of the total rehabilitation costs, which is estimated at USD 3 649/tank and USD 2 675/*anicut*. WFP plans to support annually 76 sites with 492 000 workdays, amounting to 1 452 t of food commodities.

Microfinance and Income-Generating Activities

27. The support for microfinancing loans and savings schemes for income-generating activities will focus on community groups, particularly women, that do not have access to formal credit facilities. It will target some 5 000 families and a minimum participation of women of 80%. The establishment of savings and credit groups, initially using their own resources, will be promoted by social mobilizers. The component will be implemented on a contract basis by existing microcredit institutions. In Anuradhapura, the Participatory Development Foundation, established with previous IFAD support, will be involved. Programme institutional support will be provided to the implementing agencies to expand their ongoing activities. A credit line will be available for microfinance institutions with a proven track record and a proven liquidity constraint.

Priority Community Infrastructure Development

28. In the programme area, the demand for community infrastructure is high. To meet this demand, programme resources will be used for community infrastructure investments on the basis of priorities determined through participatory rural appraisals with the whole community. Eligible investments include village road rehabilitation, wells for water supply, rainwater-harvesting devices and renewable energy sources. To complement this effort, the programme will establish a poverty alleviation fund to support small local labour-intensive works programmes. This will absorb wage labour, which is one of the main sources of income of poor households in the area; moreover, the lack of opportunities for wage labour is the main reason for labour migration. Eligible activities under the fund will include labour-intensive emergency repairs to all local infrastructure, including village roads, irrigation infrastructure not supported under the irrigation component, and community infrastructure such as meeting halls, schools and health clinics. A minimum women’s participation of 50% is anticipated.

Programme Management²

29. **Management.** The programme will finance the establishment of district management units in each of the four districts at the level of the DSs. The units will be headed by the district programme manager and include an agronomist, a rural engineer, an economist, a chief accountant, a monitoring officer and necessary support staff. The units will be equipped with office equipment and the required means of transport, and their operating funds have been budgeted for. Women will represent at least 50% of the programme management professional staff. To monitor programme implementation by the contract parties, DS division monitoring units will be established in the DS divisions at a rate of one unit for every two divisions. Staffing provisions include a monitoring officer and necessary support staff. To coordinate and facilitate programme implementation in the districts, a programme coordination unit will be established at the national level. The unit will include a programme coordinator, an accountant, a monitoring officer and support staff.

30. **Social Mobilization.** To help set up or strengthen existing community groups, the programme will undertake social mobilization according to modalities applied in past IFAD-supported and UNDP-supported projects in which, inter alia, qualified village youth, mostly young women, have been trained as social mobilizers. Support will be provided by a qualified service provider and UNDP-supported technical assistance. In Anuradhapura and Badulla, the federations of grass-roots organizations, set up with previous IFAD support, will take on this responsibility. From the beginning, a withdrawal strategy will be built into the support to ensure sustainability.

31. **Policy Studies.** IFAD and UNDP grant funds have been included in the programme so as to carry out studies on the policy constraints that will be identified in the course of implementation, including land tenure constraints, and inadequate access to credit by the poor and other bottlenecks to local development. The studies will be undertaken by qualified institutions, and the results will be disseminated through workshops. They will form the basis for policy dialogues with the relevant government ministries, including the possibility of the creation of a self-sustaining funding mechanism and institution to coordinate investments for the sustainable development of the dry zones.

D. Costs and Financing

32. Total programme costs, including contingencies, have been estimated at USD 30.40 million over a seven-year period. Costs include physical and price contingencies amounting to 6% of the base costs; the foreign exchange component is 13%.

33. Financing for the programme will be provided through an IFAD loan of USD 21.97 million (72.3% of total costs). Approval will also be sought for an IFAD grant for studies and training at USD 339 200 (1.1%). Parallel cofinancing will be provided by JBIC, for village road rehabilitation, for USD 1.14 million (3.8%), by CIDA, for support for microfinancing, at USD 963 100 (3.2%), and by WFP, for micro-tank rehabilitation, at USD 1.06 million (3.5%), and by UNDP for capacity development and technical support, at USD 1.50 million (4.9%) from its core and non-core resources. Beneficiaries and the Government will, together, contribute USD 3.43 million (11.3% of total programme costs).

² See the Organization Chart in Appendix V.

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

Components	Local	Foreign	Total	% of Foreign Exchange	% of Base Costs
A. Rainfed Upland Agricultural Development	2 245	584	2 828	21	10
B. Marketing and Enterprise Development	3 086	433	3 518	12	13
C. Irrigation Rehabilitation	3 586	578	4 163	14	15
D. Microfinance and Income-Generating Activities	3 074	115	3 190	4	12
E. Priority Community Infrastructure Development	6 648	755	7 403	10	27
F. Programme Management	4 850	1 196	6 046	20	22
Total base costs	23 489	3 661	27 150	13	100
Physical contingencies	312	35	347	10	1
Price contingencies	1 206	201	1 407	14	5
UNDP Contribution (from their core and non-core resources)	1 200	300	1 500	20	-
Total project costs	26 207	4 197	30 404	13	106

^a Discrepancies in totals are due to rounding.

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

Components	IFAD		IFAD Grant		JBIC		WFP		UNDP		CIDA		Government		Beneficiaries		Total		For. Exch.	Local (Excl. Taxes)	Duties & Taxes
	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amt.	%	Amount	%	Amount	%			
Rainfed Upland Agricultural Development	2 480.6	80.9	-	-	-	-	-	-	-	-	-	-	0.0	-	587.5	19.1	3 068.0	10.1	632.0	2 436.0	-
Marketing and Enterprise Development	3 568.0	97.3	-	-	-	-	-	-	-	-	-	-	98.5	2.7	-	-	3 666.5	12.1	452.3	3 115.7	98.5
Irrigation Rehabilitation	2 838.1	59.5	-	-	-	-	1 055.3	22.1	-	-	-	-	525.6	11.0	351.8	7.4	4 770.8	15.7	646.7	3 598.4	525.6
Microfinance and Income Generating Activities	2 276.4	70.3	-	-	-	-	-	-	-	-	963.1	29.7	0.0	-	-	-	3 239.5	10.7	120.4	3 119.1	-
Priority Community Infrastructure Development	5 759.0	74.3	-	-	1 141.6	14.7	-	-	-	-	-	-	88.9	1.1	761.1	9.8	7 750.5	25.5	790.3	6 871.4	88.9
Programme Management	5 049.6	78.8	339.2	5.3	-	-	-	-	-	-	-	-	1 020.3	15.9	-	-	6 409.1	21.1	1 254.8	4 134.0	1 020.3
UNDP Contribution for Capacity Building and TA Support	-	-	-	-	-	-	-	-	1 500	100	-	-	-	-	-	-	1 500	4.9	300	1 200	-
Total Disbursement	21 971.6	72.3	339.2	1.1	1 141.6	3.8	1 055.3	3.5	1 500	4.9	963.1	3.2	1 733.3	5.7	1 700.3	5.6	30 404.4	100.0	4 196.5	24 474.6	1 733.3

^a Discrepancies in totals are due to rounding.

E. Procurement, Disbursement, Accounts and Audit

34. **Procurement.** As many programme activities will be implemented on a limited scale to cover clusters of GN divisions, it is anticipated that most implementing agencies will be local or district-wide agencies, firms or NGOs. Therefore, all contracts with service providers equivalent to USD 20 000 or more will be determined through local competitive bidding. Contracts for service providers below USD 20 000 but more than USD 10 000 will be awarded through local shopping. Contracts with service providers of less than USD 10 000 will be concluded under the direct purchase procedure. Contracts for infrastructure works valued at USD 20 000 or more will be awarded on the basis of local competitive bidding. Infrastructure works valued at less than USD 20 000 may be contracted out through direct contracting with the contractor. Civil works related to the irrigation rehabilitation component may be carried out through force account. Microfinance institutions eligible for a credit line from the programme will conclude a subsidiary loan agreement with the apex bank to be in charge of the credit component. Contracts for the procurement of civil works and goods contracts will be grouped at the national level. International shopping will be required for purchases of more than USD 100 000, while national competitive bidding will be required for contracts between USD 20 000 and USD 100 000, and local shopping will be required for purchases worth less than USD 20 000. Operating expenditures will be covered through direct purchasing. Prior approval by the cooperating institution will be required for all contracts valued in excess of USD 100 000 (or the equivalent).

35. For the approval of procurement procedures and decisions by the programme coordination unit a programme procurement committee will be established, chaired by the chairperson of the Policy and Oversight Board and including the programme coordinator and district managers. Similar District Procurement Committees will be established for each district. For the awarding of contracts under local competitive bidding, district procurement committees will be set up in each district, chaired by the district manager and including the DS and professional staff in the district management unit.

36. **Disbursement.** The proposed flow of funds reflects the decentralized management structure, and funds are managed at the district level by each of the four district managers. A special account in US dollars will be established at the Central Bank. The authorized representative of the Government charged with signing withdrawal applications for IFAD funds will also be in charge of managing this central account. The initial deposit from IFAD into the special account will correspond to the projected six-month disbursements during programme year 1 in the respective districts and for the programme support unit; it is estimated at USD 1.85 million. Direct payments to suppliers may be requested from IFAD for all contracts exceeding USD 10 000.

37. **Audit.** The accounts of the programme and those of the implementing agencies will be audited annually by the Auditor General's Office in line with government procedures acceptable to IFAD. Certified audit reports will be transmitted to IFAD not later than six months after the end of the fiscal year. The auditor will give a specific opinion on the mechanism of funding for the implementing agencies, the use they make of programme resources, and the accountability of partners and financial reporting by them.

F. Organization and Management

38. The programme will be implemented under the overall responsibility of the Ministry of Agriculture, Livestock, Land and Irrigation. The secretary of that ministry will chair the Policy and Oversight Board, which will include representatives of: (a) the Ministry of Provincial Councils and Local Government; (b) the three ministries in charge of Udarata (Up-country), Rajarata (King's country), and Uva-Wellassa development; (c) the three provincial councils concerned, namely, North-Central, North-Western and Uva; (d) Ministry of Finance; (e) the apex bank in charge of the credit component; and (f) the Federation of the Chambers of Commerce. IFAD and cofinanciers of the programme will be invited to attend the meetings of the Policy and Oversight Board as observers. Women will be adequately represented on the board. The board will ensure that the programme is implemented in line with government policies and the financing agreements of donors and will coordinate with other projects. It will analyse and decide on any policy and implementation issues presented to it by the district managers recruited for each district and by the provincial programme boards. The secretariat of the board will be assured by a programme coordination unit, headed by a programme coordinator. The Policy and Oversight Board will appoint all the key staff of the programme, namely the four district managers and the programme coordinator.

39. A provincial programme board in each province will be chaired by the chief secretary and include representatives of the implementing agencies, the district secretaries concerned, a representative of the Chamber of Commerce of each programme district and representatives of the community organizations. The district manager will serve as the secretary of the provincial board. The provincial board will approve the district annual work programme and budget, monitor the implementation of this programme and budget, and approve the annual reports. The district managers will head the autonomous district management units and be responsible for the day-to-day implementation of the programme in their districts. They will recruit other unit staff, including division monitoring officers. In doing so, gender balance will be pursued. By programme year 3, about 50% of all professional staff should be women.

40. The programme coordination unit will be located at the national level, and it will be responsible for facilitating programme management and implementation in the districts. The coordinator will report to the secretary of the Ministry of Agriculture, Livestock, Land and Irrigation and carry out the functions of a secretariat for the Policy and Oversight Board. The unit will facilitate the programme's external relations and communications and will consolidate annual work programmes and budgets, as well as progress reports.

41. **Reporting** will occur on a quarterly basis. Each implementing agency will submit quarterly reports to the district management unit that will cover technical and physical progress and include financial statements. Quarterly and annual reports will be prepared by each unit and will be consolidated by the programme coordinator. The annual report in each district will be submitted to the provincial board for approval. Quarterly and annual reports will be submitted to the Government and IFAD within three months after the end of the reporting period.

42. **Monitoring and Evaluation.** Under the programme approach of the contracting out of all activities, the monitoring of contract performance will become an essential management activity. To be able to evaluate contract implementation, the programme will have to gather its own monitoring data. For that purpose, a network of monitoring units will be established. In each implementation agreement, the indicators to be monitored by the programme will be specified. These indicators will include data on impact as far as this is under the control of the implementer. Before programme start-up, a baseline survey will be undertaken, to be followed up by repeater surveys in programme year 3, programme year 5 and after programme completion.

G. Economic Justification

43. The programme will result in an increase in the volume and value of traded agricultural produce that will (a) raise producers' incomes through a rise in production and in the diversity of crops and a higher

share of sales price and (b) reduce marketing and transport costs. In some instances, market realizations will be increased due to improved product quality and improved storage and processing methods. Investment in the programme area will involve activities to develop and support producer groups/associations, savings and credit groups and groups involved in income-generating activities, as well as small and micro-businesses, rural road access and market infrastructure, and the promotion of interventions in market and credit linkage.

44. The overall economic rate of return of the programme is estimated at 17.9% over a 20-year period. This analysis, which is based on economic prices, incorporates all the programme costs, plus the operation and maintenance costs of economic infrastructure, such as irrigation infrastructure, roads and market fairs, assumed at 5% of the investment cost. The results of the overall economic analysis justify the programme's investments in a market-led partnership approach to the support of livelihoods in the dry zone of Sri Lanka. Sensitivity analysis confirms that these results are rather robust.

45. The programme is not expected to impact significantly on government recurrent expenditure. Instead, one of its major positive impacts will be the expected reduction in *Samurdhi* ('welfare') expenses, as many of the families that will benefit from the programme will eventually no longer qualify for *Samurdhi* payments. This will save the Government up to LKR 52.8 million (approximately USD 537 000) annually assuming 10% of the beneficiaries (80 000 households) graduate from receiving LKR 550 per month (or LKR 6 600 per year).

H. Risks

46. The programme, like any other development activity, will be exposed to the following external risks beyond the control of the programme management: (a) a deterioration in the security situation; (b) climatic and natural resource calamities that go beyond the normal variability in these conditions; (c) a slackening in the currently positive macroeconomic trends and, notably, a return to high inflation levels that reduce real growth and impact; and (d) a change in the institutional framework as a result of changes in the political setting. Under the first two calamity conditions, the Government, IFAD and the programme management will review the situation that has arisen and will consider the need for adjustment of the programme. In the face of strongly worsening overall economic conditions, the programme management may develop proposals to help the target group overcome the effects. Changes in the institutional set-up will be accommodated jointly by the Government and IFAD.

I. Environmental Impact

47. The programme will support mostly small interventions at the village level. These will be localized, labour intensive and largely of a rehabilitation or small rural enterprise nature. Because of the relative small size of the interventions, most investments are not expected to have a significant impact on the environment. Any potential impact will be readily identified and managed through proper planning and oversight. Most interventions will be determined through a participatory village planning process, and all activities will be scrutinized to identify any environmental effect and provide adequate mitigation measures. As a result, the programme has been classified as category B.

J. Innovative Features

48. The programme is in line with IFAD's strategy for Asia and the Pacific. It will directly target less favoured areas and help marginal groups improve their access to technologies, land and water, and rural infrastructure and facilities. It also represents a conflict prevention and peace consolidation endeavour because it will raise the equitable access to resources for the poor. In addition, it will enhance women's capabilities and help build coalitions of and for the poor. The programme design includes several innovative features, namely: (a) extension delivery by beneficiary-managed FFSs is based on the participatory identification of issues/themes; (b) marketing conditions will be greatly improved by the careful combination of forward contracting, inventory credit and the promotion of organic crops;

- (c) irrigation rehabilitation will be implemented in a package whereby infrastructure development will be undertaken hand-in-hand with adequate provisions for user-group formation and training; and
(d) employment creation among the poor through the proposed poverty alleviation fund.

PART III – LEGAL INSTRUMENTS AND AUTHORITY

49. A financing agreement between the Democratic Socialist Republic of Sri Lanka 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.

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

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

PART IV – RECOMMENDATION

52. 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 Democratic Socialist Republic of Sri Lanka in various currencies in an amount equivalent to fifteen million one hundred thousand Special Drawing Rights (SDR 15 100 000) to mature on or prior to 1 September 2044 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 Democratic Socialist Republic of Sri Lanka in various currencies in an amount equivalent to two hundred forty thousand Special Drawing Rights (SDR 240 000) 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 1 September 2004)

1. **Programme accounts.** The following accounts will be opened under the programme:
 - (a) The District Programme Manager (DPM) of each programme district will open and thereafter maintain in a commercial bank, proposed by the Government and accepted by IFAD, a current account denominated in Sri Lankan rupees (LKR) to receive IFAD loan, grant and other funding for programme operations, with the exception of the credit line for onlending to programme beneficiaries under the microfinance and income-generating activities component (the credit activities), in the relevant programme district (each such account referred to as the relevant “District Programme Management Unit (DPMU) Programme Account”). The relevant DPM and the Chief Accountant of the DPMU will be required to act as joint signatories for all transactions relating to the respective DPMU Programme Account.
 - (b) The Programme Coordinator (PC) will open and thereafter maintain in a commercial bank, proposed by the Government and accepted by IFAD, a current account denominated in LKR to receive loan, grant and other funding for programme operations, with the exception of the credit activities, which are to be handled by/under the responsibility of the Programme Coordination Unit (PCU) (the “PCU Programme Account”). The PC and the Chief Accountant of the PCU will be required to act as joint signatories for all transactions relating to the PCU Programme Account.
 - (c) The bank selected to facilitate the onlending under the credit activities (the apex bank) will open and thereafter maintain in a bank, proposed by the Government and accepted by IFAD, an account denominated in LKR to receive loan and other funding relating to the credit activities (the “Credit Activities Programme Account”). The Government will advise IFAD of the name and title of the individual(s) authorized and nominated by the apex bank to operate the Credit Activities Programme Account.

2. **Credit activities.** The following agreements will be entered into with respect to implementation of the credit activities:
 - (a) The Government and the apex bank will enter into an administration agreement in which the apex bank declares its commitment to the goals and purposes of the programme. The administration agreement will provide, among other things, that the Government will bear the foreign exchange risk on the funds to be made available to it as a loan to the apex bank thereunder, and that the funds made available to the apex bank will be used by the apex bank to make credits to selected microfinance institutions (MFIs) (lending MFIs) for further onlending to programme beneficiaries. The rate of interest charged by the Government to the apex bank will be specified and approved by IFAD.
 - (b) The apex bank and each lending MFI will enter into a subsidiary loan agreement (SLA), based on a model SLA to be approved by IFAD, in which the lending MFI will declare its commitment to the goals and purposes of the programme. The SLA will specify that the funds made available to the lending MFI will be used by the lending MFI to make credits to eligible programme beneficiaries, in accordance with the terms of the SLA and the credit by-laws.

3. **Revolving Funds**

- (a) **Apex Bank Revolving Fund.** The apex bank will establish and maintain a revolving fund into which all net revenues from credits extended to lending MFIs financed (directly or indirectly) by the loan will be deposited (the “Apex Bank Revolving Fund”). The apex bank will use the Apex Bank Revolving Fund to finance further credits to each lending MFI under the credit activities, in accordance with the financing agreement, for a period of at least ten (10) years from the coming into force of the relevant SLA entered into by the apex bank with the lending MFI, or such other date as specified in the administration agreement. For purposes of this paragraph, the term “net revenues” means all repayments of principal and all payments of interest, **less** reasonable operating and other costs.
- (b) **MFI Revolving Fund.** Each lending MFI will establish and maintain a revolving fund into which all net revenues from credits extended to programme beneficiaries financed (directly or indirectly) by the loan will be deposited (the “MFI Revolving Fund”). Each lending MFI will use its MFI Revolving Fund to finance further credits to programme beneficiaries, in accordance with the financing agreement, for a period of at least ten (10) years from the coming into force of the relevant SLA, or such other date as specified in the relevant SLA. For purposes of this paragraph, the term “net revenues” means all repayments of principal and all payments of interest, **less** reasonable operating and other costs.

4. **Additional events of suspension**

- (a) IFAD may suspend the Government’s right to make further disbursements from the loan upon the occurrence of the following events:
 - (i) On or after the effective date, the Japan Bank for International Cooperation (JBIC) loan agreement and/or the Canadian International Development Agency (CIDA) grant agreement and/or the World Food Programme (WFP) grant agreement and/or the United Nations Development Programme (UNDP) grant agreement has failed to enter into full force and effect by the date or dates specified therein or a later date or dates established by JBIC, CIDA, WFP or UNDP, respectively, for that purpose and substitute funds are not available to the Government on terms and conditions acceptable to IFAD.
 - (ii) The right of the Government to withdraw the proceeds of the JBIC loan, the CIDA grant, the WFP grant or the UNDP grant has been suspended, cancelled or terminated, in whole or in part, or the JBIC loan has become due and payable prior to the agreed maturity thereof; or any event has occurred which, with notice or the passage of time, could result in any of the foregoing, and/or if substitute funds are not available to the Government on terms and conditions acceptable to IFAD.
 - (iii) The credit by-laws, or any provision thereof, have been waived, suspended, terminated, amended or otherwise modified without the prior consent of IFAD, and IFAD has determined that such waiver, suspension, termination, amendment or modification has had, or is likely to have, a material adverse effect on the credit activities.
- (b) IFAD will suspend, in whole or in part, the right of the Government to request withdrawals from the Loan Account if the annual audit report for the programme has not been satisfactorily completed within twelve (12) months after the financial reporting period set forth in the financing agreement.

5. **Additional conditions precedent to effectiveness of the financing agreement**

- (a) the PC and each of the four DPMs, one in each programme district, will have been duly appointed by the lead programme agency and approved by IFAD;

ANNEX

- (b) the Government will have duly opened the Special Account in its Central Bank, and each of the six Programme Accounts will be duly opened;
- (c) the PC, DPMs, and PCU and DPMU Chief Accountants will have been given any necessary authorities and powers to operate the Special Account and relevant Programme Accounts, as the case may be, as required by the financing agreement.
- (d) the Government will have made the necessary budgetary provision for the first programme year;
- (e) the Government will have duly established the Policy and Oversight Board (POB), the three Provincial Programme Boards (PPBs), the PCU and the four DPMUs;
- (f) the financing agreement will have been duly signed, and the signature and performance thereof by the Government will have been duly authorized and ratified by all necessary administrative and governmental action;
- (g) a favourable legal opinion, issued by the Attorney-General or other legal counsel of the Government, acceptable to IFAD in form and substance acceptable, will have been delivered by the Government to IFAD.

6. **Condition precedent to withdrawals.** No withdrawals will be made in respect of expenditures relating to the credit activities until the administration agreement, containing, inter alia, the credit by-laws and the model SLA, will have been submitted to and approved by IFAD.

7. **Pest management practices.** As part of maintaining sound environmental practices as required by Section 7.15 of the *General Conditions for Agricultural Development Financing*, the programme parties will maintain appropriate pest management practices under the programme and, to that end, the Government will ensure that pesticides procured under the programme do not include any pesticide either proscribed by the International Code of Conduct on the Distribution and Use of Pesticides of the Food and Agriculture Organization of the United Nations, as amended from time to time, or listed in Tables 1 (Extremely Hazardous) and 2 (Highly Hazardous) of the World Health Organization's Recommended Classification of Pesticides by Hazard and Classification 1996-1997, as amended from time to time.

8. **Insurance of programme personnel.** The Government will insure key programme personnel against health and accident risks to the extent consistent with its customary practice in respect of its national civil service.

9. **Gender focus – implementation.** The Government will ensure that implementation modalities are gender-sensitive and that the programme parties apply this principle in their activities. The Government will ensure that women beneficiaries are equally and fully represented in all programme activities and that they receive appropriate benefits from programme outputs. Gender training and assistance of gender experts will be provided.

10. **Gender focus – programme staffing and management.** The participation of women on an equal basis will be sought in the POB and the three PPBs. The selection and appointment of key programme staff (PC and DPMs) will be conducted in a gender-sensitive manner. In the recruitment of programme staff, all things being equal, preference will be given to women candidates.

11. **Monitoring.** Within or before twelve (12) months after the effective date, the programme will establish its own monitoring system to be able to properly evaluate programme implementation. In each service provider agreement between the DPMU/PCU and each contracted service provider, the indicators to be monitored by the programme will be specified. As far as feasible, these indicators will include data on impact as far as this is under the control of the contracted service provider.

12. **Progress reports**

- (a) **Quarterly progress reports.** In the preparation and submission of the quarterly and consolidated annual progress reports for the programme, each programme party will submit quarterly progress reports, addressing technical and physical progress made during the quarter and containing financial statements relating to said quarter's expenditures, to the relevant DPMU. Each DPMU will prepare quarterly district progress reports for programme activities in its part of the programme area for that quarter, and will submit the district progress report to the PCU for overall consolidation for the entire programme for the relevant quarter.
- (b) **Annual progress reports.** The quarterly progress reports will form the basis for preparing annual progress reports on the programme, which will be prepared, processed and consolidated in the same manner as the quarterly progress reports. In addition to the foregoing, each DPMU will submit district annual progress reports to the respective PPB for approval.

13. **Creation of an autonomous dry zone development institute.** The proposed organization and management structures/arrangements for the programme, which anticipate the subsequent establishment of an autonomous body for dry zone development, will be critically reviewed during the second in-depth review to ascertain conditions and legal requirements to become an autonomous body. A decision will then be taken and appropriate preparation initiated by the Government to create the institution or body before the programme completion date.

14. **Farmer field school (FFS) methodology.** The methodology for the development and implementation of the participatory farmer-managed FFS will be reviewed at the beginning of the third programme year to assess its effectiveness, agree on appropriate adjustments to its modalities, and agree on its broad adoption and expansion in the programme area.

15. **Minor-tank selection.** In order for a minor-tank to be eligible for selection for programme intervention under the irrigation rehabilitation component, the following criteria will have been met with respect to such tank:

- (a) the community has expressed both demand for such tank rehabilitation and its commitment to maintain the rehabilitated tank;
- (b) rehabilitation is feasible within the programme's budget;
- (c) acceptable land rights exist or a viable solution has been found to any potential problems of access to land and usufruct rights for the community members;
- (d) the water users' group (WUG) for such tank has been duly formed and registered;
- (e) the WUG will have agreed to (i) establish an operation and maintenance fund, in a reputable bank, following the first harvest after completion of the minor-tank rehabilitation; at that time, the WUG will deposit an amount of money adequate to cover the estimated maintenance costs relating to the tank for the following 12 months of tank operation; and (ii) to replenish and maintain such operation and maintenance fund; and
- (f) the WUG will have devised and implemented a maintenance cost recovery scheme that will ensure the sustainability of the rehabilitation after programme completion.

APPENDIX I

COUNTRY DATA

SRI LANKA

Land area (km² thousand) 2001 a/	64.6	Gross national income per capita (USD) 2001 a/	880
Total population (million) 2001 a/	18.73	GDP per capita growth (annual %) 2001 a/	-2.8
Population density (people per km²) 2001 a/	290	Inflation, consumer prices (annual %) 2001 a/	14
Local currency	Sri Lanka Rupee (LKR)	Exchange rate: USD 1 =	LKR 98.25
Social Indicators		Economic Indicators	
Population (average annual population growth rate) 1995-2001 a/	1.3	GDP (USD million) 2001 a/	15 911
Crude birth rate (per thousand people) 2001 a/	18	Average annual rate of growth of GDP a/	
Crude death rate (per thousand people) 2001 a/	6	–1981-1991	3.9
Infant mortality rate (per thousand live births) 2001 a/	17	–1991-2001	4.9
Life expectancy at birth (years) 2001 a/	73	Sectoral distribution of GDP 2001 a/	
Number of rural poor (million) (approximate) a/	n/a	–% agriculture	19
Poor (as % of total rural population) a/	n/a	–% industry	27
Total labour force (million) 2001 a/	8.26	–% manufacturing	16
Female labour force (as % of total) 2001 a/	37	–% services	54
Education		Consumption 2001 a/	
School enrolment, primary (% gross) 2001 a/	106 b/	General government final consumption expenditure (as % of GDP)	10
Adult illiteracy rate (% age 15 and above) 2001 a/	8	Household final consumption expenditure, etc. (as % of GDP)	75
Nutrition		Gross domestic savings (as % of GDP)	15
Daily calorie supply per capita, 1997 c/	2 771	Balance of Payments (USD million)	
Malnutrition prevalence, height-for-age (% of children under 5) 2001 d/	14	Merchandise exports 2001 a/	4 817
Malnutrition prevalence, weight-for-age (% of children under 5) 2001 d/	29	Merchandise imports 2001 a/	5 925
Health		Balance of merchandise trade	-1 108
Health expenditure, total (as % of GDP) 2001 a/	4 b/	Current account balances (USD million)	
Physicians (per thousand people) 2001 a/	n/a b/	–before official transfers 2001 a/	-1 411
Population using improved water sources (%) 2000 d/	77	–after official transfers 2001 a/	-265
Population with access to essential drugs (%) 1999 d/	95-100	Foreign direct investment, net 2001 a/	172
Population using adequate sanitation facilities (%) 2000 d/	94	Government Finance	
Agriculture and Food		Overall budget deficit (including grants) (as % of GDP) 2001 a/	-10
Food imports (% of merchandise imports) 2001 a/	14	Total expenditure (% of GDP) 2001 a/	26
Fertilizer consumption (hundreds of g per ha of arable land) 2000 a/	2 766	Total external debt (USD million) 2001 a/	8 529
Food production index (1989-91 = 100) 2001 a/	123	Present value of debt (as % of gross national income) 2001 a/	42
Cereal yield (kg per ha) 2001 a/	3 280	Total debt service (% of exports of goods and services) 2001 a/	10
Land Use		Lending interest rate (%) 2001 a/	19
Arable land (as % of land area) 2000 a/	14	Deposit interest rate (%) 2001 a/	11
Forest area (as % of total land area) 2000 a/	30		
Irrigated land (as % of cropland) 2000 a/	35		

a/ World Bank, *World Development Indicators* database CD ROM 2003

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

c/ United Nations Development Programme (UNDP), *Human Development Report*, 2000

d/ UNDP, *Human Development Report*, 2003

PREVIOUS IFAD FINANCING IN SRI LANKA

Project Name	Initiating Institution	Cooperating Institution	Lending Terms	Board Approval	Loan Effectiveness	Current Closing Date	Loan/Grant Acronym	Denominated Currency	Approved Loan/Grant Amount	Disbursement (as % of approved amount)
Kirindi Oya Irrigation and Settlement Project	AsDB	AsDB	HC	12 Apr 78	03 Jul 78	30 Jun 86	L - I - 1 - SRI	USD	12 000 000	100%
Kirindi Oya Irrigation and Settlement Project	AsDB	AsDB	HC	12 Apr 78	03 Jul 78	30 Jun 86	L - I - 109 - SR	SDR	5 500 000	64%
Anuradhapura Dry Zone Agriculture Project	AsDB	AsDB	HC	05 Dec 80	29 Jun 81	30 Jun 89	L - I - 58 - SR	SDR	11 350 000	33%
Coconut Development Project	AsDB	AsDB	HC	17 Dec 81	13 Oct 82	30 Jun 88	L - I - 85 - SR	SDR	7 100 000	43%
Badulla Rural Development Project	IFAD	World Bank	HC	09 Dec 82	18 Jul 83	30 Nov 93	L - I - 111 - SR	SDR	12 950 000	81%
Kegalle Rural Development Project	IFAD	World Bank	HC	05 Dec 85	08 Jul 86	30 Jun 96	L - I - 179 - SR	SDR	7 500 000	83%
Small Farmers and Landless Credit Project	IFAD	UNOPS	HC	26 Apr 88	28 Mar 89	31 Dec 97	L - I - 219 - SR	SDR	4 850 000	86%
Second Badulla Integrated Rural Development Project	IFAD	UNOPS	HC	04 Apr 91	12 Aug 92	31 Mar 03	L - I - 283 - SR	SDR	9 900 000	91%
North-Western Province Dry Zone Participatory Development Project	IFAD	AsDB	HC	09 Sep 92	22 Feb 93	30 Jun 01	L - I - 309 - SR	SDR	6 150 000	74%
North-Central Province Participatory Rural Development Project	IFAD	UNOPS	HC	13 Sep 95	09 Jan 96	30 Jun 04	G - I - 23 - LK	USD	100000	45%
North-Central Province Participatory Rural Development Project	IFAD	UNOPS	HC	13 Sep 95	09 Jan 96	30 Jun 04	L - I - 384 - LK	SDR	5 450 000	98%
Matale Regional Economic Advancement Project	IFAD	UNOPS	HC	03 Dec 98	15 Dec 99	30 Jun 06	G - I - 61 - LK	USD	50 000	89%
Matale Regional Economic Advancement Project	IFAD	UNOPS	HC	03 Dec 98	15 Dec 99	30 Jun 06	L - I - 493 - LK	SDR	8 350 000	40%

AsDB = Asian Development Bank. UNOPS = United Nations Office for Project Services. HC = highly concessionary. SDR = special drawing right.

LOGICAL FRAMEWORK

Goal	Indicators	Source of Information	Risks/Assumptions
Incomes and livelihoods of 80 000 households in the dry zones sustainably increased and improved	<ul style="list-style-type: none"> -Number of households with improved asset indices; -Percentage increase in households above poverty line, disaggregated by gender; -Percentage decrease in child malnutrition, disaggregated by gender 	<ul style="list-style-type: none"> -Sample household surveys; -Government surveys and statistics; -Participatory impact monitoring; -Field observations, progress and supervision report 	
Purpose	Indicators	Source of Information	Risks/Assumptions
Put in place a mechanism to mobilize resources and services sustainably to increase production and add value to produce in the dry zones	<ul style="list-style-type: none"> -10% of members graduating from Samurdhi, gender disaggregated; -Incomes of members increased by 20-60%, gender disaggregated; -Daily returns to labour increased by 20-60%, gender disaggregated; -Volume of investment flows to area 	<ul style="list-style-type: none"> -Household surveys; -Self-monitoring and surveys; -Progress and supervision reports 	<ul style="list-style-type: none"> -Stable and secure macroeconomic and country setting; -Increased incomes do not induce conspicuous consumption; -No de-capitalization of the poor due to natural disasters and emergencies
OUTPUTS Component	Indicators (gender disaggregated)	Source of Information	Risks/Assumptions
Improved and increased use of rainfed lands by 72 000 poor households (50% women)	<ul style="list-style-type: none"> -Number persons trained in FFSS; -Adoption rates of new technologies; -Diversification of production packages; -Percentage increase in productivity per ha of rainfed land; -Area (ha) of rainfed land under production; -Total production of rainfed crops; -Number farmers engaged in rainfed agriculture; -Cost of production reduced (e.g. rice) 	<ul style="list-style-type: none"> -Self-monitoring and surveys (participatory analysis and household surveys) -Progress reports by implementing agencies; -Supervision reports 	<ul style="list-style-type: none"> -No drought occurs; -No negative producer price trends; -Demand for rainfed crops continue; -Low competition for limited labour. -Rainfed technologies disseminated
Irrigated crop production increased over 5 000 ha to cover needs of 10 200 smallholders (30%women)	<ul style="list-style-type: none"> -Number and ha of micro-tanks rehabilitated; -Irrigated hectareage cropped regularly; -Crop yields in each season and each year -Total production from irrigated plots; -Availability of water in micro-tanks; -Number undisputed usufruct rights to micro-tanks; -Cropping intensity on the micro-tanks; -Level of crop diversification away from paddy 	<ul style="list-style-type: none"> -Programme progress reports; -Self-monitoring and field surveys; -Supervision reports 	<ul style="list-style-type: none"> -Market channels/linkages function; -Paddy prices do not slump; -Crop diversification feasible -No major drought occurs; -Farmers take charge of operation and maintenance; -Competing waters uses resolved

Goal	Indicators	Source of Information	Risks/Assumptions
Marketing opportunities and linkages expanded and value added to the agricultural production from rainfed and irrigated areas	<ul style="list-style-type: none"> -Number of forward contracts executed; -Quantity and percentage increase in output marketed -Average farmgate price of major crops; -Ratio of produce disposed of in hungry season; -Percentage rise in the maximum price of produce; -Volume of crop storage capacity constructed; -Level of investments by micro finance institutions and private sector; -Percentage increase of farmers selling surpluses; -Percentage increase in economic activity; -Number of microenterprises operating after four years; -Success of inventory credit pilot activity; -Number of jobs generated -Percentage increase in microenterprises in area; -Expansion of marketing channels available 	<ul style="list-style-type: none"> -Market surveys; -Self-monitoring and field surveys; -Progress reports by implementing agencies; -Supervision reports 	<ul style="list-style-type: none"> -Market conditions are not disrupted by external factors (conflict, dumping, etc.); -Market prices are attractive; -Private sector is interested in investment in area over time -Niche markets are identified
Diversification of sources of income for 5 000 families, mainly women (80%) through expanded microfinance services	<ul style="list-style-type: none"> -Percentage increase in non-farm economic activity; -Number of farmers engaged in off-farm activities; -Expansion of MFI activities in the area; -Number of viable investment opportunities in area; -Number of small economic groups active; -Number of active savers and borrowers; -Amount of savings and loans distributed; -Value of gross loan portfolio 	<ul style="list-style-type: none"> -Self-monitoring and market surveys; -Programme progress reports; -Self-monitoring and field surveys; -Field and market surveys; -Financial statements of MFIs 	<ul style="list-style-type: none"> -No competition for family labour; -Terms and conditions of credit rights; -Expanded microfinance services are used for increasing income-generating activities
Priority community infrastructure constructed and operated	<ul style="list-style-type: none"> -Number of community groups operating successfully; -Number of people belonging to community groups; -Number and types of infrastructure developed; -Percentage usage of infrastructure disaggregated; -Employment generated in maintenance gangs 	<ul style="list-style-type: none"> -Programme progress reports; -Self-monitoring and surveys; -Supervision reports 	<ul style="list-style-type: none"> Conditions are conducive for communities to agree on priority infrastructure eligible under the programme

Note: The Logical Framework does not contain quantified targets. District programme managers will set their targets in the annual work plan and budget on the basis of participatory programming in the GN and DS divisions and the district, which will be closely supervised, monitored and evaluated in terms of average costs per beneficiary compared to similar programmes.

ORGANIZATION AND MANAGEMENT

A. Programme Organization¹

1. The programme will be implemented under the overall responsibility of the Ministry of Agriculture, Livestock, Land and Irrigation. The secretary of that ministry will chair the Policy and Oversight Board, which will include representatives of: (a) the Ministry of Provincial Councils and Local Government; (b) the three ministries in charge of Udarata (Up-country), Rajarata (King's country) and Uva-Wellassa development; (c) the three provincial councils concerned, namely, North-Central, North-Western and Uva; and (d) the Chamber of Commerce. Women will be fairly represented in the board. The board will ensure that the programme is implemented in concurrence with government policies and the stipulations in the financing agreements of the external financiers, and it will coordinate with other projects and programmes. It will analyse and decide on any policy and implementation issues presented to it for consideration by the district programme managers and provincial programme boards. The secretariat of the board will be assured by a programme coordination unit, headed by a programme coordinator.

2. The board will appoint the programme's key staff: the four district programme managers and the programme coordinator. Candidates will have a profile and experience in line with the Terms of Reference and will be acceptable to IFAD, and women will represent at least 50%. The board will be responsible for authorizing, through the chair of the National Policy and Oversight Board and with the help of the national programme coordinator, the contracting of activities across districts, such as technical assistance, policy studies, and baseline and repeater surveys.

3. A provincial programme board in each province will be chaired by the chief secretary and include a representative of the implementing agencies, the district secretaries concerned, a representative of the Chamber of Commerce and representatives of the community organizations. The district programme manager will serve as the secretary of the provincial board. In cases where there are more than one district per province involved in the programme, the district programme managers concerned will be co-secretaries of the board. The provincial board will review and approve the annual work programme and budget drawn up by the district programme managers; it will monitor progress, and it will review and approve the annual report and the financial statements.

4. District programme managers will be appointed in each district; they will head the autonomous district programme management unit and be responsible for the day-to-day implementation of the programme in their districts according to the approved annual work programme and budget, as well as the recruitment of the proper staff in the unit. The recruitment of the division monitoring officer is also the responsibility of the district programme manager. All programme management staff will be recruited on a contract basis so as to attract high-quality staff. Civil servants who wish to qualify must obtain suitable secondment arrangements from their parent ministry and the Public Service Commission. In the recruitment of all staff, gender balance will be pursued, and, in view of past performance on this point in previous IFAD projects, preference will be given, at equal qualifications, to women candidates. By the end of programme year 3, the goal is to have women account for 50% of all professional staff.

5. The programme coordination unit will be located at the national level, and it will be responsible for facilitating programme management and implementation in the districts. The coordinator will report to the secretary of the Ministry of Agriculture, Livestock, Land and Irrigation and will carry out the functions of the secretariat of the Policy and Oversight Board. The unit will facilitate the programme's external relations and communications and will consolidate annual programmes and budgets, as well as periodic and annual reports.

¹ See the Organization Chart in Appendix V.

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6. The legal establishment of the Policy and Oversight Board, the three provincial programme boards and the four district programme management units will be a condition of effectiveness. All these bodies will have a fair representation of women.

7. The selection and appointment, in a gender-sensitive manner, of the key staff (the four district managers and the coordinator) acceptable to IFAD is a further condition for effectiveness.

B. Implementation

Selection of GNs

8. As indicated before, GNs will be selected on the basis of poverty and remoteness (proxy) indicators available at the DS division level. Indicators will include:

- the level of income per person (lowest is first)
- the percentage of the population receiving Samurdhi support (highest is first)
- the area of arable land per person (lowest is first)
- the percentage of arable land area under irrigation (lowest is first)
- the distance to the DS division capital (highest is first)
- the literacy rate among women (lowest is first)
- the primary school enrolment rate (lowest is first)

9. On the basis of this ranking, the poorest half of all GN divisions will be selected. Some arbitration may be required to form clusters for the ease of implementation and supervision.

Phasing

10. The programme will be implemented in a phased manner, but simultaneously across the four districts. The bases for phasing are the following elements.

- All GN divisions that were covered by previous IFAD projects in Anuradhapura (254 GNs) and Badulla (284 GNs) will be covered from programme year 1 onwards for a period of three years and a half.
- In Anuradhapura, the programme will extend to an additional 126 of the poorest GN divisions that were not covered by the previous project. The corresponding number of the additional poorest GNs in Badulla is 142. The programme will support these GNs over a period of three years and six months. These GNs will be phased in over a period of five years according to a phasing of 5% of the total GNs in programme year 1, 10% in programme year 2 and programme year 3, 40% in programme year 4, when the GNs in (1.) are phased out, and 35% in programme year 5
- In Kurunegala, the programme will cover 185 of the poorest GNs, and in Monaragala the number will be 86 GNs; the phasing in of these GNs will occur according to a schedule of 10% in programme year 1, 20% in programme year 2, 30% in programme year 3 and 20% in programme year 4 and programme year 5.

Components

11. **FFSs.** As there is no broad experience with a participatory and farmer-managed FFS, the initial two years will be considered a pilot phase. The implementation will require the following broad steps.

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- Recruitment will be undertaken of experienced technical assistance from countries in the region, with expertise in the methodology of participatory extension and farmer-managed FFSs.
- The participatory analysis of priority constraints in upland farming and the identification of potential solutions of interest to school members will be carried out. Care will be taken to ensure that issues are also in the interest of women, as these will constitute at least 50% of the FFS members. This will require the contracting of an NGO for the participatory analysis and of technical expertise from universities, private firms, public line agencies, or farmer groups for the development of the potential solution.
- A school piloting programme and training curriculum will be developed by the same institutions that developed the potential solution.
- The training of agrarian services department staff in the participatory approach and farmer management of the FFSs, to be carried out by the agency that developed the curriculum and the technical assistance.
- The FFS will be conducted with support from the agrarian services department staff and the NGO. Support will be provided for farmers undertaking their own FFSs.

12. **Marketing.** The promotion of forward sales contracts will require the contracting of a facilitating agency with experience in this matter gained under the previous Central Bank pilot programme. For organic products, direct contracting of an operator in the export market is required. The same operator should also be responsible for certification and technical assistance to farmers. The Regional Development Department of the Central Bank will provide technical advice on a contract basis. The department will also carry out the pilot inventory credit programme. All implementing agencies will be made aware of the project's gender strategy and the minimum requirement of the 30% participation of women.

13. **Microenterprise Development.** The programme will invite experienced service providers to submit proposals for support for microenterprise development in the GN divisions in the programme area. For this purpose, the following steps would be taken:

- the registration of interest by service providers;
- the shortlisting of potential service providers;
- the invitation of proposals and evaluation, including the gender impact;
- the implementation of approved proposals by service providers over a period of up to 24 months; and
- monitoring by the programme.

14. Microenterprises are characterized by an employment level of less than five persons and/or an asset base, excluding land and buildings, of from LKR 50 000 to LKR 5 million.

15. **Micro-Tank Rehabilitation.** The selection of the micro-tanks to be rehabilitated will be carried out by the district programme manager on the basis of the following criteria.

- The community has expressed effective demand and considers rehabilitation a priority.
- The tank is still being used for irrigation and has not been abandoned.
- The rehabilitation is feasible within the budget foreseen.
- The command area is sufficiently developed or can be developed without excessive cost.
- All farmers in the command area have permits or titles, or can be helped to get these in a cost-efficient manner.
- The potential users have established a maintenance fund covering at least the costs of 12 months of current maintenance and have developed a policy of cost recovery for maintenance.

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- The participation of women will be at least 30%.
16. Once the potential users have set up a water users group, training in operation and maintenance will be provided prior to the start of the works. Extension training will also be provided on demand.
17. The execution of the works will be contracted to the users group, where needed, with technical back-up from a private contractor. Supervision will be provided by the Irrigation Department, a private firm, or an NGO.
18. **Microfinance and Income-Generating Activities.** Experienced and successful microfinance institutions will be invited to submit proposals to extend their services to the programme target group in poor and remote GN divisions. Proposals will be evaluated on the following criteria:
- the proposed area to be covered;
 - the number of poor household members by gender expected to be involved, with a minimum participation of women of 80%;
 - the gender approach proposed;
 - the type of services proposed: group formation, training, savings mobilization, internal loan schemes, linkages with formal financing institutions;
 - the type of income-generating activities to be supported and the financial feasibility of income-generating activities;
 - the period of intervention and the costs per beneficiary.
19. Microfinance institutions with a proven track record and a proven liquidity constraint are eligible to obtain a credit line from the programme. For this purpose, a subsidiary loan agreement needs to be executed between the institution and the Treasury Department that is acceptable to IFAD. The subsidiary loan agreement needs to specify the following:
- the amount of the loan;
 - the maturity of the loan up to eight years, with a grace period of up to five years;
 - that the principal repayments constitute a revolving fund at the institution for the purpose of re-lending to the target group;
 - that on-lending will be in rupees, and the interest rate covers the foreign-exchange risk for the Treasury.
20. **Priority Community Infrastructure.** The identification of the priority community infrastructure will be the result of participatory assessments in the communities undertaken by an experienced and qualified NGO. Design issues will also be detected in a participatory manner, while technical design will be carried out by qualified private firms and/or NGOs. In cases of investments in renewable energy, close coordination and collaboration with the expertise in the World Bank-financed Renewable Energy for Rural Economic Development Project will be ensured. The overall participation of women in this component will be at least 50%.

C. Monitoring and Evaluation

21. Under the programme approach of contracting out all activities, the monitoring of contract performance is an essential activity of programme management. To be able to evaluate contract implementation, the programme will have to gather its own monitoring data because it cannot rely on the implementing agencies to provide the required data. For this purpose, a network of monitoring units will be established.

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22. In each implementation agreement between the district programme manager and an implementing agency, the indicators that will be monitored by the programme will be specified. As far as feasible, these indicators will include data on impact to the extent this is under the control of the implementer.

23. In the Logical Framework in Appendix V, a series of indicators by gender have been defined. This also takes into account the requirements of IFAD's Results Management System, which was under preparation at the time of the appraisal mission. Under the Special Operations Facility financing, a monitoring specialist will be recruited to establish the system of contract indicators to be monitored and to define the data-collection methodology and the manner and frequency of analysis required.

DRY ZONE LIVELIHOOD SUPPORT AND PARTNERSHIP PROGRAMME

ORGANIZATION CHART

