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Enabling the rural poor
to overcome poverty

President's report

Proposed loan and grant to the Arab Republic of Egypt for the

Upper Egypt Rural Development Project

Executive Board — Eighty-ninth Session
Rome, 12-14 December 2006

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

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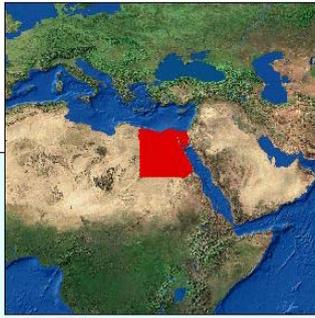
Abbreviations and acronyms

CDA	community development association
MWRI	Ministry of Water Resources and Irrigation
SFD	Social Fund for Development
SMEs	small and microenterprises
WUA	water users' association

Recommendation for approval

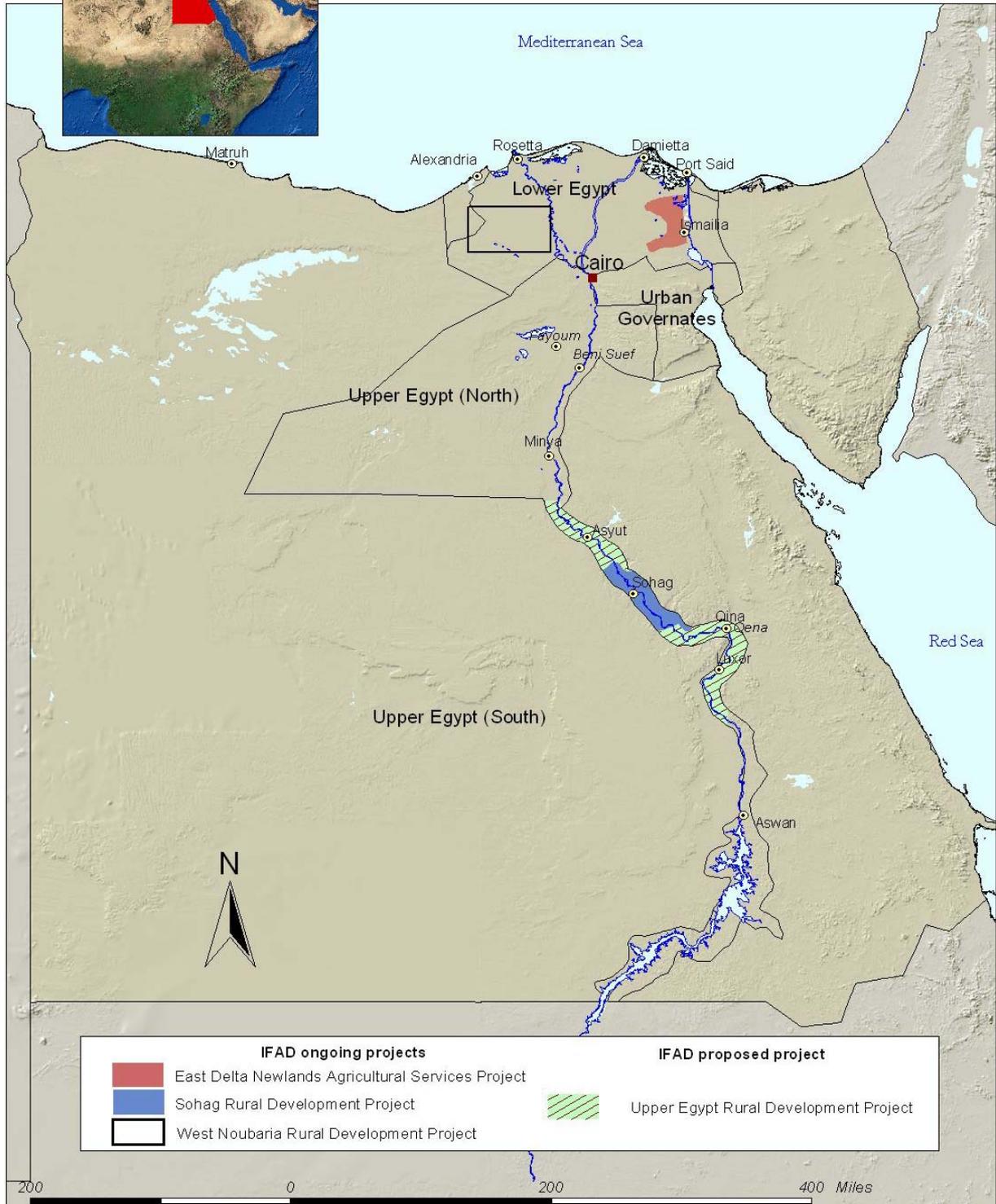
The Executive Board is invited to approve the recommendation for the proposed loan and grant to the Arab Republic of Egypt for the Upper Egypt Rural Development Project, as contained in paragraph 35.

Map of the project area



Arab Republic of Egypt

Map 1 - IFAD-financed ongoing and proposed projects



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.

Arab Republic of Egypt

Upper Egypt Rural Development Project

Financing summary

Initiating institution:	IFAD
Borrower:	Arab Republic of Egypt
Executing agencies:	Ministry of Agriculture and Land Reclamation and the Social Fund for Development
Total project cost:	US\$19.9 million
Amount of IFAD loan:	SDR 10.05 million (equivalent to approximately US\$15.1 million)
Amount of IFAD grant:	SDR 635,000 (equivalent to approximately US\$0.95 million)
Terms of IFAD loan:	20 years, including a grace period of 5 years, with an interest rate of one half of the reference interest rate per annum as determined by the Fund annually
Contribution of borrower:	US\$3.7 million
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Proposed loan and grant to the Arab Republic of Egypt for the Upper Egypt Rural Development Project

I. The project

A. Main development opportunity addressed by the project

1. The proposed project is the first of a series of projects foreseen under IFAD's new strategic framework for assistance to Egypt – as outlined in the 2006 country strategic opportunities paper (COSOP) – to help reduce rural poverty and unemployment. Given the strong links between agricultural growth, the rural economy and poverty reduction, there is a good rationale for promoting microfinance and microenterprise development, marketing and partnerships with the private sector, and more efficient irrigation systems.

B. Proposed financing

Terms and conditions

2. It is proposed that IFAD provide to the Arab Republic of Egypt a loan in the amount of SDR 10.05 million (equivalent to approximately US\$15.1 million), on intermediate terms, and a grant in the amount of SDR 635,000 (equivalent to approximately US\$0.95 million) to help finance the Upper Egypt Rural Development Project. The loan will have a term of 20 years, including a grace period of 5 years, with an interest rate of one half of the reference interest rate per annum as determined by the Fund annually.

Relationship to the IFAD performance-based allocation system (PBAS)

3. The annual PBAS allocation for Egypt is US\$9.6 million. This project is the first in the current PBAS cycle, and the total loan and grant amounts fall well within the three-year allocation.

Country debt burden and absorptive capacity of the State

4. Egypt's handling of its external debt has improved both in terms of the size of its debt and its debt servicing. In 2005, Egypt's foreign debt amounted to US\$28.9 billion (32 per cent of GDP) and its debt service ratio was 9.7 per cent. IFAD has extended eight loans over a period of 25 years to Egypt, committing more than 50 per cent of these funds to four newland settlement projects in Lower Egypt and about 30 per cent to three agricultural development projects in northern Upper Egypt. More recently, the Fund has supported a rural infrastructure development project in southern Upper Egypt. Total annual disbursements from all ongoing projects in the country average SDR 1.39 million. The Government has a good repayment record for IFAD loans.

Flow of funds

5. The IFAD loan and grant will be channelled through a standard IFAD financing agreement between IFAD and the Government, and subsequently channelled through subsidiary financing agreements between the Ministry of International Cooperation and the Social Fund for Development. The latter will on-lend credit resources to eligible financial intermediaries, such as NGOs and community development associations (CDAs), for further on-lending to the target group in the project area.

Supervision arrangements

6. The IFAD loan and grant will be directly supervised by IFAD.

Exceptions to IFAD General Conditions for Agricultural Development Financing and operational policies

7. No exceptions are foreseen. The procurement plan relating to the grant expenditure will be agreed prior to loan negotiations.

Governance

8. The following planned measures are intended to enhance the governance aspects of IFAD financing: (i) use of a private auditing firm and full adherence to IFAD's new guidelines for audit reporting; (ii) forging of partnerships with private-sector actors, such as commercial banks and private exporters; (iii) competitive service provision through competition for contracts between the project and the public, private and NGO sectors; and (iv) introduction of best practices of the Consultative Group to Assist the Poorest for the promotion of microfinance by providing technical assistance to financial intermediaries.

C. Target group and participation

Target group

9. The project will target the poorest segment of the population in the project area, including smallholders cultivating less than about one *feddan* (0.42 hectares), landless labourers, unemployed youth, and woman-headed households.

Targeting approach

10. A two-level targeting approach will be adopted: (i) targeting poor and very poor villages and village clusters, focusing within these on the less endowed communities; and (ii) in the selected areas, targeting people judged to have the skill potential and basic entrepreneurial requirements needed for the marketable products identified jointly with the community.

Participation

11. The project will assist the target group in forming community-based associations, such as farmers' and craftworkers' marketing associations and CDAs. Such associations will play a vital role in implementing project activities through (i) identification and prioritizing of village development needs; (ii) market linkages and supply chain analysis; (iii) technical advisory services; (iv) joint or individual investment in small and microenterprises (SMEs); (v) dissemination of marketing information; and (vi) combined procurement of inputs. Women will, in particular, be encouraged and supported to form marketing associations for livestock and handicraft production. The project will adopt a multi-pronged approach to gender mainstreaming by (i) expanding women's participation in the mainstream economy; (ii) increasing the outreach of productive and social services to women; (iii) ensuring women's participation in local institutions; (iv) enabling local institutions to close the gender gap through capacity-building in gender analysis; and (v) ensuring the fair representation of women on project steering committees.

D. Development objectives

Key project objectives

12. The overall project objective is to contribute to poverty reduction and improved livelihoods of the target population in the project area. The intermediate objectives will be to empower the target group to create sustained employment and increase income through (i) SME development and microfinance; and (ii) farming system research and extension to help small farmers achieve higher returns per unit of land and water.

Policy and institutional objectives

13. An important objective of the project is to help establish a sustainable microfinance system by extending microfinance support from the Social Fund for Development (SFD) into the rural areas of Upper Egypt and forming partnerships with commercial banks.

IFAD policy and strategy alignment

14. The project will seek to implement in southern Upper Egypt the COSOP strategic objective of contributing to rural employment creation and income generation. It is fully aligned with IFAD's strategic objectives of strengthening the capacity of the rural poor and their organizations, and increasing access to financial services and markets. It also supports three objectives of IFAD's Near East and North Africa regional strategy: empowering the rural poor, reducing gender disparities and improving natural resource management.

E. Harmonization and alignment

Alignment with national priorities

15. The project is aligned with the Government's poverty reduction strategy, especially with respect to the following three thrusts: (i) economic growth, through investment in productive sectors, as the basis for increasing income and employment; (ii) women's advancement and closing of gender gaps; and (iii) participatory governance to strengthen the voice of the poor.

Harmonization with development partners

16. The project will enable cross-fertilization with several donor-supported activities. In particular, it will benefit from the institution-building activities provided by (i) the World Bank-supported Upper Egypt Integrated Development Project, currently under preparation; (ii) the ongoing Swiss Import Promotion Programme, financed by the Swiss Agency for Development and Cooperation (SME development); (iii) the Netherlands-supported Water Board Project (water management); and (iv) the European Union-supported Financial Investment and Sector Cooperation Programme (rural finance).

F. Components and expenditure categories

Main components

17. The project has three components: (i) private-sector development (including marketing and SME development) and financial services development; (ii) agriculture competitiveness enhancement; and (iii) project coordination and management.

Expenditure categories

18. There are six expenditure categories: (i) vehicles and equipment (2 per cent of base costs); (ii) technical assistance and studies (3 per cent); (iii) training (12 per cent); (iv) contractual services (10 per cent); (v) credit funds (61 per cent); and (vi) recurrent costs, including salaries and organization and management (12 per cent).

G. Management, implementation responsibilities and partnerships

Key implementing partners

19. These will be the SFD and its subsidiary groups in the Governorates of Assiut and Quena (for the private-sector development component) and the Undersecretary of Agriculture in each governorate (for the agriculture competitiveness enhancement component).

Implementation responsibilities

20. The private-sector development component will be implemented by the SFD through its subsidiary organization – the Small Enterprise Development Organization (SEDO) – and its Microfinance Sector Department (MFS) in the Governorates of Assiut and Quena, following their standard operational policies, practices and procedures, as well as project regulations and guidelines. Loans will be extended through both of these entities, with SEDO focusing on SME loans in excess of 10,000 Egyptian pounds (US\$1,750) and MFS extending loans in smaller amounts. Both entities will work with intermediary institutions: SEDO with commercial banks, and MFS with microfinance institutions, NGOs, CDAs, and farmers' and craftworkers' marketing

associations that meet best practices criteria. The agricultural competitiveness enhancement component will be implemented by the Ministry of Agriculture and Land Reclamation through its governorate-level departments of agriculture. For the proposed demand-driven, on-farm research and extension, the research team and extension agents will be recruited from universities or elsewhere in the private and public sectors; this pilot demand-driven approach will be closely monitored and evaluated on a periodical basis and during the mid-term review.

Role of technical assistance

21. IFAD will provide a US\$950,000 grant to help build the capacities of the SFD, financial intermediaries and community-based associations.

Status of key implementation agreements

22. In addition to the standard IFAD financing agreement between IFAD and the Government, a subsidiary agreement will be established between the Ministry of International Cooperation (MIC) and the SFD specifying the conditions for MIC on-lending of IFAD credit funds to the SFD. In addition, several agreements will be established between the SFD and each participating commercial bank and NGO or CDA.

Key financing partners and amounts committed

23. The total project cost is estimated at US\$19.9 million over eight years. The sources of financing are IFAD (a loan of US\$15.1 million on intermediate terms and a grant of US\$0.95 million); and the Government, including SFD (US\$3.7 million).

H. Benefits and economic and financial justification

Main categories of benefits generated

24. The project will benefit rural poor households by creating on- and off-farm jobs and increasing income, production and food security. These gains will stem from the use of improved production technology and investments in on- and off-farm enterprises; improved irrigation water management practices; better margins on sales of produce; better employment prospects, associated with enhanced business development opportunities; and greater participatory involvement in marketing associations, which will help these groups achieve the production scale necessary to strengthen their bargaining power. Agricultural extension and water management will directly benefit an estimated 350,000 rural households. Around 100 CDAs, 125 farmers' associations and 75 craftworkers' associations will be established or strengthened to help establish 44,000 SMEs and 200 small businesses, thus creating around 30,000 jobs (57 per cent for men and 43 per cent for women). From an institutional perspective, the project's training of SFD staff, NGOs and CDAs will contribute to long-term, sustainable access of the rural poor to the formal financial sector. Formation and training of branch canal WUAs will directly benefit small farmers by providing opportunities to democratically achieve equity and transparency in water allocation.

Economic and financial viability

25. A series of representative on- and off-farm enterprise models were developed for investments by SMEs in dairy production, investments by microenterprises in on- and off-farm activities, and investments by individual smallholders in the production of high-value crops. The financial results show that the incremental returns are attractive enough to allow higher income and repayment of loans.

I. Knowledge management, innovation and scaling up

Knowledge management arrangements

26. The IFAD field presence officer in Cairo will organize yearly national project implementation workshops allowing project staff and other implementing partners to communicate and share lessons learned across projects. In addition, the project will make substantial use of KariaNet, the IFAD-supported regional knowledge

management network based in Cairo, which will enable it to learn from and share experiences with other IFAD projects and partners in the Near East and North Africa region.

Development innovations that the project will promote

27. Project features that are innovative in the Egyptian context include (i) promotion of sustainable access to financial services in rural areas through partnerships with the SFD (as the apex institution) and community-based financial intermediaries, and promotion of SME development through partnerships with commercial banks; (ii) introduction of a market-driven, business-oriented approach to agriculture and livestock production, which will link private exporters to producers through contractual arrangements with farmers' associations; and (iii) promotion of participatory water resource management through the establishment of branch canal WUAs with a view to their future integration into district water boards.

Scaling-up approach

28. At the end of project implementation and possibly even at mid-term, the project will have generated valuable lessons that will point to ways to expand its approaches and pilot activities throughout Upper Egypt. These initiatives' reflection of local conditions and their scaling up by the Government and other partners will contribute to making rural microfinance, market-driven agricultural production systems and participatory water resource management mainstream activities of rural development programmes.

J. Main risks

Main risks and mitigation measures

29. There are two main risks. The risk that rural women will have limited access to microfinance will be mitigated through participatory targeting and promotion of enterprises of interest to these women (e.g. in the livestock and handicraft sectors). The risk of a high rate of delinquency will be mitigated through strong investment in the capacity-building of microfinance intermediaries and the adoption of best practices.

Environmental classification

30. Pursuant to IFAD's environmental assessment procedures, the project has been classified as a Category B operation in that it is not likely to have any significant negative environmental impact.

K. Sustainability

31. By promoting microfinance best practices, the project will ensure that credit operations are financially viable and sustainable for the SFD and its participating partners. Being fully participatory, the project will create ample opportunity for community-based organizations to contribute to the management, operation and maintenance of their facilities with limited or no government support, skills they can use even beyond the project implementation period.

II. Legal instruments and authority

32. A financing agreement between the Arab Republic of Egypt and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A summary of the important supplementary assurances included in the negotiated agreement is attached as an annex.
33. The Arab Republic of Egypt is empowered under its laws to borrow from IFAD.
34. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD.

III. Recommendation

35. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

RESOLVED: that the Fund shall make a loan to the Arab Republic of Egypt in various currencies in an amount equivalent to ten million and fifty thousand special drawing rights (SDR 10,050,000) to mature on or prior to 1 September 2026 and to bear an interest rate of one half of the reference interest rate per annum as determined by the Fund annually, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

RESOLVED FURTHER: that the Fund shall provide a grant to the Arab Republic of Egypt in various currencies in an amount equivalent to six hundred and thirty-five thousand special drawing rights (SDR 635,000) and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Lennart Båge
President

Summary of important supplementary assurances included in the negotiated financing agreement

(Negotiations concluded on 9 December 2006)

Subsidiary loan agreement

1. The Government will onlend the loan proceeds to the SFD, through a subsidiary loan agreement.

Project implementation manual

2. The national project coordination unit (NPCU) will prepare a draft project implementation manual and will submit it to IFAD for its comments and no objection. If IFAD does not comment on the draft project implementation manual within 30 days of receipt, it will be deemed approved for adoption by the Ministry of Agriculture and Land Reclamation and the SFD.

Pest management practices

3. The Government will ensure that pesticides procured under the project do not include any pesticides banned by the Food and Agriculture Organization of the United Nations or classified as extremely hazardous or highly hazardous by the World Health Organization.

Gender focus

4. The Government will ensure that gender equity is observed in the recruitment of project staff and that beneficiaries are equally targeted within the project.

Conditions precedent to withdrawal

5. (a) No withdrawals will be made under the loan and grant until: (i) the special account, grant bank account and related accounts have been opened; (ii) the first annual workplan and budget has been submitted to and cleared by IFAD; and (iii) the NPCU staff have been recruited and duly appointed. (b) No withdrawals will be made under the loan until the subsidiary loan agreement has been signed.

Conditions precedent to effectiveness

6. The project financing agreement will become effective subject to the fulfilment of the following conditions: (a) the project steering committee has been duly established; and (b) a legal opinion has been delivered by the Government to IFAD.

Key reference documents

Country reference documents

National Strategy for Poverty Alleviation "Vision 2017"
National Water Strategy
National Strategy for Environment
National Strategy for Women

IFAD reference documents

PDD and Key Files
Egypt COSOP (2006)
Country Programme Evaluation (2005)
Learning Notes
Policy on Rural Finance
Administrative Procedures on Environmental Assessment
Prerequisites of Gender Sensitive Design
Private Sector Partnership and Development Strategy

Other miscellaneous reference documents

World Bank Country Assistance Strategy for Egypt (2005)
UNCDF, KFW, UNDP, USAID: Microfinance Sector Development Approach (2003)
EU-Egypt Cooperation Framework (2004)
UNDP: Human Development Report (2004)
USAID/Egypt Strategic Plan for 2000-2009

Logical framework

Narrative Summary	Verifiable Indicators	Means of Verification	Assumptions/Risks
<p>Goal</p> <ul style="list-style-type: none"> Poverty reduction and improved livelihoods of smallholder households, the landless labourers, female headed households and the unemployed youth in the project area. 	<ul style="list-style-type: none"> Poverty indicators. (Improvements in HH assets); Reduction in the prevalence of malnutrition for children under five (weight for age, height for age, weight for height); Reduction of gender gap rate in unemployment. 	<ul style="list-style-type: none"> National Household Living Standard Surveys for project Governorates; 	<ul style="list-style-type: none"> Continued Government commitment to pro-poor macro-economic policies and institutional reforms; Recent economic growth maintained; Enabling policy framework for women employment.
<p>Purpose/Objective</p> <ul style="list-style-type: none"> To empower the project target group to create sustainable employment and increase income. 	<ul style="list-style-type: none"> Per cent increase in employment and income of project target group, by gender 	<ul style="list-style-type: none"> GOE employment statistics; Baseline, socio-economic surveys and project completion report (gender-disaggregated); Independent assessments 	<ul style="list-style-type: none"> Decentralization policies continued; Urban markets continue to maintain increased demand for agricultural produce.
<p>Outputs Sought</p> <ul style="list-style-type: none"> SMEs developed ; Capacities of CDAs, FMAs, HMAs improved; their productivity, competitiveness and marketing enhanced; Financial services enhanced and accessible on sustainable basis. 	<ul style="list-style-type: none"> Number of sustainable SMEs promoted ^{ai} Number of sustainable CDAs, FMAs, HMAs established and their membership by gender ^{ai}; Enterprises developed by type, size and direct job opportunities created, temporary and full time by gender. 	<ul style="list-style-type: none"> Project monitoring reports; Annual progress and supervision reports. 	<ul style="list-style-type: none"> Best practice by SFD and MFIs implemented.
<ul style="list-style-type: none"> Demand driven farming system research and extension for crop and livestock expanded. 	<ul style="list-style-type: none"> Number of on-farm research carried out on high value crops and livestock; Increases in crop and livestock production and returns per unit land and water; Number of women and men attending training, extension, demonstration activities. (ratio in range of 50 per cent); Number of workshops conducted with FMAs and number of farmers attended by gender; Number of farmers of FMAs adopting technology by gender. ^{ai} 	<ul style="list-style-type: none"> Project monitoring reports; Annual progress and supervision reports. 	<ul style="list-style-type: none"> MALR decentralization of extension and research continues.
<ul style="list-style-type: none"> Improved water management practices; equitable distribution and rational use of available water for irrigation. 	<ul style="list-style-type: none"> Changes in crop yields at the head and tail end of the branch canals; Number of WUAs and Water Boards established and functional; area served; ^{ai} Number of women in leadership position of BCWUAs; Number of Board and Representative Assembly of BCWUAs trained by gender. 	<ul style="list-style-type: none"> Project monitoring reports; Annual progress and supervision reports. 	<ul style="list-style-type: none"> Integrated Water Management Districts (IWMDs) strengthened; Proposed Water Law is approved by the Peoples' Assembly.

^{ai} Indicators in bold refer to both the loan and grant components.

