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Enabling the rural poor
to overcome poverty

Nepal

Implementation of the first cycle of the Western Uplands Poverty Alleviation Project financed under the flexible lending mechanism

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Note to Executive Board Directors

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Kati Manner

Country Programme Manager
telephone: +39 06 5459 2790
e-mail: k.manner@ifad.org

Queries regarding the dispatch of documentation for this session should be addressed to:

Deirdre McGrenra

Governing Bodies Officer
telephone: +39 06 5459 2374
e-mail: d.mcgrenra@ifad.org

Implementation of the first cycle of the Western Uplands Poverty Alleviation Project financed under the flexible lending mechanism

1. The purpose of this information note is to comply with paragraph 13 of the flexible lending mechanism (FLM) guidelines (EB 98/64/R.9/Rev.1), which stipulates that "...for each FLM loan and prior to the end of each cycle, IFAD Management will decide whether to proceed to, cancel, or delay subsequent cycles. Management will inform the Board accordingly."

I. Introduction

2. The overall objective of the FLM is to introduce greater flexibility into the Fund's project design and implementation in order to: match project time frames with the pursuit of long-term development objectives when it is judged that a longer implementation period will be required to meet those objectives; maximize demand-driven beneficiary participation; and reinforce the development of grass-roots capacities. The specifics of an FLM loan include: (i) longer loan periods (10-12 years) to allow for the achievement of sustainable development objectives; (ii) a continuous and evolving design process through implementation of distinct, three- to four-year cycles; and (iii) clearly defined preconditions – or "triggers" – for proceeding to subsequent cycles.
3. This information note reports on the progress of the Western Uplands Poverty Alleviation Project in achieving its first-cycle triggers. The note's contents are based on the findings of an IFAD, United Nations Office for Project Services (UNOPS) and Government of Nepal joint mission fielded in October-November 2006. In accordance with operational procedures for the FLM, the task of the review was to assess the project's progress and performance in the first cycle, judge whether the criteria for IFAD approval of funding for the second cycle had been satisfied, make recommendations on possible improvements to the project, outline the content of an eventual second cycle and propose any needed changes to the loan agreement between the Government and IFAD.

II. Background

4. The Executive Board approved financing for the project on 6 December 2001, and it became effective on 1 January 2003. The total project cost is estimated at US\$32.6 million. Sources of financing are IFAD (with a loan of about US\$20.0 million and a grant of US\$360,000), the World Food Programme (US\$4.0 million), the private sector (US\$36,000), the Government (US\$8.1 million) and beneficiaries (US\$78,000). The Ministry of Local Development has overall responsibility for the project; the project coordination unit (PCU) is responsible for its implementation; and UNOPS acts as the cooperating institution. IFAD's President approved an extension of the first cycle until 15 July 2007.
5. The overall goal of the project is to ensure more resilient livelihoods and to defend the basic human dignity of poor and socially disadvantaged people in the uplands of the far and mid-western regions of Nepal. Its specific objective is to strengthen the capacity of poor and socially disadvantaged groups to mobilize their own resources (human, natural, physical, financial), gain access to external resources and ensure social justice. A secondary supporting objective is to create an institutional framework in support of the primary objective, by creating dynamic grass-roots institutions that will ultimately be federated at the village and district development committee levels.
6. Project activities are demand-driven. Efforts are made to mobilize communities and to persuade them to outline their needs and perceived difficulties. Given that community mobilization and institution-building are lengthy processes, the project is

financed under IFAD's FLM, which allows for a longer project period. The project will be implemented over 11 years, in three cycles.

III. Project performance during the first cycle

7. The five components of the project are:
 - (i) **Labour-intensive infrastructure development**, which has two subcomponents:
 - **interdistrict roads**, which envisages construction by labour-intensive methods of roads to improve access in the programme area; and
 - **community infrastructure**, which responds to community demands for such facilities.
 - (ii) **Leasehold forestry and non-timber forest product (NTFP) production**, which is to gain access to land for landless people and support them in production of NTFPs, fodder crops and timber.
 - (iii) **Crop and livestock production**: (a) crop production, which is to improve nutrition through support for production, training and information services; and (b) livestock production, which is to improve production from livestock by training for village animal health workers, support for farm technology testing and adaptive research and breeding and stud farm services.
 - (iv) **Rural microfinance**, which is to provide credit for enterprises, supported by mobilization of savings, entrepreneurship training, market information services and links with the private sector.
 - (v) **Institutional support**, which is (primarily) to strengthen institutions responsible for project implementation.
8. The loan agreement sets out the following "triggers" that must be satisfied before the end of each cycle as a condition for IFAD financing continuing for the next cycle:
 - (i) forest leases will have been made available in a timely manner and on at least 3,000 hectares of land for leasehold forestry;
 - (ii) a total of 440 community organizations and 135 leasehold forest user groups (LFUGs) will have been formed;
 - (iii) the project will have maintained loan recovery rates of at least 95 per cent;
 - (iv) at least 20 kilometres of "green road" will have been built;
 - (v) a total of 75 small-scale infrastructure works will have been constructed; and
 - (vi) all studies and evaluation reports will have been concluded to IFAD's satisfaction and made available to the review mission in project year 4.
9. The project has done well in implementation especially given the difficulties of operating in an uncertain political and administrative context and in a situation of armed conflict, factors that are compounded by the challenges presented by topography and communications in its operating area. Numerically, four of the triggers have been satisfied (i, ii, v and vi in paragraph 8), and there are highly valid reasons why the other two (green road construction and loan recovery rate) have not been satisfied.

Labour-intensive infrastructure development component

Interdistrict road subcomponent

10. It was intended that a total of 125 kilometres of green road be constructed, of which 20 kilometres would be completed within the first cycle – as is specified in the trigger for approving of funding for the second cycle. Construction would be by labour-intensive methods, and would be supported by the World Food Programme (WFP), which would make available the equivalent of US\$4.0 million under food-for-

work principles. However, WFP assistance as prescribed in the loan agreement could not be delivered for the intended project purposes as per project design, and consequently no progress in this subcomponent has been made.

11. Assessment of the infrastructure development component indicates that, since 2001 when the project was designed, several road construction projects have already been initiated or are planned in the project area by other donors. The Asian Development Bank's funded Decentralized Rural Infrastructure and Livelihood Project may follow the same alignment as the project's green road subcomponent. Future infrastructure projects also include a joint Government/World Bank programme for the mid-west and far west regions, which will substantially improve connectivity in the project districts and support linking district centres with each other and with the rest of the country.

Community infrastructure subcomponent

12. Under this subcomponent, it was foreseen that 1,006 subprojects would be completed over the life of the project. Eligible projects would include public buildings, foot and mule trails, bridges, water supply, sanitation and micro-hydro facilities. The trigger for IFAD financing for the second cycle was set at completion within the first cycle of 75 small-scale works.
13. Progress under this subcomponent has been substantial, considerably exceeding the trigger set. By July 2006, 101 subprojects had been completed in the first four districts, including irrigation facilities, bridge/culvert construction or rehabilitation, drinking water facilities, micro-hydel/water turbines, school buildings and health posts. By the end of October 2006, about 75 per cent of IFAD loan funds for the first cycle had been disbursed.

Leasehold forestry and NTFP production

14. The project set out to acquire 22,500 hectares of forest land and arrange for its being leased for terms of 40 years to about 1,000 LFUGs, whose membership would be restricted to the poorest segments of rural society. Triggers for the release of funding for the second cycle are that forest leases will have been made available in a timely manner and on at least 3,000 hectares of land for leasehold forestry, and that 440 community organizations and 135 LFUGs will have been formed.
15. Numerically, progress has been far in excess of plans and the trigger requirements: by the end of the 2006 financial year (15 July), 583 community organizations and 233 LFUGs had been formed, with leases granted on over 3,425 hectares. One reason for this success is the emphasis the project gives to community mobilization, which is seen as a mechanism for bringing the target group together for project activities. Social mobilizers are recruited from target areas and trained in formation and operation of groups. The project has also made initial progress in instituting development of the lands secured for the target groups, with some LFUGs making good starts on NTFPs production, especially by planting fruit trees and medicinal and aromatic plants. However, progress has lagged in forestry and forage and fodder crop production.

Crop and livestock production

Crops

16. The objective of this part of the component is to improve nutrition through research (on-station and on-farm) and training and other support to district agriculture development offices aimed at improving extension services for farmers. The only direct assistance for farmers is in provision of improved seeds. Some important progress has also been made in agricultural work. Adaptive research by the National Agricultural Research Council has identified varieties and techniques, which have been disseminated to farmers with promising results.
17. Since the agricultural potential of the area is limited by the resource base and climate, it is essential that the best use be made of the lands available by increasing the productivity of existing crops and introducing new crops with higher value to

farmers. Crop production is important to pursuing the objectives of improved food security and nutrition, and higher incomes.

Livestock

18. This part of the component will increase the efficiency of indigenous and cross-breed livestock by providing services to livestock keepers through village animal health workers, testing methods for increasing animal feed production and introducing improved breeding animals (buffalo and sheep) by piloting private stud farms. This process is to be supported by training the staff of the district livestock service offices (DLSOs) and providing equipment for extension work.
19. The DLSOs have achieved significant progress. Many owners have been trained in husbandry and pasture management; improved buffalo bulls, bucks and goats have been distributed; and animals have been vaccinated. Particularly noteworthy has been the successful introduction of "goat groups" piloted by the DLSOs, which offer a great opportunity for assisting the poor in improving nutrition, increasing food security and lifting incomes. However, the operations have encountered difficulties arising from limited financial resources.

Rural microfinance

20. The loan agreement and appraisal report set out two main streams of activities for this component: (i) establishment of savings and credit functions through groups of the poorest households (called "community organizations"), which would eventually federate at village development committee and district levels to provide substantial savings and loan facilities; and (ii) provision of credit, financed by the IFAD loan, to community organizations to on-lend to individual members. The funds are managed by the local development fund board in each district. It was envisaged that credit would be used primarily to finance on and off-farm enterprises. The first of two trigger indicators for success in the first cycle is that 440 community organizations will have been formed. The second indicator is that the project will have maintained loan recovery rates of at least 95 per cent.
21. Numerically, progress with the savings and credit functions has been considerable, By 15 July 2006, some 583 community organizations had been formed and had saved more than US\$70,000 in local currency. However, the assessment by the joint review mission's microfinance consultant stresses the need for continuing assistance to the savings and credit groups to ensure fiscal discipline and good money management.
22. Very little progress, however, could be made in applying the credit capital, which was intended to fill the gap in financing enterprises caused by the almost complete absence of the formal finance sector in the area. The impacts of political difficulties and armed conflict, high interest rates and a low loan ceiling are all given as reasons for the recovery rate being about 60 per cent, far below the trigger. While these all play a part, another major contributing factor is the shortage of profitable enterprises for investment. There is great need to stimulate the development of micro- small- and medium-sized enterprise as a valuable source of income for the poor.
23. The project's activities will create many options for the development of enterprises using credit to finance investment by the target group. The achievement of peace and completion of road works may have a major impact on financial services, with Nepal's formal financial institutions able to respond to likely demand for their services in the area.

IFAD loan disbursements

24. The project's financial implementation has been satisfactory, especially when account is taken of the difficulties caused by the operational context as well as the savings made following other donors' additional grant support. One example is the support provided by the Royal Danish Embassy to Nepal to carry out a land

availability/resource assessment survey under the project's leasehold forestry component.

25. IFAD-financed project expenditure during the first cycle (up to 20 February 2007) is at SDR 1.32 million, equivalent to about 60 per cent of the approved amount of SDR 2.2 million (out of SDR 15.6 million) for the first cycle.

IV. Recommendations for implementation of the second cycle

26. The review of the achievements and performance of the first cycle, summarized above, highlights lessons and recommendations to be incorporated for the second cycle of the project.

Interdistrict road subcomponent

27. Given the other government investments and donor support to develop the road network in the project districts, it is recommended that the Government and IFAD agree to terminate this subcomponent in the project's second and third cycles, and concentrate on community-level infrastructure including trails and farm-to-market road construction. Careful follow-up of the progress of the infrastructure projects is needed to ensure synergies of the project's components with other development investments in the project area.

Community infrastructure subcomponent

28. The recommendations for the second cycle include an increased allocation of funding to this subcomponent; greater involvement of the district technical offices in site selection, design and construction of facilities; and the improved quality of facilities constructed. It is also recommended that the ceiling of the cost of individual subprojects be increased from the current level to allow for the development of projects with greater community impact.

Leasehold forestry and NTFP production component

29. It is recommended that the Government and IFAD place paramount importance on this component, specifically by: (i) preparing an action plan for development of the leasehold areas, with specific attention to categorizing the lands currently under lease and deriving strategies and tactics for different land categories; (ii) increasing the allocation of funds to enable specific activities for the development of LFUGs; (iii) continuing discussions with WFP on the provision of food-for-work assistance to LFUGs, which would also serve as an incentive for them to develop their leasehold land as rapidly as possible; and (iv) facilitating private-sector involvement in NTFP development. It is also recommended that the project concentrate increasingly on the quality of the achievements and future sustainability of the LFUGs. To this end, it should review the capability of groups and classify them according to their operations, sustainability and need for support in future.

Crop and livestock production component

30. There remain many possibilities to improve agriculture through research on varieties and techniques, and through extension of findings to farmers for increasing the productivity of existing crops and introducing new crops with higher value. There is also great scope for expanding the coverage of these services by increasing the resources available.
31. The scope for improved animal production in the area is also considerable, especially for greater participation of the poorest. Feed supplies are limited at present but will increase as leasehold forest areas are developed and the profitability of livestock keeping increases. The second-cycle project should therefore allow for an increased annual budget allocation to enable the coverage of services to be expanded and – within the availability of land and feed, and based on the market demand – establish a financing mechanism to support livestock enterprise development and goat groups.

Rural microfinance

32. The main recommendations related to this component include that: (i) training of savings and credit groups be intensified to ensure better money and credit management; (ii) resources for contracting short-term consultants be used to support microfinance service delivery; (iii) assistance for entrepreneurship development be expanded taking into account the needs of all investors responding to opportunities created by economic development in general and road access improvement in particular; and (iv) possibilities for introducing alternative service providers for the credit delivery be reviewed, especially in the new project districts.

Available investment funds for the second cycle

33. The proposed funding for the second cycle is based on the original funding structure as presented in the project appraisal report. IFAD loan funds (about US\$10,050 at the time of the review) are in absolute the same as proposed. IFAD grant funds were to total US\$72,000 for the second phase; it is now proposed that an additional US\$200,000 be provided, due to the need for continued technical assistance to support the district and local implementation structures. Since the government district and local governance structures will be taking greater responsibility for project implementation during the second cycle as per the original project design, it is expected that technical assistance will be phased out by the end of the cycle.
34. The Government and local government commitments with respect to the total costs (18 per cent and 7 per cent respectively), will be revisited, especially taking into account the contributions for the interdistrict road subcomponent, which is proposed to be omitted from the second and third cycles.

V. Conclusions

35. The Government is highly committed to the project's development objectives in the project districts. They form part of the priority regions to be developed under its medium-term reconstruction and development plan. Similarly, the technical team of the project coordination unit has shown high dedication in performing their professional functions, resulting in a highly satisfactory performance.
36. The project has made significant progress during its first cycle with regard to its specific development objectives and the expected outcomes/results despite considerable challenges in the operational environment. Its components contribute to the reduction of poverty in some of the poorest and most conflict-prone areas of Nepal, and continue to be of utmost relevance in the current post-conflict situation.
37. IFAD Management consider that there is a firm basis for proceeding to the second cycle. The project's design remains relevant, and adjustments can be made to the overall project loan agreement to address the issues raised by the review mission. These include incorporating new trigger indicators for proceeding from the second to the third cycle (see annex). Changes to the loan agreement will be introduced by 1 July 2007. The framework within which the project's community mobilization activities are carried out is changing markedly as the armed conflict and political uncertainties come to an end. These events will greatly increase the project's capacity to work without restriction throughout the project area.

Proposed triggers for proceeding from the second to the third cycle

	<i>Purpose</i>	<i>Focus areas</i>	<i>Trigger</i>
1.	<p>The productive assets of the rural poor being served are increased.</p> <p>The project's management has successfully addressed the challenge presented by the nature of the leasehold land provided to the beneficiaries.</p>	Leasehold forestry	Detailed plans have been prepared and implemented, or are in process of implementation for a minimum of 70 per cent of LFUGs that have held leases for three or more years.
2.	The facilities selected and constructed meet the needs of beneficiaries and are sustainable.	Community infrastructure	Engineering assessment is that design, construction and maintenance standards for 80 per cent of facilities constructed in the second cycle are appropriate and adequate.
3.	Strict financial discipline is being maintained by agents chosen to deliver credit.	Credit	The recovery rate for loans extended using credit from IFAD and reflows should exceed 95 per cent.
4.	A system has been introduced for grading groups by their capabilities in view of their future sustainability.	Group operations	An agreed minimum of all groups operating for more than two years should be in Grades 1 and 2.
5.	Project management has succeeded in introducing and applying effective district planning and implementation procedures.	Planning and implementation	Annual workplans and budgets are prepared and implemented by district management committees for 90 per cent of all project years.
6.	Delivery of inputs is up to planned level.		At least 75 per cent of all scheduled capital expenditures have been completed.