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Enabling poor rural people
to overcome poverty

President's report

Proposed grant to Nepal for the

Poverty Alleviation Fund Project – Phase II

Executive Board — Ninety-second Session
Rome, 11-13 December 2007

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

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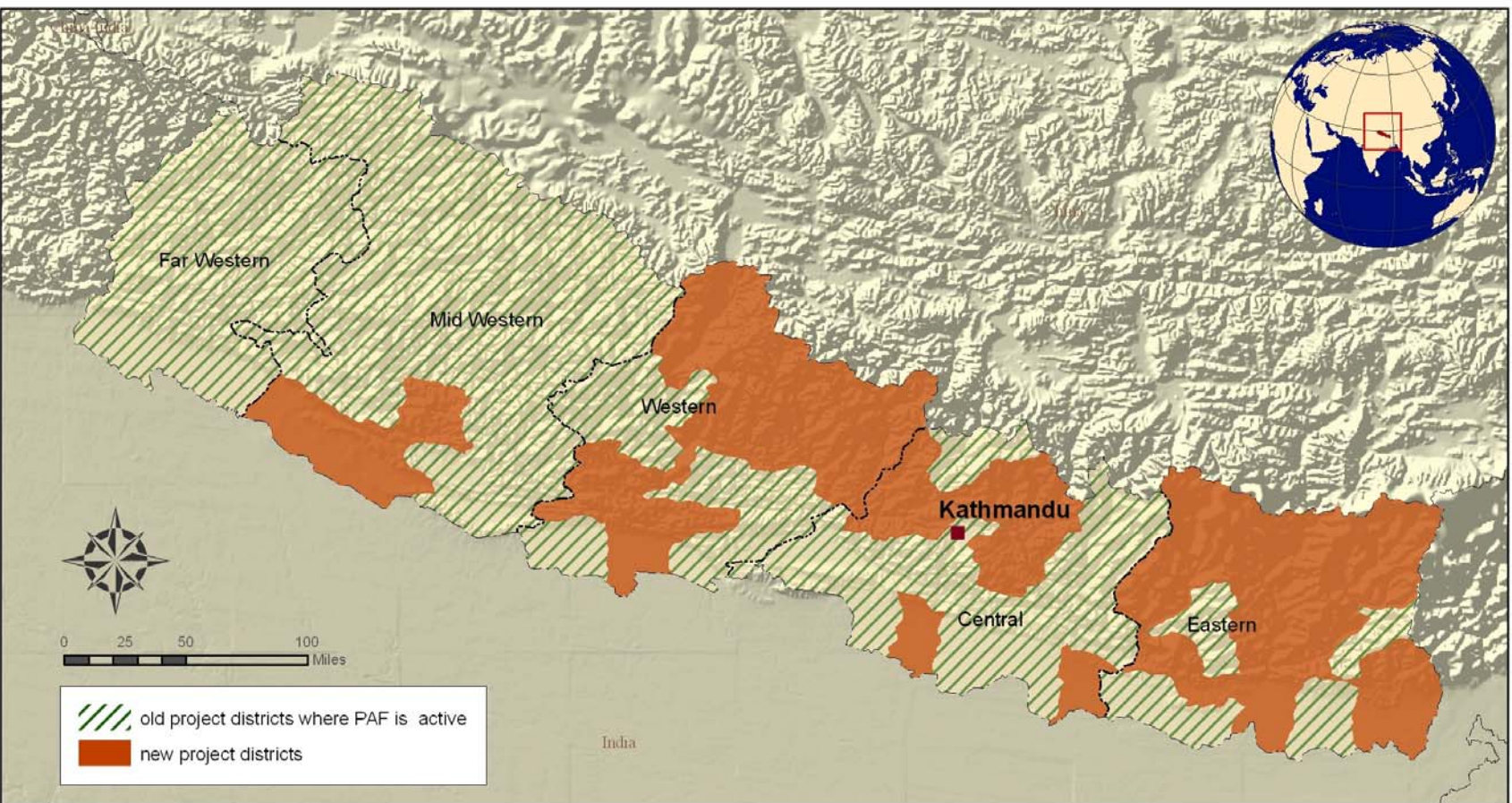
Abbreviations and acronyms

IDA	International Development Association
PAF	Poverty Alleviation Fund
VDC	village development committee

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed grant to Nepal for the Poverty Alleviation Fund Project – Phase II, as contained in paragraph 36.

Map of the project area



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

Nepal

Poverty Alleviation Fund Project – Phase II

Grant summary

Initiating institution:	International Development Association
Recipient:	Nepal
Executing agency:	Poverty Alleviation Fund
Total project cost:	US\$113 million
Amount of IFAD grant:	SDR 2.5 million (equivalent to approximately US\$4 million)
Cofinancier(s):	International Development Association
Amount of cofinancing:	International Development Association US\$100 million
Terms of cofinancing:	Grant
Contribution of recipient:	US\$1 million
Contribution of beneficiaries:	US\$8 million
Appraising institution:	IFAD
Cooperating institution:	International Development Association

Proposed grant to Nepal for the Poverty Alleviation Fund Project – Phase II

I. The project

A. Main development opportunity addressed by the project

1. The Poverty Alleviation Fund was launched as a community-driven development instrument for addressing the interrelated problems of rural poverty and social exclusion. In April 2004, the International Development Association (IDA) provided a grant of US\$15 million to finance the Poverty Alleviation Fund Project – Phase I (PAF I). PAF I was designed as a pilot, operating in six districts that were chosen on the basis of their Human Development Index and geographic location (i.e. in hills, mountains and the terai), and whether they were conflict-affected areas. Once the initial organizational phase of the PAF was complete, the implementation pace accelerated rapidly in response to greater than anticipated – and constantly growing – demands from rural communities. Following the peace process and the agreements reached among the political parties, there is a new commitment to address inequality and poverty in the country. A set of community-based programmes forms the centre of the effort to rapidly extend developmental reach to the poorer remote areas of Nepal. Among these programmes, the PAF is seen as especially important because of its success to date in effectively targeting poor communities and the marginalized within them, improving access to basic services and increasing incomes. The proposed project will use the same targeting mechanisms and the same beneficiary profiles as PAF I, but will extend its scope nationally in a phased manner, increasing by 15 districts each year.

B. Proposed financing

Terms and conditions

2. It is proposed that IFAD provide a grant to Nepal in the amount of SDR 2.5 million (equivalent to approximately US\$4 million), to help finance the Poverty Alleviation Fund Project – Phase II (PAF II).

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

3. The allocation defined for Nepal under the PBAS is US\$16.13 million over the 2007-2009 allocation cycle. The proposed grant is well within this allocation.

Country debt burden and absorptive capacity of the State

4. Nepal is considered as a red country under the Debt Sustainability Framework (DSF), therefore support is being provided in the form of a grant.

Flow of funds

5. The IFAD grant will be deposited into a special account, denominated in United States dollars, to finance project expenditures. Payments from the special account will be made in the form of reimbursement to the Government's treasury. The Government will release the budget as block grants to the PAF in three tranches, as per the fund release procedure of the Government of Nepal.

Supervision arrangements

6. The cooperating institution for the project is IDA. IFAD will participate in the supervision mission to review the capacity-building component.

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

7. Request for waiver of policy on taxes: In order to achieve the highest possible level of harmonization with the procedures used by IDA, the Government of Nepal has requested that an exception be made to IFAD's General Conditions for Agricultural Development Financing and its standard policies and procedures to permit grant

proceeds to be used to finance taxes to the same extent as permitted under IDA financing in cases where tax exemptions are not available.

Governance

8. The following planned measures are intended to enhance the governance aspects of the IFAD grant: (i) firm commitment by the Government to implement poverty alleviation investments; (ii) firm commitment by the Government and the PAF Board of Governors to continually strengthen PAF performance; (iii) solid organizational structure, scope, and procedures; (iv) a competent team of PAF Board members who are setting high standards of independence and professionalism; (v) a competent and effective Executive Director who has proven experience and a track record working on community-based programmes; (vi) a competent team of experienced and qualified staff in the PAF secretariat who have been exposed to best practices from similar operations in other countries and elsewhere in Nepal; (vii) an innovative demand-led, community-based approach that is generating a strong positive response from rural communities and local authorities; (viii) well established operational procedures and internal control framework; (ix) a harmonized approach to the country's system for financial management and procurement; and (x) openness to transparency and enhanced governance and accountability, as mandated by the Right to Information Act 2007.

C. Target group and participation

Target group

9. In accordance with the IFAD Policy on Targeting, the project's target group are poor and socially disadvantaged community members. The PAF uses targets and incentives to encourage community organizations to include women, dalits and indigenous peoples (*janajatis*) as members and beneficiaries and also to hold positions of responsibility. In 2005-2006, 66 per cent of members of community organizations were women, 43 per cent were dalits and 29 per cent were indigenous people. Fifty-five per cent of decision-making positions were occupied by women, 50 per cent were held by dalits and 26 per cent by indigenous people. This focus on participation is replicated from the grass roots up to the Board level, with representatives of excluded groups steering the PAF. The same approach will be used under PAF II.

Targeting approach

10. Before initiating activities and selecting target village development committees (VDCs) in each district, the PAF carries out a district-level social assessment to evaluate and map markers of exclusion and poverty. At the village level, partner organizations work with communities, using participatory methods to identify and involve the poor and socially disadvantaged.

Participation

11. Participation by groups that have traditionally been excluded by reasons of gender, ethnicity, caste and location is the core element of the project. The community-driven development approach adopted by the project focuses on building village-level institutions and transferring decision-making responsibilities and resources directly to communities.

D. Development objectives

Key project objectives

12. The project's development objective is to improve living conditions, livelihoods and empowerment among the rural poor, with particular attention to groups that have been marginalized because of gender, ethnicity, caste or location.

Policy and institutional objectives

13. The PAF will build the capacity of local bodies (VDCs) and district development committees in pro-poor planning and monitoring, and other relevant topics to promote inclusive planning and service delivery for local development.

IFAD policy and strategy alignment

14. The project is aligned with the objectives of the IFAD Strategic Framework 2007-2010 as the activities it supports relate to rural, off-farm employment and enterprise development; development of a broader range of financial services in rural areas; and participation in local and national policy processes associated with social inclusion and access to and management of natural resources.

E. Harmonization and alignment

Alignment with national priorities

15. The project is consistent with Nepal's Poverty Reduction Strategy (PRS), which addresses the issue of inequality and explicitly identifies social exclusion as a fundamental development challenge. The PRS is based on the country's Tenth Five-Year Plan 2002-2007 and sets reduction of the overall poverty ratio as its main objective. While broad improvement in all public services is essential for Nepal's long-term development, the need for more direct targeted interventions to assist indigenous peoples, dalits and women is also recognized, sending a clear signal that the exclusionary practices of the past are no longer acceptable.

Harmonization with development partners

16. IDA has been the PAF's external partner since 2004. In addition to IFAD, the United Kingdom's Department for International Development (DFID) has indicated that it is considering cofinancing the proposed second phase.

F. Components and expenditure categories

Main components

17. The project has five components: (i) small-scale village and community infrastructure (27 per cent); (ii) income generation projects targeted at the poorest and most excluded groups (31 per cent); (iii) innovations and special programmes (8 per cent); (iv) capacity-building (28 per cent); and (v) administration of PAF II (6 per cent).
18. IFAD support will be targeted at the fourth component – capacity-building – which has the following subcomponents: (i) social mobilization of community groups; (ii) capacity-building for local bodies; (iii) capacity-building of target groups engaged in income-generating activities; (iv) support to rural and community finance; and (v) information, monitoring and evaluation.

Expenditure categories

19. There are two expenditure categories under the IFAD grant: (i) block grants and consultant services provided by partner organizations (67.5 per cent) and (ii) goods, consultants' services (other than those provided by partner organizations) and training (32.5 per cent).

G. Management, implementation responsibilities and partnerships

Key implementing partners

20. The project will be implemented by the PAF and contracted partner organizations, which can be NGOs, community-based organizations or VDCs/district development committees, provided they meet PAF eligibility criteria.

Implementation responsibilities

21. At the national level, overall project management responsibility is with the PAF Board of Governors, chaired by the Prime Minister. The vice-chair is a full-time executive of the PAF, and the Board includes ten other members. The Executive Director of the PAF serves as the Secretary of the Board. The PAF has a lean

structure with a limited number of staff who have been competitively recruited on fixed-term contracts, and a number of consultants and/or NGOs who are retained to support operations as needed. At the regional level, the PAF establishes offices in those locations where the volume of work requires a presence. It works through partner organizations, which it recruits competitively, for the purposes of social mobilization and capacity-building at the community level. These organizations disseminate information about the project; and mobilize and work with community groups, building their capacity to develop and manage subproject proposals, and monitor the quality of participation.

Role of technical assistance

22. Contracted partner organizations have the responsibility to assist communities on a number of aspects, including social mobilization and the technical preparation and submission of proposals to the PAF. For more complex subprojects involving engineering inputs, communities procure technical assistance from the non-governmental or private sector.

Status of key implementation agreements

23. Agreements with partner organizations will be arranged through competitive bidding processes.

Key financing partners and amounts committed

24. The total project cost is US\$113 million over four years. The sources of financing are an IFAD grant of US\$4 million (3.5 per cent), an IDA grant of US\$100 million (88.5 per cent), a contribution from the beneficiaries of US\$8 million (7.1 per cent) and a contribution from the Government of US\$1 million (0.9 per cent).

H. Benefits and economic and financial justification

Main categories of benefits generated

25. The expected development outcomes are: (i) improvements in access to small-scale social and economic infrastructure and services, as prioritized by the beneficiary communities; (ii) generation of incremental employment at the village level, including both short-term participation in the implementation of subprojects and longer-term jobs resulting from economic activities promoted by the PAF; (iii) increases in incomes of beneficiary households; and (iv) greater participation and a stronger voice for citizens in community decision-making.

Economic and financial viability

26. To date, the PAF has supported both small-scale community infrastructure subprojects (microirrigation, link roads, culverts/bridges, microhydro power, water supply, sanitation, schools and health posts) and income generation activities (related to agriculture, livestock, cottage industries, trade and services). Preliminary evaluations indicate good rates of return on these investments, ranging from 20-25 per cent. For income generating activities, careful attention is paid to financial feasibility and linkages to markets, as well as to the provision of adequate technical assistance.

I. Knowledge management, innovation and scaling up

Knowledge management arrangements

27. The project contains a specific subcomponent focused exclusively on information, monitoring and evaluation. Under this subcomponent, the PAF focuses on effective use of print and electronic media for dissemination of information on the nature and role of the PAF and on poverty-related issues in general. The success stories and innovations generated under the PAF will be gathered in the field, and media such as television coverage and radio broadcasts will be used for sharing information.

Development innovations that the project will promote

28. The project features an innovations window, which supports proposals that merit special consideration owing to exceptional circumstances or demonstrate innovative

ways to improve livelihood development and reach targeted groups. These proposals can be national or regional in coverage and may be sponsored by organizations representing or working with the target groups, target groups themselves and/or local bodies. Examples under the first phase of the PAF have included innovations such as arsenic filters, forest-based cardamom cultivation, evaporative cooling technology for food preservation and women's health projects.

Scaling-up approach

29. Given that the PAF I was intended as a pilot operation, many lessons have been learned regarding the community-driven development approach that was adopted in the six original districts. This will facilitate the gradual scaling up of project activities to Nepal's 75 districts under the PAF II. To support a well planned and managed scaling-up process, the PAF has initiated preparation of a long-term vision plan (2007-2025) and completed assessments of organizational and human resource development needs.

J. Main risks

Main risks and mitigation measures

30. The project faces three main risks:
- (i) The PAF could experience political interference at the national or local level by actors wishing to use it for political gain. This risk is mitigated by the fact that: (a) PAF is managed at the national level by an independent and credible board that includes beneficiary representation; (b) PAF's operations are governed by project and financial management manuals that provide simple, clear guidelines for all stages of community mobilization and subproject selection and implementation. These manuals are widely disseminated; (c) project design incorporates a strong management information system, and the information it generates will be widely disseminated; and (d) adequate arrangements are in place for both internal and external financial auditing;
 - (ii) Civil conflict and disruption could negatively impact PAF operations. The project has been successfully implemented in districts where conflict already has posed a high risk. The critical mitigation measures that support implementation in a conflict context include continued emphasis on equity, participation and inclusion; and
 - (iii) Scaling up quickly to the national level may be a serious challenge for the existing PAF team. This is mitigated by the preparation of a long-term vision plan (2007-2025) to guide future work; studies on human resource development and organizational restructuring needs; and recruitment of additional staff to support the activities.

Environmental classification

31. 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

32. The prospects for sustainability of the subprojects are strengthened through community cofinancing (on average 10 per cent) of the costs, community management of resources during implementation and development by the community of specific plans for the operation and maintenance of investments. The PAF enjoys strong borrower commitment, as demonstrated by the request for significant scaling up of activities under PAF II. The current national budget also gives greater priority to pro-poor expenditures. The Government will finance 20 per cent of the operating costs of the second phase.

II. Legal instruments and authority

33. A project grant agreement between Nepal and IFAD will constitute the legal instrument for extending the proposed grant to the recipient. Important assurances included in the negotiated project grant agreement are attached as an annex.
34. Nepal is empowered under its laws to receive financing from IFAD.
35. I am satisfied that the proposed grant will comply with the Agreement Establishing IFAD.

III. Recommendation

36. I recommend that the Executive Board approve the proposed grant in terms of the following resolution:

RESOLVED: that the Fund shall provide a grant to Nepal in various currencies in an amount equivalent to two million five hundred thousand special drawing rights (SDR 2,500,000) and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Lennart Båge
President

Important assurances included in the negotiated project grant agreement

(Negotiations concluded on 6 December 2007)

Suspension

1. (a) IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the grant account, in accordance with the General Conditions, upon the occurrence of any events set forth therein, or any of the following events:
 - (i) IFAD, after consultation with the Government, has determined that the material benefits of the project are not adequately reaching the Target Group or are benefiting persons outside the Target Group to the detriment of Target Group members;
 - (ii) The IDA Financing Agreement has been suspended or cancelled, or any of the events specified in the IDA Financing Agreement has occurred;
 - (iii) IFAD has given notice to the Government that credible allegations of corrupt or fraudulent practices in connection with the project have come to the attention of IFAD, and the Government has failed to take timely and appropriate action to address the matters to the satisfaction of IFAD;
 - (iv) Procurement has not been or is not being carried out in accordance with the provisions of the IDA Financing Agreement.
- (b) IFAD will suspend, in whole or in part, the right of the Government to request withdrawals from the grant account if IFAD has not been provided with a copy of the audited financial statements required by the IDA Project Agreement within twelve (12) months of the financial reporting date.

Conditions precedent to effectiveness

2. The project grant agreement will become effective subject to fulfillment of the following conditions precedent, provided, however, that the effective date will not be earlier than 15 July 2008:
 - (a) The IDA Financing Agreement has entered into effect; and
 - (b) The Government has duly opened the special account.

Key reference documents

Country reference documents

Poverty reduction strategy paper

IFAD reference documents

Revised World Bank Project Appraisal Document (PAD) and IFAD Extended Project Brief
Key files
COSOP

Logical framework

Narrative summary	Performance indicators	Means of verification	Risks
Development goal			
Gender, ethnic and caste-related disparities reduced through greater inclusion of disadvantaged groups to development ¹	(i) 30% of the project beneficiary households have increased their incomes by at least 15% against the base year by end of project. (ii) At least 30 000 households belonging to the beneficiary group benefiting from increased access to community infrastructure by end of project. (iii) 20% of decision-making positions in community groups occupied by target groups (women 50%, janajati 20%, dalits 20%, extreme poor 40%).	Project MIS data and beneficiary assessments	Peace processes successfully under way
Project purpose			
Poor and excluded Communities are reached in an effective way and in coordination with other development projects through PAF.	(i) At least 30% of project beneficiary group members coming from target groups (women 50%, janajati 20%, dalits 20%, extreme poor 40%). (ii) Evidence of cost-effectiveness of PAF delivery mechanism/ Economic rates of return (ERRs) of sub-projects >15% (iii) Social mobilization processes and capacity building at the village level coordinated with other development activities and support community participation and excluded group's ability to have voice and influence at the community level.	MIS data Project Progress Reports Structured field visits and beneficiary assessments	PAF is not politicised Security situation does not deteriorate and affect implementation in project districts
Expected outcomes			
<p>Component One: Small scale village and community infrastructure developed and serving the target groups</p> <p>Component Two: Target groups benefiting from income generation projects</p> <p>Component Three: Innovations Window and Special Programs utilized and generates innovative sub-projects</p> <p>Component Four: Capacity building a) Mobilisation of community groups b) Capacity building for local bodies c) Capacity building for target groups engaged in IGAs d) Support to community and rural finance</p> <p>Component Five: Administration of the PAF – the project is well managed and coordinated at national and regional levels</p>	<p>(i) improved rural infrastructure benefits at least 750 000 people (total population) by end of project (ii) O&M measures are in place on completion of sub-projects for at least 85% of sub-projects.</p> <p>(i) At least 30% of IGA beneficiary households have increased their incomes by at least 15% by end of project.</p> <p>(i) Innovations generated by at least 200 Innovative/Special sub-projects.</p> <p>(i) At least 9500 groups formed/registered and operating successfully by end of project. (ii) Increased awareness by at least 2000 VDCs on selected topics/themes related to pro poor planning and social inclusion as well as PAF approach and activities. (iii) entrepreneurial skills by 80% of the beneficiaries improved through capacity building/training. (iv) Capacity of the communities in rural finance increased through training</p> <p>(i) Project operational manual is utilized and regularly reviewed and updated to reflect any changes in the field (ii) Effective monitoring, learning and evaluation system in place (iii) HR strategy updated and necessary staffing structure and positions in place</p>	<p>MIS data, Project Progress Reports Ex-post studies and impact evaluations.</p> <p>Baseline data will be established in new districts before sub-projects and will be followed by analysis afterwards</p> <p>Supervision field visits Process monitoring</p>	<p>Disadvantaged are able to come together in group.</p> <p>Villages are able to come together behind subprojects.</p> <p>Legitimate organisations interested. Capable POs across Nepal.</p> <p>There is sufficient demand for capacity building</p>

¹ Nepal RB-COSOP Strategic Objective no III (Dec 2006)

