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Enabling poor rural people
to overcome poverty

President's report

Proposed loan to the Republic of Azerbaijan for the

Rural Development Project for the North-west

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

IPMU	IFAD programme management unit
MFI	microfinance institution
PIM	participatory irrigation management
SAAC	State Agency for Agricultural Credits
SAIC	State Amelioration and Irrigation Committee
USAID	United States Agency for International Development
WUAs	water users' associations

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed loan to the Republic of Azerbaijan for the Rural Development Project for the North-west, as contained in paragraph 35.

Map of the project areas



- "Farm Privatization Project"
- "Rural Development Programme for Mountainous and Highland Areas"
- "North-East Development Project"
- "Rural Development Project for the North West"

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.

Republic of Azerbaijan

Rural Development Project for the North-west

Loan summary

Initiating institution:	IFAD
Borrower:	Republic of Azerbaijan
Executing agency:	Ministry of Agriculture/State Agency for Agricultural Credits
Total project cost:	US\$32.3 million
Amount of IFAD loan:	SDR 10.85 million (equivalent to approximately US\$17.2 million)
Terms of IFAD loan:	40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum
Contribution of borrower:	US\$13.0 million
Contribution of non-banking financial institutions:	US\$0.5 million
Contribution of beneficiaries:	US\$1.6 million
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Proposed loan to the Republic of Azerbaijan for the Rural Development Project for the North-west

I. The project

A. Main development opportunity addressed by the project

1. Most rural people living in north-west Azerbaijan depend heavily on irrigated agriculture for their livelihoods. The irrigation system in this part of the country, however, has long been in serious decline due to neglect, lack of maintenance and resource constraints. The proposed project will rehabilitate the deteriorating irrigation infrastructure and introduce participatory irrigation management (PIM) practices to ensure efficient and sustainable system management. It will also assist small farmers in improving crop and livestock productivity and diversifying their incomes, while also helping them to mobilize and organize themselves to access a host of support services and facilities available from other agencies and projects operating in the area.

B. Proposed financing

Terms and conditions

2. It is proposed that IFAD provide a loan to the Republic of Azerbaijan in the amount of SDR 10.85 million (equivalent to approximately US\$17.2 million) on highly concessional terms to help finance the Rural Development Project for the North-west. The loan will have a term of 40 years, including a grace period of 10 years, with a service charge of three fourths of one per cent (0.75 per cent) per annum.

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

3. The allocation defined for Azerbaijan under the PBAS is US\$17.2 million over the 2007-2009 allocation cycle.

Country debt burden and absorptive capacity of the State

4. The country's handling of its external debt has improved as a result of high oil prices and a surge in private investment. External debt stands at US\$2.0 billion (2006), or 10 per cent of GDP, and the debt service ratio stands at 2.2 per cent of export earnings. Azerbaijan has foreign exchange reserves of US\$4.5 billion (6.5 months of imports). Total disbursements from all IFAD loan operations in Azerbaijan in 2006 equalled SDR 1.9 million. The Government has a good repayment record on IFAD loans.

Flow of funds

5. The IFAD loan proceeds will be channelled through a special account for the IFAD programme management unit (IPMU) for eligible expenditures.

Supervision arrangements

6. The project will be directly supervised by IFAD, thereby assuring systematic learning from supervision experience.

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

7. Retroactive financing: Withdrawals not exceeding in the aggregate the equivalent of SDR 629,000 may be made from the loan account in respect of expenditures for categories I (civil works), II (vehicles, equipment and goods), III (training, studies and technical assistance) and V (operational costs of the project management unit) of the allocation table contained in paragraph 1 of schedule 2 of the loan agreement incurred before the date of the loan agreement but after 15 December 2007. Such expenditures will be considered eligible expenditures for all purposes of the loan agreement, if otherwise eligible. All procurement carried out under retroactive financing will be subject to the provisions of the IFAD Procurement Guidelines and schedule 4 of the loan agreement.

Governance

8. The following planned measures are intended to enhance the governance aspects of the IFAD loan: (i) the use of private-sector auditors; (ii) the selection of service providers through a transparent and competitive process; and (iii) the introduction of best practices for the promotion of microfinance.

C. Target group and participation

Target group

9. The target group, chosen in accordance with the IFAD Policy on Targeting, will comprise 22,300 households of smallholder farmers and pastoralists in four districts of north-west Azerbaijan, namely Agstafa, Gazakh, Shamkir and Tovuz. About 30 per cent of these households are headed by a single parent. Women's participation in all project activities will be actively sought.

Targeting approach

10. In line with the targeting policy, a district's initial entitlement to irrigation rehabilitation funds will be established by a formula weighting population and the potential irrigated area. In each district, water users' associations (WUAs), villages or communities will be ranked against a set of social and poverty, technical and managerial criteria aimed at choosing those most in need of IFAD support. Interaction with selected communities will be intensive, and participatory rural appraisal will be used, where appropriate, to focus on the most disadvantaged groups. Furthermore, project activities will be designed – in terms of purpose, location and scope – to be of interest mainly to poorer households. Qualifying applicants will be invited to submit proposals for assistance, which will be assessed for feasibility and probable impact, before a final decision is taken.

Participation

11. All farmers in areas chosen for the introduction of PIM will participate in the selection of WUA governing bodies and in the oversight of WUA management functions. Villagers will also participate in the selection of community focal points, in awareness-raising and mobilization endeavours, and in the formation of farmers' and community groups and associations.

D. Development objectives

Key project objectives

12. The project's goal is to reduce income poverty, malnutrition and food insecurity in a sustainable manner by improving the livelihoods of the rural poor in the project area and preventing further impoverishment. The key development objectives are to:
 - (i) rehabilitate the irrigation infrastructure and introduce participatory irrigation management to ensure a sustainable and effective irrigation management regime;
 - (ii) ensure the delivery of advisory, technology transfer, financial and enterprise support services; and
 - (iii) enhance the capability and self-reliance of communities to look after their own affairs and plan and implement their own development initiatives more effectively.

Policy and institutional objectives

13. Important project objectives are to: (i) introduce into the project area successful experiences with PIM practices and institutions; (ii) help establish a sustainable microfinance system with significant outreach into the rural areas; and (ii) empower rural communities and producer groups to establish sustainable systems for managing community initiatives and resources.

IFAD policy and strategy alignment

14. The project is consistent with IFAD's strategic objectives of strengthening the capacity of institutions of the rural poor for sustainable natural resource management; and diversifying the incomes of the poor and improving their access to rural finance. It is also in line with the country strategy objective of improving

smallholder production, productivity and competitiveness, introducing PIM and improving marketing arrangements and links.

E. Harmonization and alignment

Alignment with national priorities

15. The project is aligned with the Government's poverty reduction strategy as articulated in the State Program for Poverty Reduction and Sustainable Development, which recognizes the key role of agricultural development as a counterbalance to the rapid growth of the oil and gas sector, and defines specific thrusts including rehabilitating irrigation and drainage systems and introducing PIM; improving access to financial services, marketing channels and processing; developing farmers' organizations; and promoting enterprises for off-farm employment.

Harmonization with development partners

16. During the project design process, which involved constructive consultation with the World Bank, various United Nations agencies, the United States Agency for International Development (USAID) and several microfinance institutions (MFIs) and NGOs, consensus was reached that the project, in addition to its direct investments, would also assist community and farmers' groups in accessing a range of support services and facilities provided by projects supported by the World Bank, USAID and others.

F. Components and expenditure categories

Main components

17. The project has four components: (i) irrigation rehabilitation and participatory management; (ii) agricultural and community development; (iii) financial services and enterprise promotion; and (iv) project coordination and management.

Expenditure categories

18. There are six expenditure categories: (i) civil works (58.8 per cent of the total project costs); (ii) recurrent costs (15.6 per cent), including management and coordination costs, WUAs' salaries, and operation and maintenance on a declining basis; (iii) credit funds (15 per cent); (iv) training and workshops (4 per cent); (v) vehicles, equipment and goods (3.4 per cent); and (vi) technical assistance, contractual services and studies (3.2 per cent).

G. Management, implementation responsibilities and partnerships

Key implementing partners

19. These include the State Agency for Agricultural Credits (SAAC) of the Ministry of Agriculture; the State Amelioration and Irrigation Committee (SAIC); service providers under the auspices of other projects such as the World Bank's Second Agricultural Development and Credit Project and its Irrigation Distribution System and Management Improvement Project, and the project that USAID is planning in the area; and other service providers including the Ganja regional consulting center, the Norwegian Humanitarian Enterprise, and the Agroleasing Joint Stock Company.

Implementation responsibilities

20. SAAC will be responsible for project coordination and implementation through the IPMU. The other key government executing agency will be SAIC, the agency responsible for the main irrigation infrastructure and for water delivery to the farm gate. Service providers will be engaged to provide specialist inputs in technology transfer, business development services and microcredit. WUAs and rural producer groups will identify, supervise, and assume operation and management responsibility for community and group investments.

Role of technical assistance

21. The IFAD loan includes an allocation of US\$1.0 million for technical assistance, which will be used to (i) provide guidance for institutionalizing effective PIM practices; (ii) assisting MFIs in developing new service products and marketing strategies, improving credit analysis and upgrading financial management using best international practices; and (iii) help community-based associations acquire community organization, business development and natural resources management skills.

Status of key implementation agreements

22. In addition to the standard loan agreement between IFAD and the Government, a subsidiary agreement will be drawn up between IPMU and the collaborating MFIs, specifying the conditions for implementing credit and financial services. Other implementation arrangements will also include a memorandum of understanding with SAIC for WUA development and support.

Key financing partners and amounts committed

23. The total project cost is US\$32.3 million over five years. The sources of financing are IFAD (53.2 per cent); the Government (40.2 per cent); non-banking financial institutions (1.5 per cent); and project beneficiaries (5.0 per cent).

H. Benefits and economic and financial justification

Main categories of benefits generated

24. At farm level, it is foreseen that project activities will generate increased production and incomes through the rehabilitation of on-farm irrigation; improved access to credit; and higher crop and livestock yields as a result of better agricultural and veterinary services and the adoption of modern technical practices. At the off-farm level, household income is expected to increase through trading and value addition activities; promotion and support of group formation; and improved supply chain management, including forward contracting. The adoption of the PIM approach and the building up of human and logistical capabilities will help WUAs adopt participatory and gender-sensitive approaches that make them better able to respond to members' needs. The promotion and strengthening of producer groups of all kinds will increase their bargaining power, allow them to exploit economies of scale, and improve their ability to access training, extension and credit.

Economic and financial viability

25. Farm models demonstrate the benefits generated by greater irrigation water availability, improved management, and the use of better-quality inputs. The incremental gross revenues for crops range from 22 to 92 per cent of projected "without project" situations; while those for livestock enterprises range from 24 to 112 per cent. As a result of the project, annual household income is estimated to increase by 35-41 per cent, or between US\$3,020 and US\$3,204. The project's overall economic rate of return is 26.2 per cent.

I. Knowledge management, innovation and scaling up

Knowledge management arrangements

26. The project will be fully supervised by IFAD. It will capitalize on the knowledge and experience of the IPMU, which is presently implementing two other IFAD projects in the country. IFAD will organize yearly national project implementation workshops, allowing project staff and other implementing partners to communicate and share lessons learned across projects and to inform relevant policy forums. Small brochures recording the lessons learned will be produced.

Development innovations that the project will promote

27. The project will scale up and replicate IFAD's successful experiences with PIM in Azerbaijan. Another innovative feature in the country context is the use of community focal points and existing village and municipality development

committees in a concerted effort to improve outreach and impact. The project also relies on the services of other donor projects to provide much of the technical and economic expertise and support required for agricultural and enterprise development.

Scaling-up approach

28. The project will consist of a complementary mix of IFAD and other donor funding directed at replicating and scaling up successful activities, and further developing and extending partnerships. It will also expand the outreach of microfinance services that can be replicated in other parts of the country.

J. Main risks

Main risks and mitigation measures

29. The project faces three main risks. First, the Government may not adhere to its stated policy on PIM, and its commitment to irrigation system rehabilitation and WUA support may lessen. The planned mitigation measures include dialogue with the Ministry of Agriculture, facilitated by SAAC, and with other involved ministries or agencies facilitated by an interministerial committee. Second, at district and community levels, the district administration may be reluctant to accept change, and NGOs and the private sector, including non-banking financial institutions, may be unwilling to collaborate. This risk will be minimized by an intensive but sensitive programme of awareness creation, education, orientation and persuasion. Finally, the risk of scarcity of service providers/private advisers will be reduced by making training and technical and financial assistance available as part of the contracts, and by encouraging the clustering of communities and villages to optimize group coverage.

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. The expansion of farming activities resulting from commercialization and the increased demand for raw materials from the expansion and improvement of small and medium-sized enterprises promoted and supported by the project are not expected to be significant in relation to existing production levels. Environmental mitigation measures will be incorporated in project-supported activities, which will be subject to a checklist of environmental screening criteria related to the expected impacts. Furthermore, credit applicants will be provided with guidelines on the preparation of proposals that take environmental concerns into account.

K. Sustainability

31. The adoption of the PIM approach will assist WUAs in becoming sustainable and efficient institutions. The project will strengthen their human and logistical capabilities, enabling them to gain an appreciation of participatory and gender-sensitive approaches and therefore become more responsive to members' needs.

II. Legal instruments and authority

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

III. Recommendation

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

RESOLVED: that the Fund shall make a loan to the Republic of Azerbaijan in various currencies in an amount equivalent to ten million eight hundred and fifty thousand special drawing rights (SDR 10,850,000) to mature on or prior to 1 May 2047 and to bear a service charge of three fourths of one per cent (0.75 per cent) per annum, and to be 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 loan agreement

(Negotiations concluded on 6 December 2007)

Gender focus

1. The Government of Azerbaijan (the "Government") will ensure that gender concerns are mainstreamed in all project activities throughout the project implementation period. To this end, the Government will ensure that:
 - (a) At least 30 per cent of the members of the administrative and management layers of local organizations are women;
 - (b) There is a high degree of women participation in civil affairs;
 - (c) Gender-sensitive statistics for M&E of all activities are obtained; and
 - (d) There is an empowerment of women by training of female community leaders.

Pest management practices

2. The Government will ensure that pesticides procured under the project do not include any pesticides banned by the FAO or classified as Extremely Hazardous or Highly Hazardous by the WHO.

Resource protection

3. The Government will take all reasonable measures to ensure that existing laws are enforced to safeguard water, forest and wildlife resources in the project area. The Government will take all measures to ensure sustainability of the project without any detriment to the environment, promoting local participation during project implementation which is essential for environment sustainability.

Insurance

4. The Government will insure project personnel against health and accident risks in accordance with its customary practice in respect of its national civil service. The Government will insure all vehicles and equipment used in connection with the project against such risks and in such amounts as may be consistent with sound practice. The Government may, in either case, finance such insurance from the proceeds of the loan.

Authorizations

5. The Government will provide any project party with such delegations of authority or other authorizations as may be required under its national procedures to implement the project in accordance with the project loan agreement.

Use of project vehicles and other equipment

6. The Government will ensure that:
 - (a) The types of vehicles and other equipment procured under the project are appropriate to the needs of the project; and
 - (b) All vehicles and other equipment transferred to or procured under the project are dedicated solely to project use.

Fraud and corruption

7. The Government will promptly bring to the attention of IFAD any allegations or concerns of fraud and/or corruption in relation to the implementation of the project of which it has knowledge or become aware.

Suspension

8. (a) IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the loan account in accordance with the general conditions, upon the occurrence of any of the events set forth therein, or if:
- (i) The project management unit (PMU) director has been removed from the project without the prior concurrence of IFAD;
 - (ii) 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.
 - (iii) The subsidiary loan agreement (SLA), or any provision thereof, has 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 "Financial Services and Enterprise Promotion" project component.
 - (iv) The project operations manual, or any provision thereof, has been waived, suspended, terminated, amended or 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 project.
 - (v) Any competent authority has taken any action for the dissolution of the lead project agency (LPA) or the suspension of its operations, or any action or proceeding has been commenced for the distribution of any assets of the LPA among its creditors.
 - (vi) The Government has defaulted in the performance of any covenant set forth in the project loan agreement, and such default continues unremedied for a period of 30 days, and IFAD has determined that such default has had, or is likely to have, a material adverse effect on the project.
 - (vii) 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.
 - (viii) Procurement has not been or is not being carried out in accordance with the project loan agreement.
- (b) Notwithstanding the above, IFAD will suspend the right of the Government to request withdrawals from the loan account if the audit has not been satisfactorily concluded within twelve months of the financial reporting date set forth in the project loan agreement.

Conditions precedent to withdrawal

9. (a) No withdrawal will be made in respect of expenditures under all categories of the loan allocation table until: (i) the AWPB for the first Project Year has been submitted to, and approved by, IFAD; and (ii) the Government has made an initial budgetary allocation of counterpart funds available to the lead project agency;
- (b) No withdrawal will be made in respect of expenditures under Category IV (Credit) of the loan allocation table, until a draft model non-banking financial institution SLA has been approved by IFAD, and a copy of one signed non-banking financial institution SLA, substantially in the form so approved, has been delivered to IFAD, and all conditions precedent to the effectiveness

thereof (other than the effectiveness of the loan documents) have been fulfilled.

Conditions precedent to effectiveness

10. The project loan agreement will become effective subject to the fulfilment of the following conditions precedent:
 - (a) The project steering committee has been duly established in accordance with the project loan agreement;
 - (b) The Government's ministry of agriculture has issued a ministerial order stating that the project management unit implementing the North East Development Project will also be responsible for the implementation of the project;
 - (c) The Government has duly opened the special account and the project account;
 - (d) The Government has drafted and submitted to IFAD a procurement plan for the first eighteen months of the project, acceptable to IFAD
 - (e) The project loan agreement has been duly signed, and the signature and performance thereof by the Government have been duly authorised and ratified by all necessary administrative and governmental action; and
 - (f) The Government has delivered to IFAD a legal opinion issued by the Minister for Justice of the Government or other legal counsel authorised by IFAD to issue such opinion in respect of the matters set forth in the project loan agreement and in form and substance acceptable to IFAD.

Key reference documents

Country reference documents

Azerbaijan's State Programme on Poverty Reduction and Sustainable Development, SPPRSD, 2006-2015

Azerbaijan's State Programme on Poverty Reduction and Economic Development, (SPPRED), 2003-2005

IFAD reference documents

IFAD Strategic Framework

Sub-regional Strategy for NENA

Azerbaijan COSOP (2003)

IFAD Strategic Framework (old and revised)

Action Plan for the Seventh Replenishment

Learning Notes

Targeting Policy

IFAD Guidelines: Design Document and Key File

Rural Finance Policy

Gender Action Plan

Environmental Assessment Guidelines

Other miscellaneous reference documents

World Bank Country Assistance Strategy

EBRD Country Strategy

World Development Reports (2000-2006)

UNDP Human Development Reports (2003-2006)

Logical framework

Objective Hierarchy	Key Performance Indicators	Monitoring Mechanisms and Information Sources	Assumptions
<p>Goal: To reduce income poverty, malnutrition and food insecurity in a sustainable manner, improve the livelihoods of the rural poor in the districts of the North West</p>	<ul style="list-style-type: none"> • % reduction in Prevalence of child malnutrition; • No. of HHs with improvement in asset ownership index; • HHs with increased income and improved food security; • No. of people with access to safe, reliable drinking water. 	<ul style="list-style-type: none"> • National level HBSs, Nutrition surveys, SPPRSD M&E System • Village plan benchmarks • RIMS annual reporting and impact surveys • Project Completion Report 	<ul style="list-style-type: none"> • Political stability prevails • Macro-economic situation continues to improve • Social, economic climate remains conducive to market-based development.
<p>Development Purposes:</p> <ul style="list-style-type: none"> • Introduce effective PIM • Empower farming communities to take charge of their development • Provide sustainable financial services and access to BDS 	<ul style="list-style-type: none"> • % Irrigation schemes operating at a water efficiency level 70%; • % WUA financially sustainable • % Farmers reporting yield increases; • Loan portfolio growth and degree of client satisfaction; • New enterprises established by male and female borrowers and operating 	<ul style="list-style-type: none"> • WUA budgets and accounts • M&E reports and studies • Participating MFI(s) Reports; • SME business records and books/tax documents 	<ul style="list-style-type: none"> • Government commitment to support PIM continues • Conducive microfinance policy and macro-economic framework for development maintained; • improved access to export markets;
<p>Outputs:</p> <ul style="list-style-type: none"> • Strong financially viable WUAs serving their members interest • Rehabilitated On-Farm Irrigation Systems; • Effective Farmer and Community Groups; • Effective technology transfer , input supply and market facilitation system • Sustainable micro finance system with wide outreach 	<ul style="list-style-type: none"> • No. of WUAs covering their costs • No of ha of irrigated agriculture receiving adequate supplies of water • % change in irrigation efficiency • No. of village development plans prepared and community projects implemented; • No. of Groups and producer associations formed/strengthened with women in leadership positions; • % improvement of crop in yields and farm income • available, average loan size and financial recovery rate • No. and types of services available 	<ul style="list-style-type: none"> • SAIC/WUAs records, RCC/District reports • PRAs; • Tender, bid and contract award records; • Contract progress reports; • Project Monitoring Reports • Village Action Plans; • Community Impact Qualitative Study • Annual Impact Assessments • Village Impact Assessments; • Reports of collaborating agencies/projects; • Participating MFIs Reports 	<p>No major changes to SAIC current policies on ISF payments Continued respect for SAIC-WUA contracts for long-term infrastructure use and water rights</p> <p>Service providers, contractors and other agents (i.e. USAID, WB, GRCC, Private Advisers) collaborating with the Project</p>

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