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Enabling poor rural people
to overcome poverty

President's report

Proposed loan and grant to Bosnia and Herzegovina for the

Rural Business Development Project

Note to Executive Board representatives

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Rome, 12-14 December 2011

For: Approval

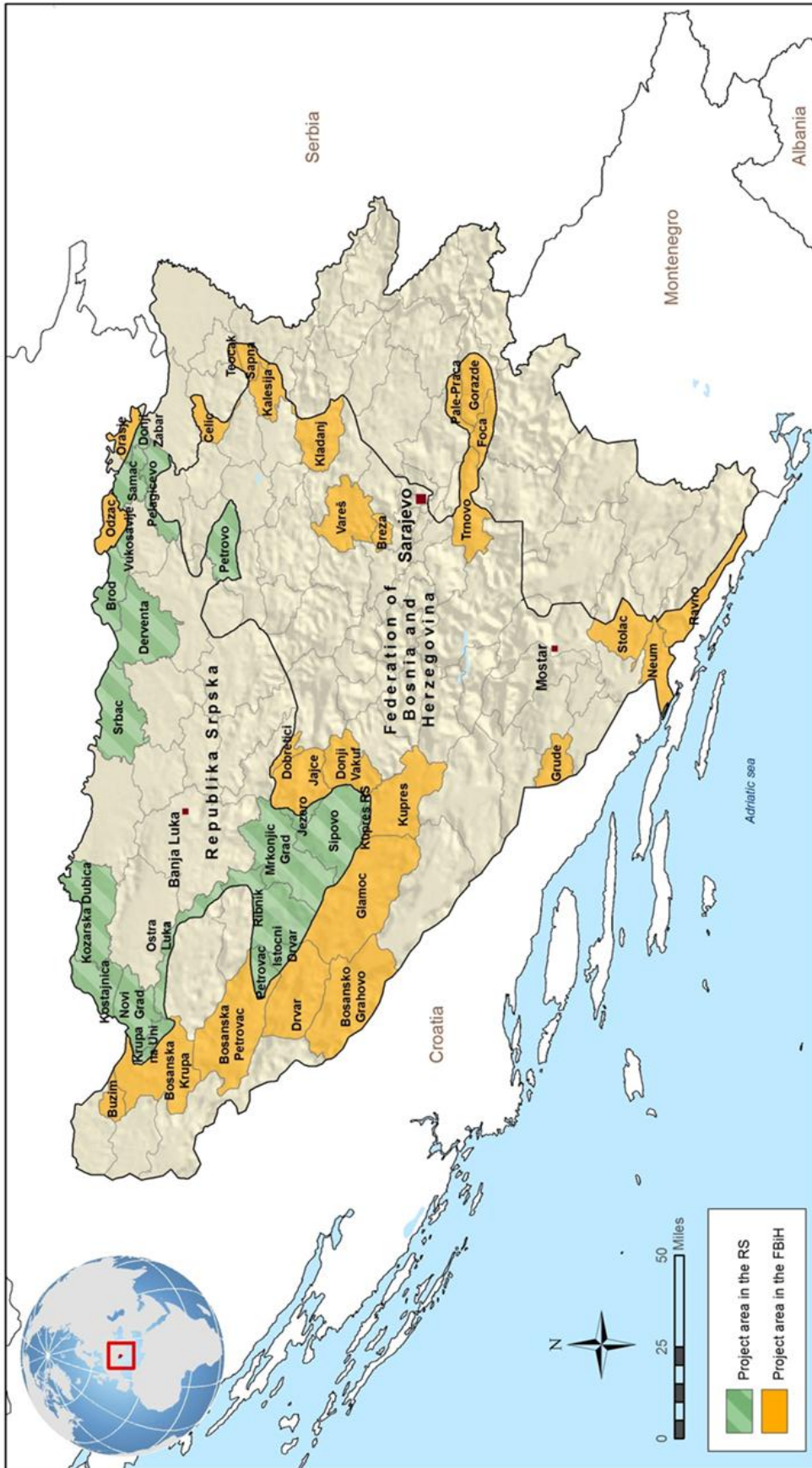
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Abbreviations and acronyms

APCU	agricultural projects coordination unit
AWP/B	annual workplan and budget
BiH	Bosnia and Herzegovina
FBiH	Federation of Bosnia and Herzegovina
M&E	monitoring and evaluation
MTDS	medium-term development strategy
PCU	project coordination unit
PFI	participating financial institution
RBDP	Rural Business Development Project
SD	Strategy of Development
SSI	Strategy of Social Inclusion

Map of the project area



18-7-2011

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

Map compiled by IFAD



Bosnia and Herzegovina

Rural Business Development Project

Financing summary

Initiating institution:	IFAD
Borrower:	Bosnia and Herzegovina
Executing agency:	Ministry of Agriculture, Water Management and Forestry of the Federation of Bosnia and Herzegovina and Ministry of Agriculture, Forestry and Water Management of the Republika Srpska
Total project cost:	US\$30.22 million
Amount of IFAD loan:	SDR 8.05 million (equivalent to approximately US\$12.72 million)
Amount of IFAD grant:	SDR 0.50 million (equivalent to approximately US\$780,000)
Terms of IFAD loan:	20 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
Cofinancier(s):	OPEC Fund for International Development (OFID) Clients/participating financial institutions (PFIs), municipalities-communities Government
Amount of cofinancing:	OFID: US\$5.35 million PFIs: US\$1.8 million
Terms of cofinancing:	To be determined
Contribution of borrower:	US\$6.79 million
Contribution of beneficiaries:	US\$2.74 million
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to Bosnia and Herzegovina for the Rural Business Development Project as contained in paragraph 42.

Proposed loan and grant to Bosnia and Herzegovina for the Rural Business Development Project

I. Strategic context and rationale

A. Country and rural development and poverty context

1. With a per capita gross national income of US\$4,700 in June 2011, Bosnia and Herzegovina (BiH) ranks as an upper-middle-income country. It has not yet fully recovered from the effects of the inter-ethnic war in the early 1990s, which caused severe destruction to the economy, infrastructure, livelihoods and social fabric. Global financial crises and the increase in global food prices of 2008 have raised both the unemployment and poverty rates.
2. The agriculture sector is a small but important part of the BiH economy, contributing some 9.8 per cent of GDP, but employing some 21 per cent of the labour force (2007). However, the sector is facing many constraints, including small holdings, outdated technology (leading to low yields and labour productivity compared with other southern European countries), constrained access to finance and poor market linkages.
3. Poverty remains a largely rural phenomenon, with about 80 per cent of poor people residing in rural areas. The rural poverty rate, at 17 per cent, is double the rate for urban areas – mostly owing to the slower growth of agriculture compared with other sectors. BiH retains a considerable agrifood trade deficit. However, the agrifood sector has good growth potential due to growing demand and a number of comparative advantages, including favourable prices for land and labour, ample labour supply due to low overall employment, good climate, and a strategic location for producing high-value products for domestic and export markets. There are already positive signs of the trade deficit decreasing as BiH trades more intensively with its neighbours.

B. Rationale and alignment with government priorities and RB-COSOP

4. The rationale for the Rural Business Development Project (RBDP) is to help smallholder farmers in BiH transform from subsistence to commercial farming. This is in line with the state- and entity-level agriculture development strategies of the Federation of Bosnia and Herzegovina (FBiH) and the Republika Srpska, which call for transforming agriculture into a more competitive sector that can substitute for imports and expand exports. About 80 per cent of the farmers in BiH are smallholders constrained by the small-scale, fragmented nature of production. They experience difficulties in obtaining inputs; operating their enterprises with efficient technologies and management practices; financing investments; and accessing markets at remunerative prices. Their situation has become more desperate as the country transforms from a centrally planned to a market-based economy, which must meet European Union accession and globalization requirements. IFAD is one of the few donors in the country working with smallholder farmers. Its previous project experience has demonstrated high impact and presents an opportunity for scaling up.

5. The development hypothesis guiding the project is that organizing smallholder farmers and providing them with technical and business skills, market access and financial services can help orient them towards commercial production, allow them to be more competitive and lead to increased incomes and employment. This will contribute to poverty reduction and enhance national food security. The goal of the project is in line with the country's Strategy of Development (SD) and Strategy of Social Inclusion (SSI).¹ The project will contribute to social inclusion – in a country recovering from many years of conflict – by encouraging the participation of the inactive population and its reintegration into the labour market and social life.
6. The project provides an opportunity to build synergy with other donors and to share lessons from their investments in the provision of financial services and infrastructure development. It will assist smallholder farmers in obtaining certification for access to European Union markets.

II. Project description

A. Project area and target group

7. The project will be implemented in 27 municipalities in FBiH and in 20 municipalities in the Republika Srpska. The selection of these municipalities is based on their low development and socio-economic ranking, their limited participation in previous IFAD projects and the potential for scaling up some interventions that have demonstrated high impact in previous IFAD projects. Moreover, within these selected municipalities, the most deprived and undeveloped communities will be targeted, especially by the rural infrastructure component.
8. The project will target 20,000 households of all nationalities, including: (i) smallholder farmers, both men and women, interested in commercial agriculture; (ii) members of producers' associations and agriculture cooperatives with an outreach to smallholder farmers; and (iii) women and unemployed youth interested in non-farm wage employment or self-employment. Woman-headed households comprise nearly 25 per cent of the target group.

B. Project development objective

9. The development objective of the project is to help subsistence farmers make the transition to commercial farming and support development of the non-farm enterprise sector for rural employment generation. The project is expected to directly benefit 20,000 rural households. The expected outcomes of the project include: (i) increased productivity and enterprise through strengthened business and advisory services; (ii) increased access to sustainable financial services; and (iii) improved access to markets and business opportunities. At least 75 per cent of the targeted households are expected to report a 30 per cent increase in average household agricultural income and a 50 per cent increase in non-farm income. The share of women and unemployed youth in wage employment is expected to increase by 5 per cent.

C. Components/outcomes

10. The RBDP will include four components: (i) rural business support; (ii) rural business investment; (iii) rural market infrastructure; and (iv) project management. The components are expected to work in close integration and synergy for maximum impact on the targeted households.
11. The rural business support component will have three subcomponents: (i) farm enterprise development; (ii) business development services; and (iii) non-farm enterprise development. The rural business investment component will provide access to financial services and will operate with two main client groups: (i) smallholder producers and rural entrepreneurs will be offered loans for durations

¹ Upon expiration of the 2004-2007 Medium Term Development Strategy (MTDS), the government prepared the BiH SD and the SSI.

of up to five years, and (ii) rural enterprises connected to one of the main project-supported value chains will also be offered loans. Innovative arrangements for financing private-sector firms with contractual arrangements with producers' associations and agricultural cooperatives will be encouraged, as these have proved to be very effective in providing timely finance to small farmers, addressing the working capital requirements of processors and wholesalers, ensuring timely payments to farmers for their produce, and providing a secure source of repayment through deduction of instalments at source, thereby reducing the transaction costs of financial institutions. The rural infrastructure component will be designed to enhance access to markets through a broad range of schemes to be undertaken in close partnership with municipal governments. All selected schemes must demonstrate their potential to enhance economic opportunities and improve livelihoods. The main types of infrastructure eligible under the rural market infrastructure component include: village and feeder roads, including bridges; pasture livestock water points; small-scale irrigation systems; and domestic water supply and sewerage systems. The project management component will finance all incremental costs of project management and coordination by the existing project coordination unit (PCU) in place in FBiH and the agricultural projects coordination unit (APCU) in the Republika Srpska.

12. The projected outcomes of the project include: (i) increased productivity and enterprise through strengthened business and advisory services; (ii) increased access to sustainable financial services; and (iii) improved access to markets and business opportunities. At least 75 per cent of the targeted households are expected to report increased incomes. It is also expected that the project will lead to a 30 per cent increase in average household incomes from agricultural sources, a 50 per cent increase in non-farm incomes, and a 5-10 per cent increase in the share of women and unemployed youth in wage employment.

III. Project implementation

A. Approach

13. The project will adopt a demand-driven approach with a view to including the most entrepreneurially-minded farmers and rural institutions, thus ensuring that project-provided services will bear fruit and have great impact on rural livelihood development. Targets for social inclusion and gender equity are included to ensure the participation of all nationalities, women and youth in various project activities.

B. Organizational framework

14. RBDP will build on arrangements already in place for ongoing IFAD projects in BiH, which are well tested and have proved effective in the past. BiH will approve the project through its institutions, ensuring its consistency with national strategies and policies. The state will then pass the proceeds of the loan and the responsibility for project implementation to the two entity governments (FBiH and the Republika Srpska) through their Ministries of Agriculture. In each entity, an interministerial project steering committee will be responsible for ensuring that the project is implemented in accordance with sound financial and administrative procedures within the government policy and institutional framework.
15. The existing PCU/APCU will implement RBDP. In implementing ongoing IFAD projects, these units have acquired operational experience and expertise in understanding the capacities and aspirations of IFAD targets, and in proactively assisting projects in overcoming the major constraints on their development. They are also well versed in the systems, procedures and requirements of government, service providers, IFAD and cofinanciers. PCUs will enter into memoranda of understanding with the stakeholders involved in implementation of project activities, including municipal authorities, and into formal results-based contracts with contractors and service providers.

C. Planning, monitoring and evaluation, and learning and knowledge management

16. Project implementation will follow annual work plans and budgets (AWP/Bs) prepared in close consultation with representatives of beneficiaries and service providers and that accord with the real needs and priorities of beneficiaries. The annual inter-entity implementation review workshop will provide feedback for adjusting the implementation strategy.
17. The monitoring and evaluation (M&E) system will be used as a key management tool intended to provide feedback to improve the effectiveness, efficiency, sustainability, relevance and impact of project activities. Overall responsibility for M&E activities will lie with the PCUs, which will conduct M&E in accordance with IFAD's Managing for Impact in Rural Development: A Guide for Project M&E and IFAD's Results and Impact Management System (RIMS) handbook, and in coordination with the M&E systems and websites of the entity Ministries of Agriculture. The M&E systems will include both progress and impact M&E.
18. Progress monitoring will concentrate on analysis of the financial and physical performance of the project, using the performance indicators of the project's logical framework (logframe). These will include appropriate RIMS indicators for this project, developed in close consultation with the stakeholders during the start-up workshop and the annual inter-entity implementation review workshops.
19. Impact monitoring will focus on the outcome and impact-level indicators specified in the project logframe, using surveys and ad hoc studies as appropriate. A baseline study will be conducted just before project start-up to define the socio-economic status of the target group, so as to allow for measurement of project impact at a later stage. Panel impact surveys of beneficiaries will be conducted as needed to track certain households in order to assess project effects and emerging impact. A mid-term review to assess project progress will be conducted jointly by the Government and IFAD at the end of project year three. At the end of the project, a completion evaluation will be conducted as an input into the project completion report.
20. Given the potential to learn lessons from the RBDP, the project will compile and disseminate project information, experience and results on an ongoing basis within the country and to IFAD. Provision has been made in the project budget for the preparation of case studies of success and failure and for brief learning notes on key aspects of the project. These notes will be presented in donor forums in coordination with the state Ministry of Finance and Treasury, as well as in other knowledge forums. Considering that more and more rural inhabitants in BiH use the Internet, PCUs will establish websites offering information on project objectives, activities, plans and results.

D. Financial management, procurement and governance

21. The respective Ministries of Agriculture in the two entities will be responsible for financial management of the project and for coordinating all financial reports from their respective implementing partners. Withdrawals from the IFAD loan and grant accounts will flow directly to the respective PCUs on the basis of withdrawal applications submitted in accordance with the AWP/Bs. The PCU and APCU will maintain a full set of accounts conforming to IFAD's requirements.
22. The procurement of goods, works and services to be financed from the proceeds of IFAD financing will be carried out in accordance with IFAD procurement guidelines, and will be consistent with the duly approved AWP/B. The aim of all procurement is to obtain the best value for money.
23. Major disbursements will be subject to internal audit by the internal auditors of each entity's Ministries of Finance as appropriate. The project's annual financial statements will be subject to annual audits – to be carried out by acceptable

independent external auditors in accordance with the IFAD Guidelines on Project Audits.

E. Supervision

24. The project will be directly supervised by IFAD. Project supervision and implementation support missions will be conducted by IFAD at six-month intervals and will cover fiduciary functions, implementation support and impact assessment. The first supervision mission will be scheduled to coincide with the start-up workshop, and one of the semi-annual supervision missions will be scheduled to coincide with the annual inter-entity implementation review workshop.

IV. Project costs, financing, benefits

A. Project costs

25. Total project costs, including physical and price contingencies, are estimated at US\$30.22 million (43.39 million BiH marka) over a five-year project period. Physical and price contingencies account for about 7 per cent of total project costs. In calculating costs, rates of inflation of 3 per cent for local expenditures and 2 per cent for foreign expenditures are used, in accordance with World Bank and International Monetary Fund forecasts. A constant purchasing parity rate has been applied in projecting the exchange rate during the project's implementation period. Costs per component are shown in the table below.

B. Project financing

26. The project will be financed by an IFAD loan of US\$12.72 million on IFAD hardened lending terms and an IFAD grant of about US\$0.78 million to be used for capacity-building among smallholder farmers and marketing support. The OPEC Fund for International Development (OFID) will provide FBiH with a credit of US\$5.35 million for the rural market infrastructure component and Republika Srpska will secure corresponding financing of approximately US\$3.43 million for this component. The two entity Governments will provide a combined contribution of US\$3.36 million, either by provision of an exemption/waiver or by payment of value-added tax and other applicable taxes, duties, etc. Municipal governments and beneficiaries will jointly contribute US\$2.74 million, or 21 per cent of the cost of the physical infrastructure and part of the contribution for supporting enterprises of producers' associations and agricultural cooperatives. Participating financial institutions (PFIs) will contribute US\$1.8 million to leverage IFAD funds for rural finance, or 20 per cent of the total cost of this component. The details of financing arrangements are shown in the following table.

	IFAD		IFAD		Government		OFID		Municipalities/ Beneficiaries		PFI		Total	
	loan		Grant		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1. Rural Business Support	1.73	52.3	0.66	19.9	0.56	16.8	-	-	0.36	11.0	-	-	3.30	10.9
2. Rural Business Investments	7.39	80.0	-	0.0	-0.00	0.0	-	-	-	0.0	1.85	20.0	9.23	30.6
3. Rural Market Infrastructure	0.84	5.8	-	0.0	5.89	47.0	5.35	37.1	2.37	16.4	-	-	14.45	47.8
4. Project Management and Coordinatio	2.76	85.2	0.13	3.9	0.35	10.9	-	0.0	-	0.0	-	-	3.24	10.7
Total PROJECT COSTS	12.72	42.1	0.78	2.6	6.80	22.5	5.35	17.7	2.74	9.1	1.85	6.1	30.23	100.0

C. Summary benefit and economic analysis

27. The organization of smallholders into agricultural cooperatives and producers' associations, coupled with training in farming as a business, will allow them to raise yields, orient their production to market demand, afford them better access to domestic and export markets and enhance their bargaining power. Improved access to financial services is expected to lead to investment in a wide range of agro-based and rural enterprises in production, post-harvest services, processing and transport that will help integrate small producers into agricultural value chains. Improved social and market infrastructure will lead to improved living conditions and better

linkages to markets and social services. The sum of project initiatives is expected to increase farm income by 30 per cent and non-farm income by 50 per cent for participating households. It is also expected to increase the capacity of the private sector for processing and exporting a higher volume of agriculture commodities from the target municipalities. Non-quantifiable benefits include the empowerment of smallholders and poor rural people, including women, to make significant decisions affecting their livelihoods individually and collectively, and to lobby local governments and other institutions in favour of a supportive policy framework on their behalf.

28. Assuming an opportunity cost of capital of 10 per cent, the project economic internal rate of return (EIRR) is estimated at 19.7 per cent and the net present value at a positive US\$25.3 million. The EIRR drops only marginally to 18.5 per cent with an increase in costs of 10 per cent. These indicators establish the economic feasibility of the project.

D. Sustainability

29. Relationships between the private sector and the smallholder farmers' organizations fostered by the project will be based on promotion of the long-term business interests of all partners and will create mutual interest in sustaining the benefits of collaboration. The sustainability of financial services will be ensured by selecting strong, operationally self-sufficient financial institutions, with a strategic commitment to providing services to IFAD target groups. The sustainability of rural market infrastructure will be ensured by selection criteria emphasizing technical and economic feasibility, and municipal governments will commit to assuming its operation and maintenance beyond the life of the project.

E. Risk identification and mitigation

30. The project faces a low risk that agricultural cooperatives and producers' associations may lack incentives to collaborate. This risk will be mitigated through working only with those agricultural cooperatives and producers' associations that demonstrate a high commitment and motivation to participate in commercial farming. A moderate risk exists that smallholder farmers and women may be excluded from project activities. This risk will be mitigated by close adherence to the defined criteria for selecting the cooperatives and associations.
31. There is an inherent risk to the project from the complex institutional and political environments prevailing in the country, which have caused frequent political gridlocks and impeded rapid advances on political and economic reform. This has retarded the development of a nationwide institutional infrastructure fully supportive of a market economy and European Union integration. It is expected that the goal of European Union accession will assist in ushering in reform.

V. Corporate considerations

A. Compliance with IFAD policies

32. Project design is fully in line with the IFAD Strategic Framework 2011-2015, as well as with the IFAD policies on targeting, rural finance and the environment and natural resources management. RBDP will promote a gender-sensitive and enabling implementation environment through various capacity-building activities and gender-balanced staffing and programme management arrangements.
33. The project is considered category B, as it is not likely to have any significant negative environmental impact.

B. Alignment and harmonization

34. The project is in line with the government's MTDS, also known as the poverty reduction strategy paper (PRSP), and the recent drafts of the country's SD and SSI. More specifically, it is aligned with the MTDS/PRSP agricultural policies to:

(i) activate natural and human potential and increase employment in rural areas; (ii) increase the competitiveness of domestic agriculture; and (iii) further the development of rural areas. The project is also in line with each entity's strategy of agricultural and rural development.

35. In addition to project cofinancing of US\$8.8 million from OFID, the project will pursue a collaborative framework for execution that comprises the national coordination arrangements for inter-donor and donor/government dialogue and the local government modality – entrenched in the community and municipal planning systems for selection of subproject investments.

C. Innovations and scaling up

36. The project offers several opportunities for innovation, including: (i) capacity-building among service providers to enable agricultural services and business development systems to provide pro-poor, demand-driven advice; (ii) support to and empowerment of non-state actors (training for the private sector, small and medium-sized enterprises and producers' associations) within value chain development and operation; (iii) exploration of alternative collateral requirements for commercial loans – a major stumbling block for beneficiaries seeking loans – such as tripartite contracts between PFIs, borrowers and processors of borrowers' produce; and (iv) enhancement of the sustainability of community institutions (e.g. producers' associations and cooperatives) through enduring links with local government institutions.
37. The RBDP comprises a building block in *Scaling up the Fight against Rural Poverty* and synthesizes previous successful experience (knowledge space), focusing on four major scaling-up pathways: (i) development/strengthening of on- and off-farm economic investments through credit by PFIs, which assume a significant part of the loans (20 per cent) with their own funds. The focus is on the whole value chain, from production to post-harvest services (e.g. agroprocessing, packaging, transport, storage, marketing), capacity-building and institutional development, with the most important drivers being unmet credit demand and the size of the financial space to be created (i.e. the amount of funds to be made available for credit); (ii) promotion of rural financial services as an instrument of poverty reduction – building and consolidating the financial basis of PFIs. A significant factor is the policy and institutional space for the development of an enabling policy and regulatory and institutional environments, including competitiveness in the banking sector; (iii) construction/rehabilitation of economic rural infrastructure through financial support to the freeing up of infrastructural bottlenecks in order to improve market linkages and the incomes of poor rural people. As with pathway (i) the important drivers are unmet demand and the size of the financial space to be created; and (iv) building capacities of service providers to enable agricultural programmes and business development systems to provide pro-poor demand-driven advice. The key determinant of success in the value chain scaling-up pathway and technical and business support services is the creation of appropriate institutional space.

D. Policy engagement

38. Through policy dialogue the project will strive for: (i) promoting measures to link project target groups to markets in an efficient, competitive and sustainable manner, including issues related to accreditation and quality standards; (ii) broadening sustainable access by target groups to rural financial services, especially with respect to developing acceptable alternatives to current collateral requirements; (iii) shifting from direct price and output subsidies to investment-oriented support in order to pave the way for possible European Union pre-accession funds for rural development; (iv) supporting assessment and raising awareness of climate change and its direct and indirect impact on the livelihoods of poor people and their production systems; and (v) promoting civil society and

private-sector participation, including private/public partnership agreements with adequate safeguards, to ensure an adequate level of economic rural infrastructure investment.

VI. Legal instruments and authority

39. A project financing agreement between Bosnia and Herzegovina and IFAD will constitute the legal instrument for extending the proposed financing to the borrower/recipient. A copy of the negotiated financing agreement is attached as an annex.
40. Bosnia and Herzegovina is empowered under its laws to receive financing from IFAD.
41. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the Lending Policies and Criteria.

VII. Recommendation

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

RESOLVED: that the Fund shall make a loan on hardened terms to Bosnia and Herzegovina in an amount equivalent to eight million fifty thousand special drawing rights (SDR 8,050,000), and 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 Bosnia and Herzegovina in an amount equivalent to five hundred thousand special drawing rights (SDR 500,000) and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement: "Rural Business Development Project"

(Negotiations concluded on 15 November 2011)

FINANCING AGREEMENT

Loan Number: _____

Grant Number: _____

Project Title: Rural Business Development Project (RBDP) (the "Project")

Bosnia and Herzegovina (the "Borrower/Recipient")

and

the International Fund for Agricultural Development (the "Fund" or "IFAD")

(each a "Party" and both of them collectively the "Parties")

hereby agree as follows:

Section A

1. The following documents collectively form this Agreement: this document, the Project Description and Implementation Arrangements (Schedule 1) and the Allocation Table (Schedule 2).
2. All provisions of the Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, as may be amended from time to time (the "General Conditions") shall apply to this Agreement.
3. The Fund shall provide a Loan and a Grant to the Borrower/Recipient (the "Financing"). Part A of the Project shall be carried out by the Federation of Bosnia and Herzegovina ("the Federation"), and Part B of the Project shall be carried out by Republika Srpska ("the RS") and, for this purpose, the Borrower/Recipient shall make available to the Federation and the RS the respective parts of the proceeds of the Financing upon terms and conditions set forth in this Agreement and in accordance with the provisions of Subsidiary Agreements between the Borrower/Recipient and each of the Federation and the RS.
4. The Borrower/Recipient intends to obtain from the OPEC Fund for International Development ("OFID") a loan in the amount of approximately USD 5.35 million (the "OFID Loan") to assist in financing Part A of the Project on terms and conditions to be set forth in an agreement (the "OFID Loan Agreement") between the Borrower and OFID. Republika Srpska will secure corresponding financing of approximately USD 3.43 million for Part B of the Project.

Section B

1.
 - A. The amount of the Loan is SDR 8 050 000.
 - B. The amount of the Grant is SDR 500 000.
2. The Loan is granted on hardened terms.

3. The Loan Service Payment Currency shall be the Euro.
4. The first day of the applicable Fiscal Year shall be 1 January.
5. Payments of principal and service charge shall be payable on each 15 February and 15 August.
6. Amounts withdrawn in advance from the Loan and Grant Accounts shall be held in four Designated Accounts denominated in Euro which shall be opened and maintained by the Borrower/Recipient in banks acceptable to the Fund (separate accounts for Loan and Grant proceeds for each of the two Entities). There shall be four Project Accounts denominated in local currency (separate accounts for Loan and Grant proceeds for each of the two Entities), to be opened in banks acceptable to the Fund.
7. Counterpart financing shall be provided for Part A of the Project for a total amount of approximately USD 1 940 000 and for Part B of the Project for a total amount of approximately USD 1 420 000 in accordance with the approved annual work plans and budget of the Project to cover all taxes and duties.

Section C

1. The Lead Project Agencies shall be the Federal Ministry of Agriculture, Water Management and Forestry for Part A and the Ministry of Agriculture, Forestry and Water Management of the Republika Srpska for Part B.
2. The following are designated as additional Project Parties: the Federation and the RS.
3. The Project Completion Date shall be the fifth anniversary of the date of entry into force of this Agreement.

Section D

The Financing shall be administered and the Project supervised by the Fund.

Section E

1. The following are designated as additional grounds for suspension of this Agreement: the OFID Loan Agreement shall have been suspended.
2. The following are designated as additional grounds for cancellation of this Agreement: the OFID Loan Agreement shall have been cancelled
3. The following are designated as additional general conditions precedent to withdrawal:
 - (a) for Part A of the Project the OFID Loan Agreement, the Project Agreement between IFAD and the Federation and the Federation Subsidiary Agreement shall all have been signed;
 - (b) for Part B of the Project the RS shall have secured adequate corresponding financing and the Project Agreement between IFAD and the RS and the RS Subsidiary Agreement shall have both been signed.
4. This Agreement is subject to ratification by the Borrower/Recipient.

5. The following are the designated representatives and addresses to be used for any communication related to this Agreement:

For the Borrower/Recipient:

Ministry of Finance and Treasury
Trg Bosne i Hercegovine br. 1
71000 Sarajevo
Bosnia and Herzegovina

For the Fund:

The President
International Fund for Agricultural Development
Via Paolo di Dono 44
00142 Rome, Italy

This agreement, dated _____, has been prepared in the (English) language in six (6) original copies, three (3) for the Fund and three (3) for the Borrower/Recipient.

BOSNIA AND HERZEGOVINIA

Authorised Representative

INTERNATIONAL FUND FOR
AGRICULTURAL DEVELOPMENT

Kanayo F. Nwanze

Schedule 1

Project Description and Implementation Arrangements

I. Project Description

1. Project Area. The Project shall be implemented in 27 municipalities in the Federation of Bosnia and Herzegovina and 20 municipalities in Republika Srpska. The selection of these municipalities is based on their low development and socio-economic ranking, their limited participation in previous IFAD projects and the potential for scaling up some of the interventions which have demonstrated high impact in previous IFAD projects. Furthermore, within these selected municipalities the most deprived and undeveloped communities shall be targeted, especially by the rural infrastructure component. In the Federation, the selected municipalities are distributed in nine cantons as follows; Hercegovina-Neretva canton: Neum, Ravno and Stolac; Sarajevo canton: Trnovo; Bosnian Podrinje canton: Foča-Ustikolina, Goražde and Pale-Prača; Zenica-Doboj canton: Vareš and Breza; Livno canton: Drvar, Bosansko Grahovo, Glamoč and Kupres; Central Bosnia canton: Dobretići, Jajce and Gornji Vakuf; Una-Sana canton: Bosanska Krupa, Bosanski Petrovac and Bužim; Tuzla canton: Čelić, Teočak, Sapna, Kalesija and Kladanj; Posavina canton: Orašje and Odžak; and West Herzegovina canton: Grude. In the RS the 20 municipalities will include the following; Jezero, Šipovo, Kupres, Mrkonjić Grad, Ribnik, Istočni Drvar, Petrovac, Oštra Luka, Krupa na Uni, Novi Grad, Kostajnica, Kozarska Dubica, Petrovo, Pelagićevo, Donji Žabar and Vukosavlje, Šamac, Brod, Derventa and Srbac.

2. Target Population. The Project shall target 20,000 households of all nationalities including: (i) smallholder farmers, both men and women interested in commercial agriculture; (ii) Producer Associations and Agriculture Cooperatives with an outreach to smallholder farmers; and (iii) women and unemployed youth interested in non-farm wage employment or self-employment. Women headed households comprise nearly 25% of the target group.

3. Goal and Purpose. The Project goal shall be rural poverty reduction by raising the target groups incomes and strengthening their resilience by building profitable farm and non-farm enterprises in Bosnia-Herzegovina. The purpose of the Project shall be to help subsistence farmers transform to commercial farming and help in developing the non-farm enterprise sector for rural employment generation. The expected outcomes of the project include: (i) increased productivity and enterprise through strengthened business and advisory services; (ii) increased access to sustainable financial services and (iii) improved access to markets and business opportunities. At least 75% of the targeted households are expected to report 30% increase in average household agricultural income and 50% increase in non-farm incomes. The share of women and unemployed youth in wage employment is expected to increase by 5%.

4. Components. The Project shall consist of four components (a) Rural Business Support (b) Rural Business Investments (c) Rural Market Infrastructure and (d) Project Management. The components are expected to work in close integration and synergy for maximum impact on the targeted households.

a. Rural Business Support Component

The Rural Business Support Component shall consist of three sub-components: (i) Farm Enterprise Development, (ii) Business Development Services and (iii) Non-Farm Enterprise Development.

(i) *Farm Enterprise Development Sub-component.* The Project shall provide training to 6000 smallholder farmers for enhancing agriculture productivity. The aim will

be to increase yields, product quality and value of existing farm enterprises through provision of advice and training; promotion of high value crops, demonstration of improved and appropriate technologies and practices for the horticulture and livestock sectors; improved agriculture inputs, improvement in herds and livestock production and management practices, enhancing food safety standards, strengthening of Good Agriculture and environmentally sound practices. All activities will be market-driven and designed to assist beneficiary farmers to improve the productivity, marketability and profitability of their produce.

In addition to training, the Project shall set up/provide:

- An *Enterprise Support Fund* to encourage members of Producer Associations and Agriculture Cooperatives to invest in new and improved infrastructure or equipment that will enhance producer links to the market and allow smallholders to gain a higher market share and increased income.
- '*Seed funding*' of up to KM 15,000 on a matching basis to well-managed profit-oriented cooperatives that can be competitive in the current environment and have the potential to benefit a large number of co-operants, generate additional incomes or employment. The seed funding shall be matched by contributions from the local Municipality and recipients themselves, and supplemented by facilitating additional loans through the Project, if required for the purposes of the business investments. The Project will link the financial support provided to funding already available from such sources as the Investment Development Bank in RS and help its clients obtain Guarantees from the RS Guarantee Facility when that becomes available.
- The *Rural Women Leaders initiative*, aiming to address the low entrepreneurial confidence of rural women by enhancing peer methodologies and leadership skills among women, strengthen women's technical capacity to engage in rural enterprise development and business skills training, strengthen and establish commercially geared producer associations and cooperatives, through which women can better access training, markets, storage and packaging solutions as well as professional networks. This activity is expected to cover around 300 women or 150 in each entity.

(ii) *Business Development Services Sub-component*. In order to link small farmers to the market, the Project shall strengthen around 60 Producer Associations and Agriculture Cooperatives with a membership of approximately 4,200. It shall provide training, on-the-job mentoring, and facilitate expansion of market linkages (e.g. connecting with downstream customers or larger traders/ wholesalers/retailers, processors, etc.). The Project shall assist Agriculture Cooperatives, Producer Association and other market intermediaries providing small farmers with opportunities to participate more actively in value chains and adoption of standards such as Hazard Analysis and Critical Control Points (HACCP), European Good Agriculture Practices (EuroGAP) and ISO 22,000 standard developed by the International Organization for Standardization dealing with food safety standards. Through training, technical assistance, marketing and assistance to obtain certification, rural entrepreneurs, both farm and non-farm, shall be assisted to develop and expand their enterprises which create opportunities to enhance incomes and rural employment and add value to the rural economy.

(iii) *Non-Farm Enterprise Development Sub-component*. The Project shall focus on creating jobs for women and unemployed youth given the lack of opportunities in rural areas and the high unemployment rate for these two groups. The project will provide support which will include identification of business and employment opportunities, preparation of technical and business feasibilities, access to financing through its rural finance component. For a few selected enterprises with the potential for employment generation, a small one-time initial capital assistance with some contribution from the Project will also be considered. This sub-component will be expected to provide training

for employment creation for around 1000 women and unemployed youth. In addition, the Project will (i) find special placements opportunities through collaboration with the private sector as apprentices (ii) collaborate closely with municipalities' business zones to facilitate youth employment (iii) develop loan products for un-employed youth for start-up businesses in collaboration with public sector support programmes and (iv) collaborate with ILO to publicize their research and analysis of development sectors with employment potential.

b. Rural Business Investments Component

The Rural Business Investment Component shall provide access to financial services and operate with two main client groups, (i) smallholder producers and rural entrepreneurs, who shall be provided loans for up to five years and (ii) rural enterprises connected to one of the main project supported value chains who shall be provided loans. Innovative arrangements for financing private sector firms with contractual arrangements with Producer Associations and Agriculture Cooperatives shall be encouraged as these have proved to be very effective in providing timely finance to small farmers, address the working capital requirements of processors and wholesalers, ensure timely payments to farmers for their produce and provide a secure source of repayment through deduction of instalments at source thereby reducing the transaction cost of financial institutions.

The Rural Business Investment Component shall also provide a refinancing facility to commercial banks and a pre-financing facility to MCOs for term finance for private individuals (farmers and micro enterprises) and for rural small and medium enterprises (SMEs). A revolving fund of USD 9.23 million (KM 12.9 million) will be provided under this component of which about 5.85 million USD will be for the Federation and 3.38 million USD for RS. This amount will be 80% of total lending funds and an additional 20% or USD 1.85 will be contributed by Participating Financial Institutions (PFIs). Project allocations in support of rural business investments will be disbursed during the five year project implementation period and reflows will be immediately revolved by the contracted PFI. It is expected that the project will provide loans to 1387 smallholder farmers and 46 enterprises. The loan funds will be provided to the participating PFIs for at least 10 years as a revolving fund.

c. Rural Market Infrastructure Component

The Rural Infrastructure component shall enhance access to markets through a broad range of schemes which shall be undertaken in close partnership with municipal governments. All selected schemes will have to demonstrate the potential of the scheme to enhance economic opportunities and improved livelihoods. The main types of infrastructure that shall be eligible under the Rural Marketing Infrastructure component shall include infrastructure such as village and feeder roads including bridges, pasture livestock water points, small-scale irrigation systems, domestic water supply and sewerage systems.

d. Project Management Component

The Project Management component shall finance all the incremental costs of project management and coordination by the Project Coordination Unit (PCU) in the Federation and the Agricultural Projects Coordination Unit (APCU) in the RS.

II. Implementation Arrangements

1. The Project shall adopt a demand-driven approach for including the most entrepreneurial-minded farmers and rural institutions thereby assuring that the project provided services will bear fruit and have high impact on rural livelihoods development. Social Inclusion and Gender Equity-specific targets are included to ensure the participation of all nationalities, women and youth in different project activities. The organizational framework of the Project shall be built on the arrangements already in place for the ongoing IFAD projects in Bosnia and Herzegovina which are well tested and have proved effective in the past. The Borrower/Recipient shall approve the Project through its institutions ensuring its consistency with national strategies and policies, and then will pass the proceeds of the Financing and the responsibility for Project implementation to the two Entity governments (the Federation and RS), through their ministries of agriculture as the Lead Project Agencies. In each Entity, an inter-ministerial Project Steering Committee (PSC) shall be responsible for ensuring that the project is implemented in accordance with sound financial and administrative procedures within the government policy and institutional framework.
2. *Project Implementation Manual (PIM)*. The PSC shall approve a draft Project Implementation Manual and submit it for non-objection to the Fund. The PIM may be amended or otherwise modified only with the prior consent of the Fund.
3. *Mid-Term Review (MTR)*. A Mid-term review shall be conducted at the end of project year three, to assess the progress, achievements, constraints and emerging impact and likely sustainability of the project and make recommendation and necessary adjustments for the remaining period of disbursement. The MTR shall be carried out jointly by the Lead Project Agencies and IFAD.

Schedule 2*Allocation Table*

1. *Allocation of Loan and Grant Proceeds.* (a) The Table below sets forth the Categories of Eligible Expenditures to be financed by the Loan and the Grant and the allocation of the amounts of the Loan and the Grant to each Category and the percentages of expenditures for items to be financed in each Category:

Category	Loan Amount Allocated (expressed in SDR)	Grant Amount Allocated (expressed in SDR)	Percentage of Expenditures to be Financed all net of tax
A. Part A of the Project in the Federation			
I. Enterprise Support Fund	31 000	32 000	100% net of municipalities/beneficiaries contributions
II. Revolving Investment Fund	2 810 000		100% net of PFI contributions
III. Civil Works	275 000		100% net of co-financier and Municipalities/beneficiaries contributions
IV. National Technical Assistance, Training, Workshops and Studies	585 000	255 000	100% net of co-financier contribution
V. (a) Equipment	91 000	14 000	100%
VI. Incremental Operating Costs	775 000		100%
Unallocated	238 000		
B. Part B of the Project in the RS			
I. Enterprise Support Fund	50 000	13 000	100% net of municipalities/beneficiaries contributions
II. Revolving Investment Fund	1 626 000		100% net of PFI contributions
III. Civil Works	190 000		100% net of cofinancing and Municipalities/beneficiaries contributions
IV. National Technical Assistance, Training, Workshops and Studies	560 000	160 000	100% net of cofinancing
V. (b) Vehicles and equipment	50 000	26 000	100%
VI. Incremental Operating Costs	615 000		100%
Unallocated	154 000		
TOTAL	8 050 000	500 000	

(b) The grant allocations for categories I, IV, V and VI shall cover expenditure for specific activities relating to Support to Producer Associations and Gender Woman Leader programmes.

Logical framework

Narrative Summary	Objectively Verifiable Indicators	Monitoring Mechanism & Information Sources	Assumptions/Risks
<p>PROJECT GOAL Sustained improvement in the livelihoods particularly incomes and employment of the poor rural communities.</p>	<ul style="list-style-type: none"> Percentage of households who have renovated their homes and up-graded household assets in targeted municipalities Consolidating the gains in reducing child malnutrition (reported at 11.6% in 2006). 	<p>Living Standard Measurement Surveys (LSMS), Household Budget Surveys (HBS) Agency for Statistics of BiH Multi-Cluster Indicator Survey by UNICEF (2011 and subsequent years).</p>	<p>Peace and stability;</p>
<p>PROJECT OBJECTIVES To help subsistence farmers in 20,000 rural households transform to commercial farming and help in developing the non-farm enterprise sector for rural employment generation.</p>	<ul style="list-style-type: none"> At least 75% of the targeted HHs report increased incomes from agriculture. 30% increase in average HH income from agriculture 50% increase in average HH non-farm income Increase in share of women in wage employment in the non-farm sector by 5% from 35% to 40% in the project municipalities Increase in share of youth in non-farm wage employment by 5% /reduction in unemployment rate of youth from 48% to 43% in project municipalities. 	<p>Panel surveys at baseline, Mid-term and project completion Surveys ; Labour Force Survey 2011. Millennium Development Goals Report for 2015. Records of Participating Municipal Governments. All surveys gender-disaggregated.</p>	<p>Peace and stability.</p>
<p>PROJECT OUTCOMES & OUTPUTS</p> <p>COMPONENT 1: Rural Business Support Outcome 1: Increase in productivity and enterprise OUTPUTS: Strengthened Producer Associations and Agriculture Cooperatives. Farmers and enterprises with upgraded technical and business skills.</p>	<ul style="list-style-type: none"> Increase in the volume and quality of agriculture products marketed (20%). No of jobs generated for women and the unemployed disaggregated by gender and age (600 jobs). No of enterprises operating on a sustainable basis. 60 Marketing Groups (PAs and ACs) with a membership of 4200 of whom at least 35% are women. 6000 farmers and entrepreneurs provided technical and business skills of whom at least 30% are women. 	<p>Panel (baseline, mid-term and completion) surveys, Service provider reports. Internal Project database. Municipality Reports.</p> <p>PA/Ag cooperative reports. Service provider reports. Panel surveys. Internal Project database.</p>	<p>Minimum disruption of the agriculture sector by disease, extreme weather and economic or financial crisis.</p> <p>Farmers interest in joining PAs and ACs. Competent service providers.</p>
<p>COMPONENT 2: Rural Business Investments</p>	<ul style="list-style-type: none"> Operational Self-Sufficiency Operating Expenses Ratio 	<p>PFI's' interim and annual reports Audit reports of PFIs</p>	<p>Minimum disruption of the agriculture sector</p>

<p>Outcome 2: Increased access to sustainable financial services</p> <p>OUTPUTS: No of loans. Volume of funds No of Participating PFIs.</p>	<ul style="list-style-type: none"> • Active Borrowers/Personnel • Portfolio at Risk. <ul style="list-style-type: none"> • 2000 new loans of which at least 40% are provided for women. • Value of gross loan portfolio increased by • No of participating Financial Institutions (PFIs). 	<p>External databases (MIX market, Planet rating, etc.)</p> <p>PFIs' interim and annual reports Audit Reports.</p>	<p>by disease, extreme weather, economic or financial crisis. PFI interest in participation in project activities Effective lending procedures Gender sensitive credit appraisal</p>
<p>COMPONENT 3: Rural Market Infrastructure</p> <p>Outcome 3: Increased access to markets and business opportunities.</p> <p>Output 3.1: Rehabilitated rural roads including structures such as bridges and drainage facilities. Water supply and/or sewerage schemes. Water points in pastures, small-scale irrigation and river bank protective works, etc.</p>	<ul style="list-style-type: none"> • Decrease in travelling time to social services, markets and business centres. • Increase in the volume of products marketed. • No of functioning infrastructure after three years. <ul style="list-style-type: none"> • 60 roads improved with a length of 85 kilometers. • 14 new water supply and/or sewerage schemes. • 20 new water points in pastures, small-scale irrigation and river bank protective works, etc. • 16,000 households with improved access to roads, domestic water supply, sewage facilities and irrigation facilities. 	<p>Panel (baseline, mid-term and completion) surveys. Internal Project database.</p> <p>Technical design documentation Contractor Reports. Minutes of Scheme Takeover Experts Assessments Supervision Reports</p>	<p>Availability of co-financing Cost effective project selection Proper infrastructure maintenance Transparent and objective criteria for screening</p>
<p>COMPONENT 4: Project Management & Coordination</p> <p>Government and IFAD contribution is delivered on time and all resources are acquired on time.</p> <p>Project staff assigned is competent and qualified for the tasks assigned.</p>			