



# Report and Recommendation of the President to the Board of Directors

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Project Number: 38423  
November 2010

Proposed Grant  
Nepal: Raising Incomes of Small and Medium  
Farmers Project

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 18 October 2010)

Currency unit	–	Nepalese rupee/s (NRe/NRs)
NRe1.00	=	\$0.01417
\$1.00	=	NRs70.58

## ABBREVIATIONS

ADB	–	Asian Development Bank
AEC	–	Agro Enterprise Center
FWDR	–	Far-Western Development Region
GESI	–	gender and social inclusion
ha	–	hectare
HVC	–	high-value commodity
MOAC	–	Ministry of Agriculture and Cooperatives
MWDR	–	Mid-Western Development Region
NGO	–	nongovernment organization
NRB	–	Nepal Rastra Bank
PAM	–	project administration manual
PMU	–	project management unit
SNV	–	Netherlands Development Organisation

## NOTE

In this report, "\$" refers to US dollars

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## PROJECT AT A GLANCE

1. Project Name: Raising Incomes of Small and Medium Farmers Project (formerly Crop Diversification and Commercialization Project)		2. Project Number: 38423-02-2	
3. Country: Nepal	4. Department/Division: South Asia Department Agriculture, Natural Resources and Social Services Div		
5. Sector Classification:	Sectors	Primary	Subsectors
	Agriculture and natural resources	✓	Agricultural production and markets
6. Thematic Classification:	Themes	Primary	Subthemes
	Economic growth	✓	Widening access to markets and economic opportunities
	Gender equity		Gender equity in economic opportunities
6a. Climate Change Impact:		6b. Gender Mainstreaming:	
Adaptation		Gender equity theme	
Mitigation		Effective gender mainstreaming	
		Some gender benefits	
		No gender elements	
7. Targeting Classification:		8. Location Impact:	
	Targeted Intervention		
	Geographic dimensions of inclusive growth	Millennium Development Goals	Income poverty at household level
General Intervention			
✓			
	Rural	High	
	Urban		
	National		
	Regional		
9. Project Risk Categorization:			
10. Safeguard Categorization:			
		Environment	FI
		Involuntary resettlement	FI
		Indigenous peoples	FI
11. ADB Financing:			
	Sovereign/Nonsovereign	Modality	Source
	Sovereign	Project grant	Asian Development Fund
	Total		20.1
12. Cofinancing:			
Netherlands Development Organization (SNV)			0.49
13. Counterpart Financing:			
	Source	Amount (\$ million)	
	Government (including contributions of beneficiaries) and sponsors	12.94	
14. Aid Effectiveness:			
		Parallel project implementation unit	No
		Program-based approach	No

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed grant to Nepal for the Raising Incomes of Small and Medium Farmers Project.<sup>1</sup>
2. The project will reduce the market and business risks for small and medium farmers<sup>2</sup> who diversify into high-value commodities (HVCs) in 10 districts of Nepal's Mid-Western Development Region and Far-Western Development Region.<sup>3</sup> The two regions have the lowest human development indexes within Nepal because of minimal investment in access to services, physical, social, and economic infrastructure. Poverty incidence on average is high for both regions; within the regions, the hill areas suffer particularly high rates of poverty—up to 70% of households fall below the poverty line. Small-farmer incomes are limited by (i) low returns from traditional agricultural commodities, (ii) small and declining farm sizes with low productivity, and (iii) a supply-driven production system that has not captured the potential market benefits for HVCs.<sup>4</sup>
3. The project will help small and medium-sized farmers diversify into HVCs by establishing market links; and providing capital for inputs and better technology, and for building postharvest value chain infrastructure such as storage, packaging, grading, and processing.<sup>5</sup> Project grants will be provided to (i) small and medium farmers who are members of farmer groups or cooperatives with established market supply agreements for initial inputs and farm technology, and (ii) postharvest enterprises for the development of value chain infrastructure to support the market supply agreements. The project will outsource service delivery to nongovernment organizations (NGOs) and the private sector for farmer mobilization, training, production, and business planning, and for feasibility studies on access to project funding.

## II. THE PROJECT

### A. Rationale

4. Nepal's national development priorities are poverty reduction and food security through economic growth. The importance of the agriculture sector is demonstrated by the fact that (i) about 80% of the population lives in rural areas and (ii) around 70% of that rural population is engaged in agriculture. Although agriculture's contribution to the gross domestic product has fallen from 72% in 1975 to 33% in 2008, most rural people continue to rely on agriculture, livestock, and forestry for their livelihoods. Higher economic growth in urban areas has reduced urban poverty incidence to 10%, compared with 35% for the rural population. Within the project regions' districts, poverty incidence exceeds 40%, and surveys of small farmers show that more than 65% of households are below the poverty line. As a consequence, men migrate for work, and agriculture and the rural communities are increasingly feminized. There is minimal investment by the private sector because of low returns, high business risks arising from conflict and political uncertainty, high logistic costs and cost of doing business.

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<sup>1</sup> The design and monitoring framework is in Appendix 1 and the list of linked documents is in Appendix 2.

<sup>2</sup> Defined as farmers with less than 1 hectare (ha) of land in the hills or less than 3 ha in the Terai.

<sup>3</sup> The project districts in the Mid-Western Development Region are: Banke, Bardiya, Dang, Dhailekh, and Surkhe. The project districts in the Far-Western Development Region are: Baitadi, Dadeldhura, Darchula, Doti, and Kailali.

<sup>4</sup> HVCs are agricultural crops and other non-livestock-based commodities, such as honey, that generate a higher rate of return to the farmer per hectare than the production of staple crops such as cereals.

<sup>5</sup> ADB. 2009. *Technical Assistance to Nepal for Preparing the Crop Diversification and Commercialization Project*. Manila. The title of the project changed during the implementation of the technical assistance.

5. Agricultural productivity in Nepal is low by international standards and in comparison with India. The low yields and the declining relative yields reflect underinvestment in inputs and innovation. Where yield advantages exist—for example, in HVCs such as vegetables, fruit, and spices—production growth occurs. Agriculture incomes are constrained by reliance on low-value, low-yield crops such as rice and wheat that are grown to offset food security risks (82% of the planted crop area). Farmers underinvest and employ low levels of technology on small fragmented plots of land, resulting in limited marketable output. Weak supply chains, limited access to credit, weak husbandry practices, poor infrastructure, underdeveloped market chains, and lack of services all contribute to low productivity, low incomes, and risk-averse decision making. Increasing climate change impacts from drought and high-intensity rain events will add risk to farm systems. Public sector agricultural services reach only 15% of farm households. Microfinance institutions withdrew services during the recent period of conflict, curbing household purchasing power and supply-chain development.

6. While trade with India has been growing at an annual rate of 16%, growth in agricultural trade is low owing to limited trade surplus and complex trade requirements, especially World Trade Organization regulations regarding border quarantine certification, traceability, and food standard certification. Trade with India is dominated by imports of HVCs, and farm inputs such as fertilizers and agricultural chemicals. Regarding fruit, domestic production directly substitutes for declining imports; whereas for vegetables and spices, both domestic production and imports continue to increase, reflecting growth in demand and off-season export opportunities. Annual domestic urban demand is estimated at 105,000 tons for fruit; 92,000 tons for vegetables; and 7,400 tons for spices. Annual export demand is estimated at 736,100 tons for fruit; 683,954 tons for vegetables; and 119,000 tons for spices.<sup>6</sup> While there is unsatisfied domestic demand, local production can create selling risks through oversupply and distressed sales, especially during peak production season.<sup>7</sup>

7. Significant opportunities in agriculture include (i) greater demand for HVCs as urban incomes increase; (ii) added demand for HVCs from continued growth in the tourism sector; and (iii) production and processing of high-value off-season products. Key market opportunities include substituting for the import of HVCs such as fruit and vegetables, and exporting to India and regional markets products with comparative advantage. Nepal is currently unable to meet World Trade Organization border compliance requirements that will limit the export of Nepal's agricultural products.<sup>8</sup>

8. Government policy aims to improve productivity in the agriculture sector as a driver for economic growth. The objectives of the National Agricultural Policy (2004) are (i) an increase in productivity, (ii) expansion of commercial agricultural production, and (iii) promotion of sustainable natural resource management. To achieve commercial agricultural objectives, the policy and its supporting agricultural perspective plan propose: (i) development of market-based, large-production pockets to achieve economies of scale in production and marketing; (ii) promotion of market-based, high-value commercial agricultural production along major highways and north–south road corridors; (iii) provision of incentives for educated youths to engage in agribusinesses; (iv) promotion of export-based organic farming; (v) protection of indigenous knowledge and technologies in agriculture; and (vi) promotion of cooperative farming and marketing of agricultural products.

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<sup>6</sup> Netherlands Development Organisation. 2010. *High Value Commodities and NTFPS in Western Nepal*. Kathmandu (report for the Ministry of Agriculture and Cooperatives).

<sup>7</sup> Some growers report distress sales of cabbage and cauliflower at prices as low as 1 Nepalese rupee per kilogram.

<sup>8</sup> The World Bank-financed project for Agricultural Commercialization and Trade, 2009–2015 includes support for the development of sanitary and phyto-sanitary facilities and food safety systems.

9. Sector objectives require commercially competitive agricultural production. The country partnership strategy<sup>9</sup> of the Asian Development Bank (ADB) identifies the agriculture and natural resource sector as a priority sector. The project, while complimenting on-going initiatives in the rural sector, including those in irrigation, rural infrastructure, commercial agriculture and rural finance,<sup>10</sup> will continue to facilitate diversification and commercialization of agriculture in regions with highest poverty levels in Nepal. And will contribute to enhanced food security and poverty reduction by supporting the transition of the rural poor and socially excluded groups from a largely subsistence economy to a commercial one.

10. The project design responds to key lessons accumulated in the sector, including greater coordination with other sectors, partnership with nongovernment organizations, catalyzing private sector investments, establishing strategic market linkages and institutionalizing impact evaluation processes. The design is also aligned with initiatives by other development partners supporting commercialization of agriculture. These include the World Bank-funded Agricultural Commercialization and Trade Project, and the International Fund for Agriculture Development-funded High Value Agriculture in Hill and Mountain Areas Project. Technical expertise supported by the Netherlands Development Organisation (SNV) and other rural initiatives with synergy potential are included in project awareness and training activities.

11. The project contributes to level 1 of ADB's results framework by boosting rural incomes, reducing poverty and increasing food security in Nepal (ADB targets 17.14% of the Asia-Pacific population living on less than \$1 per day by 2015); under the project, over 45,000 individuals will move above this threshold. ADB's level 2 country outcome performance targets are addressed by providing project grants to small and medium-sized enterprises, including farmer cooperatives; the project will support an estimated 220 enterprises and 890 farmer groups (ADB's target is to support 54,000 enterprise accounts). The project contributes to the level 3 operational targets through development of the private sector in the poorer parts of rural Nepal (ADB's target is for private sector involvement in 30% of projects) and gender mainstreaming (ADB's target is for gender mainstreaming in 40% of projects). The implementation modality builds strong partnerships with NGOs (ADB's target is for NGO inclusion in 80% of projects).

## **B. Impact and Outcome**

12. The project impact will be greater profitability of small and medium-sized farmers in 10 project districts. The outcome of the project will be increased production of HVCs by small and medium-sized farmers (footnote 1). By 2017, the 7,500 hectares (ha) of contracted HVC production will achieve an estimated annual output of 64,500 tons with a projected retail value of \$31.0 million; farm-gate value of \$13.5 million; and a gross margin to farmers of \$9.5 million per annum. Since HVC production falls into the domain of women, the project will increase women's cash income. The project is expected to benefit an estimated 18,700 farm households that would grow HVC crops on the average in 0.4 ha for existing farmers and 0.25 ha for the disadvantaged persons.<sup>11</sup>

<sup>9</sup> ADB. 2009. *Country Partnership Strategy: Nepal, 2010–2012*. Manila.

<sup>10</sup> Development Coordination (accessible from the list of linked documents in Appendix 2).

<sup>11</sup> Data presented in SNV, MOAC. 2009. *High Value Commodities and NTFPs in Western Nepal. Assessment of Value Chains in the Surjhet-Dailekh, Surkhet-Jajarkot and Surkhet-Jumla Road Corridor Districts*. Kathmandu (does not reflect additional value captured from post-harvest investment through reduced losses and value addition).

### C. Outputs

13. The project outputs will comprise: (i) establishing the agribusiness grant facility for building HVC value chains in the project regions to supply markets; (ii) formulating business plans for producing, and adding value to, HVCs in the two regions; and (iii) ensuring effective and efficient project management.

14. **Output 1: Establishing the agribusiness grant facility for building high-value commodity value chains to supply markets.** To achieve output 1, the project will establish a facility to provide grants to beneficiaries to invest in (i) postharvest facilities and support for farmer cooperatives; (ii) essential inputs for HVC production; and (iii) selected essential farm technology, including for climate change adaptation, all of which will benefit disadvantaged persons including indigenous peoples, and households headed by women that are involved in the production and marketing of HVCs. Grants will be given to successful applicants upon review by an independent advisory panel<sup>12</sup> and approval by the project director. The grant eligibility criteria and approval process are described in the project administration manual (PAM).<sup>13</sup> The provision of grants to beneficiaries is justified by the observed market failure in the agribusiness investments and the cost of doing business in the project regions: (i) high logistical costs, and (ii) political and business risks, including the costs of aggregating supply.

15. **Output 2: Business plans for producing, and adding value to, high-value commodities.** The project will (i) provide postharvest enterprises with HVCs and agribusiness training, supplier agreements, and support for formulating business plans; (ii) develop and disseminate agriculture market information; (iii) use market supply agreements, build integrated market chains linking buyers to farmer cooperatives, and cooperatives to farmer groups, with supporting production plans; (iv) open up access to on-farm services, technical support (including climate change adaptation), and production planning services to build capacity of small and medium farmers; (v) support HVC producers by strengthening the capacity of district agriculture development offices, community agricultural service centers, and agricultural resource centers to respond to the needs, constraints, and opportunities of disadvantaged persons, indigenous peoples, and women; and (vi) mobilize existing and new groups of disadvantaged farmers with predominantly female members.

16. **Output 3: Effective and efficient project management.** Output 3 will be achieved through project management and administration, and by ensuring the efficient and effective implementation of the project by the project management unit (PMU) in Nepalgunj and a liaison office in Kathmandu. The project will provide consulting services to support project management, technical backstopping for HVC value chain development and on-farm HVC production. Post-graduate training, HVC awareness programs, agricultural marketing fairs, adherence to ADB's Safeguard Policy Statement (2009), and monitoring will be undertaken.

### D. Investment and Financing Plans

17. The project is estimated to cost \$33.54 million (Table 1).

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<sup>12</sup> The independent advisory panel will include regional agricultural directors; a representative of the Agro Enterprise Center; technical specialists; and social and environmental safeguard staff from the project management unit.

<sup>13</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

**Table 1: Project Investment Plan (\$ million)**

<b>Item</b>	<b>Amount<sup>a</sup></b>
<b>A. Base Cost<sup>b</sup></b>	
1. Agribusiness grant facility	22.90
2. Securing HVC markets and supply	6.30
3. Effective project management	3.30
<b>Subtotal (A)</b>	<b>32.50</b>
<b>B. Contingencies<sup>c</sup></b>	<b>1.04</b>
<b>Total (A+B)</b>	<b>33.54</b>

HVC = high-value commodity.

<sup>a</sup> Includes taxes and duties of \$4.38 million to be financed by the government.

<sup>b</sup> In mid-2010 prices.

<sup>c</sup> Physical contingencies computed at 5% for all vehicles, equipment, and consulting services (except international, for which there is no contingency figure) and at 10% for delivery of advisory services, awareness campaigns, training and workshops, surveys and studies, and project management costs. No contingency is applied to the matching grant fund.

Source: Asian Development Bank estimates.

18. The government has requested a grant not exceeding \$20.10 million from ADB's Special Funds resources to help finance the project. The financing plan is summarized in Table 2. ADB will finance 60% of the total costs, including contingencies. The government will provide \$5.33 million equivalent to 16% of the project cost, including PMU staff salaries and taxes. Beneficiary contributions of \$7.62 million include contributions to investments and increasing payments for services established under the project. SNV will finance the agribusiness and value-chain backstopping package with parallel grant financing for 50% of the direct costs of professional staff, with the ADB grant providing the remainder. The PMU will contract SNV according to the terms of reference at a price that is equivalent to the agreed cost less the discount being offered by SNV. To determine the contract's value, the executing agency will discount the firm's representations regarding cost to the extent that the parallel grant financing is fully offset. Provision of the services by SNV will not be conditional upon its parallel financing its part of the project. SNV payments will be based on contract milestones that add up to the discounted price.

**Table 2: Project Financing Plan (\$ million)**

<b>Source</b>	<b>Amount (\$ million)<sup>b</sup></b>	<b>Share of Total<sup>a</sup> (%)</b>
Asian Development Bank	20.10	60.00
SNV	0.49	1.00
Beneficiaries	7.62	23.00
Government	5.33	16.00
<b>Total</b>	<b>33.54</b>	<b>100.00</b>

SNV = Netherlands Development Organisation.

<sup>a</sup> Includes taxes and duties of \$4.38 million to be financed by the government.

<sup>b</sup> In mid-2010 prices.

Source: Asian Development Bank estimates.

## **E. Implementation Arrangements**

19. The Ministry of Agriculture and Cooperatives (MOAC) will be the executing agency. The Department of Agriculture, the Agro Enterprise Center (AEC), which is the agricultural wing of the Federation of Nepalese Chambers of Commerce and Industry, and the Nepal Rastra Bank (NRB) will be the implementing agencies responsible for project management and coordination of implementation. MOAC will establish a steering committee, a project liaison office in

Kathmandu, and a PMU in Nepalgunj. MOAC shall open a first-generation project management imprest account and an agribusiness grant facility imprest account with NRB in Kathmandu. Two local-currency second-generation imprest accounts will be opened with NRB in Nepalgunj for project management costs and agribusiness grant facility. The imprest accounts, in aggregate, will be eligible for an advance of up to 6 months' forecast disbursement or 10% of the total grant, whichever is lower.<sup>14</sup>

**Table 3: Implementation Arrangements**

Aspects	Arrangements
Implementation period	January 2011–December 2017
Estimated closing date	30 June 2018
Management	
(i) Oversight body	Project steering committee: secretary, MOAC (chairperson); joint secretary (planning), MOAC; director general, DOA; representatives of DFTQC; DOC; FNCCI; SNV, MOF; NPC; and project director, PMU; executive director, NARC.
(ii) Executing agency	MOAC
(iii) Implementing agencies	DOA, AEC, NRB
(iv) Implementation unit	PMU in Nepalgunj, 26 staff proposed
Procurement	Agribusiness grant
	Total
	Direct contracting
	NCB
	Shopping
Consulting services	SSS–SNV
	QBS
Advance action	Consulting services and national service providers
Disbursement	The grant proceeds will be disbursed in accordance with ADB's <i>Loan Disbursement Handbook</i> (2007, as amended from time to time) and detailed arrangements agreed upon between the government and ADB.

ADB = Asian Development Bank, AEC = Agro Enterprise Center, DFTQC = Department of Food Technology and Quality Control, DOA = Department of Agriculture, DOC = Department of Cooperatives, FNCCI = Federation of Nepalese Chambers of Commerce and Industry, MOAC = Ministry of Agriculture and Cooperatives, MOF = Ministry of Finance, NARC = Nepal Agricultural Research Council, NCB = national competitive bidding, NPC = National Planning Commission, PMU = project management unit, QBS = quality-based selection, SNV = Netherlands Development Organisation, SSS = single-source selection.

Sources: Asian Development Bank estimates and ADB. 2009. *Technical Assistance to Nepal for Crop Diversification and Commercialization Project*. Manila.

## 1. Output 1: High-Value Commodity Value Chains to Supply Markets

20. Grants will be provided to enterprises and producers with market supply agreements that are signed between buyers and producer cooperatives or farmer groups based on business and production plan applications. Applications will be reviewed by the independent advisory panel that will advise the PMU of eligibility. The PMU shall prepare guidelines for the submission of grant applications, including monthly deadlines and timelines for panel meeting dates. Grant eligibility criteria are provided in the PAM. Once an application is approved, the applicant will enter into a contract with NRB and DOA pursuant to which funds will be disbursed to the applicant. Applicants will procure according to commercial practices and provide procurement documentation to the PMU for review. Upon proof of eligibility, the PMU will instruct the NRB to advance funds in installments to the beneficiary's bank account. Should the advisory panel findings be disregarded, the project director must obtain ADB's prior approval before any contract or disbursement is undertaken. For all grants over \$100,000 the project director must

<sup>14</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

obtain ADB's prior approval. The PMU will aim for beneficiaries to receive the first installment of advance from NRB within 30 days of approval by the advisory panel and upon submission of the purchase order. The balance funds will be released to the beneficiary bank account upon submission of the sales invoice and liquidation of the earlier advance. Funds used for ineligible expenditures must be immediately refunded to ADB. A performance target is set that 90% of successful applications will receive disbursements within 30 days of approval. ADB, in consultation with the government, reserves the right to reassign fund management if performance targets are not achieved on a quarterly basis.<sup>15</sup> ADB also reserves the right to review all documentation related to the agribusiness grant facility.

## **2. Output 2: Business Plans for Producing, and Adding Value to, High-Value Commodities in the Project Regions**

21. Activities for output 2 will be implemented by AEC and service providers contracted for HVC supply. AEC will also implement the securing of markets. AEC's role provides (i) access to the 700 members of the Federation of Nepalese Chambers of Commerce and Industry, which include domestic agribusiness enterprises, (ii) local presence in the two regions and 10 project districts, which will be strengthened and sustained beyond the project, and (iii) access to agribusiness capacity-building products that the AEC can supply to project beneficiaries. AEC will implement market-linking programs, HVC market network promotion, and the development of knowledge products. AEC will support the PMU in procuring training services for postharvest enterprises, and other related tasks such as service provider prequalification procedure, and reviewing local service provider business plans and grant applications. AEC will expand its agricultural market information system to the project districts. Office facilities and equipment will be procured through shopping while staff costs will be considered implementation costs.

22. To secure supply from farmer groups with market agreements, the PMU will contract a national service provider through the quality- and cost-based selection procedures for technical support, overall quality control, and supervision of local service providers. The national service provider will develop training programs, apply quality control to local service providers, and ensure training for and awareness of the project grant eligibility and application process. At the district level, the PMU will contract local NGO services. These service providers will deliver social mobilization, HVC awareness and training programs, and planning assistance that enables farmer groups to access project grants for inputs to HVC production. The project, through separate NGO contracts, will set up as many as 90 farmer groups among disadvantaged persons. These contracts include provision for mobilization, access to project training and project grants, and the leasing of land for 1.5 years (three crop seasons) to groups of landless farmers.

### **III. DUE DILIGENCE**

#### **A. Economic and Financial**

23. The project benefits will (i) boost incomes of small and medium farmers from HVC production and increase cropping intensity by 16%; (ii) provide additional employment—on-farm hired labor will increase by about 6,180 jobs per year;<sup>16</sup> postharvest employment is estimated to be about 4,130 jobs per year, of which about 1,830 are unskilled; and (iii) strengthen capacity of rural enterprises and farmer cooperatives through value addition within HVC value chains.

<sup>15</sup> This requirement reflects sector experience with delays of such disbursements and also highlights the critical nature of timely availability of inputs for HVCs, which have short growing seasons defined by market opportunities and/or climatic conditions.

<sup>16</sup> One full-time equivalent is assumed to be 200 paid days per year.

Project beneficiaries will be an estimated 18,700 producers of HVCs (Economic and Financial Analysis, Appendix 2).

24. Farmers diversifying into HVC production will have higher incomes. Small-farmer incomes per household are estimated to rise by NRs5,380 in the Terai (an increase of 17%) and by NRs8,780 in the hills (a 68% increase). Medium-sized farm incomes per household are estimated to increase by NRs22,130 in the Terai and by NRs34,690 in the hills—to three times their current levels. A sample of potential value chain investments was assessed in financial and economic analysis, and all are deemed financially and economically viable. The financial internal rates of return range from 12% to 30% compared with an estimated weighted average cost of capital of 4.7%.<sup>17</sup> The economic internal rates of return range from 14% to 30%, averaging 23% for the indicative postharvest investments. Inclusion of farmer output benefits, and project implementation and management costs results in a project economic internal rate of return of 21%.

## **B. Governance**

25. MOAC has experience in implementing ADB and donor programs. Project measures to enhance governance and prevent corruption during implementation include (i) establishment of transparent procedures for financial transactions; (ii) the use of private providers to undertake due diligence during business planning and the review of this by the national service providers; (iii) the inspection of a sample of project grants for the first 2 years by staff from district agriculture development offices; (iv) the review of grant proposals by the independent advisory panel, with prior ADB approval for grants of more than \$100,000; (v) stakeholders' annual progress evaluations; and (vi) the PMU's reporting of all project activities and related financial statements to the public on its website.<sup>18</sup>

26. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and MOAC. The specific policy requirements and supplementary measures are described in the PAM.<sup>19</sup>

## **C. Poverty, Social, and Gender**

27. The project supports the agriculture sector and ties in with Nepal's poverty reduction strategy by contributing to poverty alleviation. The project is estimated to benefit 18,700 farm households in the project regions, which have the highest incidence of poverty in the country.<sup>20</sup> The headcount measure of poverty incidence is 45% in the Mid-Western Development Region and 41% in the Far-Western Development Region, compared with a national average of 31%. The project promotes the inclusion of women and disadvantaged persons, such as marginalized and small indigenous farmers, to ensure benefits deliver inclusive growth. The majority of farm households (65%) in the project regions have food deficits, and an estimated 1 in 3 households is rated as food insecure.<sup>21</sup> A poverty reduction and social strategy, a gender equity and social inclusion (GESI) plan, and an indigenous peoples assessment and measures have been

<sup>17</sup> Postharvest indicative investments include multi-commodity on-farm storage, collection, cool storage, and commodity-specific processing.

<sup>18</sup> Nepal Post-Conflict Sensitive Approach: A Peace Building Tool (Peace Filter) for Project Design and Implementation (Appendix 2).

<sup>19</sup> Project Administration Manual (Appendix 2).

<sup>20</sup> The data used in this paragraph is taken from Central Bureau of Statistics. 2004. *Nepal Living Standards Survey (NLSS), 2003–2004*. Kathmandu.

<sup>21</sup> ADB. 2010. *Socio-economic and Gender Analysis Report*, Consolidated and Management Services Nepal (P) Ltd.

prepared.<sup>22</sup> The GESI plan for the project has three themes: (i) mainstreaming of gender empowerment in recognition of women's prevalence in agricultural work and of the potential for HVC production, processing, and marketing to further reduce the gender gaps; (ii) a program to include disadvantaged persons, such as help to access services, capital, and land; and (iii) capacity building of project stakeholders to understand the differing needs, constraints, and opportunities of indigenous peoples and disadvantaged persons, and the gender impacts.

#### D. Safeguards

28. An environmental and social management system (ESMS) for the project has been prepared, and the disaster and climate change risk screen applied.<sup>23</sup> The project is classified as category FI. Screening procedures have been established under the ESMS to ensure that all subprojects financed under the project meet ADB requirements specified in Safeguard Requirements 1-3. The eligibility for project grant funds excludes investments that fall under environment category A. Possible adverse impacts of project activities are expected to be reversible, site-specific, and small in magnitude. The PMU, AEC, and the national on-farm service provider will be responsible for the ESMS, implementing the grievance redress mechanism, implementing the monitoring plan, and reporting progress to MOAC and ADB.

29. The gender strategy, articulated in the GESI plan, also includes a strategy for social inclusion of indigenous peoples and disadvantaged persons. The social impacts are expected to be positive, especially regarding participation by women, disadvantaged persons, and indigenous peoples, and their access to project opportunities and benefits. The previous Crop Diversification Project demonstrated the benefits for women and disadvantaged persons of introducing HVCs, and it is envisaged that 75% or more of farmer group members will be female. The project will provide specifically designed programs to work with disadvantaged persons and indigenous peoples to ensure their opportunity to benefit is achieved. The project is unlikely to trigger any involuntary resettlement safeguards. However, as subprojects are not known at this stage and are stakeholder driven, a resettlement framework has been included in the ESMS<sup>24</sup> which outlines the triggers for, and indicative content of, a resettlement plan, in case one is needed. Two full-time positions are included in the PMU for applying social safeguards.

#### E. Risk and Mitigating Measures

30. Risks and mitigating measures developed in the risk assessment and risk management plan are summarized in Table 4.<sup>25</sup>

**Table 4: Summary of Main Risks and Risk Mitigation Measures**

Risks	Mitigating Measures
Inadequate attention to effective project management may adversely impact implementation	Project implementation will use service providers, including AEC, with technical backstopping from SNV and NGO service providers to offset human resource weakness and reduce risk of inadequate government funding sources.

<sup>22</sup> Summary Poverty Reduction and Social Strategy, Gender and Social Inclusion Plan, and Environmental and Social Management System Arrangement (Appendix 2).

<sup>23</sup> Environmental and Social Management Arrangement, and Disaster and Climate Change Risk Screening Results (accessible from the list of linked documents in Appendix 2).

<sup>24</sup> No resettlement is envisaged under the project. However, the resettlement framework was prepared in case there are any investments that will require relocation of assets.

<sup>25</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Risks	Mitigating Measures
Corruption and misuse of funds	Release of funds upon evidence of eligibility of procured goods, submission of purchase order(s), sales invoice(s) and receipt(s) of payment as evidence(s) of transaction settlement, required disclosure through project website, and awareness programs.
Delayed implementation and weak monitoring of project activities	Project director will be appointed before grant negotiations and consultant selection process will be completed before grant effectiveness. PMU will operate and integrate MIS and M&E program
Inadequate procurement integrity	Provision of procurement expertise, independent monitoring by service providers, public and project awareness campaigns; project director to review conflict of interest in all project contracting.
Key risks associated with HVCs: market risks and production risks	(i) Supply agreements before HVC investment; (ii) use of grant funds to offset the financial risk to small farmers who diversify; (iii) technical support to farmers through cooperatives; (iv) grant funds to reduce the risks of adopting new technology; and (v) strengthening of farmer cooperatives to build supply chains.

AEC = Agro Enterprise Center, HVC = high-value commodity, M&E = monitoring and evaluation, MIS = management information system, NGO = nongovernment organization, PMU = project monitoring unit, SNV = Netherlands Development Organisation.

Source: Asian Development Bank.

#### **IV. ASSURANCES AND CONDITIONS**

31. The government and MOAC have assured ADB that implementation of the project shall conform to all applicable ADB policies including those concerning anticorruption, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM.

32. The government and MOAC have agreed with ADB on certain covenants for the project, which are set forth in the grant and project agreements.

33. Effectiveness of the grant will be subject to execution of (i) the administration agreement between MOAC and NRB, and (ii) the subsidiary grant agreement between the government and AEC .

34. Disbursement of the grant will be subject to ADB's approval of the template agribusiness grant agreement between the DOA, NRB and the beneficiary.

#### **V. RECOMMENDATION**

35. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$20,100,000 to Nepal from ADB's Special Funds resources for the Raising Incomes of Small and Medium Farmers Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant and project agreements presented to the Board.

Haruhiko Kuroda  
President

2 November 2010

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p><b>Impact</b> Increased profitability of small and medium farmers in 10 project districts.</p>	<p>Value added for HVCs produced in project districts increased by 15% by 2020</p> <p>By 2017 farm incomes of small and medium farmers increased by at least 20% in real terms over 2011 baseline</p>	<p>Government statistics on agricultural production, productivity, and household incomes</p> <p>Central Bureau of Statistics surveys on: (i) Nepal living standards, and (ii) poverty trends in Nepal</p>	<p><b>Assumption</b> The government's budget continues to support agriculture and improve rural infrastructure.</p> <p><b>Risk</b> Negative impact of climate change</p>
<p><b>Outcome</b> Increased production of HVCs by small and medium farmers</p>	<p>By 2017, small and medium-sized farmers with 7,500 ha of supply agreements have increased their returns from HVCs by 30%.</p> <p>By 2017, at least 200 HVC enterprise grants and 30 farmer cooperatives with HVC supply contracts and grower agreements with farmer groups</p> <p>Proportion of women's cash income contributing to family welfare increased by 60% from 2011 levels.</p>	<p>DADO annual monitoring reports for farmer group and post-harvest investment</p>	<p><b>Assumption</b> Market agreements are respected.</p> <p><b>Risk</b> Supply default by producers results in either loss of supply agreement or markets.</p>
<p><b>Outputs</b></p> <p>1. HVC value chains in the Mid-Western Development Region and the Far-Western Development Region are supplying markets</p> <p>1.1 Postharvest enterprises are adding value to HVC production</p> <p>1.2 Small and medium farmers producing HVCs are meeting supply agreements</p> <p>2. Business plans for producing and adding value to HVCs in the project regions.</p>	<p>By 2017, HVC value chain grants disbursed</p> <p>By 2017, at least 200 postharvest grants awarded for value adding (including 10 medium-sized enterprises and 10 new women-owned enterprises)</p> <p>40 farmer cooperatives with business plans providing input supply chains to HVC farmer group members by 2013</p> <p>800 farmer groups with 16,800 members producing HVCs profitably by 2016</p> <p>90 disadvantaged persons, indigenous peoples, women-headed households groups with 1,900 members producing HVCs with market links by 2016.</p> <p>By 2017, supply agreements for 800 existing farmer groups and 90 new groups of disadvantaged persons and indigenous peoples, covering a</p>	<p>Agribusiness fund disbursement records</p> <p>Value chain monitoring and impact assessment reports</p> <p>Baseline, midterm, and completion enterprise monitoring surveys</p> <p>Production Pocket Area socioeconomic profile submitted with application for project support</p> <p>Baseline, midterm, and completion farmer monitoring surveys</p> <p>Project monitoring and impact surveys for farmers and HVC enterprises</p>	<p><b>Assumption</b> Farmer cooperatives will be efficient actors in value chains.</p> <p><b>Risk</b> Input supplies are inferior and not available in a timely manner.</p> <p>Private sector will utilize supply agreements.</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
2.1 HVCs markets identified, value chain market information systems developed, and postharvest investment proposals assessed	<p>minimum of 7,500 ha</p> <p>By 2015, postharvest service providers producing at least 70 business plans and investment proposals for postharvest grants</p> <p>By 2016, at least 40 farmer-owned cooperatives with effective financial systems and governance rules</p> <p>By 2017, 30 postharvest entities using alternative energy sources</p> <p>By 2012, 15 new AMIS centers established and self-financing by 2016</p>	<p>National service provider quarterly reports</p> <p>DADO monitoring reports and annual monitoring and evaluation reports</p>	
2.2 Farmer groups with market supply agreements, HVC production plans, and HVC production and farm technology investment proposals	<p>By 2014, 10 DADO offices, 10 CASCs and 3 ARCs strengthened</p> <p>Participating farmer groups will have at least 75% female membership (baseline of 49%).</p> <p>By 2015, 890 farmer groups with HVCs supply agreements; and at least 40 agricultural cooperatives supplying farmer groups using project funds</p> <p>Participating farm cooperatives will have at least 40% women in decision making roles.</p>	<p>DADO reports</p> <p>AEC contract performance reports</p> <p>IAP document register</p> <p>Farmer monitoring surveys – baseline, midterm, and completion</p>	
2.3 Grant disbursement – impact and governance assessed	<p>Disbursements by PMU within 30 days for 95% of approved applications</p>	<p>IAP document register and service provider reports</p>	
3. Effective project management	<p>PMU and PIU staffed and lead ASP contracts (AEC, 2 NGOs) by month 6</p> <p>Project monitoring with sex, caste, and ethnicity disaggregated data by December 2011</p>	<p>Contract documents</p> <p>IAP formation and meeting notes</p> <p>Monitoring survey results</p>	

<b>Activities with Milestones</b>		<b>Inputs</b>	
1.0	Establish agribusiness promotion grant imprest account.	<b>Total Project Cost: \$33.54 million</b>	
1.1	Appoint IAP for grant awards – define operational procedures.	<b>Item</b>	<b>Amount (\$million)</b>
1.2	Disburse grants approved by IAP for cooperative strengthening, postharvest investment, farm input grants, and farm technology.	Credit Line	22.95
1.3	Mobilize technical service providers as required.	Vehicle	0.39
2.0	Prequalify postharvest service providers, and national and local on-farm service providers through AEC.	Equipment	0.39
2.1	Implement awareness and market networking programs.	Consultants	2.01
2.2	Implement a market-linking program in two regions and develop supply agreement, identify farmer cooperatives, develop business plans and grant applications.	Services/studies	1.18
2.3	Design and implement the AMIS program.	Training	1.50
2.4	Design and implement post-harvest training programs.	NGO contract	3.20
2.5	Upgrade DADO, CASC, and ARCs; on-farm service providers contracted.	Project Management	0.88
2.6	Contract on-farm service providers, farmer group awareness raising, and market-linking program with training, production planning, and grant applications.	Contingencies	1.04
2.7	Mobilize new farmer groups and support training and grant applications.	<b>Financing</b>	<b>Amount (\$million)</b>
2.8	DADO-trained and implementing monitoring and impact assessment programs	ADB	20.10 (equivalent 60%)
3.0	Establish and implement project management arrangements, including structure and procedures, and staff recruitment.	Government of Nepal	5.33 (equivalent 16%)
3.1	Select and train ASPs in HVC production, postharvest handling and marketing, and awareness of gender, indigenous peoples, and climate change issues.	Beneficiaries	7.61 (equivalent 23%)
3.2	Conduct overall project promotion and awareness campaign, including study tours.	SNV	0.49 (equivalent 1%)
3.3	Establish and operate PPMS.		
3.4	Procure and operate vehicles and equipment.		
3.5	Prepare and submit project accounts and progress reports.		

ADB = Asian Development Bank, AEC = Agricultural Enterprise Corporation, AMIS = agriculture marketing information system, ARC = Agriculture Resource Center, ASP = agricultural service provider, CASC = community agriculture service center, DADO = district agriculture development office, ha = hectare, HVC = high-value commodity, IAP = independent advisory panel, NGO = nongovernment organization, PIU = project implementation unit, PMU = project management unit, PPMS = project performance monitoring system, SNV = Netherlands Development Organisation.

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=38423-02-2>

1. Grant Agreement
2. Project Agreement: Nepal Rastra Bank
3. Project Agreement: Agro Enterprise Center
4. Sector Assessment (Summary): Agriculture and Natural Resources
5. Project Administration Manual
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Economic and Financial Analysis
9. Country Economic Indicators
10. Summary Poverty Reduction and Social Strategy
11. Environmental and Social Management System
12. Gender Equity and Social Inclusion Plan
13. Risk Assessment and Risk Management Plan

### **Supplementary Documents**

14. Disaster and Climate Change Risk Screening Results
15. Nepal Post-Conflict Sensitive Approach: A Peace Building Tool (Peace Filter) for Project Design and Implementation