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Effectiveness of Participatory Approaches:

Do the New Approaches Offer an Effective Solution to the
Conventional Problems in Rural Development Projects?

December 2004

ABBREVIATIONS

ADB	–	Asian Development Bank
ADTA	–	advisory technical assistance
ARB	–	agrarian reform beneficiary
ARC	–	agrarian reform community
ARCP	–	Agrarian Reform Communities Project
BNRMP	–	barangay natural resources management plan
CARP	–	Comprehensive Agrarian Reform Program
CBD	–	community-based development
CBO	–	community-based organization
CDD	–	community-driven development
CHARM	–	Cordillera Highland Agricultural Resources Management Project
CPMO	–	county project management office
CU	–	credit union
DAR	–	Department of Agrarian Reform
DDC	–	Dairy Development Corporation
DLS	–	Department of Livestock Services
DLSO	–	district office of Department of Livestock Services
DPWH	–	Department of Public Works and Highways
EA	–	executing agency
FC	–	Financial Company for Support and Development of Credit Union
FINCA	–	Foundation for International Community Assistance
GTZ	–	German Technical Cooperation
IA	–	Irrigators' Association
IFAD	–	International Fund for Agricultural Development
KFAC	–	Kyrgyzstan Agricultural Financial Corporation
LAT	–	livestock action team
LGED	–	Local Government Engineering Department
NGO	–	nongovernment organization
NIA	–	National Irrigation Administration
NRB	–	Nepal Rastra Bank (the central bank in Nepal)
O&M	–	operation and maintenance
OEM	–	Operations Evaluation Mission
PCR	–	project completion report
PFI	–	participating financial institution
PMO	–	Project Management Office
PMSS	–	Pokhara Milk Supply Scheme
PPMO	–	Provincial Project Management Office

Director, Operations Evaluation Division 1
Evaluation Team Leader

: Graham Walter
: Qiaolun Ye

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PPTA	–	project preparatory technical assistance
PO	–	people’s organization
PRC	–	People’s Republic of China
RRP	–	report and recommendation of the President
SES	–	special evaluation study
TA	–	technical assistance
UNDP	–	United Nations Development Programme
VAHW	–	village animal health worker
WDR	–	World Development Report
WMCA	–	water management cooperative association
WSUA	–	water and sanitation users’ association

WEIGHTS AND MEASURES

cm	–	centimeter
GWh	–	gigawatt-hour
ha	–	hectare
km	–	kilometer
m	–	meter
MW	–	megawatt
t	–	metric ton

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Qiaolun Ye, senior evaluation specialist (team leader), was responsible for the preparation of this report and for the conduct of the Operations Evaluation Mission in the Philippines, People's Republic of China (PRC), Bangladesh, Nepal, and Kyrgyz Republic. Thomas W. Dichter, international consultant, participated in fieldwork in the Philippines, PRC, and Kyrgyz Republic. Octavio Damiani, international consultant, participated in fieldwork in Bangladesh and Nepal. R. Keith Leonard, principal evaluation specialist, and Njoman Bestari, senior evaluation specialist, functioned as peer reviewers and provided valuable advice from beginning till end. Olive P. Nuestro, evaluation officer, supported the study with research assistance in Manila.

In accordance with the guidelines formally adopted by the Operations Evaluation Department (OED) on avoiding conflict of interest in its independent evaluations, the Director General of OED did not review the case study in the People's Republic of China and delegated approval of this evaluation to the Director of Operations Evaluation Division 1. To the knowledge of the management of OED, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.

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EXECUTIVE SUMMARY

A framework for mainstreaming participatory development processes into Asian Development Bank (ADB) operations was introduced in 1996. It was prepared in response to recommendations in the Report of the Task Force on Improving Project Quality, which emphasized the need for ADB to do more to enhance the sense of ownership among beneficiaries and developing member country governments for projects that are supported by ADB, and for greater beneficiary participation in all aspects of the project cycle. This special evaluation study (SES) was initiated in view of the consequent proliferation of participatory approaches in the new generation of rural development projects and the widely reported poor performance of earlier rural development projects using top-down and supply-driven approaches.

The problems in earlier projects (referred to as “conventional problems” in this report) include, in particular, less relevant project interventions and poor project sustainability. Considering the top-down and supply-driven approach as the cause of these conventional problems, a new set of participatory or bottom-up approaches has emerged as a solution. In rural development projects financed by ADB, bottom-up approaches include (i) beneficiary consultation and participatory planning, (ii) community development support, (iii) engagement of nongovernment organizations (NGOs), (iv) local government involvement, and (v) private sector participation. In view of the rapid scaling up of the new approaches, there is a need to provide early feedback on their performance as well as lessons learned.

The SES sought to find out if the new approaches offer an effective solution to the conventional problems. The SES applies a “principal-agent” model, which focuses on the issue of how a principal designs incentive measures for his/her agent so that the agent’s best interests, given those incentives, lead to a desirable outcome for the principal. This model has been used in analyzing incentive structures in public services. The effectiveness of services depends on relationships among three major players—policymakers, service providers, and beneficiaries. Citizens as a whole (the public) are the principal, represented by elected governments, which are therefore the proxy principal. Citizens influence governments through voice and elections, and governments influence service providers, which act as the agents for policymakers in governments.

In rural development projects financed by ADB, ADB and national governments act as the proxy principal, designing projects, determining implementation policies, and controlling providers—executing agencies and frontline providers, who are the agents. Using this model as a conceptual framework, the SES examines the roles of the major players in five central elements of rural development projects—resources, information, decision making, delivery mechanisms, and accountability. The SES selected six rural development projects as cases to examine in detail how the roles and relationships of the players have changed in the new generation of projects using participatory approaches.

Findings from the case studies show that the actual application of the participatory approaches varied significantly across the six projects examined—some of them spent substantial resources and long periods on beneficiary consultation and participatory planning. There was evidence that the participatory approaches improved information flows and created new delivery mechanisms. However in the case of intensive consultation, there was no evidence that the increased participation empowered beneficiaries in resource control and decision making, nor did it give them authority to hold providers accountable, enhance their ownership, or motivate them to take care of project facilities that were formally transferred to

them. In particular, inadequate maintenance of project facilities (such as rural roads and irrigation systems) remained widespread, leading to poor sustainability of project benefits.

The SES identifies a set of issues from the cases studied, including beneficiary ownership and project sustainability, downward accountability of providers to beneficiaries, the real value of beneficiary consultation and participatory planning, poverty reduction through the efforts of the nonpoor, the need for contextualized project design instead of following a standard model, the need to simplify monitoring and data requirements, and the critical importance of thorough fieldwork at the project design stage. Factors underlying these issues are investigated, leading to suggestions for better alternatives.

The SES provides a number of insights. First, the participatory or bottom-up approaches examined did not offer an effective solution to problems encountered in earlier projects, because they did not alter the principal-agent relationships among policymakers, project providers, and beneficiaries. While citizens as a whole were the principal, beneficiaries—individually or as groups—did not have the authority as the principal to hold providers accountable in the provision of services via policymakers. Providers were the agents working for policymakers and therefore responded to policymakers instead of to beneficiaries.

Second, the conventional problems—especially less relevant project interventions and poor project sustainability—were persistent, prevailing in not only the earlier projects but also the new projects examined. A deeply-seated institutional cause of the problems seemed to be intrinsic in the nature of the grant financing of the projects, which were largely free to beneficiaries, whose lack of payments to providers underlay their lack of real power to control providers.

Third, of the five central elements of service delivery—resources, information, decision making, delivery mechanisms, and accountability—control of resources was the most critical, determining the power in decision making and the authority as the principal to hold providers as the agents. In a competitive market, clients individually act as the principal to hold providers accountable, because they control payments to providers. In the projects examined, project funds were controlled by policymakers. Beneficiaries controlled few resources and therefore had little power in decision making and in controlling providers.

Fourth, information flow and delivery mechanisms seemed to be less important, although information was powerful under certain conditions, such as when beneficiaries had multiple choices of providers. Some of the participatory approaches (such as beneficiary consultation, participatory planning, engagement of NGOs, formation of beneficiary groups, and beneficiary training) focused on information flow or delivery mechanisms instead of the key issue of resource control, and achieved more rhetoric than real results.

It was not the application of a standard package of participatory approaches that made project interventions more relevant or sustainable. Rather, the design of the interventions needs to be based on a thorough understanding of local realities in project areas. Instead of requiring a uniform application of participation, ADB should ensure thorough fieldwork is conducted at the project design stage, encourage the design of local solutions for local problems based on local realities, and reward project staff based on the quality of project design rather than on lending approvals. Sufficient time and resources must be provided for not only consultants but also ADB staff to conduct thorough fieldwork at the grassroots level. The 1996 Staff Instruction on mainstreaming participatory processes into ADB operations needs revisiting.

Since participation is not a goal in itself but a means to achieve an objective, the use of participation should have a clear purpose. The form of participation may vary depending on that purpose, as well as on local conditions in particular project areas. The practice of applying a standard package of participation in all rural development projects without a clear purpose—by hiring NGOs, organizing beneficiary groups, conducting consultation workshops, providing training courses, and developing village plans—is not necessarily worthwhile, and automatic application should be discontinued.

Depending on specific conditions, alternative forms of participation may be explored, such as those focusing on the establishment and strengthening of direct relationships between beneficiaries and providers by making providers more accountable to beneficiaries. In cases where the direct approach is not practical, appropriate incentives should be designed for policymakers and providers so that their best interests, given the incentives, lie in achieving the objectives of the public. The SES proposes alternative measures, with a view to encouraging innovation and discussion of these. The need for pilot testing of such measures is highlighted, and this should be followed by an evaluation of the pilot testing before more widespread application.

Graham M. Walter
Director, OED1
Operations Evaluation Department

I. INTRODUCTION

A. Rationale of the Study

1. A framework for mainstreaming participatory development processes into Asian Development Bank (ADB) operations was introduced in 1996.¹ It was prepared in response to recommendations in the Report of the Task Force on Improving Project Quality,² which emphasized the need for ADB to do more to enhance the sense of ownership among beneficiaries and developing member country governments for projects that are supported by ADB, and for greater beneficiary participation in all aspects of the project cycle. This special evaluation study (SES) was initiated in view of the consequent proliferation of participatory approaches in a new generation of rural development projects and the widely reported poor performance of conventional rural development projects using top-down and supply-driven approaches. As reported in Appendix 1, the problems in earlier projects (called “the conventional problems” in this report for convenience, without implying that they no longer exist) have been well documented by postevaluation studies conducted by ADB. The conventional problems include (i) less relevant project interventions due to standardized solutions not being suited to local problems at different subproject³ sites; (ii) poor project sustainability due to beneficiaries’ lack of ownership; (iii) project staffs’ lack of incentives to improve services or reduce costs, leading to inefficiencies such as overdesign and poor construction of rural infrastructure; and (iv) insignificant impact on poverty reduction even when projects are located in poor regions, due largely to the capture of most of the project benefits by a few influential or connected people. Since most of Asia’s 700 million poor live in rural areas, it is essential for ADB to find more effective and efficient ways to support rural development. Improving the performance of rural development projects is essential to achieve ADB’s vision of an Asia-Pacific region that is free of poverty.

2. Various participatory or bottom-up approaches have been developed and applied worldwide in response to the perception that top-down and supply-driven approaches are the cause of the problems. In rural development projects financed by ADB, the new approaches include (i) beneficiary consultation and participatory planning; (ii) community development support; (iii) engagement of nongovernment organizations (NGOs); (iv) local government involvement; and (v) private sector participation, defined in this report as the use of private individuals, enterprises, or financial institutions to achieve project objectives. For convenience, these approaches are called “participatory approaches” in this report, a broader meaning than beneficiary participation.

3. With the exception of beneficiary participation and NGO engagement, which have been the subject of several evaluations,⁴ there has so far been no evaluation by ADB of the performance of these new or bottom-up approaches. Most of the projects that use such approaches are still ongoing; postevaluations are not conducted until 3 years after project completion.

¹ Staff Instruction from the President, 4 December 1996.

² ADB. 1994. *Report of the Task Force on Improving Project Quality*. Manila.

³ In this report, a subproject refers to a specific project activity at a specific project site.

⁴ ADB. 2003. *Special Evaluation Study on Participatory Approaches in Forest and Water Resource Operations in Selected Developing Member Countries*. Manila; ADB. 2000. *Special Evaluation Study on Participatory Development Processes in Selected Asian Development Bank Projects in Agriculture, Natural Resources, and Social Infrastructure Sectors*. Manila; ADB. 1999. *Special Evaluation Study on the Role of Nongovernment Organizations and Community-Based Organizations in Asian Development Bank Projects*. Manila.

4. In view of the rising interest in bottom-up approaches by project staff at ADB and the development community at large, and the rapid replication of beneficiary participation in almost all rural development projects, there is a need to provide early feedback on the performance of these approaches, including an assessment of initial results and effectiveness in overcoming the conventional problems.

5. The remaining sections of Chapter I present findings from the literature review, provide a conceptual framework, and discuss the objective and scope of the SES and the evaluation methodology, including core questions to be addressed. Chapter II assesses the performance of participatory approaches and analyzes their impact on project relevance and sustainability. Chapter III identifies a set of issues and investigates underlying causes. Chapter IV summarizes the findings, proposing answers to the core questions raised in Chapter I.

B. Literature Review and Conceptual Framework

1. Failure in Public Services

6. The *World Development Report 2004* (WRD 2004) opens with a sharp statement: “Too often, public services fail poor people—in access, in quantity, and in quality.”⁵ Research by Pritchett and Woolcock (2002)⁶ points out that the failure is “systemic,” because it has routinely occurred even in settings where intentions and resources are reasonably good. They also find that the failure is intrinsic in the nature of development projects, which are designed based on an assumption that “inadequate services” is *the* problem, and the supply of top-down and uniform public services is *the* solution, ignoring the interactions among clients (beneficiaries), service providers (government agencies), and policymakers (aid agencies and national governments). This top-down approach, by standardizing project interventions across various project sites, ignores the fact that locally produced services are discretionary by nature, and their delivery requires decisions to be made by providers on the basis of imperfect information. The right decision depends on local conditions that are hard to assess and, hence, it is difficult to monitor whether or not the right decision was taken (Appendix 1). Since most rural development projects provide locally produced services (such as rural roads, small-scale water systems, microcredit, training, and extension services), this SES, including its literature review, focuses on these services instead of those with a large economic scale.

2. The Principal-Agent Model

7. To provide an in-depth analysis of the underlying causes of the problem, Pritchett and Woolcock apply a “principal-agent” model. A principal-agent problem arises when one actor (the principal) with one objective contracts with another actor (the agent) to undertake a task that affects the principal’s objective, while knowing that the agent may have a different objective. In this case, the issue facing the principal is how to design incentive measures for the agent so that the agent’s best interests, given those incentives, lead to a desirable outcome for the principal.

⁵ World Bank. 2004. *World Development Report 2004: Making Services Working for Poor People*. Oxford University Press.

⁶ Pritchett, Lant and Michael Woolcock. 2002. *Solutions When the Solution Is the Problem: Arraying the Disarray in Development*. Center for Global Development. Working Paper No. 10. Washington D.C.

3. Major Actors in Service Provision

8. To explain the nature of the problem, WDR 2004 unbundles the service delivery chain into three sets of actors—clients, service providers, and policymakers. The effectiveness of services depends on relationships among these players, including in particular the structure of incentives facing providers and recipients, which in turn are shaped by five central elements of service delivery—resources, information, decision making, delivery mechanisms, and accountability. The five elements are the central items identified in the context of institutional solutions to the principal-agent problem (footnote 6).

4. Market versus Government Provisions

9. In a competitive market, services are provided through market transactions between providers and clients. Clients control payments to providers, make decisions, and select providers from multiple choices. The key information is customer satisfaction/dissatisfaction, which flows from clients to providers through repeated or discontinued business. Poorly performing providers may lose clients and be forced out of markets. In this way, clients hold providers accountable through payments, market competition, and exit from markets. The primary merit of the market mechanism is a robust institution that automatically generates accountability of providers to clients. Market competition provides a strong incentive for providers to improve services and reduce costs, and generates consistent pressure for innovation and efficiency. The weakness of markets, however, is inequality, because clients' power to hold providers accountable is based on purchasing power, which is unequal across clients. The concern about inequality and "market failure" is the primary justification for public provision of services.

10. For services provided by government agencies, however, there is no direct accountability of providers to clients, because services are provided not through market transactions but through an indirect route involving policymakers in the government, where clients as citizens influence policymakers in the government, and policymakers influence providers. Competition among providers is lacking, due to the monopoly nature of most government agencies in their respective sectors.

5. Evaluation of Participatory Approaches

11. Numerous studies and evaluations have been made of the performance of various participatory or bottom-up approaches. A recent review by Manzuri and Rao (2004)⁷ covers 138 studies on community-driven development (CDD) projects. Findings from the review do not support the high expectations placed on beneficiary participation. There is some evidence that CDD projects create effective community infrastructure and improve welfare outcomes. However, such evidence is missing for most projects reviewed. Furthermore, the studies do not establish that it is the participatory elements in CDD projects that cause improved project outcomes. Overall, the evidence does not suggest that CDD projects have been well targeted to the poor within communities. In conclusion, the authors find that a naïve application of complex contextual concepts like "participation," "social capital," and "empowerment" is endemic among project implementers, contributing to poor design and implementation of development projects.

⁷ Manzuri, Ghazala and Vijayendra Rao. 2004. *Community-Based and -Driven Development: A Critical Review*. World Bank Policy Research Working Paper 3209.

12. Evidence of the principal-agent problem is also found. The incentives of project implementers are often poorly aligned with the needs of the projects. In some cases, both beneficiaries and project implementers have an incentive to present an impression of a successful project to outsiders, and may collude for this purpose. Manzuri and Rao note a tendency in the World Bank for project designers to “borrow” a best practice that works well in a particular country and use it in very different settings instead of making vigorous efforts at contextualized project design.

13. Manipulation of beneficiary needs is reported by a number of studies reviewed. Even in projects with a high level of participation, identified local needs can be shaped by local power relationships, by outsiders’ agendas, or by beneficiaries’ perceptions of what the projects can deliver (Appendix 1).

6. Innovations in Introducing Market Mechanism

14. After attributing the various problems to the failure of institutional accountability, the WDR 2004 promotes the use of market mechanisms to enhance accountability in public services. Specifically, it suggests (i) increasing the power of the poor over providers by providing them with finance directly, such as the use of vouchers; (ii) promoting competition by allowing subsidies to the poor to be transferable between public and private providers, such as changing the form of subsidy from a zero price to competitive prices, with cash or voucher payments to compensate; and (iii) increasing information on services and providers, such as strengthening the role of clients in monitoring providers and increasing poor people’s choices in service delivery (Appendix 1).

15. Various innovations have been practiced worldwide to strengthen the direct relationship between providers and beneficiaries in public services. The WDR 2004 quotes several examples of such innovations, including demand-side financing, which gives purchasing power directly to beneficiaries, or gives cash compensation to providers conditional on services provided. Cases quoted by that report include (i) a program in Mexico that gives cash payments to poor families that send children to schools or visit a clinic; (ii) a school program in Bangladesh that provides grants to secondary schools based on the number of girls enrolled; (iii) school voucher schemes in Chile, Colombia, Côte d’Ivoire, and Czech Republic; (iv) water vouchers in Chile; and (v) sanitation vouchers in Bangladesh. Another innovation is promoting competition among providers, such as allowing the private sector and NGOs to compete for public services delivery, or granting beneficiaries the right to choose providers. An example quoted by the WDR 2004 is a project in El Salvador wherein parent associations have the right to hire and fire teachers. Recognizing that clients are in the best position to monitor services provided, a “citizen’s reporting card” has been used in Bangalore, India since 1994, resulting in pressure for public agencies to improve services. In another example, the government in Zambia provided appropriate incentive for beneficiaries, from their self-interest, to maintain infrastructure provided by the government (Appendix 1).

C. Objective and Scope of the Study

16. This SES aimed to find out if participatory or bottom-up approaches offer an effective solution to the problems observed in conventional projects using the top-down and supply-driven approach (para. 1). The SES included (i) an assessment of the performance to date of participatory approaches under six rural development projects selected for case study (para. 24), (ii) an analysis of issues identified and underlying causes, and (iii) a search for possible alternatives that may improve the design and implementation of future projects.

D. Methodology

1. Conceptual Framework

a. The Principal, Proxy Principal, and Agent

17. The SES applied the principal-agent model (para. 7) as its conceptual framework to examine the roles and relationships of major players in rural development projects. Citizens as a whole (the public) are the principal, represented by elected governments. Citizens influence governments through voice and elections. Governments are supposed to work in the interest of the public, and are therefore the “proxy principal.” Governments provide a budget to organizational providers (line agencies) and hold them accountable; organizational providers manage frontline providers (field staff) and hold them accountable.

18. Aid organizations are entrusted by governments of developed countries to use funds contributed by taxpayers to support development in developing countries, with the final goal of reducing poverty; aid organizations finance development projects and provide policy advice. For example, ADB staff design projects in consultation with governments and other stakeholders and provide policy advice, while governments determine implementation policies and regulations. Thus, ADB and national governments are policymakers and the “proxy principals”.

19. Project providers are the agents in this report, including organizational providers (executing agencies [EAs]) and frontline providers (EAs’ local offices, field staffs, and contractors, who are in direct contact with beneficiaries at the grassroots level).

20. Applying this model, the SES examined the roles and relationships of policymakers (ADB and national governments); project providers (EAs and frontline providers); and beneficiaries, who are defined as the endusers and others who are expected to benefit from project interventions. It focused on issues at the project level, not the macro and sector level.

b. Challenges in Project Design

21. Two principal-agent issues emerge in the indirect provision of services via policymakers in the government. First, the objective of policymakers (the proxy principal) may not be the same as that of the public (the principal). It is possible that policymakers have their own unstated agendas, which may sometimes be more powerful than the stated objectives. Second, the objectives of EAs and frontline providers (the agent) may differ substantially from that of policymakers (the proxy principal) and the public (the principal), especially in the presence of perverse incentives.

c. Roles of Actors under Conventional Projects

22. Applying this framework, the SES analyzed the roles of major actors in resource control, information flow, decision making, delivery mechanisms, and accountability. In the case of conventional projects, resources are controlled by policymakers and organizational providers—ADB controls project loans; national governments control budgetary allocation; and EAs channel project funds to frontline providers. Decision making is done by policymakers and providers—ADB staff design projects and monitor implementation; governments and EAs determine implementation guidelines and regulations; frontline providers follow guidelines and exercise discretionary power in selecting subproject sites and beneficiaries. Information flows upward—from frontline providers via EAs to ADB and national governments. Delivery mechanisms are EAs, field staff, and contractors. Accountability is upward—with frontline providers responding to

organizational providers, which in turn respond to policymakers. The role of beneficiaries is minimal in conventional projects—they have neither control of resources and decision making nor authority to hold providers accountable. Unlike the case in a competitive market, providers in public agencies seldom treat beneficiaries as clients (footnote 5).

2. Core Questions

23. The SES examined how the roles and relationships of the major players (policymakers, project providers, and beneficiaries) have changed with the new generation of rural development projects using participatory approaches. Specifically, the SES aimed to answer the following questions:

- (i) In what aspects and to what extent have participatory approaches changed principal-agent relationships in the five central elements of service provision (paras. 8, 22)?
- (ii) How have the roles of beneficiaries changed in new projects using participatory approaches? In what aspects and to what extent do beneficiaries function as the principal and exercise control of resources and decision making?
- (iii) In what aspects and to what extent have participatory approaches mitigated conventional problems in terms of less relevant project interventions and poor project sustainability?
- (iv) Is the top-down and supply-driven approach really the cause of the problem? Do bottom-up approaches offer an effective solution to the problem?

3. Methods

a. Unit of Observation

24. Under the SES, the principal units of observation were selected rural development projects that applied participatory or bottom-up approaches. In close consultation with the operations departments of ADB, six projects in five countries were selected for case study. These were (i) Agrarian Reform Communities Project (ARCP) in the Philippines (Loan 1667-PHI), (ii) Cordillera Highland Agricultural Resources Management (CHARM) Project in the Philippines (Loans 1421/1422-PHI[Sf]), (iii) Fujian Soil Conservation and Rural Development Project in the People's Republic of China (PRC) (Loan 1386-PRC), (iv) Small-Scale Water Resources Development Sector Project in Bangladesh (Loan 1381-BAN[Sf]), (v) Third Livestock Development Project in Nepal (Loan 1461-NEP[Sf]), and (vi) Rural Financial Institutions Project in the Kyrgyz Republic (Loan 1529-KGZ[Sf]).

25. Appendix 2 discusses the rationale for selecting these projects and provides detailed information about them. The two projects in the Philippines provided multiple interventions ranging from community development to rural infrastructure (rural roads, small-scale irrigation systems, and potable water supply) and agricultural support services. The PRC project provided credit to farmers and private enterprises. The Bangladesh project constructed small-scale water control systems and established water management cooperative associations (WMCAs) to operate and maintain them. The Nepal project used multiple interventions to support farmers and small enterprises to promote livestock production and marketing. The Kyrgyz project provided a credit line to onlend to rural borrowers through credit unions (CUs). These projects

cover a wide range of ADB's rural sector operations in terms of geography and subsectors. At the time of field visits, two of the projects had been recently completed, and the remaining four were in their 4th–6th year of implementation (Appendix 2).

b. Data Collection

26. The SES applied quantitative and qualitative methods in data collection, primarily case studies, which were nonrepresentative by nature and micro in scope. The SES did not evaluate the selected projects per se. Nor did it attempt to give them an overall rating. Rather, the SES used the projects and their subprojects as cases to understand in detail how different approaches worked or did not work under different conditions. The objective of the SES was to provide insights that may lead to a better understanding of the complicated interactions among various actors in rural development projects, and derive lessons learned for better design and implementation of similar projects in the future.

27. For the above reasons, the SES did not conduct household sampling or structured surveys to estimate or quantify project impacts. Rather, the SES relied on in-depth interviews with various stakeholders, including project designers at ADB and in governments; implementers in executing and implementing agencies; field staff working directly with beneficiaries; NGOs, contractors, and financial institutions engaged in project implementation; local politicians, village leaders, and other influential groups; leaders of beneficiary groups; and ordinary residents in project areas.

c. Fieldwork

28. Fieldwork in each of the five countries was carried out by an Operations Evaluation Mission (OEM) that comprised a mission leader (a senior evaluation specialist from ADB), an international consultant, and a local consultant. The OEM visited a total of 83 subprojects and nonproject villages in the five countries. Visits to villages were informal, less prearranged, and spontaneous. At the beginning of each country visit, the OEM purposefully went to some of the best and worst subproject sites to get an overall impression of subproject performance and issues encountered. After that, to the extent possible, the OEM visited subproject sites without preannouncement or a fixed schedule. The OEM did not call for prearranged beneficiary meetings, at which a large number of villagers may gather but only a few persons usually dominate. Often, information collected during such meetings reflects more official views than real practices. Instead, the OEM interviewed individuals in their houses or at work places—both poor and nonpoor, both those who benefited from project interventions and those who did not. Sometimes, the OEM members asked local people to bring them to the poorest households in their village. The OEM also interviewed residents encountered in villages, on roadsides, in fields, or along irrigation canals. Discussions with ordinary villagers were carried out without the presence of government officials, field staff, or village/group leaders to minimize the chance of interviewees being coached in answering questions. In almost all cases, the interviews were conducted on an individual basis, and ranged from 20 minutes to over 1 hour. The conversations were open-ended, without structured questionnaires, relying on probing and following up on answers. Often, the OEM stayed in a village for 5–6 hours to a full day, and stayed overnight with villagers in a number of cases to maximize the time with ordinary people at the grassroots level. These approaches enabled the OEM to observe broadly and closely what was going on, and identified issues that had not been reported by ADB's previous missions or evaluation studies.

d. Triangulation

29. Triangulation was applied to the extent possible: Information from ordinary villagers was compared with formal presentations given by community leaders, field staff, and government officials, as well as with data documented in progress reports, budgetary statements, village development plans, and minutes of meetings. The OEM did not rely solely on guidelines and procedures written in formal documents, or on official data submitted by project offices. Rather, it paid particular attention to the formal and informal practices actually occurring at the grassroots level, which frequently deviated from official presentations. Finally, the OEM paid close attention to not only project details but also the cultural, social, political, and economic contexts, within which the projects were designed and implemented.

II. PERFORMANCE OF PARTICIPATORY APPROACHES

A. Participatory Approaches Used

30. Appendix 3 discusses participatory approaches used in the six projects studied, including beneficiary consultation and participatory planning, community development support, NGO engagement, local government involvement, and private sector participation. The OEM found that actual application of these approaches varied significantly across the projects (Appendixes 4–8).

31. The two projects in the Philippines (the ARCP and CHARM) spent a large amount of resources and took a long time for beneficiary consultation and participatory planning. NGOs were engaged for long periods to establish beneficiary groups; conduct workshops and seminars; and prepare village development plans, which were written at great length in English and contained varied information about the villages and a list of investment proposals. In contrast, the Nepal and Bangladesh projects spent less time and fewer resources on beneficiary participation, and the PRC and Kyrgyz projects did not conduct workshops or consultations at all during implementation, although consultations with stakeholders were carried out at the project design stage.

32. The typical form of community development support was group formation and beneficiary training. Incentives used to attract group membership were entitlement to obtain employment in subproject construction work (paid at higher-than-market rates), subsidized inputs, and free training. These benefits were given to group members exclusively, at the cost of denying access of nonmembers to project services. The Nepal, Bangladesh, and Philippine projects relied heavily on beneficiary groups in subproject implementation, such as distributing subsidized inputs to group members, transferring water systems to user groups, and making them responsible for the operation and maintenance (O&M) of the systems. The Kyrgyz project did not spend resources on group formation. However, incentives offered by that project—an attractive interest spread and easy entrance requirements—motivated numerous private entrepreneurs to establish CUs, which emerged all over the country. The PRC project did not form any groups but used existing village committees to deliver small loans to and collect repayments from farmers.

33. NGOs played a major role in the two Philippine projects. The Nepal project engaged a large number of small NGOs. The Bangladesh project engaged NGOs as required by the project design, but their actual role was more nominal than real (Appendix 6). In sharp contrast, no NGOs were engaged under the PRC and Kyrgyz projects.

34. Local governments played a major role in subproject implementation under the two Philippine projects by participating in subproject implementation and by sharing 10%-20% of the investment cost. Local governments also played a major role under the PRC project by selecting end borrowers for the ADB credit line and by guaranteeing subloan repayments (Appendix 5). In contrast, the role of local governments was minimal in the other projects.

35. While none of the projects studied explicitly adopted a private sector approach, some of them used private enterprises, individuals, and financial institutions as agents to achieve project objectives. For example, the PRC project, through credit support for agroprocessing enterprises, generated rural employment. The Kyrgyz project, by attracting private individuals to establish CUs and participate in credit delivery, increased rural credit supply and facilitated agricultural recovery. The Nepal project engaged participating financial institutions (PFIs) to channel an ADB credit line to small farmers for animal purchase. In the best subprojects visited under the Bangladesh project, a few large farmers organized WMCAs, collected fees, and managed O&M of the water systems.

36. Interesting innovations were also observed. Under the Bangladesh project, a new policy required cash contributions from farmers before construction of the water control systems. Such a policy was implemented without farmer resistance, contradicting the commonly held belief that, because farmers are poor, they can contribute labor but not cash, and because they have no savings, it is impossible to ask them to pay before they benefit. The Bangladesh case suggests that farmers' willingness to pay for an investment that will bring them more benefits than costs may have been substantially underestimated, and the best bargaining power that a project has is before commencement of construction. The Nepal project engaged community-based organizations (CBOs) as NGOs to serve villagers, who were both the clients and members of the CBOs. Since the CBOs were from the same villages, their engagement resulted in better sustainability than using outside NGOs, which would leave the villages after contract expiration. The PRC project imposed a tough policy of "no subsidy," by which end borrowers had to repay the full amount of subloans plus all interest charges in real terms, in addition to bearing the exchange rate risk. Strict implementation of that policy provided incentives for end borrowers to treat subloans as their own money. The Kyrgyz project used mass media (newspapers, radios, and television) to disseminate project information at low cost, with wide outreach to the general public.

37. In summary, while some projects adopted a typical package of participation by hiring NGOs; organizing user groups; and conducting workshops, seminars, and beneficiary training, others used alternative approaches based on the needs of the projects as well as local conditions. As discussed in Appendixes 4–8, the performance of the projects varied significantly—but not necessarily due to the form and degree of the participatory approaches used.

B. Roles and Relationships of Major Players

38. This section examines the roles and relationships of policymakers (ADB and national governments), project providers (EA offices, field staff, and contractors), and beneficiaries in (i) information flow, (ii) resource control and decision making, (iii) delivery mechanisms, and (iv) accountability.

1. Information Flow

39. Information about project implementation flowed upwards in all projects studied, primarily through a standard project monitoring system, by which monthly or quarterly reports were submitted by project offices to ADB. The downward flow of project information was limited to targeted beneficiaries, such as end borrowers selected under the PRC project, farmer/women's groups established under the Nepal project, and leaders of WMCAs under the Bangladesh project. Even under the two Philippine projects where substantial resources were spent on information campaigns, it was village officers and group leaders that were repeatedly consulted. Most of the ordinary villagers interviewed by the OEM, if they were not members of any group, said that they attended few meetings and knew little about the details of the ADB-financed projects or of the village plans developed as the primary output of the intensive consultations (Appendix 4).

40. Ordinary villagers' lack of project information, however, did not seem to negatively affect project implementation, and the OEM heard no complaint about that. What mattered to farmers seemed to be information about market prices and technology, which was widely available under the PRC project but limited under the Nepal project. Under the Bangladesh project, what seemed to matter most was that those who ran the WMCA had an incentive to make it work well, and with the capacity to collect user fees for adequate O&M. In the Philippines, what mattered most to the landless and jobless poor interviewed by the OEM was employment generation, or access to microcredit, since a small loan could enable a poor household to develop income-earning activities (e.g., pig raising) (Appendix 4).

41. The primary value of the intensive consultations under the two Philippine projects was local knowledge collected for the preparation of village development plans. However, the plans seemed to be used more by outsiders than by locals, as most of the village plans were submitted to ADB and project offices. The OEM did not find evidence of intensive use of the village development plans by the village communities themselves.⁸

42. The only case in which project information was disseminated widely to ordinary people was the Kyrgyz project, which used mass media to disseminate information, with a good impact and at low cost. In the project areas visited, the OEM noted that detailed project information, such as the availability of the ADB credit line, requirements for establishing a CU, eligibility to borrow from the credit line, lending interest rates to CUs, and the ratio of matched loans to share capital, was well known to the CUs and their members, as well as to the general public. In conjunction with other factors, the widely disseminated project information contributed to increased market competition in the rural financial sector in the Kyrgyz Republic (Appendix 8).

43. In summary, information flow under the projects studied reflected the function of project offices (the agent) responding to the requirements set by policymakers (the proxy principal). The limited downward flow of project information to direct beneficiaries was for the needs of project implementation. The value of information flow will be analyzed later (para. 119).

⁸ In most villages visited under CHARM, the OEM could not find a copy of the village development plan, although village officers insisted that it existed. In one village, the OEM found a village profile written in English. When asked how that document was used, the president of the people's organization said: "we show it to visitors like you."

2. Resource Control and Decision Making

a. Roles of Policymakers and Providers

44. The OEM found that the power in resource control seemed to determine the power in decision making. At the top, ADB controlled project loans and designed projects in consultation with other stakeholders. The national governments controlled budgetary allocations and set policies and regulations. Under the two Philippine projects, where local governments contributed counterpart funds for subproject investment, they influenced the selection of subproject sites and investment items. In the Nepal and Bangladesh projects, subprojects and sites were selected by EAs and their local offices, which controlled project funds allocated to them through budgetary allotment.

b. Role of Beneficiaries

45. In spite of intensive consultation and participation under the two Philippine projects, beneficiaries did not seem to have any power in resource control or decision making. In particular, they had little say in selecting contractors. Local communities could (and some did) complain about the quality of construction work when it was poor, but they had no power to stop construction or replace contractors. For irrigation and drinking water systems, beneficiaries were required to contribute 30% of the investment cost in the form of cash, local materials, or labor. In actual implementation, members of beneficiary groups worked at subproject construction and received higher-than-market-rate payments, with a portion (10–25%) of the payments deducted as their “free labor contributions,” and the net wage to laborers remaining higher than or equal to market rates. Since beneficiaries’ contribution was more nominal than real, they had little power in resource control or decision making.

46. Under the Bangladesh project, WMCAs contributed cash for subproject investment. The cash payments, however, amounted to less than 3% of the subproject cost. Since over 97% of the subproject cost was a grant from the national government, resources were controlled by the EA and its district offices. So was decision making, especially in terms of contractor selection and subproject design.

47. Under the Nepal project, two farmer representatives were included in the Livestock Action Team (LAT), which comprised representatives from the district offices of various government agencies and was established to be the “main thrust” of participatory planning. While the LAT had the power to select subproject sites and determine project activities (based on guidelines set by the project management office), the inclusion of farmer representatives in the LAT did not lead to farmers’ power in decision making. The OEM found that the farmer representatives were appointed by the heads of the EA’s district offices, and without the responsibility to report to the farmers what was going on in the LAT meetings. Decisions in the LAT meetings were initiated by the EA’s district offices, with concurrence from other LAT members. The OEM was told that there was seldom disagreement at the LAT meetings.

c. Factors Determining Subproject Investment

48. Actual decisions about subproject investments seemed to be the result of a mix of (i) compliance with project requirements, (ii) local politics, and (iii) local needs. Among these factors, compliance with project requirements appeared to be the dominating determinant. Under the ARCP, the OEM noted that project funds were used to upgrade short dead-end roads

to unnecessarily high standards in some agrarian reform communities (ARCs)⁹ with light traffic and few beneficiaries.¹⁰ In a poor municipality visited, where 18 of its 30 villages had no access roads, the mayor said that they would rather have built a road connecting the dead ends of existing roads to benefit poor villages currently without road access if they had had decision making power. However, since the 18 villages were not ARCs and not eligible for support from the ARCP, project funds were used to upgrade existing roads in three ARCs.

49. The second determinant was local politics. In cases where local governments contributed counterpart funds for subproject investment, the OEM was told that the relationship among village captains, municipal mayors, provincial governors, and representatives in congress affected which villages received subprojects.

50. The last determinant was local needs, which was supposed to be the driving force to decide on subproject investments. In the village development plans examined under the two Philippine projects, the OEM found that the priority items (paras. 67-68) on the long list of beneficiary priorities in the plans were almost identical across villages, reflecting what was financed by the projects. Under the Bangladesh project, the OEM observed a case where local demand was adjusted to what could be supplied by the project. Since that project financed water control systems and not roads, local leaders shifted their demand for a road to that for an embankment, which was used as a substitute for a road (Appendix 6).

51. In summary, decisions at the project level were made by policymakers, who controlled project funds. At the subproject level, local governments and frontline providers influenced the selection of subproject sites and beneficiaries. The role of beneficiaries was minimal, as they controlled few project resources.

3. Delivery Mechanism

52. Infrastructure subprojects such as rural roads, irrigation systems, and drinking water supply were delivered by contractors together with engineers from EA offices. Soft components such as beneficiary consultation, participatory planning, preparation of village development plans, group formation, and beneficiary training were delivered by NGOs hired by the projects, although EA staff also participated in the provision of beneficiary training. A major weakness of using NGOs as a service delivery mechanism was poor sustainability. The OEM noted that many NGOs left the local communities in which they were assigned to work after the expiration of their contracts, without leaving behind a significant impact on the local communities. Under the two Philippine projects, the use of NGOs to prepare village development plans had further problems: In most cases, NGOs were not expert in development planning; their field staffs were typically young and inexperienced at the time of hiring. Although the NGOs gained experience

⁹ There was no clear definition of an ARC, which vaguely included agrarian reform beneficiaries (ARBs) living in 3–7 villages. ARBs were those who received land distribution under the Comprehensive Agrarian Reform Program (CARP) implemented in the Philippines since 1988. In many cases, ARBs were tenants working for landowners whose land was redistributed by the CARP. ARBs were low-income households but not necessarily poor, as they all had their own land. In many villages visited by the OEM, over 50% of the households were composed of landless and jobless poor, who did not receive land and were therefore not ARBs. The OEM noted that ARBs accounted for about 10% of the households in the villages visited, and ARCs accounted for 10–15% of the villages in the municipalities visited (Appendix 4). The ARC approach was not effective in targeting the poor, since the majority of the poor were not ARBs. In fact, such an approach may reflect demarcations among government agencies in the Philippines. Since the Department of Agrarian Reform is responsible for ARCs, its projects cannot cover non-ARC villages, which are the domain of the Department of Agriculture.

¹⁰ The OEM visited a subproject that had upgraded a 1.5-kilometer dead-end road to a fully cemented road of 4 meters wide and 15 centimeters thick, benefiting about 50 households along the roadside (Appendix 4).

through training and practice during the course of project implementation, the time and resources spent on them did not lead to sustainable benefits for the local communities, as the NGOs left the villages after their contract periods. While village governments were by law responsible for village development, they did not play a major role in preparing the village plans, missed the learning opportunity, and remained weak in development planning and management. This was evident in the sixth year of project implementation, when an NGO was recruited again by CHARM to “enhance” the village plans for “incorporating into municipal development plans,” probably due to a perception that village governments were incapable of such a task.

53. Beneficiary groups were established under the Bangladesh, Nepal, and Philippine projects as a mechanism to allocate subsidized inputs to farmers, organize them in project activities, and be responsible for O&M of project facilities (irrigation and other water systems). A major weakness of this mechanism was the unclear sustainability of the groups, as discussed in para. 71.

54. While three projects provided credit services, they were delivered through different mechanisms due to different conditions in the project areas. The Nepal project used small PFIs to deliver loans to farmers for animal purchase. The Kyrgyz project used private entrepreneurs to run CUs and deliver loans to rural borrowers. Due to a lack of banks that were willing to participate in agricultural lending, the PRC project used government agencies (finance bureaus) to channel the ADB credit line, which caused problems,¹¹ although it provided a mechanism to guarantee loan repayment (Appendix 5). At the village level, instead of hiring NGOs or establishing groups, the PRC project used existing village committees to deliver small loans to farmers and collect repayments, which seemed to work well.

55. In summary, the projects used a variety of players as delivery mechanisms, such as EA offices, field staff, contractors, NGOs, beneficiary groups, PFIs, existing government structures, and other institutions (such as village committees in the PRC). The role of these players as agents to work for projects is analyzed in paras. 125–126 and 133.

4. Accountability

56. Accountability was upward under all projects studied. Contractors and NGOs were accountable to EAs and their local offices, which awarded contracts and gave payments. EAs and their local offices were accountable to ADB and national governments, which provided loans and budgetary allocations.

57. In all projects studied, the OEM observed no evidence that subproject providers were accountable to beneficiaries. In most cases, since the infrastructure and other project benefits (such as subsidized inputs and training) were largely free to beneficiaries, community leaders and local governments focused on fighting for whatever they could receive from the projects instead of challenging a subproject design or demanding better services. Overall, the projects lacked a mechanism for beneficiaries to hold providers accountable for the use of project funds. The consultation and participation might have provided opportunities for beneficiaries to complain about a subproject design or construction if it was poor. However, contractors could easily ignore beneficiaries, who had no authority over contractors. In some cases, beneficiaries

¹¹ Including unreasonable repayment schedules for agroprocessing enterprises, heavy upfront repayments, short grace periods before cash flows were sufficient, and complicated procedures for subloan approval and disbursement.

forwarded their complaints to EA offices. The OEM was told, however, that EA offices did not always have incentives strong enough to hold contractors accountable, especially for those well connected with politicians (Appendix 6).

58. Downward accountability was observed in only a few cases under the Nepal project, where savings and credit schemes were run by beneficiary groups almost independently. That project did not provide a credit line, and beneficiary groups financed the credit schemes by mandatory savings from members. The accountability seemed to be high in groups with small size (10–20 members), where members knew their leaders very well. Furthermore, CBOs that were engaged as NGOs to work with their own members (para. 36) seemed to be more accountable to beneficiaries than NGOs from outside.

59. In the case of credit provision, accountability for the use of loans from projects was observed, such as (i) when end borrowers had to repay the full amount of loans plus all interest charges under the PRC project, which imposed a strict policy of no subsidy; and (ii) under the Kyrgyz project, where borrowers faced a penalty of doubling interest charges if they delayed repayments, or losing their property (collateral) if they failed to repay loans (Appendix 8). In these cases, end borrowers treated subloans from the projects as their own money and made investment decisions carefully.

60. In summary, accountability in the projects studied reflected the relationship of project providers (the agent) being accountable to policymakers (the proxy principal). The role of beneficiaries was minimal, as is analyzed in paras. 123–124.

C. Impacts of Participatory Approaches on Project Performance

61. Of the various problems identified in conventional projects (para.1), the most critical are (i) less relevant project interventions, and (ii) poor sustainability of project benefits. These are important causes underlying inefficiency and insignificant impact on poverty reduction. This section examines to what extent that these problems were addressed by participatory approaches in the six projects studied.

1. Relevance of Project Interventions

a. Design Interventions Based on Local Realities

62. Relevance of project interventions seemed to depend heavily on how well the project designers understood local realities in the project areas, including key sector issues as well as the political, economic, social, and cultural environment. For example, under the PRC project, the key constraints in the project area were (i) intensive population pressure on the limited amount of fragile farmland with red soil, and (ii) insufficient rural employment opportunities to absorb the large amount of surplus labor. Consequently, the project design focused on employment generation through private investment in agroprocessing. Since the key factor restricting private investment was lack of access to long-term credit, the project provided credit but not a subsidy (para. 36). Due to a good understanding of local institutions, the project used existing village committees instead of hiring NGOs or establishing groups to deliver loans to farmers. Such an approach not only saved time and resources, but also led to better sustainability. The village committees had functioned well before the project, and continued to operate after project completion. The weakness of the project design, however, was its provision of loans to all types of borrowers instead of focusing on enterprises with a large impact

on employment generation. In one case, large loans were given to capital-intensive cage fishing without generating significant employment (Appendix 5).

63. In the case of the Kyrgyz project, the legacy of the Soviet culture made farmers treat loans from the government as grants or subsidies with low repayments. In view of this reality, the project design used private individuals instead of the government to channel loans to end borrowers. The high interest spread offered by the project motivated numerous private individuals to establish CUs, which emerged all over the country. The weakness of the project design, however, was a savings-based CU model and a top-down imposed apex company. Such a design was based on theory instead of local realities. Given the lack of a legal basis for CUs to take savings deposits (not even from members), and an apparently insufficient demand for savings services in the transitional period, the savings-based CUs did not emerge as anticipated. Without sufficient demand from CUs for apex services, the externally imposed apex company did not function well, with inefficiency, lack of accountability, and political interventions (Appendix 8).

64. In the Bangladesh project, the construction of water control systems was relevant and generated positive impacts. The uniform requirement of establishing WMCAs at all subproject sites regardless of existing formal and informal institutions in particular villages, did not serve well the objective of establishing a mechanism to handle O&M of the water systems. In the best subprojects visited, the OEM found that it was a few largest beneficiaries (landed influential villagers) who contributed the major portion of the O&M funds and organized O&M activities, because they had the most to lose if the water systems failed (para. 92). In other villages visited, the establishment of WMCAs did not solve the conventional problem of lack of O&M funds after project completion. In spite of formal transfer of water systems to WMCAs and provision of training on O&M, many WMCAs visited did not collect sufficient fees for O&M. The practice of deferring repairs remained widespread (Appendix 6). If thorough fieldwork had been conducted at the project design stage, project designers might have recognized the negative impact of free government investment in the past on beneficiaries' dependence on government for O&M (para. 80).

b. Impact of Participatory Approaches

65. Under the Nepal project, the participatory approaches used during project implementation, such as the LAT, group formation, and NGO engagement, did not seem to affect project relevance, because project interventions had already been determined at that stage. If the project designers had obtained a thorough understanding of the local realities during the design stage, they might have identified "milk holidays" (a period of 1–3 days a week when dairy processing enterprises refuse to accept milk from farmers, due largely to insufficient processing capacity) as the key issue restricting livestock development in the country. Interventions could have been developed to correct the price distortions created by the dominating state-owned milk company, which set the same price for both peak and lean seasons. Instead, that project distributed subsidized equipment to processing enterprises as the primary instrument to promote milk marketing, resulting in continued milk holidays after 6 years of project implementation. Without understanding farmers' high demand for new technology and their willingness to pay for training, the project followed the conventional practice of providing free training and improved forage seeds exclusively to group members as "carrots" to induce group formation, at the cost of excluding access to the new technology by nonmembers, who were the majority (80% or more) of the residents in the villages visited (Appendix 7).

c. Less Relevant Interventions

66. Less relevant project interventions were observed under the two Philippine projects, including (i) upgrading short dead end roads to unnecessarily high standard with light traffic and few beneficiaries, instead of building new roads to connect the dead-ends with better impact on poverty reduction (para. 48); and (ii) rehabilitating small-scale irrigation systems that benefited only a small portion (5–10%) of the better-off farmers in villages where 50% or more households were landless and jobless poor (Appendix 4).

d. Beneficiary Priorities

67. While many poor interviewed in the Philippines said that their number one priority was microcredit, such as a small loan to buy a piglet to start animal raising, the top items in the long list of investment proposals in the village development plans were typically rural roads, irrigation systems, and drinking water supply—subprojects offered by the two Philippine projects.

68. Three factors might have influenced the “beneficiary priorities” listed in the village plans: First, since subprojects (roads, irrigation systems, and drinking water supply) were essentially free to beneficiaries, their best response was to accept whatever they were given instead of demanding something that was not supplied by the projects, such as microcredit or livelihood activities.¹² Second, since the village plans were prepared by outsiders (drafted by NGOs based on ADB requirements, and revised with assistance from consultants and project staff), it is not surprising that the projects’ agendas were reflected in the village plans. Lastly, it was said that local governments preferred physical construction, which is more visible than microcredit programs. Such a preference might have influenced the order of priorities in the village plans.

2. Sustainability

a. O&M of Infrastructure

69. The lack of secured funding sources for O&M after project completion was, and still is, a major threat to the sustainability of many rural development projects. In the villages visited under the Philippine and Bangladesh projects, the OEM observed inadequate maintenance of rural roads, irrigation facilities, and other water systems, including in particular deferred repair of damage caused by typhoons, which occur frequently in these countries. The primary cause of poor O&M was a lack of sufficient O&M funds after project completion, when ADB loans were closed. While local governments were responsible for maintaining rural roads, they typically suffered from a shortage of budgetary resources. In the poor municipalities visited under the two Philippine projects, the majority (about 70%) of the annual budget was used for personnel services, another 5% for a calamity fund, and 20% for a development fund. Of the 20% for the development fund, a portion was used for mandatory national programs devolved to local governments. The remaining budget was insufficient to cover all other needs, including O&M of existing roads. However, many mayors had a strong incentive to allocate the limited budget as counterpart funds to obtain externally financed projects, which brought them more political mileage than financing O&M of existing roads (Appendix 4).¹³

¹² No credit line or livelihood funds were provided by the two Philippine projects. While the design of the ARCP required the Land Bank of Philippines to provide loans to ARCs, this was not realized in the villages visited.

¹³ This finding confirms another study by ADB on rural roads. After examining rural roads at selected project sites in the Philippines, that study found that regular maintenance is often neglected both because of lack of funds and because there is little political capital gained by carrying out minor maintenance. Major rehabilitation is subsequently authorized once the road becomes impassable (ADB. 2002, *Impact of Rural Roads on Poverty Reduction—A Case Study-Based Analysis*, October).

70. The small irrigation and other water systems constructed or rehabilitated were transferred to user groups after the completion of construction. Reports from the Bangladesh project revealed that only 80 of the 248 WMCAs established under the project continued to collect O&M fees, and the fees collected were equivalent to about 10% of what were required for proper O&M (Appendix 6). The OEM confirmed this finding during its fieldwork, as most WMCAs visited (with a few exceptions—see para. 92) did not collect fees for O&M, although mandatory savings were collected from members for microcredit schemes run by the WMCAs (the project did not provide any credit line). Similarly, at all irrigation sites visited under the two Philippine projects, the OEM did not find any irrigators' associations that regularly collected fees for O&M, although a small one-time fee was collected for office expenses of these associations. A common practice was that farmers contributed labor but not cash; beneficiary groups did minor maintenance and waited for government agencies to come when typhoons caused damage. The deferred repair of damage was a major cause of continued deterioration of the infrastructure, leading to substantial reduction of project benefits shortly after the investment. This finding confirms the report by another ADB study that rural roads, especially gravel roads, quickly deteriorate if not regularly maintained, and that benefits can be quickly lost (footnote 13).

b. Sustainability of Service Delivery Mechanisms

71. The above issues were not observed in the Nepal, PRC, and Kyrgyz projects, which did not create any infrastructure with public or collective ownership. Under these projects, sustainability of project benefits depended on the continuity of the service delivery mechanisms created by the projects, such as NGOs and beneficiary groups. NGOs left the local communities after the expiration of their contracts without leaving significant impacts (para. 52). Training and extension services were short term by nature, since government agencies seldom had sufficient training budget or travel allowance to visit demonstration farms after project completion when they had to operate within their routine budgets. Beneficiary groups created by projects typically suffered from a lack of clear purpose and funding sources after project completion, because they were established for the purpose of project implementation instead of for the mutual benefit of their members. Many farmers joined the groups because only group members were entitled to construction work or subsidized inputs. Since many groups relied heavily on financial support from the projects, it is not clear how they could continue to operate after project completion when no more funds would be available. In more than one case, the OEM found that beneficiary groups stopped operation after the completion of subprojects in their villages. The only exception observed was the savings and credit schemes under the Nepal project. The schemes were created by demand from members instead of by project requirement, and financed by mandatory savings from members instead of by the project.

c. Sustainability of Project Benefits

72. Under the PRC project, the provision of long-term credit was a one-time activity, because the central Government prohibited the operation of revolving funds under externally financed projects (Appendix 5). While the credit provision was discontinued, the sustainability of the project's primary benefit—employment generation in rural areas—is likely. Most of the enterprises visited by the OEM seemed to be strong enough to continue their operations after the one-time support of access to long-term credit (Appendix 5).

73. Under the Kyrgyz project, since the CUs were established and managed by private entrepreneurs, who considered CUs as their best employment (para. 95), they had strong self-interest to continue CU operations. If the ADB credit line is closed in March 2005 as planned, all of the CU presidents interviewed said that they would continue to operate, using their own

institutional capital generated from retained profit, as well as share capital contributed by members. They might also borrow from the revolving fund generated from repayments of earlier loans, or borrow from other externally funded programs or commercial banks, albeit at higher interest rates. There is sufficient evidence that the primary benefit of the project—farmers' easy access to credit—will continue in rural Kyrgyz Republic in the future (Appendix 8).

74. In summary, the problem of poor maintenance of rural infrastructure was persistent in the projects examined, with underlying causes embedded in the principal-agent problem, which is analyzed in paras. 76–80. The weak sustainability of NGOs and beneficiary groups as delivery mechanisms related to the design of the projects, which contracted NGOs and beneficiary groups to implement project activities, and rewarded them in accordance with their fulfillment of physical targets instead of the sustainability of project benefits. In contrast, the sustainability of project benefits under the PRC and Kyrgyz projects was due to appropriate project design, which used private enterprises and CUs as the agent, and provided them with appropriate incentives to achieve project objectives (employment generation and credit delivery, respectively).

III. ISSUES, UNDERLYING CAUSES, AND ALTERNATIVES

75. Several issues were identified in each of the five countries studied. Appendixes 4–8 discuss a total of 21 issues. This section summarizes the most important ones, investigating underlying causes and searching for better alternatives.

A. Beneficiary Ownership and Project Sustainability

76. Postevaluation studies conducted by ADB have reported numerous cases of poor sustainability of rural development projects (Appendix 1). These projects typically suffered from a lack of O&M funds after project completion. There was often a disconnection between the capital investment financed by ADB and the recurrent budget allocation by governments. ADB financed the capital investment and assumed that the national and local governments would take care of O&M. National governments frequently encountered fiscal constraints and could not allocate a sufficient amount of the promised O&M budget. Local governments often suffered from budgetary shortages. Beneficiary groups failed to collect sufficient user fees as anticipated by the project design. The top-down and supply-driven approach has often been blamed for not generating beneficiary ownership and, consequently, poor project sustainability. However, the new projects studied, while adopting “bottom-up” approaches, did not seem to be immune to this conventional problem.

77. A critical review of the relationship between beneficiary ownership and project sustainability helps to analyze this problem. It is not clear if beneficiary ownership should be expected for all types of externally financed projects. For example, if a rural road subproject is financed by ADB and given to a municipal government largely as a grant from the national government, is it realistic to expect beneficiaries to feel ownership of the road just because it passes their villages and benefits them?

78. It appears that the real issue is not ownership but a principal-agent problem. The real owner of the road is the public (the principal), which is represented by the national and local governments as well as politicians (the proxy principal). While the objective of the public is sustainability of the road, national and local governments as well as politicians that approve budgetary allocations might have different objectives. Some of them are interested mostly in the investment and are less keen on O&M, because bringing in an ADB-financed project might have significant political meaning in terms of popularity, political patronage, and future votes. In

contrast, there is little recognition or political mileage to take care of the more mundane and less glamorous O&M.¹⁴ Without appropriate incentive measures to reward budgetary allocation for and good performance of O&M (para. 84), the participatory approach alone cannot solve the conventional problem of poor project sustainability.

79. For a small-scale irrigation or water control system, the nominal owner is the user group. Here the ownership issue is less clear, because the subproject is financed by an ADB loan and given to the user group as a grant from the national and local governments, with the user group paying only a tiny portion of the investment (3% cash contribution under the Bangladesh project) or a nominal “free labor” contribution (under the two Philippine projects; para. 45). Even after formal transfer of the water system to the user group, it is difficult for individual beneficiaries to feel ownership of the system, which is built by contractors, paid for by governments, and financed by the ADB loan. Since what works in the real world is the principle of “no pay, no play,” beneficiaries do not have real power over government engineers or contractors to demand least-cost subproject design. Nor do they have the authority to select contractors or to replace them when they perform poorly. In many cases, overdesign and poor construction of water systems contribute to high O&M costs, which are beyond beneficiaries’ willingness to pay, especially in areas where farmers traditionally pay only labor and no cash for simple irrigation structures made of local materials.

80. In areas with a history of past externally financed projects, beneficiaries, community leaders, and local politicians have learned from past experience, and expect continued financing of O&M by governments, or future rehabilitation projects financed by aid agencies. Even after the signing of formal agreements about O&M responsibilities, it is not uncommon to observe that user groups defer the repair of damage until complete nonfunction of irrigation systems. Although the cost of immediate repair is much lower than rehabilitation, instead of collecting fees from members to do immediate repairs, leaders of user groups tend to wait for government agencies to come and fix the damage for them, or wait for future rehabilitation projects. Some group leaders interviewed by the OEM said that they would wait as long as there was such a hope.¹⁵ Here the issue is not ownership of the infrastructure, but the moral hazard of a dependence syndrome evolved and reinforced by grant-financed projects.

B. Mechanisms of Downward Accountability

81. Findings so far suggest that a deep-seated institutional cause of the various problems observed was the lack of an effective mechanism for beneficiaries to hold subproject providers (contractors, field staff, and project offices) accountable for the use of project funds. In the private sector, providers are held accountable by individual clients through direct payment from clients, who select suppliers from multiple choices. In the public sector, however, development projects are financed by aid agencies and national governments; EAs receive loans from the aid agencies and budgets from national governments; contractors receive contract awards and payments from project offices; beneficiaries receive project assistance largely free of charge. While government funds are from taxpayers, and this includes beneficiaries, they do not feel that they are sharing the cost of the subproject investment, due largely to dilution in the principal-agent relationship in the indirect provision of services via policymakers (para. 10).

¹⁴ The OEM observed billboards in front of many subproject sites, praising mayors, governors, and member of congress for bringing in the ADB-financed projects. In contrast, the OEM did not find any billboard praising those that allocated the budget for O&M.

¹⁵ When beneficiaries requesting for government assistance to repair damage, a typical response is: “Our budget for this year has been finished. We will see if we can help you next year.” Such a signal provides wrong incentives for beneficiaries to defer repairs.

Although citizens as a whole (the public) are the principal and hold governments accountable, individual beneficiaries do not have the authority as the principal to hold government agencies or frontline providers accountable. In the projects studied, government agencies and project staff receive budgets from authorities above, and naturally respond upwards instead of downwards. Similarly, contractors respond to project offices instead of to beneficiaries because it is the former that award contracts and give payments. Beneficiaries have no power to select subproject providers (contractors, field staff, or line agencies). The lack of competition pressure among providers generates little incentive for them to improve services or reduce costs.

82. To establish downward accountability, the WDR 2004 (para. 6) calls for building and strengthening the direct link between providers and beneficiaries in public services. To correct the weakness of the market mechanism, measures of demand-side financing may be used to grant purchasing power directly to targeted beneficiaries, especially the poor and the disadvantaged.

83. The current package of participatory approaches examined did not offer an effective solution. Innovations are needed to search for alternatives that (i) give purchasing power to beneficiaries to let them hold providers accountable, (ii) provide appropriate incentives to providers, and (iii) develop mechanisms to encourage competition. As subproject providers are motivated by budgetary allocations, contract awards, and payments, the design of incentive measures may link these powerful elements to beneficiary satisfaction, with a view to generating “downward responsiveness” of providers to beneficiaries.

84. To explore alternatives and stimulate discussion, the following ideas are offered for consideration:

- (i) Allocate budgets to government agencies and give payments to contractors based on beneficiary satisfaction. Depending on local conditions, project design may establish appropriate mechanisms to ensure that beneficiaries’ “voice” or views influence the assessment of providers and the selection of contractors. When appropriate, assessment of user satisfaction may be required prior to contractor payments. For example, user endorsement may be required before giving payments to contractors. “Beneficiary report cards” may be used to evaluate the performance of providers. In Bangalore, India, the use of citizen’s report cards generated pressure for government agencies to improve services (para. 15). To avoid corruption or manipulation by providers (such as bribing a few community leaders to get endorsement for payment or a satisfactory rating), user report cards should be filled by a large number of beneficiaries instead of just by a few group leaders.
- (ii) Instead of allocating budgets directly to government agencies based on physical targets, distribute project funds available for a village to targeted beneficiaries in the form of “development coupons” (such as \$100 per household). In conjunction with other measures, including in particular options for investment items and multiple choices of providers (government agencies, engineers, and contractors), the coupons may become beneficiaries’ purchasing power to “purchase” or voting power to “vote” for their preferred subprojects from preferred providers. The number or amount of “development coupons” collected by government agencies or contractors becomes the basis for budgetary allocation or contract awards. Similar to the demand-side financing and the various school vouchers used in some countries (para. 15), this measure would aim to generate downward responsiveness of providers to beneficiaries, who may now have the power to hold providers accountable, because they “pay” providers. To avoid corruption or manipulation,

- measures need to be developed together with beneficiaries to avoid potential problems, such as selling coupons for cash at high discount.
- (iii) For village infrastructure that benefits a local community, measures are needed to make the community treat project funds as their own money, with sufficient incentives to take good care of the infrastructure after construction, including timely repair of damage. Depending on local conditions, it may be appropriate to establish a village O&M fund in the community by giving them a one-time grant, together with a clear policy of no free money from external sources to this community in the future for O&M, damage repair, or rehabilitation. Cash contributions from the community could be required as a precondition for receiving the grant. The cash contribution could become a part of the village fund. For such a policy to work effectively, decision power on the use of the fund, selection of contractor, and endorsement of payments may be transferred to the community, with checks and balances developed to control local corruption. Aid coordination is also needed to ensure consistency of policy.
 - (iv) For group infrastructure that benefits only a small number of the better-off farmers, such as small-scale irrigation systems (para. 66), make matching grants from externally financed projects available only after end-users invest their own money in the subproject. As discussed in Appendix 4, grant financing of most investment costs for group goods is not fully justified if the group goods benefit only a small number of the nonpoor without significant impacts on the poor. However, partial subsidies may be considered if there is reason to encourage private investment in group goods. Here a major concern is manipulation by contractors, who may pay the required cash contribution on behalf of user groups to get subproject approval, and then recover their cost by using poor materials in construction.¹⁶ To avoid corruption or manipulation, cash contributions from end users should be large enough (one third or more)¹⁷ to provide end users with real power to hold providers accountable, and strong incentives to demand for least-cost design and high quality of construction work.

85. Problems and unanticipated developments are bound to occur in the actual design and implementation of innovative measures. Thus, the above ideas should be pilot tested before full-scale adaption. Timely evaluation should follow to elicit lessons learned. Success of a pilot project in one area does not guarantee its successful replication in another area with different conditions. The selection of specific measures should be based on a thorough understanding of local conditions.

C. Real Value of Beneficiary Consultation and Participatory Planning

86. In spite of good intentions, competent project staff, substantial resources, and sufficiently long periods spent on beneficiary consultation and participatory planning under the two Philippine projects, no evidence was found that the intensive consultation and participation empowered beneficiaries in resource control and decision making, fostered their ownership of

¹⁶ In the case of the Bangladesh project, the OEM was told that some contractors paid the 3% cash contribution on behalf of WMCAs to get subproject approval.

¹⁷ Farmers may be willing to pay a large portion of irrigation investment if they have no better alternatives. The OEM visited three nonproject villages in Bangladesh that suffered similar flooding problems but did not receive any assistance from the project, which could not cover every village in the project areas. Since there was no hope of receiving free funds, community leaders interviewed said that they were willing to pay the full investment cost for water control systems if long-term credit could be provided at no interest (Appendix 5).

subprojects, or motivated them to take good care of project facilities. The high expectations established by ADB's guidelines on participatory approach were not met.¹⁸

87. Instead, poor maintenance of project facilities was observed in the subprojects visited, including deterioration of roads and irrigation systems only 2-3 years after subproject completion, due partly to insufficient routine maintenance, and partly to deferred repair of damage caused by typhoons (Appendix 4). The underlying causes included (i) a shortage of budgetary resources in most poor municipalities, and (ii) beneficiaries' reluctance to pay cash for O&M. These issues are similar to findings of several postevaluation studies of conventional projects using the top-down and supply-driven approach (Appendix 1).

88. Since intensive consultation and participation did not lead to beneficiaries' power in the control of investment funds, they did not have real power in decision making. Nor did they have the power to hold providers accountable. The substantial resources, time, and effort spent on information sharing and consultation during project implementation, in the absence of multiple choices of providers and freedom to determine investment, did not seem to be worthwhile.

89. The OEM noted that the use of workshops and seminars to facilitate information flow was costly in terms of project funds and time, and was less effective in reaching ordinary people at the grassroots level, especially the poor, who could not afford the time to participate in meetings. This finding is consistent with the views of Manzuri and Rao (2004), who argue that the poor may have wealth levels that are so low that participation in collective actions may violate their survival constraint (Appendix 1). In the case of the two Philippine projects, the OEM found that it was the village officers and beneficiary group leaders who repeatedly attended workshops, seminars, training courses, and monthly management meetings. In contrast, ordinary people interviewed seemed to be less informed (para. 39).

90. Instead of automatic application of a standard participation package (such as hiring NGOs, establishing beneficiary groups, conducting consultation workshops, providing training, and preparing village development plans) in all projects, it may be more efficient if project designers first clarify what is the real purpose of the proposed beneficiary consultation and participatory planning, and examine if there are alternatives that may serve the same purpose with less cost. Consideration could be given to the following:

- (i) If the purpose is to enhance the relevance of project interventions by collecting local knowledge, including in particular beneficiary priorities, village consultation workshops conducted during project implementation may be costly and less effective for three reasons: First, at the time of implementation, project interventions have already been determined. Collection of local knowledge is too late to influence the project design. Second, "beneficiary priorities" identified in workshops may be biased, as they most likely reflect the views and interests of the workshop participants, who may or may not represent the interest of the poor, especially in areas with high heterogeneity and a power structure that benefits only a few. In the cases observed in the Philippines, most workshop participants were village officers and group leaders instead of the poor. Third, in the cases studied, the final outputs of the workshops—the village development plans—were prepared by NGOs from outside the villages, hired by the projects. The "beneficiary priorities" listed in the

¹⁸ According to the guidelines, potential benefits of participatory approaches include more appropriate development interventions, better sustainability of development initiatives, increased ownership, greater efficiency, greater accountability, and empowerment. See ADB. 1996. *Mainstreaming Participatory Development Processes*. Manila.

village plans were influenced by the projects' agenda (paras. 67-68). A better alternative may be to interview beneficiaries, including in particular the poor and the disadvantaged, in their homes during the project design stage to obtain a thorough understanding of their constraints and underlying causes. At the implementation stage, a more inclusive and low-cost form of beneficiary participation may be the distribution of "development coupons" to targeted households, and to let them use the coupons to "vote" for their preferred subproject from preferred providers (para. 84[ii]). The coupons may increase the power of beneficiary "voice."

- (ii) If the purpose of beneficiary participation is to disseminate project information to beneficiaries, it may be more cost-effective to publicize project information on billboards in the local language and install them at popular locations such as local markets and bus stops. The use of mass media (television, radio, and newspaper) to disseminate project information is another alternative proven effective under the Kyrgyz project.
- (iii) If the purpose of the consultation is to ensure beneficiaries' support for the investment project, project proponents should be aware that beneficiaries' full support for an externally financed project may not carry significant meaning when the project is largely free to them. Available studies show that beneficiaries may support even a bad project as long as they will benefit a little from it, because a little is better than nothing when the project is free.¹⁹
- (iv) If the purpose of participatory planning is to generate beneficiary ownership of externally financed projects, the assumption that consultation generates ownership requires a critical review (paras. 76-80).
- (v) If the purpose of beneficiary participation is merely for the sake of participation, because it is required by ADB's guidelines, it may be cost-effective to review the ADB guidelines critically, and modify them accordingly to minimize undue use of public resources.

91. The above analysis does not imply that participation should be discarded, or that workshops and seminars should not be used. Rather, the findings suggest a need to put participation in a proper perspective with realistic expectations. Beneficiary participation is useful for collecting local knowledge to influence project design, and should be conducted during the project design stage. Workshops and seminars are useful for consulting stakeholders at the national or regional level, such as representatives from various government agencies, aid organizations, and civil society. To obtain the views of ordinary people including the poor and the disadvantaged, however, project designers need to conduct thorough fieldwork at the grassroots level, interviewing not only government officers and community leaders, but also ordinary residents, both poor and nonpoor.

D. Poverty Reduction Through Efforts of the Nonpoor

92. The OEM observed successful cases of indirect poverty reduction through appropriate incentives for the nonpoor under the Bangladesh, PRC, Kyrgyz, and Nepal projects. In the best subprojects visited in Bangladesh, a few large farmers played a key role in collecting user fees

¹⁹ Platteau, Jean-Philippe and Frederic Gaspart. 2003. *The Risk of Resource Misappropriation in Community-Driven Development*. World Development, Vol. 31, No. 10, pp. 1687–1703.

from beneficiaries and in managing O&M, because they had a strong self-interest to ensure the sustainability of the water control systems. A win-win result was observed at these subproject sites after the water systems controlled the annual flood and increased the water supply in the dry season. The large farmers benefited from increased profits brought about by increased crop yields and, more significantly, from the change of rice production to high value cash crops. The landless and jobless poor—casual laborers without permanent jobs, who were the majority in the villages visited—benefited indirectly from increased demand for labor and rising wages, because cash crops require more labor than rice production (Appendix 6).

93. The Nepal project involved the participation of 17 small PFIs, which were attracted by the interest spread offered by the project as well as by access to the ADB credit line, which enabled them to expand operations. As a result, the PFIs expanded their businesses, and the project achieved its objective of providing small loans to farmers.

94. The PRC project did not target the poor. Instead, long-term loans were given to private enterprises, none of them from the poor. As the ADB credit line enabled the enterprises to expand operations, rural residents benefited indirectly from the project due to the increased employment generated.

95. The Kyrgyz project, by offering an attractive interest spread and easy entrance requirement, motivated numerous individuals to establish CUs and participate in rural credit delivery. A win-win result was observed. The CU presidents—none of whom were poor—used CUs to employ themselves as well as their family members, relatives, and friends, and benefited from the profits made from allocating credit. The project reached its objective of increasing the rural credit supply for small borrowers. In conjunction with other factors, the increased number of players in the rural financial sector intensified market competition, and contributed to falling interest rates and improved credit services, such as reduced paperwork and shortened processing time. Since many CU borrowers, including shop owners in towns, used loans to buy animals or farmland, and hired labor to take care of their animals and crops, poor laborers, who did not borrow from the CUs, benefited indirectly through increased employment opportunities and rising wages (Appendix 8).

96. While the nonpoor benefited significantly from projects that intended to benefit the poor, they were also used by the projects as agents to achieve the project objectives, albeit unintentionally. The large farmers under the Bangladesh project managed O&M of the water systems; the private enterprises under the PRC project generated rural employment; the PFIs in Nepal and the CUs in the Kyrgyz Republic enhanced small farmers' access to rural credit.

97. These findings are consistent with those of other available studies, which reveal that elite capture of project benefits may not always be negative (Appendix 1). To some extent, elite domination is unavoidable in rural development projects, as project operation at the village level depends on highly motivated individuals who have the power to organize collective action in their villages and the capacity to communicate effectively with outsiders (footnote 7). Instead of bypassing local elites, it may be better to use them as an agent to work for projects, and design appropriate incentives to motivate them, from their self-interest, to strive for the achievement of project objectives.

98. The win-win result was not observed under the two Philippine projects, where the small-scale irrigation schemes benefited only a small number of the better-off farmers (including landlords) without noticeable impact on the landless and jobless poor, who were the majority in the villages visited by the OEM (Appendix 4). One major reason was the small amount of water

available in the dry season even after the subproject investment, which increased the water supply for only a small area (less than 100 ha in most cases, with the smallest system irrigating only 10 ha). The small increase in water supply did not lead to a shift from rice production to cash crops in these villages. The irrigation subprojects increased rice yields and thus the labor required for the rice harvest. The increased labor requirement, however, was too small to be noticed, as it was absorbed by family members of the water users. While these households—many of them the better-off in their villages due partly to their good farmlands located along irrigation canals—benefited from increased rice yields, the subprojects did not cause any noticeable impact on the poor, even though the projects were located in poor regions. This is similar to what was observed in the conventional projects, where location of a project in a poor region did not guarantee a reduction in poverty.²⁰

99. Since the landless and jobless poor had only labor to offer, many of them said that the best way to help them was job creation. It seems that a win-win result can be generated if appropriate incentives are provided to motivate the active participation of the nonpoor in rural employment generation.

100. The OEM noted, however, that not all assistance to the nonpoor automatically generated the desired impact on the poor or the realization of project objectives. For example, the subsidized equipment given to processing enterprises under the Nepal project did not lead to the anticipated impact of promoting livestock marketing. The key constraint faced by the enterprises was not a lack of equipment or subsidy, but price distortions imposed by the dominating state milk company (para. 65). Without removing the binding policy constraint, the project subsidies benefited the nonpoor without generating positive impact on the poor. Similarly, large loans provided for cage fishing under the PRC project, while benefiting the nonpoor, did not generate significant employment for the poor, largely due to the capital-intensive nature of cage fishing (para. 62). In these cases, the private sector benefited from project investment but did not contribute to the fulfillment of project objectives.

101. Careful study in the project areas is needed at the project design stage to obtain a sound understanding of the local realities, which may determine whether or not public assistance to private individuals or enterprises will lead to poverty reduction. One key factor seems to be the use of labor-intensive technology, which increases the demand for labor.

E. Deviation from the Standard Model

102. The CUs established under the Kyrgyz project deviated significantly from the standard CU model or the generally accepted “best practice,” by which a CU should be savings-based, members should have a common bond, and lending to members should not require collateral. In contrast, many members of the CUs visited by the OEM did not have a common bond; all loans were given against collateral; and CUs operated well without taking any savings deposits. These deviations resulted from particular conditions in the Kyrgyz Republic during the transitional period, where savings-based CUs were not possible due to the lack of a legal framework, low public confidence in banks, and insufficient demand for savings deposits (Appendix 8). The OEM found that most borrowers were interested in access to credit services instead of CU ownership, and some CUs functioned essentially as private-run retailers, channeling the ADB credit line to small rural borrowers at the household level. In spite of the deviations, the project fulfilled its objective of increasing rural credit supply to facilitate

²⁰ ADB. 2002. *Project Performance Audit Report on the Second Barani Area Development Project in Pakistan*. Manila.

agricultural recovery—an urgent issue at the time of project design. In contrast, the apex company, established based on the theory that CUs should have an apex over them, suffered from various problems (para. 63).

103. The PRC project used a top-down approach in project implementation. Although consultations with stakeholders were conducted at the design stage, no time and no resources were spent during project implementation on beneficiary consultation and participatory planning. No NGOs were engaged, no beneficiary groups were established, and no banks were involved. Instead, the existing government structure and village committees were used to channel loans to end borrowers and to collect repayments. The adoption of these approaches was based on the local realities at the time of project design, when no banks were willing to lend to farmers, but local governments and village committees were strong and functioned well. These approaches were also derived from the particular needs of the project intervention, which focused on the provision of long-term credit for private enterprises, and through them to generate employment. There was no need for NGOs or beneficiary groups.

104. These cases suggest that relevant project interventions are best formulated based on local realities in the project areas instead of merely a theory, a standard model, or a “best practice.” Since a particular project area at a particular period has its particular nature, it is not realistic to assume that there is a standard, universally applicable model. As concluded by Manzuri and Rao (footnote 7), the best practice may be the absence of a best practice.

F. Project Monitoring and Data Requirements

105. Project staff interviewed complained about the increase in monitoring requirements and data demanded by ADB in recent years. While this has been met, it has been partly at the cost of compromised quality of the data submitted. The OEM was told that some field staff “manipulated” (or “created”) the required data, partly due to difficulties in collecting such data with reliability, but also due to insufficient time for adequate fieldwork. Project staff at the management level did not check data accuracy carefully due to pressure to submit the required reports to ADB on time. In addition, data collection was seen by EAs as an additional transaction cost of using funds from ADB and of limited value to themselves. The monthly or quarterly reports submitted to ADB had few readers. Project staff focused on meeting ADB requirements on time as budgetary allocations were based on achievements of such targets. ADB seemed to focus more on the timeliness of report submission in line with the monitoring system, and gave insufficient attention to data quality and reliability and the actual use of the data.

106. The real value of the numerous monitoring requirements, which seem to be dominated by indicators reflecting project activities and outputs instead of results and impacts, needs to be critically reviewed.²¹ Two factors might have restricted the usefulness of this data. First, the collection of accurate data requires significant time, resources, and staff skills to conduct appropriate fieldwork. In many cases, the increased monitoring requirements were imposed on project agencies and field staff by ADB in the project design without a parallel increase in resources, time, and staff. The harsh reality is that most EAs have insufficient budgetary resources and limited staff capacity. This resulted in lower quality data collected and submitted. The timely submission of monitoring reports might have contributed to a high level of compliance with project requirements, but not necessarily better project management.

²¹ Most progress reports examined by the OEM contained numerous data on the accomplishment of physical targets but little information on the realization of project objectives and impacts.

107. Second, most interventions under rural development projects were discretionary by nature, especially the “soft” components such as agricultural extension, training, and capacity building, for which it is the quality of the services rather than quantity that matters. Thus, the fulfillment of project targets, such as the number of training courses and trainees, the number of beneficiary groups and members, and the number of female participants, might not carry significant meaning. Such data does not reflect the quality or usefulness of the services, or the realization of project objectives. This is true even in the case of rural infrastructure such as irrigation and drinking water systems.²²

108. In the above cases, the objective of the public (the principal) was poverty reduction. The objectives of project providers (the agent), however, were associated with budgetary allocations, contract awards, and payments. Since budget allocations were linked to the fulfillment of targets (such as kilometers of roads or number of irrigation systems, wells, training courses, or trainees) rather than the project goal (such as the number of poor people exiting from poverty), project offices naturally monitored the fulfillment of physical targets instead of the realization of project objectives. The OEM found a tendency for ADB to design complicated monitoring systems and require comprehensive data to cover ADB requirements rather than a sharp focus on data that are absolutely necessary for assessing the realization of a project’s goal and objectives. This added to the transaction costs of the EA, weakening the incentives to collect the data.

109. Instead of requiring comprehensiveness in project monitoring, it may be better to design project monitoring systems that focus on data reliability and timeliness. It may be necessary to reduce data requirements if sufficient resources—time, money, and staff—needed to collect data with reliability do not exist. Monitoring requirements should focus on a few critical indicators that (i) reflect project results, and (ii) are relatively easy to collect with reasonable reliability. Examples include (i) the number of jobs generated by enterprises supported by a project, (ii) the number of poor households in a village before and after a subproject investment, (iii) the percentage of households directly assisted by a subproject in a village, and (iv) the percentage of villages directly assisted by a project in the project areas. These indicators are important as they provide a clear picture of a project’s impacts. The OEM observed that some projects, while covering a large number of districts or subdistricts, directly assisted only a small portion of the villages in these districts or subdistricts, and a tiny portion of households in the project villages.

110. The OEM is of the view that indicators of project objectives/goals should be monitored during the course of project implementation and not just after project completion when project funds are no longer available for monitoring. Since subprojects are usually implemented in a phased manner, for each subproject completed it should be possible to monitor the number of households directly assisted by that subproject, the number of jobs created, or the number of households exiting from poverty in that village. As a lesson learned from project monitoring: “You get what you monitor,”²³ it is likely that focusing on monitoring project results rather than

²² In examining a drinking water component under a rural development project, a postevaluation mission found that about 37% of the wells constructed did not function. Of the functioning wells, about 70% produced water that was not potable, because project staff and contractors focused on fulfilling physical targets without sufficient attention to water availability and quality. Instead of monitoring the number of wells constructed, that project should have monitored the number of households that received potable water before and after a subproject construction. This mission also found overdesign of small irrigation systems, because engineers adopted the easy way of following a standard design instead of preparing the least-cost design based on local conditions (see ADB. 2002. *Project Performance Audit Report on the Second Palawan Integrated Area Development Project in the Philippines*. Manila).

²³ In the case given in footnote 22, the project monitored the number of wells constructed but not the number of households that received potable water. As a result, the project constructed many wells that did not produce potable water.

activities may encourage project staff to focus on results instead of physical targets. To facilitate such a reorientation, appropriate incentives are needed. Budgetary allocations may be linked to project results (such as the number of poor households or percentage of those in poverty being reduced) rather than activities or physical targets.

G. Thorough Fieldwork at the Project Design Stage

111. From the projects examined, the relevance of project interventions and the sustainability of project benefits depend, to a significant degree, on thorough fieldwork conducted at the project design stage. In the best cases observed, the design of project interventions focused not only on the most binding constraint in the project areas, but also on its primary causes. For example, the PRC project initially aimed at addressing the issue of severe soil erosion in the project areas. After thorough fieldwork, the project designers recognized that the primary cause of the soil erosion was the intensive population pressure and the large amount of surplus rural labor, who depended on intensive grain production on hills and slopes, endangering the fragile red soil. Without substantial employment generation to absorb the surplus labor, promotion of soil conservation measures would not be feasible and sustainable. Consequently, the project design focused on employment generation through the provision of long-term credit to private enterprises, whose business expansion had been restricted by the lack of long-term capital.

112. Similarly, the Kyrgyz project focused on the provision of credit to rural borrowers to enable agricultural recovery—an urgent issue at the time of project design. Recognizing the negative influence of the Soviet culture, under which farmers considered loans from the government as grants or subsidies with little need for repayment, the project used private individuals to organize CUs and deliver credit instead of using national agencies or local governments. While the CUs established under the project deviated significantly from a standard model of commonly accepted “best practice,” they worked effectively and are likely sustainable (para. 73).

113. In contrast, the design of some projects apparently borrowed a standard model of integrated rural development, simultaneously investing in (i) rural infrastructure (roads and irrigation), (ii) agricultural support (supply of inputs, farm extension, and training), and (iii) social services (drinking water supply). While these elements are needed in all rural areas, they are not necessarily the most binding constraints restricting rural development in a particular project area. The OEM observed blind investment in upgrading short dead-end roads without bringing in businesses, promoting growth, generating employment, or reducing poverty. Investment in small-scale irrigation benefited only a small number of better-off farmers, without noticeable impacts on the poor (para. 98).

114. The design of some projects was not based on a sound understanding of rural institutions in the project areas. For example, the two Philippine projects engaged NGOs to prepare village development plans instead of using existing village councils or village development councils, which are by law responsible for village development, and have better sustainability than NGOs. Instead of using existing groups in the project areas, the Nepal project adopted a standard package of establishing beneficiary groups, distributing subsidized inputs, and conducting training courses. The OEM found that groups organized by the project required intensive supervision and continued subsidies, in contrast to the microcredit schemes that were run almost independently by villagers without financial support from the project, due largely to a real demand from beneficiaries (paras. 58, 71).

115. The lack of sound analysis at the project design stage is criticized by another ADB study,²⁴ which found that many investment projects are proposed without a clear understanding or careful analysis of the issues to be addressed by the investment. Many projects address the symptoms or effects of a problem instead of its primary causes.

116. Instead of a standard requirement of beneficiary consultation and participatory planning at the implementation stage, when project interventions have already been determined, thorough fieldwork should be required at the project design stage. The first requirement could be a clear identification of the most binding constraints in the project areas, and a thorough analysis of the various factors underlying the constraints. In addition to meeting government officials and community leaders, project designers, including ADB staff, should spend sufficient time and effort to interview poor households directly. It is essential to collect not only official views but also the views of ordinary people at the grassroots level to understand their concerns and constraints.

117. The second requirement would be to conduct a vigorous analysis of local institutions. This would include assessing the homogeneity or heterogeneity of the population, initial equalities or inequalities, local power structure, various social groups and their relationships, formal and informal roles and practices, private sector responses to proposed policies and incentives, the capacity of the poor to take advantage of the project investment and the likely distribution of project benefits. The history of past external assistance and legacies—both positive and negative, including aid dependency fostered by free assistance—should also be carefully examined.

IV. CONCLUSIONS

118. Participation has been seen as a step forward compared with the top-down and supply-driven approach used in the past. However, participation has its own limitations. Findings from the SES do not support the assumption that participatory or bottom-up approaches offer an automatic or effective solution to conventional problems, which are complicated, with no ready, easy, or standard solutions. In the projects studied, two of the most worrisome problems—less relevant project interventions and poor project sustainability—were persistent, even in cases where substantial resources and long periods were spent on beneficiary consultation and participatory planning. To understand why the new approaches do not solve the conventional problems, this section first examines in what aspects and to what extent the new approaches have changed the roles of major players or the principal-agent relationships. After that, an analysis of the causes underlying the conventional problems is provided, followed by insights obtained from the case studies. Finally, recommendations on the direction of future improvements are made.

A. What Has Changed in the Roles of Major Players?

119. **Information Flow.** Information about project implementation flowed upwards in the projects studied, similar to conventional projects. What was new was the downward flow of project information to project areas. In five of the six projects studied, the downward flow of project information seemed to be limited to a small portion of the residents in the project areas, including primarily village officers, group leaders, and direct beneficiaries, such as group members or selected end borrowers. The only exception was the Kyrgyz project, which disseminated project information to the general public via mass media; the widely disseminated

²⁴ ADB. 2004. *Economic Analysis Retrospective: 2003 Update*, June. Manila.

information on project policies, in conjunction with other factors, contributed to intensified market competition (para. 42). A major factor underlying the power of information in this case was CU members' multiple choices of credit suppliers (Appendix 8). Increased access to information is a powerful tool when beneficiaries have multiple choices of service providers.

120. **Resource Control and Decision Making.** Similar to the case of conventional projects, ADB and national governments controlled most resources (project loans and government counterpart funds) and determined project interventions. EAs controlled budgetary allocations to frontline providers and determined implementation guidelines. Frontline providers followed guidelines and exercised discretionary power in selecting beneficiaries and determining subproject activities. Beneficiaries controlled few resources and had little say in investment decisions. What was new was the involvement of local governments: Some of them influenced the selection of subprojects and sites when they contributed counterpart funds for subproject investment (Appendix 4); some selected end borrowers when they were required to guarantee subloan repayments (Appendix 5).

121. **Delivery Mechanisms.** Similar to the case of conventional projects, subprojects were delivered by EA offices, field staff, and contractors. What was new in some of the projects studied was the use of NGOs and beneficiary groups as mechanisms to implement project activities at the grassroots level, such as distributing subsidized inputs to farmers. However, these mechanisms were not sustainable because NGOs left local communities after contract expiration without creating significant impacts. Beneficiary groups depended heavily on project funds, with little likelihood of continuity when funds were no longer available after project completion.

122. **Accountability.** Similar to the case of conventional projects, accountability of providers was upward under the new projects studied. Field staff and contractors responded to EA offices; EAs responded to ADB and national governments. There was no evidence of downward accountability of providers to beneficiaries.

B. What Has Changed in the Principal-Agent Relationships?

123. In most cases, the new projects studied did not differ significantly from conventional projects, where ADB and national governments acted as the proxy principal, with EAs and frontline providers being the agent. By allocating project loans and budgets, the proxy principal controlled the agent, and the agent responded to the proxy principal. Beneficiaries had a limited role. Their nominal "free labor" (para. 45) or 3% cash contribution (para. 46) to subproject investment was too small to give them real power over providers.

124. The new changes observed included the use of NGOs and beneficiary groups as agents to work for EAs and frontline providers. NGOs were awarded contracts and implemented project activities as dictated by their terms of reference. Beneficiary groups received subsidized inputs or entitlements to construction work, and cooperated with frontline providers in project implementation, such as distributing inputs to group members or participating in consultation workshops.

125. Some middle-income groups (such as small PFIs under the Nepal project, agroprocessing enterprises under the PRC project, and CU presidents under the Kyrgyz project) were used as agents to achieve project objectives. The OEM found that these private participants were attracted by the incentives offered by the projects, such as interest rate spreads or access to credit. They participated in project implementation, benefited themselves

by taking advantage of project interventions, and contributed to the fulfillment of project objectives, such as increasing farmers' access to small loans under the Nepal project, employment generation under the PRC project, and increased rural credit supply under the Kyrgyz project.

126. In the best subprojects observed under the Bangladesh project, a few large farmers acted as agents as well, although this was not intended by the project design. Due to their large farm holdings in the subproject areas, they were the largest beneficiaries of the subproject investment in water control systems, and had the most to lose if the systems failed due to poor O&M. For reasons of strong self-interest, they played a key role in collecting user fees and organizing O&M, and thus contributed to the sustainability of the water systems.

C. The Real Causes of the Conventional Problems

127. Findings so far show that both the past and the new projects examined suffered similar problems regardless of their top-down or bottom-up approaches. Blaming the top-down approach as the primary cause of this is overly simplistic. This SES suggests alternative explanations of the causes of the conventional problems (para. 1):

- (i) Less relevant project interventions are not attributable to the top-down approach and standard project components. Rather, the problem reflects a lack of thorough understanding of the local realities in particular project areas, due largely to a lack of vigorous due diligence work at the project design stage. While project designers, acting as the proxy principal, are supposed to design projects in the best interests of the public (the principal), they may also have their own agendas that deviate from this. For example, consultants may focus on meeting various ADB guidelines and requirements; ADB staff may focus on obtaining government concurrence to deliver projects on time as demanded by their supervisors. These motivations may negatively affect the time and effort spent on fieldwork at the grassroots level and, consequently, the quality of project design.
- (ii) Poor sustainability of project benefits may not be associated with beneficiaries' lack of ownership. Rather, it more likely reflects weaknesses in the project design, which fails to recognize deviations in the objectives of the principal, the proxy principal, the agent, and the beneficiaries. In the case of poor road maintenance observed in the two Philippine projects, local governments have strong incentives to seek additional road investment and less interest in O&M, due largely to the lack of appropriate incentives for local governments to work for the best interests of the public (sustainability of project benefits) instead of promoting their own agenda (bringing in additional investment projects to spread public popularity). In the case of deterioration of small-scale irrigation systems, the problem reflects an aid-dependence syndrome fostered by free external assistance in the past, and the moral hazard of waiting for free assistance instead of using own resources and effort (para. 80). Considering irrigation investment as a free gift from governments, the objective of some user groups was to maximize subsidies received and minimize their own cost.
- (iii) Project staff's lack of incentive to improve services or reduce costs might be associated with weaknesses in project design that allocates budgets to providers based on physical targets instead of quality of services, beneficiary satisfaction, or realization of project objectives. Consequently, project staff focused on fulfillment of physical targets and gave less attention to beneficiaries.

- (iv) Local influential persons' capture of project benefits may not be avoidable, and is not always a problem (footnote 7). Under certain conditions, these people may be used as an agent to work for the interest of the public. In the best subprojects observed under the Bangladesh project, a few large farmers were motivated, in their own self-interest, to work for the sustainability of subproject investment, which benefited not only themselves, but also the landless poor, albeit indirectly (para. 92). The "certain conditions" depend on local realities, including, among others, heterogeneity of the local communities, appropriate incentives for the better off and influential, and careful selection of the latter to avoid those who are interested in investment but not O&M, such as absentee landlords, contractors, and businesspeople, whose major revenues are not from agriculture (Appendix 6).

D. New Insights

128. Findings from the case studies provide new insights into the issues examined:

- (i) The typical forms of participatory or bottom-up approaches examined did not offer an effective solution to the conventional problems because they did not alter the principal-agent relationships among policymakers, providers, and beneficiaries. While citizens as a whole (the public) were the principal, beneficiaries—individually or as groups—did not have the authority as the principal to hold providers as their agent in the indirect provision of services via policymakers. Providers were the agents working for policymakers and therefore responded upwardly to policymakers instead of downwardly to beneficiaries.
- (ii) The conventional problems—especially less relevant project interventions and poor project sustainability—are persistent, prevailing in not only past projects but also in the new generation of rural development projects examined. A deeply seated institutional cause of the problems seems to be intrinsic in the nature of the grant financing of the projects, which are largely free to beneficiaries, whose lack of payments to providers underlies their lack of real power to hold providers accountable.
- (iii) Of the five central elements of service delivery—information, resource control, decision making, delivery mechanisms, and accountability—control of resources is the most critical, since it determines the power in decision making and the authority as the principal to hold providers accountable. In a competitive market, clients individually act as the principal to hold providers accountable because they control payments to providers. In rural development projects, project funds are controlled by policymakers. Beneficiaries control few resources and therefore have little power in decision making and little authority in controlling providers.
- (iv) Information flow and delivery mechanisms are less important in the cases studied. Information was powerful under certain conditions, such as when beneficiaries had multiple choices of providers (para. 119). Some of the participatory approaches (such as beneficiary consultation, participatory planning, NGO engagement, and beneficiary group formation) focused on information flow or delivery mechanisms instead of the key issue of resource control, and achieved more rhetoric than real results. In contrast to some ideologically or politically correct beliefs, what works in this imperfect world is the principle of no pay, no play.

E. Recommendations

129. Where projects have been successful, it has not been the application of a standard package of participatory approaches that have made project interventions more relevant or sustainable. Rather, a thorough understanding of local realities in the design of project interventions was the driver of success. Rather than adopting a uniform application of participation during project implementation, ADB should require thorough fieldwork at the project design stage (paras. 116-117) and encourage the design of local solutions for local problems based on local realities. Participation may be used as one of the tools at the design stage to obtain local knowledge. The 1996 staff instruction on mainstreaming participatory processes into ADB operations needs revisiting. Incentives should be provided for project designers, together with sufficient time and resources for both consultants and ADB staff to conduct thorough fieldwork at the grassroots level.

130. The use of participation should have a clear purpose, because it is not a goal in itself but a means to achieve an objective. The specific form of participation may vary depending on the particular needs of the objective as well as local conditions in project areas. The practice of applying a standard package of participation in all rural development projects without a clear purpose—by hiring NGOs, organizing beneficiary groups, conducting consultation workshops, providing training courses, and developing village plans—is not necessarily effective or efficient and should be discontinued.

131. Depending on specific conditions, alternative forms of participation need to be explored. For example, it may be more effective to establish and strengthen the direct relationship between beneficiaries and providers by making providers more accountable to beneficiaries through project designs that:

- (i) give purchasing power to beneficiaries by distributing available project budgets to targeted beneficiaries in the form of “development coupons” (para. 84 [ii]); beneficiaries would use the coupons to “pay” providers and hold them accountable; this is similar to demand-side financing and the voucher schemes practiced in some countries (para. 15);
- (ii) promote competition among providers by allowing beneficiaries to choose providers from multiple choices—government agencies, private companies, local contractors, and NGOs; and/or
- (iii) make providers respond downwardly to beneficiaries by evaluating providers based on beneficiary feedback by, for example, assessing beneficiary satisfaction prior to paying contractors; the idea of user report cards or user endorsement of payments to contractors (para. 84 [i]) may deserve pilot testing; these ideas are similar to the citizen’s report card used in Bangalore, India (para. 15).

132. In cases where the direct approach is not practical, design appropriate incentives for policymakers (the proxy principal) and providers (the agent) so that their best interest, given the incentives, is to achieve the objective of the public (the principal). Examples may include the following:

- (i) Align incentives for project designers in ADB to work for the best interests of the public instead of their own agendas by rewarding project designers and their

supervisors based on the quality of project design instead of the number of loans approved.

- (ii) If possible, align incentives for EAs and frontline providers by linking budgetary allocations to the realization of project objectives instead of activities or outputs. For example, the investment budget for drinking water supply may be allocated based on the number of households that receive potable water instead of the number of wells or water systems constructed. Instead of allocating the budget based on the number of training courses conducted or beneficiary groups established, it may be better to make allocations based on the number of poor households directly assisted or exited from poverty. This approach may provide incentives for EAs to focus on projects' objectives rather than on physical targets.

133. Assuming that the objectives of a rural development project reflect the best interests of the public (the principal), various players—EAs, frontline providers, beneficiaries, PFIs, NGOs, private enterprises, influential citizens, and local politicians—can be used as agents to achieve project objectives. To be effective, project designers should keep in mind that these agents have their own agendas, which may differ substantially from the project objectives.²⁵ In spite of their different motivations, however, they may contribute to the realization of project objectives if appropriate incentives are offered so that their best interest is to achieve the objectives of the project. Within this context, the following ideas deserve consideration:

- (i) Contract out employment generation or poverty reduction to the agents and provide them project assistance (such as project funds, access to credit, or other investments that release their key constraints) conditional on the number of jobs created, or the number of poor households exiting from poverty through the efforts of these agents.
- (ii) Provide incentives for beneficiaries to treat project funds as their own funds and motivate them to demand least-cost subproject design, monitor subproject construction, and maintain the infrastructure after construction. Examples of measures may include (a) providing long-term loans instead of free funds for village investment; (b) offering matching funds based on communities' counterpart contributions; (c) giving a one-time grant to a community for establishing a village fund in conjunction with a strict policy of no future assistance to this community (para. 84[iii]); and (d) open bidding for access to project assistance among communities with the same level of poverty, with an aim to promote competition among them. The last measure may lead to the selection of communities with the highest demand and willingness to pay for the subproject investment. It may also mitigate the negative impact of "easy money" from donors.

134. In principle, these recommendations may be applicable to locally produced services, which are the outputs of most rural development projects. The distinction between public and private goods may not carry significant meaning due to the small size of the "public goods."²⁶ A

²⁵ For example, local politicians may wish to bring in ADB-financed projects for political patronage; NGOs use projects for revenue generation; PFIs and private enterprises are interested in project credit for business expansion.

²⁶ For example, many small-scale irrigation systems visited by the OEM benefited fewer than 50 households; many rural roads covered only 1-3 villages, including a cemented road of 1.5 kilometers leading to a dead end in a village with about 50 households (Appendix 4).

more important feature of these goods is their discretionary nature, as their effectiveness depends on the relevance of the interventions in relation to local conditions as well as the quality of the services. In practice, however, these measures should not be automatically applied to all projects without a prior understanding of the local realities in particular project areas. Pilot testing is required, followed by vigorous evaluation of the pilot results.

135. As summarized by Pritchett and Woolcock (footnote 6), the old king is dead, but there is no new king who can take his place. What are needed are conditions under which efforts to find more appropriate local solutions to local problems can be nurtured and sustained. Since there is no ready solution, innovative approaches are needed. Instead of tolerating the repetition of conventional problems, it would be better to risk new approaches with the possibility of mistakes and failures, if they may lead to more appropriate and workable solutions. It is in this spirit that the above recommendations, albeit unrefined, are proposed for discussion and consideration. By nature, innovations should be pilot tested before conclusions are drawn.

LITERATURE REVIEW

1. This appendix summarizes the findings of a literature review, including (i) postevaluation findings on conventional rural development projects; (ii) analyses of causes underlying the problems observed in conventional projects; and (iii) evaluation and other studies on the new or bottom-up approaches worldwide.

A. Conventional Problems and Underlying Causes

2. Postevaluation studies conducted by the Asian Development Bank (ADB) have repeatedly reported problems with conventional projects. In 1995, a sector synthesis based on postevaluation findings from 57 irrigation and rural development projects found that only 40% of the projects were rated generally successful, 48% partly successful, and 12% unsuccessful.¹ One common cause highlighted in that study was weak project sustainability. Postevaluations conducted in the early 2000s continued to report similar problems in rural development projects adopting a standard integrated area development model. These problems included (i) less relevant project interventions due to a lack of tailor-made solutions to local problems at vastly different subproject sites; (ii) poor sustainability of subprojects due to local governments' and communities' lack of ownership; (iii) project staff's lack of incentive to reduce project costs or improve services, leading to inefficiency, such as overdesign and poor construction of infrastructure; and (iv) insignificant impact on poverty reduction, even when projects were located in poor regions, due largely to local influential persons' capture of most project benefits.²

3. These problems were not unique to projects financed by ADB. The *World Development Report 2004: Making Services Work for Poor People* (WDR 2004) highlights the issue that public services too often fail poor people in terms of access, quantity, and quality.³ Recent research by Pritchett and Woolcock (2002)⁴ shows that the conventional problems are "systemic," because failures routinely occur even in settings where intentions and resources are reasonably good. They further point out that the problems are intrinsic to the nature of the project design, which considers "inadequate services" as *the* problem, and the supply of top-down and uniform public services as *the* solution, ignoring the interactions among clients (beneficiaries), service providers (government agencies), and policymakers (aid agencies and national governments). Attempting to remedy the problem of inadequate services by calling upon a centralized bureaucracy to supply a top-down and uniform public service, three steps are typically used in the design of conventional projects: (i) define the goal as a "need"; (ii) find the least-cost supply solution, which is usually standardized; and (iii) implement this solution nationally by government agencies.

4. The primary weakness of this "needs/supply/civil service" model is that it treats all problems as amenable to the logic of "policies" and "programs." Under these programs, resources are centralized; information is tightly controlled and flows internally and upward;

¹ ADB. 1995. *Sector Synthesis of Postevaluation Findings in the Irrigation and Rural Development Sector*. Manila.

² ADB. 2000. *Project Performance Audit Report on the Sorsogon Integrated Area Development Project in the Republic of the Philippines*. Manila; ADB. 2002. *Project Performance Audit Report on the Second Barani Area Development Project in Pakistan*. Manila; and ADB. 2002. *Project Performance Audit Report on the Second Palawan Integrated Area Development Project in the Philippines*. Manila.

³ World Bank. 2004. *World Development Report 2004: Making Services Work for Poor People*. Oxford University Press.

⁴ Pritchett, Lant and Michael Woolcock. 2002. *Solutions When the Solution Is the Problem: Arraying the Disarray in Development*. Center for Global Development, Working Paper No. 10.

decision making is done primarily by government agencies; delivery mechanisms are via government agencies; and accountability of the service providers flows internally and upwards.

B. New Solutions and Expectations

5. When the old solutions failed, the initial response was intensification, amplification, and policy reform. When these solutions also failed, and thereby became *the* problem, a variety of new responses emerged, including in particular the bottom-up approach of beneficiary consultation and participation. In rural development, a new generation of community-based development (CBD) or community-driven development (CDD) projects have been designed and implemented worldwide.⁵

6. High expectations have been established for CBD and CDD projects, which are viewed as a mechanism to (i) enhance project sustainability; (ii) improve efficiency and effectiveness; (iii) allow poverty reduction efforts to be done to scale; (iv) make development more inclusive; (v) empower poor people, build social capital, and strengthen governance; and (vi) complement market and public sector activities.

C. Evaluation of the New Approaches

7. While most CBD/CDD projects are ongoing, Manzuri and Rao (2004) of the World Bank conducted a critical review of the performance of such projects.⁶ The review examined 138 studies, including (i) impact evaluations that use statistical or econometric techniques to assess the causal impact of specific project outcomes, and (ii) ethnographic/case studies that use anthropological methods such as participant observation, in-depth interviews, and focus group discussions. While the last cannot be used to attribute impact, they often provide a more nuanced and contextualized picture of CBD/CDD processes, in particular contexts, and yield insights that can be difficult to generate with quantitative techniques.

D. Major Findings

8. Findings from the review of 138 studies, however, did not support the high expectations of CBD/CDD (para. 6). Overall, the evidence does not suggest that CBD/CDD projects have been well targeted to the poor within communities. There is some evidence that CBD/CDD projects create effective community infrastructure and improve welfare outcomes. However, such evidence is missing for most projects. Also, these studies also do not establish that it is the participatory elements in CBD/CDD projects that are responsible for improving project outcomes.

9. Furthermore, new problems are encountered. Manzuri and Rao (2004) find that a naïve application of complex contextual concepts like “participation,” “social capital,” and empowerment” is endemic among project implementers, contributing to poor design and implementation of development projects.

⁵ In this study, CBD refers to projects that actively include beneficiaries in their design and management; CDD refers to CBD projects where communities have direct control over key project decisions as well as the management of investment funds.

⁶ Manzuri, Ghazala and Vijayendra Rao. 2004. *Community-Based and -Driven Development: A Critical Review*. World Bank Policy Research Working Paper 3209.

E. The Discretionary Nature of Services

10. Pritchett and Woolcock (2002) find that a major cause underlying the conventional problems is the nature of services, which are discretionary to the extent that their delivery requires decisions by providers to be made on the basis of information that is imperfectly specified and incomplete, thereby rendering them unable to be mechanized. The right decision depends on conditions that are difficult to assess, and hence it is very difficult to monitor whether or not the right decision was taken.

11. Similarly, the WDR 2004 considers services as transaction-intensive, and the transactions require discretion. That report highlights three characteristics in locally produced services that make it particularly difficult to structure relationships of accountability. First, services are discretionary and transaction intensive. Second, they are multiple tasks with multiple principals. Finally, it is difficult to attribute outcomes.

F. The Principal-Agent Problem

12. To provide an in-depth analysis of the problem, Pritchett and Woolcock (2002) apply a “principal-agent” model. The “principal-agent” problem arises when one actor, called the principal, with one objective contracts with another actor, called the agent, to undertake a task that affects the principal’s objective, knowing the agent may have a different objective. In this case, the problem facing the principal is how to structure the incentives for the agent so that the agent’s best interests, given those incentives, lead to a desirable outcome for the principal. Thus, effective service provision depends on the structure of incentives facing providers and recipients.

13. This assumption is supported by empirical studies reviewed by Manzuri and Rao (2004), who find that project implementers’ own incentives are often poorly aligned with the needs of the projects. Implementers may choose to gloss over differences within target groups that underscore local power structures, and to shortchange the difficult and more time-intensive task of institution building in favor of more easily deliverable and measurable outcomes. In other cases, studies report that both beneficiaries and project implementers have an incentive to present an impression of a successful project to outsiders, and may collude for this purpose.

G. Problems with Best Practices

14. Furthermore, Manzuri and Rao (2004) note a tendency in the World Bank for project designs to “borrow” best practices that work well in a particular country and air-drop them into very different settings. Given the contextual complexities involved, initial designs based on best practices are bound to be imperfect, because “practices” are by definition not able to be standardized and (easily) replicated. To caution against such an approach, Manzuri and Rao suggest that terms such as “best practices” be retired into the archives of development, and much greater emphasis be placed on contextualized project design. In their views, the best practice may be the absence of a best practice. Effective CBD/CDD has to involve slow, gradual, persistent learning-by-doing where project design gradually adapts to local conditions by learning from the false starts and mistakes that are endemic to all complex interventions.

H. Manipulation of Local Needs

15. One study reviewed by Manzuri and Rao (2004) reports that, even in projects with a high level of participation, identified local needs could be shaped by local power relations, or by

outsiders' agendas: Project facilitators may shape and direct consultation processes; villagers' "needs" may be shaped by perceptions of what the project can deliver; and, in some cases, the idea of participation is used to legitimize a project's own priorities and needs.

I. Positive Role of Local Elites

16. Against a commonly held belief, Manzuri and Rao (2004) find that domination by local elites need not always be a problem. In fact, some degree of domination is perhaps inevitable, particularly in rural development projects, where local elites are often leaders who embody moral and political authority. Often, they are also the only ones who can effectively communicate with outsiders. Since they are likely to have strong interests in the common pool resource, they have strong incentives to protect such resources. In heterogeneous communities, a small group of motivated individuals may make greater contributions to the project, perhaps because they are better educated, have fewer opportunity costs on their time, and therefore have the greatest net benefit from participation. In contrast, the poor may have wealth levels that are so low that participation in collective actions may violate their survival constraint.

17. An empirical study reviewed by Manzuri and Rao (2004) investigated village institutions in a district in South India and found that mobilizing community action may require the leadership of the more educated and well-connected. It may be necessary to organize around existing structures of authority, with a major role for them, because effective village bodies are often composed of those who can exercise authority.

18. Furthermore, a number of theoretical studies suggest that inequality can be conducive to the provision of public goods. In contrast, in a large homogenous group, where no single individual or group can make any significant difference in the provision of public goods, all would want a free ride, leading to no provision. This occurs because of a dilemma, as cooperation is collectively rational for the group as a whole, but individual cooperation is not necessarily individually rational for each member. Thus, smaller and more unequal groups might do better, as collective action can impose differential costs and benefits on members of a heterogeneous community.

19. Based on the above arguments, Manzuri and Rao (2004) suggest a distinction between potentially "benevolent" forms of elite domination and more pernicious types of "capture." What matters is not elite domination but an understanding of what types of checks and balances are most effective in a particular project area to reduce capture by elites and systematic exclusion of the poor.

J. Beneficiary Payments and Accountability

20. The WDR 2004 reports an interesting case, where poor farmers in Haryana State in India were paying a significantly high level of user fees for irrigation services. As a surprise to the interviewer, these farmers said that they were happy to pay, because now the irrigation departments were much more accountable to them. In the words of a farmer, "We will never allow the government to again give us free water."

K. Market Mechanism and Accountability

21. The WDR 2004, after attributing the conventional problems to the failure of institutional accountability, promotes institutional reforms to strengthen accountability in three key

relationships in the delivery of public services: between poor people and providers, between poor people and policymakers, and between policymakers and providers. Specifically, it suggests (i) increasing the power of the poor over providers by giving them finance directly, (ii) increasing competition, and (iii) increasing information about services and providers. For the first purpose, the WDR 2004 suggests the use of voucher mechanisms to increase the purchasing power of the poor, giving poor people more direct say in what gets delivered. For the second purpose, it suggests promoting competition by allowing subsidies to the poor to be portable between public and private providers, because private providers may not exist simply because services provided by the public sector are free. Governments can increase competition by changing the form of subsidy from a zero price to competitive prices, with cash or voucher payments to compensate. For the last purpose, the WDR 2004 suggests strengthening the role of clients in revealing demand and in monitoring providers by increasing poor people's choice and participation in service delivery.

22. Finally, the WDR 2004 argues that institutional arrangements need to take advantage of the strengths of the market—with its strong customer responsiveness, organizational autonomy, and systemic pressures for efficiency and innovation. The market relies fairly exclusively on client power, which is based on choice and backed by purchasing power. Customer power is the main relationship of accountability. A competitive market automatically creates accountability of sellers to buyers. In the private sector, the key information is customer satisfaction, and the key enforceability is the customers' choice of supplier. Competitive markets have proved to be a robust institutional arrangement. A major weakness of the market mechanism, however, is unequal distribution, because the market responds only to those with purchasing power, doing nothing to ensure universal access or an equitable distribution.

L. Innovations Practiced Worldwide

23. To improve public services for the poor, the WDR 2004 promotes strengthening the short-route relationship between service providers and the poor by giving beneficiaries' power over providers. Various innovations have been practiced in many projects worldwide, including the following.

- (i) **Demand-side financing.** In Mexico, an education, health, and nutrition program gives cash to poor families if their children are enrolled in school, and if they regularly visit a clinic. As a result, school enrollment has increased and children's health status has improved. Similarly, a female secondary school assistance program in Bangladesh provides a grant to reimburse schools based on the number of girls they enroll. In addition, various voucher programs are used worldwide, including school vouchers in Chile, Colombia, Côte d'Ivoire, and the Czech Republic; water vouchers in Chile; and sanitation vouchers in Bangladesh.
- (ii) **Competition among providers.** In Madhya Pradesh, India, a recent innovation allows nongovernment organization to compete for concessions to operate primary schools, with payments conditional on higher test scores. In Cambodia, government contracting out primary health care services to the private sector, nongovernment organizations, and public agencies has resulted in improved health indicators. Under a community-managed school program in El Salvador, parents' associations are given the right to hire and fire teachers, resulting in reduced teacher absenteeism and improved student performance.

- (iii) **Citizen's report cards.** In Bangalore, India, a citizens' report card has been used since 1994 to evaluate the city's public services from the perspective of its residents. Based on report cards filled out by clients, the Public Affairs Center conducts surveys of the quality of service delivered by various public agencies. Findings of the survey are published, mobilizing civil society groups to voice their demand for better performance, and causing some of the public agencies to improve their services.
- (iv) **Incentives for beneficiaries.** In Zambia, the government introduced a road fund financed by a charge on trucks. As a result, truck drivers took turns to police a bridge crossing to make sure that overloaded trucks did not cross.

M. No Easy and Ready Solutions

24. While the conventional problems are well documented and recognized, the effectiveness of the new approaches in solving the conventional problems is not yet evident. In the words of Pritchett and Woolcock (2002): The old king is dead, but there is no new king that can take his place. What is needed, in their view, are conditions under which genuine experiments to discern the most appropriate local solutions to local problems can be nurtured and sustained.

SELECTION OF PROJECTS FOR CASE STUDIES

1. This special evaluation study (SES) involved two phases. Phase I developed the evaluation methodology and pilot tested it in two rural development projects in the Philippines from July to September 2003. Phase II applied the methodology to another four projects in four countries from November 2003 to April 2004. Thus, a total of six projects in five countries were studied under the SES. These projects were as follows:

- (i) *Agrarian Reform Communities Project* in the Philippines (Loan 1667-PHI), for \$93.2 million, approved on 18 December 1998; effective on 31 July 1999; in its fourth year of implementation at the time of the Operations Evaluation Mission's (OEM) field visit;
- (ii) *Cordillera Highland Agricultural Resources Management Project* in the Philippines (Loans 1421-PHI/1422-PHI[SF]), for \$19 million, approved on 11 January 1996; effective on 3 June 1997; in its sixth year of implementation at the time of the OEM's field visit;
- (iii) *Fujian Soil Conservation and Rural Development Project* in the People's Republic of China (PRC) (Loan 1386-PRC), for \$65 million, approved on 28 September 1995; effective on 16 February 1996; completed on 30 June 2002, prior to the OEM's field visit;
- (iv) *Small-Scale Water Resource Development Sector Project* in Bangladesh (Loan 1381-BAN[SF]), for \$32 million, approved on 26 September 1995; effective on 8 April 1996; completed on 15 January 2003 prior to the OEM's field visit;
- (v) *Third Livestock Development Project* in Nepal (Loan 1461-NEP[SF]), for \$18.3 million, approved on 19 September 1996; effective on 23 March 1997; in its sixth year of implementation at the time of the OEM's field visit; and
- (vi) *Rural Financial Institutions Project* in Kyrgyzstan (Loan 1529-KGZ[SF]), for \$12.5 million, approved on 21 August 1997; effective on 30 April 1998; in its sixth year of implementation at the time of the OEM's field visit.

2. Detailed data on these projects are given at the end of this appendix, including project objectives, scope, expected benefits, investment costs, financing arrangements, executing agencies (EAs), implementation periods, related activities, and Asian Development Bank (ADB) missions. The first two projects—the Cordillera Highland Agricultural Resources Management Project (CHARM) and the Agrarian Reform Communities Project (ARCP)—were in the Philippines. They were selected for case study under the SES because of their intensive use of the “bottom-up” approaches, such as beneficiary consultation, participatory planning, nongovernment organization (NGO) engagement, and local government involvement. Both projects provided multiple interventions, including community development, rural infrastructure (rural roads, small-scale irrigation systems, and potable water supply), and agricultural support services. The ARCP received an award as one of the best projects in the Philippines, and CHARM was one of the earliest ADB projects that applied the participatory approach. Appendix 4 provides a detailed assessment of these projects as well as of the new approaches used.

3. The Fujian Soil Conservation and Rural Development Project in the PRC was selected for case study in view of its unique feature of employment generation through private sector development. The project provided direct support for agroprocessing enterprises, which hired farmers in their factories or farms and generated employment indirectly through the purchase of large quantities of farm products (through formal contracts or informal agreements). This project provided credit to small farmers for orchard plantations; to large farmers for aquaculture development; and to private entities for agroprocessing, hydropower development, and

agricultural markets. This project was the only ADB-financed agricultural project in the PRC with a “highly successful” rating, and the only agricultural loan for which the PRC Government requested a follow-up project to replicate its interventions to other areas. Appendix 5 provides a detailed assessment of the project as well as its private sector approach.

4. The Small-Scale Water Resources Development Sector Project in Bangladesh was selected because of its involvement of beneficiaries in water resources investment and maintenance. With an aim to increase farm income and sustain agricultural growth, the project (i) constructed small-scale water control systems to mitigate floods, improve drainage, and increase water supply in the dry season; and (ii) established user groups to take care of the water systems. The project’s experience in mobilizing beneficiaries in water resources development has been replicated by ADB and other aid agencies in the design of similar projects both in and outside Bangladesh. Appendix 6 provides a detailed assessment of the project as well as the impact of the new approaches used.

5. The Third Livestock Development Project in Nepal was selected because of its use of participatory approaches in project planning, formation of beneficiary groups, engagement of NGOs, and involvement of private financial institutions in credit delivery. With a final goal to reduce rural poverty, the project used multiple interventions, including establishment of beneficiary groups to distribute inputs, goats, animal medicines, and improved forage seeds to farmers; provision of training and subsidized equipment to processing enterprises to promote livestock marketing; training for village animal health workers; and support for EA offices. This project was the first agricultural project in Nepal that initiated NGO engagement, and its experience contributed to the development of government policies on working with NGOs. Appendix 7 provides a detailed analysis of the performance of the project and the new approaches used.

6. The Rural Financial Institutions Project in Kyrgyzstan was selected because of its involvement of private individuals (including many that belonged to the middle-income class) in the delivery of rural credit to small borrowers. With the short-term objective of increasing financial services in rural areas and the long-term goal to rebuild a sustainable rural financial system, the project provided a credit line to onlend to end borrowers through credit unions (CUs), and established an apex company to supervise the CUs. The project deviated significantly from a standard CU model or the generally accepted “best practices,” yet functioned effectively in achieving its objective and goal. Appendix 8 provides a detailed analysis of the variables affecting the performance of the project and its private sector approach.

7. The six projects covered a wide range of ADB’s rural sector operations in terms of geography (including countries in South Asia, Southeast Asia, and East and Central Asia) and subsectors (including irrigation, rural roads, water supply, agricultural support, employment generation, soil conservation, water resources management, livestock, and rural finance). Findings from these projects are reported in the country reports, presented in Appendixes 4–8, which support the main text analysis with detailed facts and analyses.

Cordillera Highland Agricultural Resources Management (Loan 1421/1422[SF]-PHI)

PROJECT DESIGN (as stated in the Report and Recommendation of the President [RRP])

Project Objective: The primary objective of the project was to reduce poverty in the Cordillera Administrative Region by increasing the disposable incomes of the smallholder farm families in the target areas. The project covered 82 barangays in 16 municipalities in Abra, Benguet, and Mountain Province.

Project Scope: The project components included

- (i) community mobilization and resource management,
- (ii) rural infrastructure development,
- (iii) agricultural support services, and
- (iv) project management and coordination.

Expected Project Benefits

- (i) average annual household incomes to increase from \$820 (P21,200) to \$2,170 (P56,000) in the target municipalities, and net farm incomes to increase from 104% to 239%, depending on the farming system;
- (ii) improved living conditions from domestic water supply systems;
- (iii) improved family nutrition arising from increased incomes and diversified high-value cropping systems;
- (iv) improved health from reduced pesticide use;
- (v) generate about 5,800 person-years of employment during the implementation period primarily through its reforestation and civil work activities, and additional farm employment of about 2,700 person-years after project completion;
- (vi) improved mobilization of communities and their involvement in participatory planning, which will assist them to become more self-sufficient and to independently access needed services such as credit and health facilities; and
- (vii) direct benefits to a total of about 23,150 households and approximately 139,000 people.

Project Cost: Estimated at appraisal: \$41.4 million

Financing

ADB loan: \$19.0 million

International Fund for Agricultural Development (IFAD): loan: \$9.2 million

KEY DATES

Loan Approval: 11 January 1996

Loan Effectiveness: 3 June 1997

Project Completion

Estimated at appraisal: 31 March 2003

Extended to: 30 June 2004

Loan Closing

Estimated at appraisal: 30 September 2003

Extended to: 30 September 2004

EXECUTING AGENCY: Department of Agriculture

PROJECT PREPARATION

Technical assistance (TA) 1915-PHI: Second Highland Agriculture Development Project
 TA amount: \$550,000
 Date of approval: 26 July 1993

RELATED ACTIVITIES**Technical Assistance**

TA 518-PHI: Highland Agriculture Development Project (project preparatory technical assistance [PPTA])
 Approved amount: \$225,000
 Date of Approval: 1 June 1983

Loan

Loan 802-PHI: Highland Agriculture Development
 Project cost

Estimated: \$26.9 million
 Actual: \$25.5 million

Financing

ADB loan: \$18.9 million
 IFAD loan: \$4.6 million

Date of approval: 25 November 1986

Date of completion:

Estimated at appraisal: 31 March 1992
 Actual: 31 July 1994

Post-Evaluation Rating: Generally successful (PE507, 5 August 1998)

ADB MISSIONS

Number of Loan Review Missions (up to June 2004): 10

Inception Mission: 19–25 August 1997

Last Review Mission: 29 October–12 November 2003

Agrarian Reform Communities Project (Loan 1667-PHI)

PROJECT DESIGN (as stated in the RRP)

Project Objective: The primary objective of the project is poverty reduction. The project will increase the income of the agrarian reform beneficiaries, improve their quality of life by providing basic infrastructure and development support services, and increase agricultural production. Of the 984 agrarian reform communities nationwide, the project will assist about 140, selected on the basis of comprehensive criteria.

Project Scope: The project has four components:

- (i) rural infrastructure: access infrastructure (roads, bridges, etc.), communal irrigation, and potable water supply;
- (ii) land survey for about 100,000 hectares (ha) of public land;
- (iii) development support services, namely for agriculture, rural enterprises, community and institutional development, and credit from the Land Bank of the Philippines from its own resources for agricultural production and enterprise investments; and
- (iv) project management and capacity building.

Expected Project Benefits

- (i) about 28,000 households in 140 ARCs to directly benefit from investments in agriculture and rural infrastructure;
- (ii) some 200,000 people to benefit from the improved road network;
- (iii) incremental increase in farm income, estimated at 36%;
- (iv) some 17,000 person-years of incremental employment generated; and
- (v) substantial nonquantifiable benefits, in particular in the Special Zone for Peace and Development and other poverty-stricken ARCs, including providing for the sustainability of the peace process.

Project Cost: Estimated at appraisal: \$168.9 million

ADB Loan

Estimated at appraisal: \$93.2 million
Cancelled amount: \$13.9 million

KEY DATES

Loan Approval: 18 December 1998

Loan Effectiveness: 31 July 1999

Project Completion: Estimated at appraisal: 31 July 2005

Loan Closing: Estimated at appraisal: 31 December 2005

EXECUTING AGENCY: Department of Agrarian Reform

PROJECT PREPARATION

TA 2767-PHI: Agrarian Reform Communities Development Project

TA amount: \$253,000

Date of approval: 12 March 1997

ADB MISSIONS

Number of Loan Review Missions (up to June 2004): 8

Inception Mission: 18 August–15 September 1999

Last Review Mission: 14–16 April 2004

Fujian Soil Conservation and Rural Development Project (Loan 1386-PRC)

PROJECT DESIGN (as stated in the RRP)

Project Objective: The objective of the project was to promote sustainable growth in the rural economy of Fujian that would benefit the poorer members of the rural community.

Project Scope: The project had five components:

- (i) **Soil conservation and agricultural development.** This component supported integrated development for sloping lands and soil conservation by establishing about 5,200 ha of new orchards (litchi, longan, citrus, loquat, and Chinese olive), and bamboo plantations; rehabilitating about 9,800 ha of existing orchards and tea gardens; establishing about 4,000 ha of catchment protection forest on upper hill slopes, and windbreaks; and strengthening the extension services and training, research, and monitoring facilities.
- (ii) **Aquaculture development.** This component supported aquaculture development at 14 sites covering about 1,542 ha, freshwater fish culture at 4 sites, and mariculture at 10 sites.
- (iii) **Agricultural market development.** This component supported the marketing of agricultural produce by establishing nine new markets. These wholesale centers facilitated the flow of agricultural produce from producers to urban consumers, agro-processors, and exporters.
- (iv) **Agroprocessing development.** This component provided funds for developing new agroprocessing units in the non-State sector and for expanding existing ones. The units processed some of the output of farmers assisted by the project, thus resulting in value added benefits and increased employment opportunities in the project area.
- (v) **Small hydropower schemes development.** This component supported the development of seven small hydropower schemes with installed capacities ranging from 1.0 megawatt (MW) to 4.1 MW and annual outputs ranging from 5.7 gigawatt-hours (GWh) to 23.8 GWh.

Expected Project Benefits

- (i) restoration to sustainable use of 19,000 ha of eroded and potential lands that might be affected by erosion;
- (ii) annual production of 47,500 metric tons (t) of high-value fruits, 5,000 t of Chinese tea, 23,300 t of aquaculture products, about 15,000 t of processed fruits and beverages, and 13,400 t of bamboo poles and shoots at full development of the project;
- (iii) ease of wholesale transactions of agricultural produce;
- (iv) generation of 81 GWh of electric energy per annum; and
- (v) about 68,000 families participating in the agricultural production activities to double their average family income from Y3,299 per annum to Y6,928 per annum (at 1995 constant prices) at full development of the project.

Project Cost

Estimated at appraisal: \$163.0 million
Actual: \$159.4 million

ADB Loan

Estimated at appraisal: \$65.0 million
Actual: \$60.347 million
Cancelled amount: \$4.653 million

KEY DATES**Loan Approval:** 28 September 1995**Loan Effectiveness:** 16 February 1996**Project Completion**

Estimated at appraisal: 31 December 2001

Actual: 30 June 2002

Loan Closing

Estimated at appraisal: 30 June 2002

Actual: 30 June 2002

EXECUTING AGENCY: Provincial Government of Fujian**PROJECT PREPARATION**

TA 1860-PRC: Fujian Soil Conservation and Rural Development Project

TA amount: \$406,000 (TA was cofinanced by the Food and Agriculture Organization in the amount of \$134,000)

Date of approval: 29 March 1993

RELATED ACTIVITIES**Technical Assistance**

TA 2407-PRC: Capacity Building for Soil and Water Conservation

Approved amount: \$590,000

Date of approval: 28 September 1995

TA 2408-PRC: Land Use and Land Tenure Policy in Fujian Province

Approved amount: \$600,000

Date of approval: 28 September 1995

TA 3551-PRC: Fujian Soil Conservation and Rural Development Project, Phase II (PPTA)

Approved amount: \$650,000

Date of approval: 24 November 2000

Loan: Loan 2082-PRC: Fujian Soil Conservation and Rural Development Project II

Approved amount: \$80.0 million

Date of approval: 28 April 2004

ADB MISSIONS**Number of Loan Review Missions:** 12**Inception Mission:** 23 July–4 August 1996**Last Review Mission:** 21–30 March 2002

Small-Scale Water Resources Development Sector Project (Loan 1381-BAN)

PROJECT DESIGN (as stated in the RRP)

Project Objective: The objective of the project was to facilitate sustainable growth in agricultural production and in the income of about 140,000 beneficiary families who were mostly small landholders or landless farmers.

Project Scope: The project consisted of three parts:

- (i) **Beneficiary participation and water management association development.** This component consisted of mobilizing beneficiaries to participate in the selection, design, implementation, and operation and maintenance of subprojects through local governments and NGOs in a manner that has been tested and implemented successfully in Fadipur District.
- (ii) **Development of small-scale water control systems.** This component comprised about 400 small-scale schemes (with an average investment of \$100,000) for flood control, drainage improvement, water conservation, and command area development, with appropriate agricultural extension, floodplain fisheries mitigation activities, and environmental monitoring in environmentally sensitive subproject areas.
- (iii) **Institutional support for small-scale water resources development.** This component supported project management capacity for small-scale water resources development at the national, district, and *thana* levels through the provision of consultant services.

Expected Project Benefits

- (i) improvement of the nutritional status of the beneficiaries;
- (ii) greater employment and increased income in marketing, processing of farm products, and farm services;
- (iii) increased production and marketing of farm inputs (seed, fertilizer, pesticides, etc.);
- (iv) reduction in water-related diseases due to improved drainage in densely settled areas; and
- (v) about 750, 000 people to benefit from the project.

Project Cost: Estimated at appraisal: \$66.0 million

ADB Loan

Estimated at appraisal: \$32.0 million

Actual: \$27.318 million¹

Cancelled amount: \$0.67 million

¹ The loan was approved in SDR equivalent. After cancellation of \$0.67 million (SDR 0.491 million) at loan closing, the final SDR equivalent was SDR 20.59 million (\$ 27.318 million). The small difference in US dollar equivalent was attributed to depreciation of the dollar from loan approval to loan closing.

KEY DATES

Loan Approval: 26 September 1995

Loan Effectiveness: 8 April 1996

Project Completion

Estimated at appraisal: 30 June 2002

Actual: 30 June 2002

Loan Closing

Estimated at appraisal: 31 December 2002

Actual: 15 January 2003

EXECUTING AGENCY: Local Government Engineering Department

PROJECT PREPARATION

TA 1817-BAN: Small-Scale Water Resources Development Project

TA amount: \$500,000

Date of approval: 23 December 1992

RELATED ACTIVITIES**Technical Assistance**

TA 3358-BAN: Second Small-Scale Water Resources Development Sector Project (PPTA)

Approved amount: \$400,000

Date of approval: 22 December 1999

Loan

Loan 1831-BAN: Second Small-Scale Water Resources Development Sector Project

Approved amount: \$34.0 million

Date of approval: 12 July 2001

ADB MISSIONS

Number of Loan Review Missions (up to May 2004): 10

Inception Mission: 5–15 December 1995

Last Review Mission: 7–17 October 2002

Third Livestock Development Project (Loan 1461-NEP)

PROJECT DESIGN (as stated in the RRP)

Project Objective: The overall goal of the project was to reduce poverty in rural areas by improving the nutrition, income, and employment opportunities of farmers and resource-poor rural people, especially women, through increased productivity of the livestock subsector in a manner that is ecologically sustainable and socially equitable.

Project Scope: The project comprised a number of integrated components to

- (i) raise the productivity of livestock owned by farmers by increasing group access to improved technical support services, feed, input supplies, animal health services, genetic material, and credit;
- (ii) develop alternative market outlets for livestock and livestock products including milk, meat, eggs, fiber, and live animals, through the diversification of agroprocessing activities and improved marketing practices;
- (iii) develop the institutional capacity and reorient the approach of the Department of Livestock Services (DLS) and related agencies to facilitate livestock subsector development towards self-sustainable growth in the private sector;
- (iv) develop livestock farmer groups that can plan, manage, monitor, and evaluate their own operations and become self-reliant; and
- (v) expand the capacity of DLS to coordinate, manage, and monitor the execution of the project according to a process approach, with participation of all stakeholders in the design and management of project investments.

Expected Project Benefits

- (i) average participating family incomes to increase by 30%;
- (ii) increased per unit production of livestock products from targeted livestock on individual farms: cow milk—70%; buffalo milk—23%; buffalo meat—20%; goat meat—15%; pig meat—30%; chicken meat—30%; eggs—20%; and
- (iii) about 55,000 farm households to benefit from the project.

Project Cost: Estimated at appraisal: \$27.9 million

ADB Loan

Estimated at appraisal: \$18.3 million
Cancelled amount: \$4.23 million

KEY DATES

Loan Approval: 19 September 1996

Loan Effectiveness: 23 March 1997

Project Completion

Estimated at appraisal: 31 December 2002
Actual: Extended to 31 July 2004

Loan Closing

Estimated at appraisal: 31 July 2003
Actual: Extended to 31 July 2004

EXECUTING AGENCIES

Department of Livestock
Nepal Rastra Bank (the central bank of Nepal)

PROJECT PREPARATION

TA 2129-NEP: Preparation of Third Livestock Development Project
TA amount: \$562,000
Approval date: 4 August 1994
Implementation period: May–November 1995

RELATED ACTIVITIES**Technical Assistance**

TA 235-NEP: First Livestock Development (PPTA)
Approved amount: \$230,000
Date of approval: 11 May 1978

TA 329/330-NEP: First Livestock Development (advisory technical assistance [ADTA])
Approved amount: \$850,000
Date of approval: 19 December 1979
Source: United Nations Development Programme (UNDP) and ADB

TA 331-NEP: Second Livestock Development (PPTA)
Approved amount: \$170,000
Date of approval: 19 December 1979
Source: European Economic Community

TA 605-NEP: Second Livestock Development (PPTA)
Approved amount: \$250,000
Date of approval: 8 June 1984

TA 710-NEP: Second Livestock Development (ADTA)
Approved amount: \$1,600,000
Date of approval: 24 October 1985
Source: UNDP

TA 1094-NEP: Livestock Sector Study (ADTA)
Approved amount: \$334,000
Date of approval: 22 December 1988

TA 1431-NEP: Preparation of a Livestock Sector Master Plan (ADTA)
Approved amount: \$363,000
Date of approval: 5 December 1990

TA 1854-NEP: Agriculture Perspective Plan (ADTA)
Approved amount: \$680,000
Date of approval: 15 March 1993
Completion: July 1995

TA 2851-NEP: Third Livestock Development (ADTA)
Approved amount: \$750,000
Date of approval: 18 August 1997
Source: Australian Agency for International Development

TA 4039-NEP: Community Livestock Development (PPTA)
Approved amount: \$400,000
Date of approval: 16 December 2002

Loans

Loan 445-NEP: Livestock Development Project
Approved amount: \$12.28 million
Date of approval: 19 December 1979
Completion: October 1988
Rating: Unsatisfactory

Loan 745-NEP: Second Livestock Development Project
Approved amount: \$14.0 million
Date of approval: 24 October 1985
Completion: 17 November 1994
Rating: Partly satisfactory

Loan 2071-NEP: Community Livestock Development Project
Approved amount: \$20.0 million
Date of approval: 19 December 2003

ADB MISSIONS

Number of Loan Review Missions (up to May 2004): 13

Inception Mission: 18–26 March 1997

Last Review Mission: 22 December 2003–14 January 2004

Rural Financial Institutions Project (Loan 1529-KGZ)

PROJECT DESIGN (as stated in the RRP)

Project Objective: The long-term development goal is to rebuild a sustainable rural financial system. The project objective is to increase the level and availability of savings mobilization and lending services in rural communities.

Project Scope: The project has two components: the establishment of a CU system, and project management. The project is providing a credit line of \$8.4 million equivalent to match CU member contributions. The Financial Company for the Support and Development of Credit Unions (FC), which provides the services of an apex union, was established and is being developed further through technical support, training, and provision of furniture and equipment to promote, develop, and provide regulation and supervision of the CUs. Staff of the National Bank are also being trained in regulation and supervision of the CU system. The CUs are being trained by FC staff in the management and operations of the CUs. The project also supports the National Bank and FC to strengthen their capacity in project management.

Expected Project Benefits

- (i) establishment of about 280 CUs across all six regions of the country, with an average of about 100 members per CU;
- (ii) CU members expected to mobilize about \$11 million equivalent in share capital and retained earnings;
- (iii) development of a rural financial system, including the establishment of a financially self-sustaining system of CUs that will provide essential financial services to rural areas;
- (iv) increased competition in the provision of rural finance that will promote efficiency in the delivery of services;
- (v) increased trust by the general population in financial institutions; and
- (vi) strengthened capacity of the National Bank and FC to regulate and supervise the CUs.

Project Cost: Estimated at appraisal: \$22.1 million

ADB Loan

Estimated at appraisal: \$12.5 million

Cancelled amount: \$2.2 million

Cumulative disbursement amount: \$6.4 million (as of 30 June 2004)

KEY DATES

Loan Approval: 21 August 1997

Loan Effectiveness: 30 April 1998

Project Completion: Estimated at appraisal: 30 September 2004

Loan Closing: Estimated at appraisal: 31 March 2005

EXECUTING AGENCY: National Bank of the Kyrgyz Republic

PROJECT PREPARATION

TA 2453: Agriculture Credit Pilot Project

TA amount: \$910,000

Approval date: 27 November 1995

Implementation: from January 1996 to June 1996

ADB MISSIONS

Number of Loan Review Missions (up to May 2004): 15

Inception Mission: 22 November–8 December 1997

Last Review Mission: 14–15 March 2004

PARTICIPATORY APPROACHES USED

1. The Operations Evaluation Mission (OEM) found that actual application of the participatory or bottom-up approaches varied significantly across the six projects selected for case study, as analyzed below.

A. Beneficiary Consultation and Participatory Planning

2. The two projects in the Philippines (the Agrarian Reform Communities Project [ARCP] and the Cordillera Highlands Agricultural Resource Management Project [CHARM]) spent a large amount of resources and long periods for beneficiary consultation and participatory planning during their implementation (Appendix 4). Numerous workshops and seminars were held at the village, municipal, provincial, and regional levels. As a primary output of the participation, a village development plan was produced for each of the 82 villages covered by CHARM, and for each of the 140 agrarian reform communities (ARCs) covered by the ARCP. These village plans were written in large volumes of English text, containing many maps, tables, photos, and diverse village information—ranging from rainfall and cropping patterns to household profiles. A long list of investment proposals was contained in each plan, claiming to represent local needs and beneficiary priorities. According to the appraisal document of the ARCP, each indicative ARC plan (village development plan under the ARCP) cost about \$5,000, exclusive of the cost of executing agency (EA) staff.

3. In comparison, the Nepal and Bangladesh projects spent less time and fewer resources on beneficiary participation. The Nepal project held village meetings to identify the poor and to select them as direct beneficiaries (members of groups established under the project). The Bangladesh project focused on strengthening leaders of the newly formed water management cooperative associations (WMCAs) instead of involving ordinary villagers.

4. In sharp contrast, the People's Republic of China (PRC) and Kyrgyz Republic projects did not spend time and resources on beneficiary consultation or participatory planning during implementation. However, consultations with government officials and other stakeholders were conducted during the project design stage, and local knowledge collected during this stage contributed to the appropriate design of project interventions.

B. Community Development Support

5. Under the projects studied, major instruments used to support community development were group formation and beneficiary training. The two Philippines projects established various beneficiary groups such as cooperatives, irrigators' associations, water and sanitation user associations, and people's organizations. These groups received training and financial support from the projects. Earthwork for construction of subprojects was given exclusively to group members, who were paid higher-than-market wages. The Bangladesh project established a WMCA at each of the 248 subproject sites, transferring to it the ownership of the water control system built under the project, and providing it with training on operation and maintenance (O&M) of the water system. Under the Nepal project, beneficiary groups were established to implement project activities, such as distributing goats to members. Training and subsidized inputs were given exclusively to these groups, providing the incentive to join groups.

6. In contrast, the PRC project did not organize any groups. Instead, existing village committees were used to deliver small loans to villagers and collect repayments from them. While beneficiary training was provided, its amount was considered excessive and unnecessary

by project staff interviewed. The Kyrgyz project did not provide resources for group formation. However, numerous credit unions (CUs) were established by private individuals in responding to incentive measures provided by that project (Appendix 8).

C. Engagement of Nongovernment Organizations (NGOs)

7. NGOs were engaged under four of the six projects studied. Under the two Philippines projects, NGOs played a primary role in organizing beneficiary groups, conducting workshops, and preparing the village development plans. Under CHARM, NGOs were engaged for long periods to draft, revise, and “enhance” the village plans (Appendix 4). The Nepal project, instead of giving a single contract to a large NGO located in the capital, engaged a large number (48) of district-based NGOs under small contracts (up to NRs50,000, or less than \$700). The performance of the NGOs varied, apparently relating to variations in their nature and history, as well as to their relationship with the local communities in which they were assigned to work (Appendix 7). NGOs were also engaged under the Bangladesh project as required by the project design, but their actual role was minimal, due partly to their lack of experience in water resource management, and partly to their lack of close connection with local communities (Appendix 6). In sharp contrast, no NGO was engaged under the PRC and Kyrgyz projects.

D. Local Government Involvement

8. Local governments were involved in three of the six projects studied. Under the two Philippines projects, local governments played a major role in subproject implementation: They prepared subproject proposals (with assistance from project staff), provided the required counterpart funds (10%–20% of investment cost), and participated in subproject implementation and monitoring.

9. The PRC project was initiated by a provincial government, which designed and implemented the project together with the Asian Development Bank (ADB). In addition, county and township governments played a major role in project implementation by selecting end borrowers for the ADB credit line and by guaranteeing subloan repayments (Appendix 5).

10. In contrast, local governments played little role in the remaining three projects. Although some local governments or politicians under the Bangladesh and Kyrgyz projects lobbied for subprojects in their jurisdictions, they contributed no counterpart funds and played no role in project implementation or maintenance. The Nepal project was implemented by a national government agency using its district offices. Although district governments were required to approve the work plans of the EA’s district offices, they played a role that was more nominal than real.

E. Private Sector Participation

11. While none of the projects stated explicitly the adoption of a private sector approach, some of them used private individuals, enterprises, and financial institutions as agents to achieve project objectives. For example, the PRC project supported agroprocessing enterprises by providing them with long-term credit. By mitigating this key constraint and enabling the enterprises to expand their operations, the project achieved its objective of rural employment generation. The Kyrgyz project, by offering a large interest spread and low entrance requirement, attracted numerous private individuals to establish CUs and participate in rural credit delivery. Through the efforts of the individuals, the project fulfilled its objective of increasing rural credit supply to facilitate agricultural recovery (Appendix 8).

12. The Nepal project engaged participating financial institutions (PFIs) to channel an ADB credit line to small farmers for animal purchase. Incentives provided by the project were (i) access to the ADB credit line, and (ii) interest spread. Originally, the project engaged only two large banks, which had sufficient liquidity of their own but no experience in working with small farmers. The incentives offered by the project were not attractive to them, and the credit component performed poorly. After the midterm review, ADB modified the project design to engage another 17 small PFIs, which lacked liquidity and considered the project a good opportunity to expand operations, and the performance of the credit component improved significantly. In addition, the Nepal project provided subsidized equipment to selected processing enterprises to promote livestock marketing. Since the key constraint faced by these enterprises was not a lack of equipment or subsidy, the incentive offered by the project did not lead to the anticipated result (Appendix 7).

13. In the best subprojects under the Bangladesh project, the OEM observed a positive role of large farmers, who organized WMCAs, collected user fees, and managed O&M for the water control systems. These villages were characterized by heterogeneity, and these farmers were the largest beneficiaries of the water control systems established under the project, due primarily to their large farm holdings located in the subproject areas. They had a strong incentive not only in the construction of the water systems but also in their sustainability, because they had the most to lose if the systems failed (Appendix 6).

14. Under the two Philippines projects, the OEM did not observe active private sector participation, although an engineering firm was engaged under the ARCP to supervise subproject design and construction.

F. Other Innovative Measures

15. In addition to the above, interesting innovations were observed in some projects studied. Under the Bangladesh project, a new policy required cash contributions from farmers before construction of the water control systems as a precondition for subproject approval. This policy was implemented without farmer resistance, in sharp contrast to the commonly held belief that, because farmers are poor, they can contribute labor but not cash, and because farmers have no savings, it is impossible to ask them to pay before they benefit. In contrast, the Bangladesh experience seemed to suggest that (i) farmers are willing and able to pay cash (or crops) for an investment that brings them real benefits that exceed costs, and (ii) the effective bargaining power that a project has to ensure farmers' willingness and commitment to pay is before commencement of construction. It appeared that beneficiaries' willingness to pay for services might be significantly underestimated. The World Development Report (WDR) 2004² reports that poor farmers in Haryana state, India are happy to pay fees for irrigation services, because government irrigation departments become much more accountable to farmers after the payments (Appendix 1).

16. An innovation under the Nepal project was its use of community-based organizations (CBOs) as NGOs to serve villagers, who were both the clients and members of the CBOs. As compared with the use of outside NGOs, which leave the local communities after contract expiration, CBOs seem to have the advantage of better sustainability (Appendix 7).

² World Bank. 2004. *The World Development Report*. Washington, D.C.

17. The PRC project imposed a policy of “no subsidy,” and implemented it strictly. When channeling the ADB credit line to enterprises and farmers, end borrowers had to repay the full amount of the loans plus all interest charges in real terms. In addition, they had to bear the risk of exchange rate variations. While the loans were repaid in local currency, both principle and interest charges were calculated in US dollars (Appendix 5).

18. Instead of using workshops and seminars, the Kyrgyz project used mass media (newspapers, radios, and television) to disseminate project information, at low cost and with wide outreach to ordinary people. The project did not target the poor as borrowers; nor did it restrict the use of subloans, which is the case under many rural credit projects. Furthermore, CUs established under this project deviated significantly from the standard CU model or best practice. Yet, through appropriate incentives for private individuals, the project contributed to employment generation in the rural Kyrgyz Republic (Appendix 8).

19. The above analysis seems to suggest that, with appropriate incentives, various players—beneficiaries, large farmers, private enterprises, financial institutions, CBOs, NGOs—can be used as agents to work for the fulfillment of project objectives. What matters is not the form of participatory approaches, but the attractiveness of incentives to the players involved.

CASE STUDY: PHILIPPINES
Agrarian Reform Communities Project (Loan 1667-PHI)
Cordillera Highland Agricultural Resources Management Project
(Loans 1421/1422[SF]-PHI)

A. Introduction

1. Selection of the Projects for Case Studies

1. At the recommendation of project staff from the Asian Development Bank (ADB) and concerned government agencies, the Agrarian Reform Communities Project (ARCP) and the Cordillera Highland Agricultural Resources Management Project (CHARM) were selected for this special evaluation study (SES). The ARCP received an award in 2003 as one of the best projects in the Philippines. The CHARM was one of the earliest ADB-financed projects that adopted participatory approaches. Both projects adopted a set of bottom-up approaches, including beneficiary consultation and participatory planning, community development support, nongovernment organization (NGO) engagement, and local government participation. At the time of the fieldwork for the study, the ARCP and CHARM were in their 4th and 6th years, respectively, of implementation.

2. Fieldwork of the Operations Evaluation Mission

2. From July to September 2003, the Operations Evaluation Mission (OEM) conducted five trips to seven provinces in the project areas and visited 17 municipalities. The OEM spent a total of 21 days in the field and inspected 30 subprojects in 23 barangays (barangays—villages). Table A4.1 provides a list of subprojects visited. In addition to the large number of people interviewed by the OEM, a local consultant conducted a small survey of 50 village residents.¹ To broaden the base of the observation, the OEM interviewed not only government officers, field staff, and village leaders, but also ordinary residents in the villages, both the poor and the better-off, those who benefited from project interventions and those who did not.

¹ The small survey included 10 village officials or leaders of beneficiary groups, 15 group members, and 25 ordinary villagers who were not members of any beneficiary group. The survey results supported the OEM's findings but did not add substantial value.

Table A4.1: Subprojects Visited

Province	Municipality	Barangay	Subproject
Abra	Bucloc	Ducligan	Reforestation Demonstration Farm
		Lamao	Irrigation Reforestation Demonstration Farm
	Sallapandan	Bila-bila	Drinking Water System Road
		Maquyepyep Naguilian	Drinking Water System Irrigation
Benguet	Tublay	Ambongdolan	Road Reforestation
Eastern Samar	General McArthur	Domrog	Road
		San Isidro	Road
	Llorente Quinapondan	Waso	Road
		Poblacion 5	Road
Iloilo	Lambunao	Panuran	Road
		Pughanan	Road Training
	Lemery San Dionisio San Enrique	Velasco	Demonstration Farm
		San Nicolas	Training
		Cubay	Road
La Union	Caba	San Jose	Road
	Lambunao	Panuran	Drinking Water System
	Naguilian	Mamat-ing Sur	Road
Mt. Province	Bauko	Otucan Sur/Norte	Drinking Water System
		Otucan Sur	Irrigation
	Tadian	Lubon	Road Drinking Water System
Pangasinan	Aguilar	Laoag	Road
	Bugallon	Laguit Padilla	Road

Total		Type of Subproject	
Provinces	– 7	Roads	– 14
Municipalities	– 17	Irrigation	– 3
Barangays	– 23	Drinking Water System	– 5
Subprojects	– 30	Reforestation	– 3
		Demonstration Farm	– 3
		Training	– 2
		Total Subprojects	– 30

3. To enhance the reliability of information collected, the OEM requested informal visits without prearranged meetings accompanied by a large number of officials. In spite of repeated requests, the OEM's first trip was accompanied by about 20 project staff in four vehicles when it finally reached a subproject site. Under such conditions, the OEM could not talk with ordinary people freely, as some project staff were eager to give "the correct answers" before interviewees responded, or coach/correct answers given by interviewees. In another case, the

OEM started its visit in a barangay by visiting barangay officials, who then followed the OEM for the rest of the visit, making it difficult to conduct free and in-depth discussions with ordinary villagers.

4. After repeated efforts, the OEM finally convinced project staff to agree on the following approaches: First, the OEM's village visits would be in a small group—only one project staff member would accompany the OEM as guide and interpreter. Second, the OEM's visit would be informal—without preannouncement, formal meetings, or a fixed schedule; the OEM might stay overnight with barangay residents when necessary. Third, the OEM would adopt a bottom-up approach by starting its visit in a barangay by interviewing ordinary villagers randomly, including in particular the landless and jobless poor. After inspecting subproject facilities and interviewing the poor, the OEM would discuss its findings with Barangay officers and beneficiary group leaders, providing them opportunities to correct OEM's findings if they were wrong. Finally, the OEM would discuss its findings with local government authorities (governor, mayors, and planning officers) as well as senior staff in project offices.

5. Thanks to strong support of senior project staff in both projects, the OEM was able to adopt the approach of field visits without preinforming local communities. Open-ended interviews were conducted with villagers on an individual basis without structured questionnaires, relying on probing and following up on “clues.” Triangulation was applied, by which information given by interviewees was compared with formal statements given by officials or documents. Most of the interviews were conducted in farmers' houses or in the fields. To inspect project facilities and estimate project benefits, the OEM walked along irrigation canals and interviewed not only farmers with farmlands located at the head of the irrigation systems, but also those at the tail of the systems. Finally, the OEM paid attention not only to the details of project activities, but also to the social, political, and economic context within which the projects were implemented. These approaches enabled the OEM to observe broadly and closely the real situations at the grassroots level, and to identify issues that had not been reported before.

3. Local Realities in the Project Areas

a. Persistent Rural Poverty and Primary Causes

6. Both projects aimed at reducing rural poverty, which was widespread in the Philippines at the time of project design (45% rural poverty in 1997). The major causes of persistent rural poverty included the sluggish growth in agriculture and the rural economy in contrast to the rapid growth of population and of rural laborers. The skewed land distribution and underinvestment in rural infrastructure were also identified by the project designers as factors underlying the sluggish agricultural growth.

7. This analysis was confirmed by the OEM, which observed a large number of landless poor in the villages visited. While extremely large landlords were not observed, the OEM noted that landowners accounted for fewer than 20% of the households in some villages visited, in contrast to the numbers of landless and jobless poor, which accounted for more than 50% of the households in the villages, with the remaining being landless tenants. In the mountainous areas, more farmers owned land than in the lowlands, but the size of their landholdings was extremely small. Many of the households visited owned several pieces of land with an aggregate size of only 0.04–0.1 hectare (ha) per household.

8. The large number of landless casual laborers, in conjunction with the sluggish rural economy, contributed to the difficulty of searching for jobs in the rural areas. Many of the poor

said that they could find work only one day in a week in the dry (lean) season, and one week in a month in the wet (peak) season. Labor migration was common in the areas visited. Many households had family members working in cities or overseas. However, remittances were reportedly small and irregular, since the migrants had to support their own families in the cities. Some migrants had returned to the villages, claiming that they could not afford the high living expenses in cities.

b. Other Concerns

9. The lack of access roads was another major cause restricting economic growth in rural areas. In one municipality, the OEM observed farmers carrying on their backs heavy baskets with farm products or wood, hiking from the highlands to the towns in the lowlands. The OEM was told that 18 of the 30 barangays in this municipality had no access roads. Farmers had to hike up to 20 kilometers (km) of trails to do marketing in towns. The shortage of bridges further exacerbated the problem by reducing the usefulness of roads. In one village visited, farmers had to travel by boat to get drinking water from a nearby village.

10. Insufficient supply of drinking water was quoted by many interviewees as a top problem. Shortage of irrigation water in the dry season was also common. While sufficient water could increase rice yields by 50% or more and double cropping intensity, in most villages visited only 5–10% of the farmers received sufficient water in the dry season, simply due to the small volume of water available, which was enough only for farmlands located next to the canals. The OEM noted that farmers with sufficient irrigation water were usually the better-off groups in their villages, especially in villages where the majority of residents were landless and jobless poor.

11. For the landless and jobless poor interviewed, the top concern was the lack of a regular income and job. Many of them said that their first priority for assistance would be livelihood projects, such as a small loan to buy a piglet or a few chicks or a small boat and a net for part-time fishing. While private moneylenders were readily available, their high interest rate (5% per month) could easily trap a poor borrower into accumulated debt forever. Thus, many of the interviewees appreciated savings and credit programs, especially those with sufficient flexibility, allowing them to save money in any amount at any time whenever they could, and withdraw money whenever they needed.

c. External Assistance and Its Legacies

12. Externally-financed rural development projects were spread all over the Philippines. The Report and Recommendation of the President (RRP) of the ARCP noted that, from 1992 to March 1998, the Philippines received 23 agrarian reform community (ARC)²-related projects financed by the World Bank, the European Union, the United Nations Development Programme, and bilateral agencies such as those from the United States, Japan, Canada, Switzerland, and Belgium. Grants from these sources amounted to \$226 million, or 74% of the \$307 million

² There was no clear definition of ARC, which vaguely included agrarian reform beneficiaries (ARBs) living in 3–7 barangays. ARBs were those that received land distribution under the Comprehensive Agrarian Reform Program (CARP) implemented in the Philippines since 1988. In many cases, ARBs were tenants working for large landlords whose land was redistributed by the CARP. These tenants received land and became ARBs, but many landless and jobless poor in the same villages did not receive land, and were therefore not ARBs. The OEM noted that ARBs accounted for about 10% of the households in the villages visited, and ARCs accounted for 10–15% of the barangays in the municipalities visited. The ARC approach was not effective in targeting the poor, since the majority of the poor were not ARBs. In fact, such an approach seems to reflect demarcations among government agencies in the Philippines. Since the Department of Agrarian Reform is responsible for ARCs, its projects cannot cover non-ARC villages, which are the domain of the Department of Agriculture.

project costs. By March 1998, 321 of the 984 ARCs in the country had received both technical assistance (TA) and investment projects financed externally; another 301 received TA but not infrastructure. The ADB-financed ARCP covered a further 140 ARCs, making a total of 762 (77%) of the 984 ARCs being covered by assisted projects. In addition to aid agencies, local politicians (members of congress and governors) provided grants to local governments, although the amount was very small. In the areas visited, the OEM could not find a single village that had never received any form of external assistance. In more than one case, the OEM found 5–6 externally-financed projects being implemented simultaneously in one municipality, largely due to proactive mayors who were capable of bringing in projects.

13. The numerous projects seemed to have left certain legacies in the project areas. First, there were many groups and committees established by various projects. In one barangay office, the OEM found an organization chart indicating 14 committees in this small barangay with only 22 households. Many groups had ceased operation after the completion of the projects, with some of them being “reactivated” by subsequent projects. Second, the grant nature of most projects seemed to have fostered an attitude of aid dependency. In one village, the OEM observed a damaged irrigation structure constructed by the National Irrigation Administration (NIA), which had been abandoned because farmers were waiting for NIA to come and fix the damage caused by a typhoon 7–8 years before. Farmers interviewed said that they could have fixed the damage themselves if they had known from the very beginning that NIA would never come to fix it.³ In fact, before the NIA project, farmers had the tradition of organizing themselves and building simple irrigation structures on their own, using their own labor and local materials.

4. The Projects

14. The CHARM was a successor of the Highland Agricultural Development Project,⁴ implemented from 1987 to 1994 in two mountainous provinces in the Cordillera Administrative Region. The CHARM expanded the project area to 82 barangays in three mountainous provinces in the same region, with similar components covering (i) community mobilization and resource management; (ii) rural infrastructure development, including rural roads, small-scale irrigation systems, and drinking water supply; (iii) agricultural support services; and (iv) project management. The CHARM differed from its predecessor by including resource management and community participation, allocating 1.5 years of its 7-year implementation period (from 1997 to 2004) to community mobilization at the beginning. With a total project cost of \$41.4 million, the CHARM was cofinanced by an ADB loan of \$19 million and a loan of \$9.2 million from the International Fund for Agricultural Development.

15. The ARCP targeted 140 of the 984 ARCs in the country. The ARCP was not involved in land acquisition or distribution, but supported ARCs where land had already been distributed and titled. The four components under the ARCP were similar to those under CHARM: (i) rural infrastructure, including rural roads, small-scale irrigation systems, and drinking water supply; (ii) land survey to facilitate land titling; (iii) development support services, including in particular agricultural extension; and (iv) project management. With a total cost of \$168.9 million financed by an ADB loan of \$93.2 million, the ARCP was to be implemented in 6 years from 1999 to 2005.

³ When beneficiaries required government assistance to repair damage, a typical response was: “Our budget for this year has been finished. We will see if we can help you next year.” Such a signal provided wrong incentives for beneficiaries to wait and defer damage repair.

⁴ Loan 802-PHI: *Highland Agriculture Development Project*, with a total cost of \$26.9 million jointly financed by an ADB loan of \$18.9 million and a loan of \$4.6 million from the International Fund for Agriculture Development.

B. Evaluation of Project Performance

1. Project Design

16. The design of both projects emphasized community mobilization and participatory planning, and allocated sufficient budget for these activities. Under the ARCP, a five-stage planning process was conducted in each ARC to produce an “ARC plan.” The entire process lasted for 3–6 months, involving (i) orientation for government officers, (ii) fieldwork to collect data for preparing household ARC profiles, (iii) training and planning, (iv) draft report preparation, and (v) workshops to present the reports. A team of 8-22 members was mobilized to produce each ARC plan, including barangay captains; leaders of beneficiary groups; as well as 4-5 staff from the provincial and municipal offices of the Department of Agrarian Reform (DAR), and the planning, agriculture, and engineering offices of municipal governments. It was estimated that, excluding the cost of DAR staff, an average of \$5,000 was required to prepare an ARC “indicative plan” (see RRP of the ARCP). Under CHARM, NGOs were engaged to mobilize local communities, organize “barangay workshop consultations,” and produce a barangay natural resources management plan (BNRMP) for each of the 82 barangays covered by the project. A total of 41 community mobilization officers were hired by NGOs to be in charge of planning, coordination, and following-up at every step of this process.

17. Both projects required local counterpart contributions to subproject investments. For rural roads, local governments contributed 20% of the investment costs if they were better-off (class I-III) municipalities, or 10% of the cost if they were poor (classes IV–VI) municipalities, with the remaining cost financed by the ADB loan as a grant from the National Government. For irrigation and drinking water supply, endusers were required to contribute 30% of the investment cost in the form of cash, local materials, or labor, with the remaining cost financed by the ADB loan as a grant from the National Government.

18. The policy of cash contribution from local governments provided an incentive for them to monitor the construction of rural roads. In addition, the ARCP engaged a private engineering firm to independently supervise the design and construction of infrastructure subprojects, especially roads and bridges. These measures seemed to have contributed to better quality roads. Field staff and farmers interviewed said that construction quality under the two projects was better than that of roads built by the Department of Public Works and Highways (DPWH) under previous projects. Nevertheless, problems in the design and construction of roads were observed, including in particular inadequate drainage systems, due partly to insufficient budget in some cases.

19. Detailed operation and maintenance (O&M) arrangements were included in the RRP of the ARCP. For rural roads, local governments at the provincial, municipal, and barangay levels were responsible for road maintenance and repair. Various agreements were signed between DAR and the provincial, municipal, and barangay governments, requiring local legislation to force municipal councils to allocate annual budgets for O&M of the roads constructed under the ARCP. The project design also included a sanction measure stating that, if a municipality failed to do proper O&M, the grant from the National Government would be converted to a loan to the municipality, and deducted from the internal revenue allotment to that municipality. For irrigation and drinking water supply, user groups were to be established and be responsible for collecting user fees and maintenance.

2. Project Implementation

a. Participatory Planning

20. Both projects spent sizeable resources and sufficiently long periods for community consultation, participatory planning, and beneficiary training. Under CHARM, a BNRMP was produced for each of the 82 barangays. Under the ARCP, an ARC plan was produced for each of the 140 ARCs. These village plans were written in English in large volumes (50–80 pages), with barangay maps and color photos as well as comprehensive data and descriptions about rainfall patterns, cropping seasons, farming systems, and social profiles. Finally, there were ranking of priorities and a long list of investment proposals. The OEM noted that these plans were produced for and used more by outsiders than by village communities (para. 40).

b. Training

21. Various training courses were provided for beneficiaries, local government officers, and project staff at various levels. Training for project staff focused on project implementation, especially in terms of preparing feasibility studies and subproject proposals. Municipal engineers benefited significantly from engaging directly an infrastructure project that was, in many cases, the largest investment ever in their municipalities. A substantial amount of training was provided to beneficiaries, with the majority of the trainees being barangay officers, leaders of beneficiary groups, and demonstration farmers. While many trainees interviewed said that they appreciated the training opportunities, they failed to provide stories of how they used the knowledge obtained from the training, or how they shared the knowledge with other villagers after the training.

c. Agricultural Extension

22. Both projects allocated considerable resources for agricultural extension, which adopted a standard model such as that observed in many conventional agricultural projects. Farmers with good farmlands located in “strategic places” (along major roads, with good visibility) were selected as demonstration farmers. Grant or heavily subsidized inputs (seeds, fertilizer, seedlings of fruit trees, chicks) were provided to the demonstration farmers along with training and intensive supervision from government extension workers, who contacted mainly demonstration farmers as well as village/group leaders during their village visits. The impact of the extension services on other farmers seemed to be limited, partly due to other farmers’ lack of the same conditions as the demonstration farmers (such as good farmlands, subsidized inputs, and frequent visits by extension staff) to adopt the recommended technology. Furthermore, many of the new technologies promoted were land-based, which did not seem to be relevant to the landless poor. One tenant interviewed said that he did not adopt a new variety of banana promoted in his village in spite of his strong interest in it, because he had no land of his own. If he had planted the new banana on his landlord’s land, he would have received only half of the harvest while bearing all the incremental costs and risks, as he had to submit half of the harvest to his landlord for whatever he grew on the landlord’s land.

d. Beneficiary Contribution

23. The OEM observed problems in implementing the policy of beneficiary contribution for subproject investment. In one irrigation subproject under CHARM, farmers worked on the construction and were paid by the project P160 per day, with P30 deducted as their “free labor contribution.” The OEM was told that the market rate for casual labor was P100 per day in that

area. In another case, members of a cooperative who worked on road construction under the ARCP received a payment of P150, of which P25 was deducted by the cooperative in the name of management, capital build-up, and mandatory savings. Again, the market rate for labor in that area was P100 per day. Interviews with project staff found that these arrangements were common under both ARCP and CHARM.

e. Road Construction

24. The standard of road construction seemed to vary significantly under the two projects. In a steep mountain area, the OEM observed rehabilitation of a rural road under CHARM, which allocated a budget of P11.9 million for the rehabilitation of 7.4 km of road sections. Since the budget was too small to pave the entire road, the OEM observed partial paving or “tire tracking” on only “critical sections” of the road. Considering the steep slopes of the mountains, the number of landslides observed along the road, and the low standard of the rehabilitation, it seemed that the lifespan of this road could be very short, and the cost of maintenance would be very high after the rehabilitation. The OEM was then told that this kind of gravel road in this area requires rehabilitation every 8 years with proper maintenance, and might not last for more than 3 years if the maintenance is poor.

25. In contrast, the standard of some roads upgraded under the ARCP seemed to be unnecessarily high. In one lowland area, the OEM observed that a budget of P7.4 million was spent to upgrade a 1.5-km road from gravel to a fully paved road of 4 meters (m) wide and 15 centimeters (cm) thick. As this road led to a dead end with fewer than 50 households scattered along the roadside, the traffic was very light. When the OEM questioned about the need for such a high standard road for the small number of beneficiaries, the answers were that (i) these households were ARBs targeted by the ARCP, and (ii) the budget allocation for this road was in accordance with a standard (4 m wide and 15–20 cm thick) given by DPWH, and engineers designed the roads based on the standard. In a high altitude area, the OEM found that P33 million was spent on the construction of a 14-km road leading to a barangay with only 67 households. Again, the rationale for such an investment was that these households were ARBs targeted by the ARCP.

26. Meanwhile, the OEM noted that 18 of the 30 barangays in a municipality had no access roads (para. 9). Instead of building new roads for these barangays, the ARCP upgraded a gravel road to a fully paved road (4 m wide and 20 cm thick), which benefited only three barangays that already had access roads. Again, the rationale was that these three barangays were ARCs whereas the eighteen barangays were not. The concerned municipal government said that their first priority would have been to construct a new circumventing road connecting two dead-end roads, which would benefit nine barangays, if they had had the power to freely make the investment decision. Project staff said that they had noticed this issue. However, since the ARCP covered only ARCs, they had no choice but to follow the project design.

3. Initial Results

a. Participatory Planning

27. Due largely to the initial 2 years of delay in recruiting NGOs and the long periods spent on community mobilization and participatory planning, implementation of CHARM was significantly behind schedule, and the project completion date was extended from March 2003 to June 2004.

28. As a major output of the participatory planning, a substantial number of reports were produced under CHARM, including 10,200 household profiles; 82 barangay profiles; 82 socioeconomic profiles; and 82 BNRMPs, which were revised, “enhanced”, and reviewed. By the end of October 2003 (after more than 6 years of project implementation), preparation of 82 “enhanced BNRMPs for adoption as the barangay development plans” was still ongoing. These plans were produced by NGOs in consultation with barangay officers and group leaders, presented in Barangay workshops, and reviewed and revised by consultants hired by ADB.

b. Maintenance of Irrigation Systems

29. Insufficient maintenance of infrastructure remained a major concern under both projects. In spite of the project design’s requirement of establishing irrigators’ associations (IAs) to be in charge of fee collection and O&M, the numerous training sessions provided to the IAs, and the formal transfer of ownership of the irrigation systems to them, no user fees were collected for O&M purpose in any of the subproject sites visited, although a small (P10–20) annual or one-time membership fee was collected to cover office expenses of the IAs. Most of the IA leaders and members interviewed said that they would contribute free labor but not cash. When damage occurred after a typhoon (which is a frequent event in the project areas), the common attitude was to wait for NIA to come to fix things.

30. At an irrigation subproject site, the OEM walked along a 3-km canal constructed at a cost of P6.3 million under CHARM. The construction had started in early 2002 and, at the time of the OEM’s visit in August 2003, a section of 300 m had not been completed due to insufficient budget, as the cost of constructing the canal in this mountainous area was higher than anticipated. Meanwhile, wild plants, grasses, and landslides had already covered many of the completed sections of the canal, making it impossible to use.⁵ Instead of organizing farmers to clear the landslides and cut down grasses, the president of the IA requested an additional grant from the national and local governments as well as visitors like the OEM, and then waited for external help.

c. Maintenance of Rural Roads

31. Although an item for maintenance of roads rehabilitated or upgraded under the two projects had been included in the annual budget of the municipalities visited, the amount of the O&M budget was insufficient using the standard given by DPWH, which required a unit cost of P20,000 per km for O&M of concrete roads and P40,000 per km for gravel roads. The OEM inspected 14 roads under the two projects and observed inadequate maintenance, including in particular deferred repair of damage. In the worst cases, large potholes had already occurred only two years after the rehabilitation of gravel roads, due partly to inadequate drainage systems and partly to the lack of prompt repair after damage caused by typhoons.

32. In spite of the detailed O&M arrangements (para. 19), local governments, especially at the municipal and barangay levels, did not seem to understand clearly and accept their responsibilities for road maintenance. The project design required provincial, municipal, and barangay governments to be in charge of road maintenance without further specifics. In a few roads visited, the municipal governments said that barangay governments should be

⁵ The OEM spent almost 1 hour and walked through only 2 km of the 3-km canal due to the thick grasses and wild plants that covered the canal. Significant effort was spent to cut down the vegetation in order to “open” a path for the walk. The OEM observed nine landslides (some involving large rocks) in the 2 km of canal walked, and was told that there were another five landslides in the remaining section of the canal.

responsible for the maintenance of the road sections passing through their villages because they benefited from the roads. Barangay governments, however, considered road maintenance a responsibility of the municipal and provincial governments. The OEM supported this view because (i) Barangay governments had neither funds nor equipment for road maintenance; and (ii) users of municipal roads included not only residents in these villages but many others.⁶

33. The OEM examined the annual budgets in some municipalities, and noted severe financial constraints faced by these governments. In a poor municipality (classes IV–VI), the annual budget was typically P15–20 million (\$0.3–\$0.4 million), of which the majority (70% or more) was spent on personnel payments, 5% was allocated for a calamity fund as required, and 20% was by law allocated as a “development fund.” In one municipality, the OEM noted that, of the P3 million development fund available in the budget, P700,000 was spent on mandatory National Government programs that were devolved to local governments, and another P760,000 was used as counterpart funds for a road built under the ARCP. The mayor admitted readily that he had no budget left for the routine maintenance of existing municipal roads (about 18 km). Due to the pressure from project offices, municipal governments allocated a budget item for the O&M of the “ADB roads” (roads rehabilitated or upgraded under the ARCP or CHARM). However, the amount was insufficient due to the budgetary shortage.

34. The design of the ARCP included a sanction that, if a municipality failed to conduct proper maintenance of a road invested under the ARCP, the National Government grant for road construction would be converted into a loan (para. 19). Up to now, however, not a single municipal government had received such a penalty. Factors restricting the implementation of such a sanction might include (i) the harsh reality that almost all poor municipalities (classes IV–VI) suffered a shortage of budgetary resources; and (ii) government officials’ lack of incentives strong enough to enforce the conversion of grants into loans. In spite of good intentions in the project design and competent project staff, the numerous agreements signed between local governments and DAR did not seem to have secured the allocation of sufficient resources for road maintenance.

C. Evaluation of New Approaches

1. New Approaches Used

35. Both projects spent sufficient resources and time for beneficiary consultation and participatory planning. Before the approval of the ARCP, experts from a Food and Agriculture Organization-financed project conducted intensive beneficiary consultations and produced “indicative ARC plans” for ARCs that were later covered by the ARCP. In the case of CHARM, participatory rural appraisal was conducted in 47 barangays by consultants hired by ADB under a project preparation TA. During project implementation, numerous workshops and seminars were held at the barangay, municipal, provincial, and regional levels. NGOs contracted by CHARM were engaged for long periods to mobilize local communities, organize beneficiary groups, and prepare village plans. Various groups were established by field staff hired through NGOs (such as community mobilization officers under CHARM and development facilitators under the ARCP), as well as staff from line agencies such as DAR, NIA, and the Department of Agriculture. These groups were formed primarily for the purpose of subproject implementation, such as cooperatives for road construction, IAs for irrigation rehabilitation, water and sanitation user associations (WSUAs) for drinking water supply, and people’s organization (PO) for reforestation. Incentives were provided for farmers to join these groups, such as the policy that

⁶ Municipal roads link barangays, and provincial roads link municipalities.

only group members were entitled to construction work under these projects.⁷ Substantial budget was spent on community development support, including in particular numerous training courses (some courses involved 12 sections over 12 weeks) as well as monthly management meetings for group leaders. Local governments played a major role in subproject implementation, including document preparation for subproject application, submission of subproject proposals (with assistance from project staff), provision of the required counterpart funds, and involvement in subproject implementation. The private sector did not play a significant role under either project, although a private engineering firm was hired under the ARCP to supervise the design and construction of roads and bridges.

2. Role of Actors

36. This section analyzes the role of policymakers, subproject providers, and beneficiaries in information flow, resource control and decision making, service delivery mechanisms, and accountability.

a. Information Flow

37. Beneficiary consultations were conducted in all barangays visited. Examination of meeting minutes and discussions with interviewees found that most of the consultations and meetings were attended by barangay officers,⁸ group leaders, and a few “sector representatives” assigned by barangay captains. Barangay officers and group leaders interviewed said that they attended consultation workshops and various meetings because it was their duty, and the OEM noted that they received a monthly allowance from the projects. Ordinary villagers interviewed, if they were group members, usually attended meetings relating to their groups, such as IA members attending meetings organized by NIA on irrigation subprojects, and PO members attending meetings organized by staff from the Department of Environment and Natural Resources. The other interviewees, if they were not group members, said that they attended few meetings and knew little about the details of the ADB-financed projects or the village development plans, which were developed as a primary output of the consultations. Some poor interviewed said that they did not attend any meeting because they could not afford the time (many consultation workshops were held from 9 am to 1 pm). A few said that they were not informed of the meetings, assuming that only barangay officers or group leaders were invited to the meetings. In all cases, no separate group discussions were held for the disadvantaged groups (such as the landless and jobless poor) before the barangay workshops; their agendas were not announced before their commencement.

38. The OEM estimated that the intensive consultation and participation so far reached only 15–20% of the households in the villages visited, because (i) most workshops, seminars, training courses, and monthly management meetings were attended by barangay officers and group leaders; (ii) some meetings were attended by group members; (iii) group members typically accounted for 10–15% of the residents in the villages visited; (iv) barangay officers and group leaders accounted for less than 5% of village population; and (v) it was common to find multiple members, leaders, or barangay officers from a same family, such as husband being the cooperative chair and the wife being the cooperative treasurer. In some cases, the OEM noted that the hardcore poor were excluded by beneficiary groups established under the projects. In

⁷ The OEM noted substantial increases in group membership during the construction period. Many cooperative members interviewed admitted that they joined the groups for the sake of construction work. Given the difficulty in searching for employment in rural areas, the construction work and its payments were particularly attractive.

⁸ A barangay typically has 11 officers, including the captain, the secretary, the treasurer, 7 board members, and the chair of youth council.

one case, a landless and jobless laborer interviewed said that he did not join the cooperative because he could not afford the minimal share of P120 required for coop membership, because he lived “from hand to mouth” every day.⁹ A poor couple said that they did not join the cooperative in spite of the attractive construction work, because payments for the construction work were typically delayed for 1–3 months, and they could not afford the delay due to lack of any savings. In addition, the OEM was told that IA membership was limited to owners of farmlands benefiting from the irrigation systems, and IA members accounted for about 5% of the farmers in the villages visited.

39. Ordinary villagers’ lack of project information did not seem to have negatively affected project implementation, as project activities were implemented in spite of the incomplete dissemination of project information. The OEM observed no complaint about the lack of project information.

40. It appeared that the primary value of the intensive community consultations was local knowledge and barangay data collected for the preparation of the village development plans (BNRMP under CHARM and APC plans under the ARCP). These plans may benefit aid agencies in the future when they look for potential projects to finance, as information about the villages and a long list of project proposals are readily available in these plans. The OEM noted that most BNRMP were submitted to ADB, and most ARC plans were submitted to the central and regional project offices of the ARCP. Furthermore, there were hints that the village plans were produced for and used more by outsiders than by village communities,¹⁰ or for the purpose of fulfilling physical targets or project requirements on baseline data and monitoring.

b. Resource Control and Decision Making

41. Since beneficiaries’ contributions to subproject investment were more nominal than real (para. 23), they did not have power in resource control or decision making relating to subproject investment.

42. Actual decisions about subproject investments seemed to be a mix of (i) compliance with project requirements, (ii) local politics, and (iii) local needs. Among these factors, compliance with project requirements appeared to be the most important determinant. For example, since the ARCP was implemented by DAR and targeted only ARCs, non-ARC barangays, no matter how poor and how great the changes could have been if they had access roads, were excluded from project assistance. Furthermore, many landless and jobless poor interviewed said that their first priority was livelihood projects such as small-scale animal raising. The top items in the long list of “beneficiary priorities” in the village plans, however, were almost identical across villages, including rural roads, irrigation systems, and drinking water supply—exactly the items financed by the two projects. It appeared that, since local governments and community leaders knew that the ADB-financed projects would not finance livestock or microcredit, they adjusted their requests to what the projects could supply.

43. The second important factor determining subproject decisions was local politics. Since a counterpart contribution of 10–20% of the investment cost would bring in an ADB-financed road project with substantial political mileage, the projects provided strong incentives for municipal

⁹ This was a local expression describing the situation of the landless and jobless laborers: Whatever they earned on a single day with their hands, they spent immediately on food without any savings.

¹⁰ In most barangays visited under CHARM, the OEM could not find a copy of the BNRMP, although village officers insisted that it existed. In one barangay, the OEM found a barangay profile written in English. When asked how that document was used, the PO president said: “we show it to visitors like you.”

mayors to fight for the limited number of road projects available to their regions. The common strategies used by mayors was to meet all project requirements, such as contributing the required counterpart funds,¹¹ submitting the required project documents on or even ahead of time, and personally visiting project offices to lobby for subprojects. Since municipalities were typically restricted by cash shortage, many mayors requested help from governors or member of congress in their regions. The relationships among captains, mayors, governors, and members of congress therefore affected which barangays received subprojects.¹² The last factor was local needs or beneficiary priorities, which will be analyzed in para. 52.

c. Service Delivery Mechanism

44. Infrastructure subprojects under CHARM and the ARCP were delivered primarily by contractors, although engineers from local governments and field staff from project offices actively participated in subproject planning and supervision. For “soft” components such as community mobilization, beneficiary group formation, and preparation of village plans, NGOs played a major role. In the case of CHARM, NGOs drafted BNRMP in consultation with community leaders, and revised/enhanced these plans with guidance and assistance from consultants and project staff. Meanwhile, beneficiary groups were established to be the primary mechanism of beneficiary participation in subproject implementation. For example, cooperatives organized members to participate in the construction of rural roads; IAs organized members in the construction of irrigation systems; POs organized members in reforestation. These members received higher-than-market-rate payments for construction work and tree planting. Since only group members were entitled to the work, membership in these groups increased substantially during the subproject periods.

45. The OEM noted certain problems in the approach of hiring NGOs to prepare development plans for barangays instead of using existing government institutions such as barangay councils and barangay development councils. First, most NGO staff were not experts or professionals experienced in development planning. In particular, field level staff of NGOs were typically young and inexperienced at the time of hiring. While many of them gained experience after training and practice during the course of project implementation, the time and resources spent on capacity building for the NGO staff did not result in sustainable benefits for the villages, as the NGOs left after the expiration of their contracts without leaving significant impacts. Second, village governments were by law responsible for village development planning and management. Although many village officers did not have adequate capacity and experience in preparing village plans, capacity-building efforts should have been spent on them, since they had to continue village planning after the departure of the NGOs.

46. Furthermore, the use of beneficiary groups instead of village governments to organize villagers participating in subproject implementation and maintenance seemed to be problematic. First, these groups typically had a small number of members and excluded nonmembers in the same villages, such as the hardcore poor who could not afford the minimal share required for cooperative membership, or delays in payments for construction work (para. 38). Second, the long-term sustainability of the groups was questionable after project completion, when no project funds would be available, since these groups relied heavily on financial assistance from projects (para. 56).

¹¹ The OEM was told that some mayors even borrowed from banks to make up the required cash contribution. This, however, was not confirmed.

¹² Some interviewees said that one major reason that their villages received subprojects was that their captains were in the same party as their mayors.

47. Consequently, it might be unrealistic to expect that these groups would take good care of the irrigation systems, drinking water supply, and trees planted after project completion. The OEM observed deferred repair and deterioration of some irrigation systems, and noted that none of the IAs visited collected user fees for O&M purpose. For drinking water supply, the new approach of establishing WSUAs to be responsible for O&M of the water systems seemed to contradict the local practice that village governments took care of drinking water supply in villages. While the water systems were still new at the time of the OEM's visit, with little damage observed, government officers interviewed foresaw problems in the future when cash would be required to repair damage, and anticipated that the WSUAs would come to the barangay governments for help. For trees planted under CHARM, while the POs received sizable contracts for both tree planting and maintenance, no effective mechanisms had been established to ensure the proper use of the funds. When the funds were finished, the risk of no maintenance would be likely, as the POs were not the owners of the trees, which were planted on community lands belonging to the villages instead of the POs.

d. Accountability

48. In spite of intensive community consultations and participatory planning, no evidence was found to suggest that project providers were accountable to beneficiaries under the two projects. For road subprojects, since 80–90% of the investment costs were financed by a grant from the National Government, local governments focused on fighting for whatever they could get instead of challenging a subproject design or demanding improvements in the services provided. For irrigation subprojects, since the 30% contribution by beneficiaries was more nominal than real (para. 23), the irrigation systems were seen as a free gift from governments and aid agencies. Most of the IA leaders accepted the irrigation systems designed by NIA engineers and constructed by contractors, although some of them complained about a design problem or construction quality. In one case, a governor told the OEM that he had “no hands over NIA” when the OEM reported to him problems observed in an irrigation project in his province.

49. Overall, the two projects lacked an effective mechanism for beneficiaries to hold subproject providers accountable. The intensive consultation and participation might have provided opportunities for beneficiaries to complain about a subproject if it was poor, but providers could easily ignore them because they did not pay for the subproject investment, and had no authority over providers. The contractors, consultants, NGOs, and project staff were paid by the projects, and therefore responded to the National Government and ADB, which allocated project funds.

3. Impact of New Approaches

50. This section examines if the new approaches used under the two projects offered an effective solution to the conventional problems of less relevant project interventions and poor sustainability observed in many conventional rural development projects.

a. Relevance of Project Interventions

51. The intensive consultation and participatory planning did not seem to have significantly enhanced the relevance of project interventions under the two projects. In all village plans (BRNMP under CHARM and ARC plans under the ARCP) examined by the OEM, the top items in the long list of “beneficiary priorities” and investment proposals were almost uniformly rural

roads, irrigation systems, and drinking water supply—exactly the items supplied by the two projects. The OEM’s interviews with ordinary villagers and field staff found, however, that the top priority of many landless and jobless poor was microcredit, which would allow them to start small-scale animal raising. In the case of upgrading the 1.5-km dead-end road with fewer than 50 households along the roadside (para. 25), while the poor benefited from an easier walk on the paved road as compared with the gravel road before the ARCP, the P7.6 million spent on upgrading the road did not bring in more job opportunities for the poor visited. One landless and jobless woman said that pig prices had increased after the road upgrading because some buyers now came to her village to buy pigs. However, she did not benefit from the rising price as she had no money to buy a piglet to start pig raising. Some NGO staff interviewed said that animal raising could have been most effective in helping the landless and jobless poor in the project areas. However, since livestock was not included in the project design, they did not highlight it as a top priority in the village plans.

52. It appeared that three factors might have influenced the “beneficiary priorities” listed in the village plans. First, since subprojects (roads, irrigation systems, and drinking water supply) were essentially free to beneficiaries, their best response was to accept whatever they were given instead of demanding something that was not supplied by the projects. Second, since the village plans were prepared by outsiders (drafted by NGOs based on ADB requirements and revised and enhanced with assistance from consultants and project staff), it was not surprising that the projects’ agendas were reflected in the village plans. Lastly, it was said that local governments tend to prefer physical construction such as roads, irrigation systems, water supply, or even day care centers, which are more visible than microcredit programs. Such a preference might have influenced the order of “beneficiary priorities” and investment proposals in the village plans.

53. Less relevant project interventions were observed, such as (i) upgrading short dead-end roads with light traffic and few beneficiaries to unnecessarily high standard because the few beneficiaries were ARBs targeted by the ARCP; (ii) construction of a road to a village with only 67 households because these were ARBs; and (iii) upgrading of existing roads to unnecessarily high standard for ARCs that already had access roads instead of building new gravel roads for Barangays currently without access to roads (paras. 24–25). For training and demonstration activities, while the demonstration farmers benefited from exposures to new technology as well as subsidized inputs from the projects, the external impact on other farmers was not visible, partly due to the fact that other farmers did not have the training, technical supervision, and subsidized inputs to replicate the demonstrations. The concentration of training on a small number of barangay officers, group leaders, and demonstration farmers appeared to be for the sake of fulfilling quantified project targets, especially in cases where village officers attended over 20 training courses.

b. Sustainability of Project Benefits

54. For roads, the lack of sufficient funds for maintenance seemed to be common in the municipalities visited. Even on paper, the OEM noted that the amount of budget allocated for O&M of the project roads was insufficient if measured by the unit cost given by DPWH (para. 31). Considering the severe resource constraints in the poor municipalities visited, the strong incentives for mayors to allocate their limited budget as counterpart funds for new investment, and the common practice of ignoring O&M of existing infrastructure, there seems to be a risk that, in the future, the 20% development fund in these municipalities would be allocated as counterpart contribution for another externally financed project, further reducing the limited funds available for O&M of the “ADB roads.” The OEM already observed deferred repair

of damage on some roads visited, including large potholes on gravel roads rehabilitated only 2 years before OEM's visit.

55. For small irrigation systems, the project design stipulated that IAs be responsible for the collection of fees and conduct of O&M. In all barangays visited, however, no regular payments had been collected for O&M. Farmers interviewed said that they would contribute labor but not cash for the systems, as it had been the tradition in their villages. In the past before externally-financed projects, farmers built simple irrigation systems using their own labor and local materials, and fixed the systems without cash involved. Under the projects, irrigation systems were designed by NIA and constructed by contractors using cement and purchased materials. Consequently, cash was required for the repair of even small damage, and the cash payment seemed to be beyond the willingness to pay of IA leaders and members. This argument was used by IA leaders to justify why they were waiting for NIA to come and fix the damage for them.

56. The sustainability of the cooperatives, IAs, and POs seemed to be at risk. These groups were established for the purpose of project implementation instead of for mutual benefits to their members. The incentive for members to join the groups was the entitlement for construction work. In some cooperatives visited, the OEM noted that the major sources of revenues of the cooperatives were from project support, such as the mandatory deduction of wages from members working for road construction. Some POs received sizeable contracts from projects, which paid higher-than-market wages to PO members for nursery development and tree planting, and gave a large amount of funds to the POs for tree maintenance for 3 years. While these groups enjoyed large revenues during the project period, it is unclear how they would continue when no more project funds would be available after project completion. Similarly, the various training, demonstration, and agricultural extension seemed to be short-term by nature, as extension workers from local governments would have little travel budget to visit demonstration farmers, or provide them with training and subsidized inputs after project completion.

D. Issues, Underlying Causes, and Alternatives

1. The Real Value of Beneficiary Consultation and Participatory Planning

57. In spite of very competent project staff at the top level and diligent staff at the field level, and in spite of sufficient resources and time spent on beneficiary participation under the two projects, no evidence was found that the intensive consultation and participatory planning empowered beneficiaries in resources control and decision making, fostered their ownership of subprojects, or motivated them to take good care of project facilities.

58. In contrast, poor maintenance of project facilities, especially rural roads and irrigation systems, was observed, including deterioration of roads and irrigation systems only 2 years after subproject completion, due partly to insufficient routine maintenance and partly to deferred repair of damage. The primary causes were (i) shortage of budgetary resources in most poor municipalities; (ii) local governments' strong incentive to fight for new investment and being less keen on O&M; and (iii) beneficiaries' reluctance to pay cash for O&M of project facilities.

59. It appeared that the primary benefits of the intensive consultation and participation under the two projects were (i) collection of local knowledge and village data for the preparation of the village development plans; and (ii) improved dissemination of project information at the municipal and Barangay levels.

60. Based on interviews with community leaders and ordinary villagers, the OEM estimated that dissemination of project information reached only a small portion (15–20%) of the residents in the villages visited (para. 38). It was village officers and group leaders who were repeatedly present at the numerous workshops, seminars, training courses, and monthly management meetings. Many ordinary villagers interviewed, if they were not members of beneficiary groups, attended few meetings and knew few details about the projects and the village plans. It appeared that workshops and seminars were not an effective mechanism to reach ordinary people at the grassroots level, especially the poor and disadvantaged, who could not afford the time for meetings.

61. The OEM noted that ordinary villagers' lack of project information did not seem to have negatively affected project implementation. What appeared to be critical to farmers was information about market prices and improved technology, as well as microfinance services at an affordable cost. Unfortunately, neither project provided microfinance services, and the agricultural extension services were highly concentrated on a few demonstration farmers, with limited external impact on others.

62. If the primary benefit of beneficiary consultation and participation were to collect local knowledge to influence project design, the consultation might have had higher value if it had been conducted at the project design stage instead of during implementation, when project interventions had already been determined. A thorough understanding of local realities in a project area, including local politics, power structures, formal and informal institutions, key constraints faced by the poor, and the root causes of the constraints, appears to be most important in improving project design and, consequently, project relevance and sustainability.

2. Private Investment in Small-Scale Irrigation Systems

63. The size of the irrigation systems under the two projects was small, with most systems irrigating less than 100 ha of farmland, and the smallest one covering only 10 ha. Due to the small amount of water available in the dry season, these systems benefited only a small number of households in the villages visited (fewer than 20 households in some cases), usually the better-off farmers who owned good farmland along irrigation canals. This was especially true in villages where more than 50% of the households were landless and jobless laborers; and many others, although they owned small parcels of lands, did not receive water in the dry season due to insufficient water supply or poor location of their lands. While the irrigation projects substantially increased rice yields and doubled cropping intensity (from one crop to two crops per year), it was the small number of the better-off farmers who benefited from the public investment, and the external impact on other villagers was minimal. In particular, the OEM failed to observe increased employment opportunities for the landless and jobless poor as a result of the irrigation investment for the following reasons: First, the irrigation systems did not lead to a change from rice production to cash crops, which would require much more labor. Second, since only a few households received sufficient water supply, the increased demand for labor was small and absorbed by the family labor of the water users.

64. It appears that the small-scale irrigation projects did not have the full characteristics of public goods, which are defined as goods that, once produced, cannot be denied to anyone else and whose consumption by one person does not diminish the consumption by others. The OEM suggests that the small irrigation systems be more appropriately seen as "collective goods" or "group goods," because they benefit only a small group of farmers without noticeable impacts on others. Public investment on these systems on a grant basis may not be fully justified.

65. Based on the high level of financial internal rates of return calculated by the feasibility studies of the irrigation subprojects, the financial returns for investors were large enough to cover both the full investment and O&M costs. Farmers interviewed confirmed the substantial benefits of irrigation investment, which would double cropping intensity and substantially increase rice yields for both crops. Thus, some farmers interviewed expressed their willingness to contribute cash for both irrigation investment and O&M, if grant financing from external sources was not available. Furthermore, the OEM uncovered a local tradition of farmers building irrigation systems on their own without external assistance before grant-financed projects. It appears that, if farmers knew for sure that no free money would be available for “group goods” in the future, there is a possibility that some would be willing to contribute both cash and labor to build irrigation systems that would bring them more benefits than costs. Private investment in irrigation systems might provide end users with real ownership and, consequently, strong incentive and power to demand least-cost design and high-quality construction. To encourage private investment in small-scale irrigation systems, the provision of long-term credit at low cost might be considered.

3. Incentives for Investment versus Maintenance

66. The OEM noted that a most urgent issue in a poor municipality was its lack of sufficient budget to properly maintain existing infrastructure including in particular rural roads. Many of the municipalities visited did not do proper routine maintenance of roads due to budgetary shortages. When hit by a typhoon, there were many potholes that could not be fixed immediately due to a lack of sufficient equipment and funds at the provincial and municipal levels. Thus, a common practice was to go on a road as long as it was passable, and request assistance from the National Government or externally financed projects for rehabilitation when a road was finally not passable. Meanwhile, aid financed projects typically covered only investment and not O&M, assuming that local governments would have sufficient budget and incentive to maintain the roads after project completion. Given the strong incentives to fight for the dole-out projects, local governments tended to agree with the maintenance requirements even when they did not have the necessary financial capacity.

67. Thus, public resources were spent on construction, rehabilitation, or upgrading of roads instead of securing proper maintenance of existing roads, in spite of the fact that routine maintenance and timely repair of roads had much higher economic returns than new investment, especially when a newly rehabilitated road did not generate much loan repayment capacity due to its poor maintenance and short span of life.

68. The underlying causes of this issue included distorted incentives for local governments to fight for new investment and ignore maintenance. Under the two projects, a small (10–20%) contribution of investment cost from local governments could bring in an ADB-financed road project, which implied significant political mileage in terms of popularity, political patronage, and future votes. The OEM observed many billboards in front of subproject sites praising the politicians that had brought in the ADB-financed subprojects. However, there was not a single billboard praising a local government that allocated budget for, and properly maintained existing roads.

CASE STUDY: PEOPLE'S REPUBLIC OF CHINA
Fujian Soil Conservation and Rural Development Project (Loan 1386-PRC)

A. INTRODUCTION

1. Selection of the Project for Case Study

1. The Fujian Soil Conservation and Rural Development Project was selected for case study because of its use of private enterprises to promote rural development and poverty reduction. By providing long-term credit for private investment, the project encouraged agroprocessing enterprises to expand operations, and through them generated rural employment. The project also provided long-term credit directly to farmers for rehabilitating or upgrading bamboo and orchards, or investing in aquaculture. This project was rated “highly successful” by Asian Development Bank’s (ADB) project completion report (PCR),¹ making it the only agriculture project in the People’s Republic of China (PRC) with such a high rating. At the request of the PRC Government, a follow-up (phase II) project was approved in early 2004, making this the only loan in the agriculture sector for which the PRC Government requested a second phase to expand its interventions to other areas, largely due to its success in promoting rural employment.

2. Fieldwork of the Operations Evaluation Mission

2. The Operations Evaluation Mission (OEM) visited the project areas during 3–16 November 2003. The OEM held meetings with policymakers in the Provincial Planning Committee, the Agricultural Commission, the Provincial Financial Bureau, and the Provincial Project Management Office (PPMO), which was in charge of overall project implementation. The OEM benefited from the PCR prepared by ADB in September 2003, another PCR prepared by the PPMO in late 2002, and an assessment of the project’s socioeconomic and poverty impacts prepared by the Provincial Office for Poverty Reduction in February 2003.

3. The OEM conducted two field trips and visited 11 subproject sites in 9 of the 30 counties covered by the project. During these visits, the OEM held discussions with field staff from the concerned county project management offices (CPMOs) as well as with officers at the county, township, and village levels. Meetings were also held with branch managers and other staff from the Agricultural Bank of China and rural credit cooperatives to understand issues relating to agricultural lending in the project areas. The OEM spent most of its field time interviewing private enterprises and farmers, including businesspersons engaged in the processing of tea, bamboo, vegetables and fruits, as well as farmers who had invested in orchards (fruit trees), tea gardens, bamboo, and aquaculture production. For the purpose of comparing counterfactual cases, the OEM visited three private enterprises unconnected with this project and interviewed ordinary villagers in the project areas who had not benefited directly from the project. Interviews with farmers and villagers were conducted on an individual basis in their houses or at work places without formal meetings. Efforts were made to reduce the chance of interviewees being coached by government officers or village leaders so as to enhance the reliability of information collected. Table A5.1 provides a list of subprojects visited.

¹ ADB. 2003. *Project Completion Report on the Fujian Soil Conservation and Rural Development Project in the People’s Republic of China*. Manila.

Table A5.1: Subprojects Visited

County	Village/Township	Subproject
Lianjiang	Guang Wu Village, Xiao Chen Township	Guang Wu Kelp Processing
Xiapu	Guang Jin Yang Aquaculture Zone, Xi Nan Township	Cage Net Fish Aquaculture
Shouning	Wu Qiu Village/Township	Tea Garden Rehabilitation
Putian Municipality	Nan Men Village, Licheng District	Agriculture Market
Xianyou	Xu Feng Village, Fen Ting Township	Longan Orchard Rehabilitation
	Shi Cang Township	Qing Long Xi Small Hydropower Scheme
Yongchun	Wujiang Village, Shiguo Township	Ma Bamboo Plantation
Anxi	Daiping Village/Township	Wulong Tea Garden Rehabilitation
Zhangpu	Guan Bei Village/Tong Kan Village, Pan Tou Township	Longan/litchi Orchard Development/Rehabilitation
Pinghe	Nansheng Township	Quick Frozen Food Processing Development
	Xia Zai Township	Nan Tian Food Co., Ginger Processing

3. Local Realities in the Project Areas

a. Intensive Market Competition

4. The Project was implemented from 1996 to 2002 when the PRC was undergoing rapid economic growth. Being one of the most dynamic regions in the PRC, Fujian experienced faster economic growth than the national average. As the supply of agricultural products increased substantially, their prices dropped due to the low price elasticity of the demand for food. When a new variety of fruit, vegetable, or aquaculture product emerged, the first batch of producers gained sizable profits. As the supply of the new product increased following rapid replication by

other producers, its price fell and the profit margin declined quickly for the late adopters. The intensified market competition placed small farm households (which were the majority in the rural PRC) in a disadvantaged position due to the small size of their farm operations.

b. Shift in Rural Development Strategy

5. These changes led to a major shift in the Government's rural development strategy. It was recognized that yield increases and crop diversification alone were not sufficient to significantly increase farmers' income when 70% producers (rural population) produced food for 30% consumers (urban residents). The long-term solution to agriculture depended on continued growth in the non-agricultural sectors, and the removal of the large amount of surplus labor from agriculture—a fundamental condition for high labor productivity in agriculture.² Consequently, employment generation for rural labor became a primary objective of the central and local governments in the late 1990s and early 2000s.

c. Employment Generation by Private Enterprises

6. During this period, some agro-processing enterprises in Fujian Province expanded their operations and generated employment for rural residents. Some large companies from Taipei, China and Hong Kong, China established factories, farms (called "production bases" in the PRC), and chain stores in Fujian for agricultural production, processing, and marketing. These enterprises not only employed a large number of rural laborers in their factories or production bases, but also generated indirect employment through the purchase of raw products from farmers.³ To promote employment generation, the provincial government selected about 100 of the largest agroprocessing enterprises every 2 years, named them "dragonhead enterprises,"⁴ and awarded a grant to some of them to subsidize their interest payments for loans from commercial banks.

d. Problems in the Rural Finance Sector

7. At the same time, the PRC's financial sector was undergoing dramatic reforms. As a result of the transition, the Agricultural Bank of China—the only bank serving agriculture—had severely tightened its lending to agriculture, with almost zero lending to small borrowers in rural areas. While the rural credit cooperatives continued to lend to farmers, the loan size was small (less than Y30,000 or \$3,700), and the terms were short (less than 1 year in most cases). While informal lending was said to be active in the project areas, including borrowing from relatives, friends, and underground moneylenders (with high interest charges), most of these loans were small in size and short in terms. In particular, there was a lack of midsize loans (Y3–5 million or \$370,000–\$625,000) for medium to long-term (3–5 years) investment. This was quoted by almost all entrepreneurs interviewed as the number one constraint on their business expansion.

² According to official statistics, at the end of 2003, about 900 million of the 1.3 billion population in the PRC lived in rural areas, including 500 million rural laborers. Due to the limited amount of arable land in the PRC, agricultural production required only 100 million laborers. While township and village enterprises as well as migration to cities had absorbed over 100 million rural laborers, there remained about 300 million surplus laborers in the rural PRC.

³ The OEM visited a production base of the *Caodai Modern Agricultural Group*, one of the 36 bases that the company had established in 13 provinces in the PRC. More than 600 farmers were hired as permanent workers working in that production base, producing organic vegetables for export to Hong Kong, China. The OEM visited another large enterprise, the *Tienfu Group* from Taipei, China, which had more than 300 tea shops in 31 provinces and cities in the PRC. This company procured dry tea from thousands of farmers in the project areas.

⁴ Dragonhead enterprises were agroprocessing enterprises that generated (directly or indirectly) rural employment through linkages with agricultural production and farm producers.

e. Dynamic Farmers

8. One feature that impressed the OEM was the dynamic nature of farmers in the project areas. In spite of the small size of their farmlands, the farmers were educated, proactive, and willing to take risks by taking out loans and investing in new products with rising market demand. Some of them became successful businesspersons with factories processing farm products. These farmers were not isolated or uninformed, and the OEM observed no discernable problem of information asymmetry; farmers had good access to multiple channels of information about market prices and technology. They were quick to learn, replicate, and change. Traders and larger buyers from outside were often channels for innovation and technical information, and changes in market prices were key switches to turn on or off production in a given sector, providing farmers with the basis for diversification.

4. The Project

9. With an overall objective to promote sustainable growth in the rural economy so as to benefit the poor, the project comprised five components: (i) soil conservation and agricultural development including mainly rehabilitation and development of orchards, tea gardens, and bamboo plantations; (ii) aquaculture development including cage fishing, oyster cultures, and other fish culture; (iii) agricultural market development through construction of wholesale markets for agricultural products; (iv) agroprocessing development by financing the expansion and investment of private enterprises; and (v) small-scale hydropower schemes including investment in power stations. The project covered 30 of the 81 counties in Fujian Province, concentrating in the densely populated areas along the eastern coast.

10. The total project cost was estimated at \$163 million at appraisal, financed in part by an ADB loan of \$65 million. The project was implemented in 6 years from 1996 to 2002. The Executing Agency was the Fujian Provincial Government, and the implementation agencies included local governments in the 30 project counties. The finance bureaus⁵ at the provincial and county levels participated in the project by channeling the ADB credit line to end borrowers, including private enterprises and farmers. At the village level, village committees⁶ were responsible for allocating subloans⁷ to individual farmers and collecting repayments from them, although each end borrower signed a subloan agreement with the township office of a county finance bureau.

B. Evaluation of Project Performance

1. Project Design

a. Initiation of Project Concept

11. The project was initiated by the Fujian Provincial Government. At the time of project preparation in the early 1990s, an overriding concern of the Provincial Government was the intensive cultivation of grain crops on the limited amount of arable land, including uplands and hill slopes. In conjunction with the highly erodible red soils in this province, the intensive cultivation caused a severe problem of soil erosion. The provincial government had developed a

⁵ Finance bureaus were the counterpart agencies of the Ministry of Finance at the provincial and county levels. They received technical guidance from the Ministry of Finance and salaries from the provincial and county governments.

⁶ Village committees were the lowest level of administrative body in the PRC. Officers of the village committees were elected by villagers and received monthly allowance from governments.

⁷ In this report, subloans refer to loans to end borrowers.

program on soil conservation, and the original project design intended to use external financial assistance to accelerate the implementation of that program.

b. Modification of Project Design

12. At the suggestion of ADB, additional components on rural development were added to the project design, including the development of agriculture, aquaculture, agroprocessing, hydropower, and agricultural markets. The expansion of the project scope was based on an analysis that the primary causes of soil erosion in this province were the intensive population pressure⁸ and farmers' heavy dependence on grain production. The low value of grain production and the extremely limited amount of farmland per household made it necessary for farmers to intensify land use, resulting in overcultivation of the fragile soil. The project designers recognized that sustainable solutions to soil erosion should include not only direct measures for soil conservation but also interventions to divert grain production to high-value crops, aquaculture, and agroprocessing so as to mitigate the population pressure on farmlands. At the time of appraisal, fruits (longan and lichi) and aquaculture were attractive investments with high market demand and rising prices; agroprocessing added value and generated employment; and small hydropower stations in this mountainous province were found to have high financial returns. Agricultural markets were included in the project design to promote the marketing of fruits and other farm products. At the end, the project's objectives were modified to promote economic growth, control soil erosion, and increase farm income.

c. Key Constraints

13. The key constraints identified in the appraisal document included (i) scarcity and poor quality of agricultural land, (ii) inadequate physical and institutional infrastructure in rural areas, and (iii) a lack of adequate medium-term and long-term credit for private investment in agriculture and agroprocessing. Consequently, the project provided credit to small farmers for orchard, tea, and bamboo investments; to large farmers for aquaculture development; and to private and shareholding companies for agroprocessing, hydropower, and agricultural market development.

d. Project Interventions

14. Overall, the OEM considered the design of the project interventions appropriate, since it was based on a good analysis of not only key issues in the project areas, but also causes of the problems identified. As a result of the sound fieldwork, the project design focused on addressing the root cause of the soil erosion problem (surplus rural labor and intensive population pressure on fragile soil) instead of merely soil conservation measures, which might not be implementable and sustainable without removing the surplus labor from agriculture. The innovation of providing long-term credit to private enterprises to enable them to expand businesses, and through them to generate employment for rural residents provided a new approach of indirect poverty reduction (paras. 59-61).

⁸ At project appraisal, Fujian had per capita arable land of 0.036 hectares (ha), less than half of the national average of 0.1 ha per capita, which was one of the lowest in the world.

2. Project Implementation

a. Use of Existing Institutions

15. The project was implemented by local governments at the provincial, county, and township levels as well as village committees. Instead of newly recruited contractual staff, most of the implementers under the project were officers already employed at the provincial, county, township, and village levels. The PPMO was established within the Provincial Agricultural Commission, with most staff coming from that Commission. Staffs of CPMOs came from the county agricultural offices. No international consultant was recruited under the project, and only a few local consultants were engaged for specific short-term assignments. The PPMO and CPMOs coordinated project implementation at the provincial and county levels, respectively. The primary project intervention was lending to farmers and enterprises. Local governments selected subprojects, sites, and end borrowers.⁹ The CPMOs prepared feasibility studies for subprojects in cooperation with concerned agencies. For large and medium size loans, finance bureaus channeled the loans to and collected repayments from end borrowers. For small loans, village committees channeled subloans to and collected repayments from farmers. Large subprojects were approved by the PPMO jointly with the Provincial Finance Bureau, whereas small loans to farmers were allocated by village committees. Other project activities (such as agricultural extension and beneficiary training) were implemented by PPMO and CPMO staffs.

b. A Policy of No Subsidy

16. This project implemented a strict policy of no subsidy, and end borrowers were required to repay the full amount of subloans plus the full payment of interest charges in real terms. Under the project, the Central Government (Ministry of Finance) passed on the annual interest rate charged by ADB to the Provincial Government (Provincial Finance Bureau) with neither subsidy nor levy (Table A5.2).¹⁰ The Provincial Finance Bureau passed the interest rates to endborrowers plus additional levies to cover its incremental cost in managing the ADB credit line. The levies were 0.5% for aquaculture and orchards, 1% for markets and hydropower, and 2% for agroprocessing.¹¹ In addition, end borrowers had to bear the risk of foreign exchange variations. While the loans and repayments were made in local currency, calculation of the loans, principal, and interest charges was in terms of US dollars, and converted to local currency using the exchange rate at the time of the transaction. As seen from Table A5.2, exchange rates were stable during the project period; inflation rates were low and even negative in some years; domestic interest rates were even lower than ADB lending rates since 1998.¹²

⁹ The project implemented a policy of no subsidy (para. 16), and required local governments to guarantee subloan repayments. As these policies discouraged rent seeking, local governments' selection of end borrowers did not seem to result in serious problems of political intervention.

¹⁰ The annual interest rate charged by ADB was determined in accordance with ADB's pool-based variable lending rate system, which was 6.91% at project appraisal in 1995 and 6.69% at project completion in 2002.

¹¹ While three extra staff were hired by the Provincial Finance Bureau to handle the ADB credit line, no extra staff were hired by county finance bureaus, which used existing staff at the county and township levels to disburse subloans and collect repayments. Since repayment of subloans was guaranteed by local governments with low risk, the 0.5–2% interest spread was sufficient to cover the incremental costs of the finance bureaus in handling the credit line.

¹² Although the ADB lending rates were higher than domestic rates, enterprises and farmers borrowed the ADB credit line due to the lack of long-term credit available to rural borrowers.

Table A5.2: Interest Rates, Exchange Rates, and Inflation Rates in the PRC (1996–2002)

Item	1996	1997	1998	1999	2000	2001	2002
ADB Lending Rate (%) ^a	6.89	6.79	6.93	6.38	6.46	6.70	6.69
Domestic Interest Rate (%)							
Deposits	7.47	5.67	3.78	2.25	2.25	2.25	1.98
Lending	10.08	8.64	6.39	5.85	5.85	5.85	5.31
Domestic Inflation (%) ^b	8.32	2.81	(0.85)	(1.41)	0.26	0.46	(0.77)
Exchange Rate (Yuan/US\$)	8.31	8.29	8.28	8.28	8.28	8.28	8.28

ADB = Asian Development Bank.

^a ADB lending rate to the Central Government before levies to end borrowers.

^b Consumer price index.

Source: International Monetary Fund, International Financial Statistics Browser.

c. Loan Delivery and Repayment Collection

17. Due to the lack of banks willing to engage in agricultural lending during the transitional period, subloan disbursement under the project and collection of repayments was through finance bureaus at various levels of the government structure. Repayment of subloans was guaranteed by local governments, which selected the end borrowers. An upper level of government would deduct the due amount of loan repayments from the budgetary allocation to a lower level of government if end borrowers failed to repay their subloans. While this mechanism effectively ensured loan repayments for the upper level governments, it also reduced their incentive to monitor repayments by endborrowers. The OEM observed no subloan tracking systems that could reflect repayments made by endborrowers and signal outstanding amounts and arrears.

18. Lending to small farmers was for investments in orchard, bamboo, and tea garden development or rehabilitation, where measures for soil conservation were required as a condition for receiving loans. The loan amount to each household was small (Y1,000–3,000 or \$125–\$375 in most cases), accounting for about one third of the investment cost, with farmers contributing the remaining funds required for orchard rehabilitation or development. The terms of the loans were long: 10 years including a grace period of 4 years for orchard rehabilitation, and 20 years including a grace period of 6 years for new orchard development. Selection of participants was based on identified plots of orchard for demonstration purpose, where all farmers with farmlands located on the demonstration plots were entitled to borrow from the project. Lending to farmers and collection of repayments were through the village committee already existing in each village. The OEM noted that, in the case of farm products with good prices (such as bamboo and tea), all end borrowers repaid their due amount on time and fully. In one village, however, the OEM found that none of the farmers repaid any amount due because of the sharply reduced prices for longan and lichi at the end of the 1990s and the early 2000s,¹³ which wiped out the profit for longan and lichi production.

19. Loans for aquaculture and agroprocessing were large or medium in size, with 10 years for aquaculture including a grace period of 4 years, and 6 years for agroprocessing including a grace period of 2 years. Township and county governments selected end borrowers for these

¹³ The price of longan had gone down from about Y10/kg in 1996 to Y1/kg in 2002, and slightly increased to Y2/kg in 2003 due to poor harvest. A similar price trend for lichi was observed in the project area.

loans. The OEM noted that some of the enterprises generated sizable employment. For example, a kelp processing factory located in one village created more than 700 jobs for residents in that village, and another 500 or so jobs outside the village. In another case, however, the OEM observed an investment of Y670,000 (about \$84,000) in cage fish production by a group of seven households employing only two permanent workers in addition to using family labor. The concerned county government selected the cage fishing project in view of its high value added, which contributed significantly to the growth rate of gross domestic product in that county—an indicator used to assess the performance of a local government in the 1990s. To provide appropriate incentives for local governments to push for employment generation, the project could have developed criteria for credit allocation based on employment generation instead of merely growth rates.

d. Problems with Using Government Agencies in Credit Services

20. The use of finance bureaus instead of banks in loan delivery caused various problems. Due to a lack of banking experience, the finance bureaus imposed unreasonable repayment schedules for agroprocessing enterprises, requiring heavy repayments up front when the enterprises were at their initial stage of operation with insufficient cash flow. The short grace period (2 years) made it almost impossible for many enterprises to repay their subloans on time when they received the loans with substantial delays, due largely to the complicated procedures for subloan approval, procurement, and disbursement, which delayed operations.

21. Furthermore, the system of guaranteeing loan repayments by local governments provided little incentive for the PPMO to push for timely repayment of subloans. Based on the original project design, the ADB loan to the Ministry of Finance was for 25 years, but subloans to end borrowers ranged from 6 to 20 years. Repayments collected were to be used as a revolving fund to relend to endborrowers. In late 2000, however, the Central Government prohibited the operation of all revolving funds under externally financed projects so as to tighten its control on financial institutions. Under such a regulation, the Provincial Financial Bureau would lose money if it collected the full repayments on time in accordance with the original project design, because the money collected could not be used for relending, but would be kept in a savings account earning an annual interest rate of about 2%, while paying ADB an annual interest rate higher than 6% (Table A5.2). Since the ADB loan and the full interest charges were passed on to the end borrowers, the longer the delay in repayments, the fewer losses the Provincial Financial Bureau would bear. They therefore had a strong incentive not to collect repayments on time. For end borrowers, since subloans from the project were the only long-term credit available, they had a strong incentive to delay repayments when no one pushed for timely repayment. Perhaps due to these considerations, the project readjusted end borrowers' repayment schedule by extending it to 12 years for agroprocessing and 22 years for bamboo, orchard, markets, and hydropower (footnote 1).

22. While the full amount of subloans was not yet due, the PCR reported that, at the end of 2002, repayment rates of the amount due varied by project component, ranging from 54% in agroprocessing to 84% for aquaculture and 88% for orchards and bamboo rehabilitation. The aggregated repayment rate for the entire Project was 69% of the total amount due. The OEM discussed this issue with the PPMO and the local governments interviewed. All of them were confident that end borrowers would repay the amounts due immediately when it became necessary for timely repayment, because the provincial and county finance bureaus had the authority and means to deduct the due amount from the annual budgetary allocations of the township governments, as well as from the allowances of village officers, who, in turn had effective means to enforce repayments from end borrowers when it became necessary.

23. While this might well be the case, given the power of local governments in the project areas, the OEM identified certain risks. First, the lack of financial discipline concerning timely repayment might have sent a wrong message to end borrowers that credit from ADB was “easy money” without the need to strictly adhere to subloan agreements. This may have generated a long-term impact and may negatively affect the implementation of future projects. Second, although many farmers, especially those producing bamboo and tea, repaid their due amount on time and fully because the prices of these products were rising and profits were good at the time of the OEM’s visit, they may not repay the remaining loan amount if market prices fall in the future. The OEM observed such a case at a subproject site with orchard rehabilitation, where no farmers repaid their due amount in view of the sharply reduced prices and profitability of longan and lichi (para. 18).

3. Results and Impacts

24. The project was implemented largely as designed without the assistance of any international consultant. Most of the physical targets were fulfilled or exceeded, and the loan was closed on time. According to the PCR (footnote 1), poverty in the project areas was reduced from over 30% to 2% during the project period and farmers’ income more than doubled. These remarkable changes in rural poverty were confirmed by a social survey conducted in early 2003 by the Provincial Office for Poverty Reduction, which interviewed 400 enterprises and farmers in 19 villages, and compared their living standards in 2001 versus those in 1995. The OEM found a similar trend in the villages visited, where ordinary residents reported substantial improvements in their living standards during the project period. Most impressively, the OEM hardly observed poverty in the villages visited.

25. The remarkable changes in living standards and poverty reduction, however, could not be attributed solely to this project, because poverty in the entire province was also reduced to about 2% during this period. The project probably contributed to the achievement through the demonstration of improved technology (such as rehabilitation of orchard and bamboo). Adoption of technology, however, could have occurred with or without this project, because farmers in the project areas had multiple accesses to technology information—through normal government programs, mass media, private traders, as well as technicians from agroprocessing enterprises. In fact, market prices seemed to be the single most important stimulator in guiding farmers’ adoption of new technology.

26. What the project could claim credit for is the large number of employment opportunities generated for rural residents. The PCR estimated that the project generated 17,479 person-years of direct employment. While the OEM could not confirm this number during its short visits in the project areas, it observed significant employment generation at the subproject sites visited, including the kelp processing factory, which employed more than 700 workers in a village and another 500 or so workers outside the village; the *Candai* company, which employed 600 farmers; a ginger processing factory, which employed 80 permanent and 200 seasonal workers; and a food company that produced frozen vegetables and fruits for export to Japan, North America, and Europe, which generated 900 jobs including permanent workers in its processing factory and on its own farm, as well as purchasing vegetables and fruits from other farmers.

C. Evaluation of New Approaches

1. New Approaches Used

27. The project adopted a top-down approach and implemented project activities through existing government structures at the provincial, county, and township levels as well as village committees at the lowest level. It did not engage any nongovernment organization (NGO), nor did it establish any beneficiary groups. During the implementation period, the project did not spend time and resources on workshops, seminars, or information campaigns for beneficiary consultation or participatory planning. Although training for farmers and project staff was conducted as required by the project design, the amount of the training (over 1 million person-days) was considered excessive and unnecessary by project staff interviewed.

28. The most interesting innovation under the project was direct support for private enterprises by providing them with access to long-term credit, which was the key constraint restricting their business expansion. By enabling private enterprises to expand their operations, the project achieved its objective of rural employment generation.

29. No subsidy for end borrowers was another interesting feature, which seemed to have provided correct price signals to guide private investment. The use of local governments to guarantee subloan repayments was probably the second best option, given the reality in the project areas during the transitional period, with no banks being willing to participate in agricultural lending. The guarantee system seemed to have provided the incentive for local governments to carefully select end borrowers, but also reduced the incentive of the PPMO and CPMOs to monitor the financial performance of end borrowers and repayments (para. 17).

2. Role of Actors

30. This section analyzes the role of policymakers, subproject providers, and beneficiaries in (i) information flow, (ii) resource control and decision making, (iii) service delivery, and (iv) accountability.

a. Information Flow

31. The upward flow of information about project implementation went from village committees to township governments, CPMOs, and finally the PPMO, which produced quarterly progress reports for ADB. The downward flow of project information was limited. As the project did not focus on information campaigns, beneficiary consultations, or participatory planning, information about it was not disseminated widely in the project areas. In the villages visited, the OEM noted that only the selected end borrowers knew about the availability of the credit line from ADB. Many ordinary residents in the same villages, if they were not end borrowers, heard about this "ADB project" but knew little about its content. The OEM, however, observed no negative impact on project implementation generated by nonborrowers' lack of project information. What mattered most to ordinary villagers seemed to be information about market prices and new technology, which was readily available to all farmers through multiple sources, such as mass media, regular government extension programs, private traders, and technicians from processing enterprises, who provided technical guidance to farmers that supplied farm products to the enterprises.

b. Resource Control and Decision Making

32. The project loan was controlled by ADB and the PPMO, which approved large subprojects jointly with the Provincial Finance Bureau. Local governments played a major role in selecting subprojects, sites, and end borrowers. While the selection followed criteria and guidelines established by the PPMO, a key concern of the local governments was the end borrowers' creditworthiness, because local governments had to guarantee the repayment of subloans. If end borrowers failed to repay loans, budget allocations to the concerned local governments would be deducted by the higher level government.

33. While project designers in the provincial government and ADB determined the project components and activities, and local governments selected subprojects and end borrowers, investment decisions about subprojects were made by private investors (end borrowers), who financed a major portion of the subproject investment.¹⁴ The requirement that end borrowers had to repay the full amount of principal plus all interest charges, and bear the risk of foreign exchange changes probably discouraged overinvestment.

c. Service Delivery Mechanisms

34. Major services provided under the project were credit delivery and training. Training and extension services were provided by technicians from existing government agencies, similar to the case of regular extension programs. Credit was delivered by finance bureaus at each level of the government structure instead of by banks, due to the lack of banks willing to lend to agriculture. Instead of engaging NGOs or creating beneficiary groups as a mechanism to deliver project services, existing local institutions (village committees) were used to deliver subloans to and collect repayments from farmers. The design of such mechanisms was based on the local realities in the project areas, where local governments functioned effectively.

d. Accountability

35. The policy of no subsidy made end borrowers bear the full costs of borrowing under the project, including the full amount of subloans, all interest charges, and the risk of foreign exchange variations. Such a policy seemed to have provided correct price signals to guide private investment. End borrowers interviewed seemed to treat the subloans borrowed from the project as their own money.

36. Further accountability for the use of the project's credit line was provided through the repayment guarantee system: Loan repayment to ADB was guaranteed by the Central Government; loan repayment to the Central Government was guaranteed by the provincial government; loan repayments to the provincial government were guaranteed by county governments; and loan repayments to county governments were guaranteed by township governments. Since the higher level governments had the authority and means to deduct budgetary allocations to lower level governments in case of nonrepayment, the guarantee mechanism seemed to be effective and provided incentives for local governments to carefully select end borrowers based on their creditworthiness.

37. While strong accountability was observed relating to the use of the credit line, the project funds used for other activities, such as training and extension services, did not seem to have the

¹⁴ For bamboo and orchard rehabilitation, subloans from the project constituted about one third of the investment cost in most cases examined. For agroprocessing, the project loans could be up to 40% of the investment cost in some enterprises interviewed.

same level of accountability. While project staff interviewed considered the excessive training provided under the project a waste of time and resources, they completed the training as required so as to fulfill quantified targets. In this case, they treated the training funds as “other people’s money,” without an incentive strong enough to resist the unreasonable requirements or change the project design based on local realities. Their lack of authority was another factor underlying this issue.

3. Impact of New Approaches

38. This section examines whether the new approaches used under the project offered an effective solution to the conventional problems of less relevant project interventions and poor sustainability observed in many conventional rural development projects.

a. Relevance of Project Interventions

i. Design Interventions Based on Key Constraints

39. Overall, the OEM considered the project design highly relevant, reflecting the project designers’ solid grasp of the key issues in the project areas. Since the key constraints in the project area were (i) intensive population pressure on the limited amount of fragile farmland, and (ii) insufficient rural employment to absorb a large amount of surplus labor, the project focused its interventions sharply on employment generation through private investment in agriculture and agroprocessing. Since the key factor restricting private investment in the project area was lack of access to long-term credit instead of affordability, the project provided access to credit but not subsidy. Such an approach seemed to have generated an incentive for investors to treat subloans from the project as their own money.

ii. Use of Existing Institutions

40. The OEM noted that the project did not engage NGOs to create beneficiary groups as a mechanism to channel credit, training, or extension services. Instead, existing government structures and village institutions were used to select borrowers, allocate subloans, and collect repayments. This approach, again, reflected project designers’ good understanding of local institutions in the project areas. As a result, the project enabled end borrowers to invest in agriculture and agroprocessing, and through them generated rural employment; and diverted grain production on slopes to long-term tree crops, which helped to stabilize the red soils in the project areas. The use of existing institutions instead of creating new mechanisms for service delivery probably saved time and resources. It might have enhanced project sustainability as well, since postevaluation of many rural development projects has found that new groups created under projects typically cease operation after project completion when no more project funds are available.

iii. Weaknesses in Project Design

41. While the project’s provision of long-term credit for private sector development was relevant, it should not have provided loans to all types of end borrowers with creditworthiness. In particular, the OEM found that loans provided for capital-intensive cage fishing and construction of wholesale markets, while benefiting the nonpoor, did not generate significant employment. To maximize employment generation, the project could have focused sharply on medium-size agroprocessing enterprises for the following reasons: First, the provision of small loans (Y1,000–3,000) to farmers did not seem to be necessary, as most of the farmers interviewed

appeared to have the capacity to arrange such a small sum of money on their own, either from savings or borrowing from friends. The 10-year term was unnecessarily long, as most farmers could have repaid the small loans within 1 or 2 years. The terms for small loans could have been 1–3 years and, if farmers wanted to borrow again, the risk of lending could have been reassessed.

42. Second, lending to small agroprocessing enterprises at their initial stage of operation seemed to be unnecessary and risky. Due to the intensive market competition in the project areas, many small enterprises failed; only some survived and gradually built up their marketing channels with stable clients. At the initial stage, the most binding constraint was not access to credit but stable markets, clients, and management skills. Based on the OEM's interviews with entrepreneurs, the capital required for their initial operation was small, and they arranged it through their own savings or informal sources.

43. Third, lending to large enterprises should not be the task of externally-financed projects. These enterprises, due to their strong financial position, large assets, and good reputation in loan repayment, had easy access to formal lending by banks. For these enterprises, cheap loans from projects or grants from governments for interest payments did not make a big difference in their investment decisions. Their decisions on whether or not to expand operations to a particular region depended on the costs of land, labor, and transportation in that region, as well as on the "soft environment," such as transparency in local government policies and regulations.

44. The project could have focused its lending on mid-size agroprocessing enterprises that were in their first or second round of expansion. These enterprises had already survived the initial market competition with stable marketing channels and clients. To gain a further market share, they had to create their own brand with a stable supply, and reduce unit costs by expanding the operational scale. The OEM noted that the expansion of these enterprises had a much larger impact on direct and indirect employment than did small enterprises during their initial stage, when family members were the primary labor force. The major constraint to the mid-size enterprises was the lack of access to mid-size loans (Y3–5 million or \$375,000–\$625,000) for 3–5 years. At the time of the OEM's visit, no banks in the project areas provided such loans for investments in agriculture or agroprocessing. Borrowing from the informal sector was too small and too short to be useful.¹⁵ According to the entrepreneurs interviewed, the lack of external financing could have delayed the expansion of their businesses by 5 years or more if they had to rely on their own savings, which involved a slow process of accumulation.

b. Sustainability of Project Benefits

45. The provision of long-term credit under the project was a one-time activity, due to the Central Government's restriction on revolving fund operations (para. 21). While the credit provision was discontinued, sustainability of the project's primary benefit—employment generation in rural areas—is likely, because most of the enterprises interviewed seemed to be strong enough to continue their operations after the one-time support of the long-term (6–20 years) credit.

46. The Project did not spend time and resources on beneficiary consultation and participatory planning. Yet beneficiaries' lack of ownership of, and financial means to maintain

¹⁵ Borrowing from relatives and friends could be free of interest, but it was usually in small amounts and short in terms. Loans from moneylenders charged an interest rate high enough to discourage investment.

project facilities after project completion—a problem commonly observed in many rural development projects—did not occur under this project.

47. A number of factors might have contributed to the likelihood of project sustainability. First, under this project, investment decisions on subprojects were made by private individuals (end borrowers) instead of by government officials. Since subloans accounted for only a minor portion (about one third) of the investment cost of the subprojects, and end borrowers had to use their own money to finance the remainder of the investments, they were the ones to decide if they would invest in the subprojects. The requirement that end borrowers repay the full amount of subloans and bear all interest charges and exchange rate risk probably provided strong incentive for them to treat subloans as their own money. As private investors, they had to consider their capacity to finance O&M before they made investment decisions. Partly due to this reason, no overinvestment was observed under this project, which is a common issue in many other rural development projects.¹⁶

48. Second, the project did not create any infrastructure or facilities with public or collective ownership. All facilities built under the project were private property, and properly maintained by their owners.

49. Third, the project used existing local institutions such as village committees to deliver subloans and collect repayments. No NGOs were engaged, and no beneficiary groups were created as mechanisms to deliver project services. Consequently, the issue of poor sustainability of NGO services and beneficiary groups commonly observed in many rural development projects did not occur under this project.

D. Issues, Underlying Causes, and Alternatives

1. Design Project Interventions Based on Local Realities

50. The original project design focused narrowly on soil conservation, which was later expanded to multiple interventions on rural development. The expansion of the project scope was based on the recognition that the root cause of soil erosion in the project areas was the intensive population pressure on the limited amount of farmland with fragile red soil in the province. Without generating rural employment to absorb the surplus labor and mitigate the population pressure, implementation of soil conservation measures would not be feasible and sustainable.

51. The project did not follow the conventional model of rural development projects, which typically invest in three areas: (i) rural infrastructure development of roads and irrigation systems; (ii) support for agricultural production including provision of subsidized inputs and extension services; and (iii) social services such as health care centers, drinking water supply, and/or beneficiary groups. Instead, the project focused sharply on the provision of long-term credit to farmers and enterprises. Such a design was based on the recognition that the key factor restricting rural employment in the project areas was the lack of long-term credit available for private investment in agriculture and agroprocessing. Furthermore, it was believed that employment generation for rural residents was the solution to other social issues as well: If the

¹⁶ Overinvestment is a moral hazard observed in many rural development projects, where decisionmakers (line agencies, community leaders, or local politicians) are not accountable for the use of the investment funds. Under such conditions, many decisionmakers are interested in subproject investment but not O&M; the external loans provided under these projects finance investments but not O&M; and the end users and local governments have no financial capacity or willingness to pay for O&M of the infrastructure built by the projects.

income of most households increased as a result of employment generation, rural communities would have the financial capability to solve other social issues on their own, such as improving water supply, sanitation, rural education, health care, and assisting the poor and vulnerable groups in their villages. The OEM's field visits confirmed this assumption.¹⁷

52. A lesson may be derived from the success of this project: Project design should be based on a solid grasp of not only the key issues in the project areas, but also the root causes of the issues identified. Project interventions proposed should be derived from the need to address the root causes instead of following a standard model.

2. Top-Down Approach May Work Under Particular Conditions

53. A top-down approach was used under this project. While the project designers conducted fieldwork to consult stakeholders and collect local information during the design stage, no time and resources were spent during the implementation period to organize workshops and seminars to disseminate project information or consult beneficiaries. Instead of engaging NGOs and creating beneficiary groups to deliver services, existing government structures and village institutions were used to select end borrowers, channel subloans, guarantee repayments, and collect repayments from end borrowers.

54. The OEM considered the above approaches appropriate, as they were based on the specific conditions in the project areas, including in particular the strong government structures and village institutions that had worked effectively prior to the project, the rapid economic growth in the country during the project period, and the dynamic nature of the farmers in Fujian Province. Furthermore, the design of the approaches was based on the particular needs of the project interventions. For example, the project did not engage NGOs or create beneficiary groups because (i) the primary focus of the project was employment generation through private enterprises, and (ii) the instrument used was the provision of long-term credit. Given the reality that no banks were willing to lend to farmers, the use of existing government structures and village committees was more appropriate than hiring NGOs or creating beneficiary groups. Finally, since a system of annual budget allocations among multiple levels of government already existed and worked well in the project areas, the project used it as the mechanism to guarantee subloan repayments. The incentive for local governments to participate in loan guarantees was that aid funds from the project might accelerate economic growth in their counties.

55. While the above approaches and the conditions within which they worked were particular, some general lessons can be derived. First, the top-down approach can work effectively under particular conditions, and the assumption that bottom-up approaches are superior under all conditions may not always be valid. Second, existing local institutions can be used for project implementation under particular conditions, and the creation of beneficiary groups may not be necessary for all types of projects. Third, the experience of this project is not replicable in areas without similar conditions, but the principle of designing project interventions based on local realities in a particular project area is applicable universally.

¹⁷ In the village with the kelp processing factory, the OEM noted that all senior residents (60 years or above) received a monthly subsidy of Y30 and 15 kilograms of rice from the village committee, because the kelp factory generated more than 700 jobs for residents in that village, and the income of most households increased substantially.

3. The Policy of No Subsidy

56. No subsidy was provided under this project. End borrowers were required to repay the full amount of subloans plus the full charges of interest rates, and to bear the risk of foreign exchange variations (para. 16). The design of such a policy was based on the recognition that the key constraint to private investment in agroprocessing was the lack of long-term credit instead of affordability. There was no need to provide interest subsidies for private investment.

57. The policy of no subsidy provided not only correct price signals to guide private investment, but also strong accountability for the use of subloans provided by the project. As end borrowers treated subloans as their own money, overinvestment was not observed. Furthermore, the system of local governments guaranteeing subloan repayments provided a strong incentive for them to select end borrowers based on creditworthiness instead of political patronage, because budgetary allocations to local governments could be cut if end borrowers failed to repay subloans. To this extent, this policy made local governments treat the credit line as their own money as well.

58. Lessons may be derived from the experiences of the project. First, subsidies should be avoided when the key constraint in a particular project area is the availability of services instead of their affordability. Second, aligning incentives faced by beneficiaries, providers, and local politicians is critical, and this, rather than participation, should be in itself an objective. Third, a key focus in the design of incentives is how to make various players treat project funds as their own money. The policy of no subsidy, by charging beneficiaries the full cost of project services, provided appropriate incentives to all parties involved.

4. Indirect Poverty Reduction

59. Although with a final goal to benefit the poor in rural areas, the project did not focus on increasing agricultural production or targeting the poor. Instead, large subloans were provided to agroprocessing enterprises, which generated sizable employment for rural residents (para. 26). The success of the project contradicts a commonly held belief that rural development has to focus on agricultural growth, and poverty reduction has to target exclusively the poor.

60. The project's experience denies the assumption that there is one standard model applicable to all regions at all times. Instead, the project's success was conditioned on the particulars in the project areas during the particular period. The key constraint in the project areas was not low crop yields or a lack of extension services. On the contrary, crop yields in the project areas had been high prior to the project, and farmers had full access to market information and new technology. The most binding constraint in the project areas, however, was the extremely low land/labor ratio, with a per capita arable land of 0.036 ha in the province. Without measures to move the large amount of surplus labor out of agriculture, labor productivity in the agriculture sector would remain low, and farmers would remain poor in spite of high levels of crop yield.

61. Based on a good grasp of such a reality, the project design focused on employment generation in the non-agriculture sector instead of promoting agricultural production or land productivity. Recognizing the important role of private sector development to employment generation, the project directly supported agroprocessing enterprises, although none of the entrepreneurs were poor. Knowing that the key constraint faced by the private sector was the lack of long-term credit, the project provided access to credit but not subsidies. As the credit enabled the expansion of private enterprises, the project benefited not only the middle-income

class (entrepreneurs), but also the rural poor, who had more employment opportunities as a result of the business expansions. A trickle-down impact was realized, because the enterprises supported by the project used labor-intensive technology.

CASE STUDY: BANGLADESH
Small-Scale Water Resources Development Sector Project (Loan 1381-BAN)

A. Introduction

1. Selection of the Project for Case Study

1. The Small-Scale Water Resources Development Project was selected for case study because of its involvement of beneficiaries in water resources investment and maintenance. The project was closed in 2002, and a follow-up project (Phase II) approved in 2001 was ongoing at the time of field visits. The first project's experience in mobilizing beneficiary participation in water resources development was replicated by the Asian Development Bank (ADB) and other aid agencies in the design of small-scale water resources projects both in and outside Bangladesh.

2. Fieldwork of the Operations Evaluation Mission

2. An Operations Evaluation Mission (OEM) visited the project areas during 2–18 December 2003. The OEM held meetings with the Executing Agency—the Local Government Engineering Department (LGED)—and its Project Management Office (PMO). Intensive discussions were held with the consultant team that facilitated the implementation of this project as well as the follow-up (Phase II) project. Three field trips were conducted, during which the OEM visited 11 subprojects in 8 subdistricts (*upazilas*). Table A6.1 provides a list of the subprojects visited.

Table A6.1: Subprojects Visited

District	Subdistrict	Subproject/Village
A. Subprojects		
Rajbari	Pangsha	Brajamul-Bhitikhal Flood Control and Drainage
Faridpur	Madhukhali	Sonatala Flood Control and Drainage
Nilphamari	Domar	Haridara Water Conservation
Rangpur	Mithapukur	Veluar Beel Flood Control and Drainage
	Priganj	Moranadi Water Conservation
Nawabganj	Sadar	Agrani Area Development
Natore		Rampur Flood Control and Drainage
Bogra	Sherpur	Simbari Flood Control and Drainage
Siranjganj	Ullapara	Puthia-Failia Flood Control and Drainage
	Belkuchi	Dahapara-Goyhatta Flood Control and Drainage
		Chandi Beel Flood Control and Drainage
B. Nonproject Villages		
Nawabganj	Sadar	Bidirpuro Village
Natore	Sadar	Makupara Village
Siranjganj	Belkuchi	Boyra Bari Village

3. The OEM purposely selected some subprojects for visit, including three best ones and three less performing ones based on recommendations of the PMO. The other subprojects visited were arbitrarily selected on the day of the visit, with a view to providing no time for project staff to preinform local communities of the visits. For comparison, three villages located near the subproject sites were also visited. The nonproject villages suffered problems similar to those of the subproject sites but did not receive assistance from the project. These visits were also informal; efforts were made to reduce the chances of local communities being preinformed of the visits so as to maximize the opportunity of observing normal conditions.

4. The OEM's fieldwork involved mainly in-depth interviews with various stakeholders, including LGED officers and field staff (engineers and socioeconomists), consultants, contractors, leaders and members of water management cooperative associations (WMCAs) established under the project, facilitators who worked with the WMCAs, formal and informal village leaders such as village elders, businessmen, large and small landowners, tenants, landless laborers, and women. Most of the interviews were conducted on an individual basis, ranging from 20 minutes to over 1 hour. Efforts were made to minimize the chance of interviewees being coached by officers or WMCA leaders so as to enhance the reliability of the information collected.

5. The OEM's fieldwork benefited from the project's management information system, which produced brief subproject information within a short time upon request. The OEM also benefited from existing evaluation studies about the project, including (i) the project completion report (PCR) prepared by LGED and the consultant team in January 2003; (ii) the Phase II project's inception report prepared in November 2003, which reviewed in great detail every step of the implementation process of this project; and (iii) an external evaluation financed by the Royal Netherlands Embassy and prepared by local consultants from a university and a research institute in June 2003, which studied 30 subprojects randomly selected. These reports contain valuable information about many details of this project.

3. Local Realities in the Project Areas

a. Key Constraints

6. At the time of project appraisal, an overabundance of water during the monsoon season and a lack of water during the dry season were identified as the key constraint restricting farming activities in Bangladesh. These problems were common in the areas visited by the OEM. In a typical village, the OEM was told that, before the project, shallow flooding restricted crop production during the monsoon season, and soils suffered dry conditions when the rains finished early, thus negatively affecting the cultivation of rice in the monsoon season and other crops in the dry season.

7. In answering the OEM's question about key constraints, some community leaders ranked widespread poverty as their number one concern, followed by bad roads, annual floods, and drainage problems. The widespread rural poverty seemed to relate to the extremely limited amount of farmland in contrast to the large population in the context of limited off-farm employment in rural areas. In some villages visited, only 10–15% of the households owned

land, with the majority being landless casual laborers or tenants.¹ The landless poor considered the shortage of jobs as their number one concern.

8. To the Government, water resources development was, and still is, a top priority; it consists of two major tasks: (i) flood protection and drainage management; and (ii) water conservation and irrigation development. Large amounts of external funds were invested in these areas. Prior to the approval of this project in August 1995, ADB alone had provided 26 loans to the water resources sector in Bangladesh, with a total amount of about \$900 million plus another \$20 million of technical assistance (see PCR). While most of these projects were large scale and were implemented by the Bangladesh Water Development Board, a few loans focused on small-scale (less than 1,000 hectares [ha]) water control systems and were implemented by LGED. With about 10,000 staff, LGED had an annual budget of \$165 million at the time of appraisal (see the report and recommendation of the President [RRP]), and had implemented four small-scale water development projects prior to this project. At the time of the OEM's visit, LGED had 70 ongoing projects in various sectors, including 2 in the small-scale water resource sector.²

b. Private Investment in Irrigation

9. Reforms in the water resources sector started early in Bangladesh, including efforts toward cost recovery, transfer of operation and maintenance (O&M) responsibility to end users, and private investment in irrigation. Of particular interest were changes in government policies in the late 1980s that removed all duties and taxes on small diesel engines. The reform induced a sharp increase in private investment in minor irrigation equipment (shallow tubewells and low lift pumps), leading to a substantial increase in irrigated area and a remarkable increase in crop yields that allowed Bangladesh to almost achieve food self-sufficiency in 1993 (see RRP).³

c. O&M Problems and Underlying Causes

10. Poor sustainability of water resources projects was identified as a major concern at the time of appraisal, caused by end-users' sole dependence on the Government for O&M of the water systems and the Government's inability to provide sufficient budget for O&M (see RRP). The OEM noted that local governments also lacked the financial capacity to take care of O&M. The chairmen of the union parishad⁴ interviewed said that they had neither transfers from the Central Government nor authority to collect taxes. The only source of revenue they had was fees collected from allocating spaces in local markets, which was insufficient for O&M of roads and markets. Thus, O&M of small-scale water systems traditionally depended on LGED.

11. The long history of LGED constructing water systems on a grant basis had a negative impact on end users' willingness to pay for maintenance of the systems. In one village, the OEM observed a drainage system constructed by the Government about 20 years ago that had not been reexcavated in the past 10 years. While poor drainage was identified as a top concern and the potential benefits (increases in crop yields) of cleaning the canal were well recognized,

¹ In a village of about 1,300 households, the OEM found that about 200 (15%) families owned land; 600 (46%) were landless, working as tenants; and the remaining 500 (39%) were landless casual laborers. In another small village with about 300 families, the OEM found that only 10% of the households owned land, with an average of 1.25 ha.

² In the districts visited, the number of ongoing projects (financed by external agencies or government programs) in LGED offices ranged from 5 to 13.

³ Rice yield increased from 1.5 tons (t)/ha in 1987 to 2.4 t/ha in 1992.

⁴ The union parishad is the lowest level of government in Bangladesh.

village leaders did not do anything (such as collecting funds from users and organizing canal cleaning) except repeatedly requested the Government for help, and then waited for it to come.

d. Good Cases of Community Investment

12. In a few cases, the OEM observed strong community leaders organizing investment and O&M for small-scale water projects without outside help. In one village, farmers had built a cross dam made of bamboo to prevent floods, although the structure was rustic and required rebuilding every 2–3 years. In a subproject site, farmers had built a canal for irrigation in the 1960s without any government help. Furthermore, they had enlarged the canal and more than doubled its distance in the 1980s, again without any government help. Their organization operated and maintained the water distribution system, paid fuel and rental fees for a pump, hired labor to clean the canals regularly, and had 15 collectors to collect fees from water users during harvest time with enforcing measures set by their organization.⁵

e. Nongovernment Organizations (NGOs)

13. NGOs operated actively in the project areas, mostly engaged in microcredit programs. In spite of the widespread presence of NGOs in the country, not many of them had experience with water resources management, so the project ended up engaging NGOs without proper experience and linkages with beneficiaries (para. 42).

4. The Project

14. The project's primary objective was to facilitate sustainable growth in agricultural production and increase the income of 140,000 beneficiary families. The project scope involved (i) beneficiary participation and water management association development; (ii) development of small-scale water control systems, including flood management, drainage improvement, water conservation, and command area development; and (iii) institutional support for small-scale water resources development. The project targeted the construction of 400 small-scale water systems covering about 150,000 ha in 37 districts, with an average cost of \$100,000 per water system.

15. At appraisal, the total project cost was estimated at \$66 million, to be cofinanced by an ADB loan of \$32 million, a loan of \$10.4 million from the International Fund for Agricultural Development, and a grant of \$6.8 million from the Government of the Netherlands.

16. LGED was the Executing Agency. The Department of Fisheries and the Department of Agricultural Extension provided extension services. The project was implemented in 6 years from 1996 to 2002.

B. Evaluation of Project Performance

1. Project Design

17. The project had a number of interesting features: First, it imposed a policy of cash contribution from end users before construction as a precondition for subproject approval.⁶ This

⁵ If a farmer did not pay the water fee at harvest time, he would incur a penalty of 14% of the amount due. The next season he had to pay the full amount plus the penalty; otherwise, he would receive no water.

⁶ In this report, subprojects refer to project activities at specific project sites.

was an innovation in ADB-financed irrigation and water resources projects, as previously most small-scale irrigation projects had failed to collect cash contributions from end users due partly to the misconception that, because farmers were poor, they could contribute labor but not cash, and because they had no savings, it was impossible to ask them to pay before they benefited. Experience from this project, however, showed that farmers were able and willing to pay for investment that brought to them more benefits than the cost they had to share, and the only bargaining power that a project had to convince farmers to pay was before subproject construction.

18. Second, the project focused institutional development efforts on the leaders of WMCA instead of organizing numerous workshops or information campaigns to consult ordinary beneficiaries. This approach seemed to be practical and worked well (para. 39). Finally, the project used better-off farmers to organize WMCAs, collect investment and O&M funds, and manage O&M. In cases where the better-off farmers had a large amount of farmland located in the subproject area and benefited significantly from the water control system constructed, they had a strong incentive to make the subproject successful and sustainable.

2. Project Implementation

a. Initiation and Implementation of Subprojects

19. In a number of cases, the OEM noted that the subprojects had been initiated by a union parishad chairman, with support from engineers in LGED's local (district or subdistrict) offices, frequently as a result of demands from some large landowners most affected by floods. Later on, a facilitator paid by the project and hired through NGOs and a socioeconomist from the LGED local office became major actors in following up the necessary steps to establish a WMCA, promote the collection of funds to comply with the required cash contribution, and train end users in O&M and other areas. A number of subcommittees were established under a WMCA to handle O&M, agriculture, fisheries, health and sanitation, and microcredit, with assistance from the facilitator, the socioeconomist, and extension workers from the departments of Fisheries and Agricultural Extension.

b. Independent Microcredit Schemes

20. While the project did not provide a credit line, microcredit programs were established in most WMCAs with funds generated solely from member shares and mandatory monthly savings. The project provided training on microcredit, and facilitators gave much attention to the credit programs. The OEM noted two factors underlying the active microcredit programs in the WMCAs: First, demand for microcredit was high in the project areas, due largely to small farmers' lack of access to formal banking services. Second, while NGO microcredit programs were readily available, their interest rates were considered too high by local people. In contrast, WMCAs were able to provide loans to members at lower interest rates due to their low transaction costs and associated risks. The low rates attracted many people who did not benefit directly from the water control systems (mostly landless poor) but were interested in access to loans. They became WMCA members by paying the required capital share and monthly savings.

⁸ This WMCA bought seeds; signed contracts with farmers; and processed, packed, and sold the seeds.

c. Impact of Microcredit Schemes

21. Membership fees paid by WMCA members financed payments for WMCA staff including chairpersons, accountants, and collectors of membership fees, mandatory savings, and O&M charges. Microcredit activities also required monthly meetings of WMCAs, which otherwise would have no activities in most of the months throughout the year. In a small number of cases, the OEM noted that part of the O&M funds collected for the water systems were used for microcredit lending, creating a potential risk of lack of immediately available funds for O&M if an emergency occurred. In one case, the OEM noted that the elected leaders of the WMCA were not the largest beneficiaries of the water system and lacked sufficient incentives to ensure O&M. This seemed to relate partly to local politics (paras. 25–27), and partly to the large WMCA membership, which included many people who did not benefit directly from the water system and were interested only in access to credit.

22. The OEM also noted that some WMCAs accumulated a large sum of money from (i) collection of O&M funds; (ii) operation of microcredit programs (capital shares and mandatory monthly savings); and (iii) other businesses, such as fisheries or seed production. At a few subproject sites visited, a sound financial system seemed to be absent at the village level. Since the large sum of money might generate temptation to abuse funds in the absence of strict supervision and monitoring, the project could have focused on establishing and improving financial management for WMCAs.

d. Performance of WMCAs

23. Formally, the project transferred to WMCAs the ownership and O&M responsibilities of the water systems 1 year after their construction. With assistance from engineers from LGED local offices, WMCAs were expected to prepare annual plans for O&M, estimate required budgets, and collect funds from end users to ensure O&M. In practice, the OEM observed mixed performance of the WMCAs at the subproject sites visited. In a few cases, strong WMCAs collected fees (Tk5–10 monthly per member or 5–10 kilograms of rice per household) for O&M of the water systems in addition to a monthly “service” fee of Tk1 to pay for WMCA staff who operated the water system, collected fees, and ran the microcredit program. In one case, a WMCA also engaged in production and marketing of certified seeds of onion, rice, and wheat.⁸ The OEM noted that this WMCA was dominated by a small number of large farmers, who were the largest beneficiaries of the subproject due to their large tracts of land located in the subproject area. In addition to paying the total amount of the cash contribution required for subproject approval, these large farmers contributed a major portion of the annual O&M funds. They were willing to do so because they had the most to lose if the water system failed.

e. O&M Problems and Underlying Causes

24. In other cases, however, the OEM observed WMCAs having difficulties in collecting user fees and managing O&M. Various factors might explain the problems observed. First, some water systems constructed were of low quality. In one case, an embankment had broken the same year the construction was completed, due primarily to the poor construction quality related to inappropriate design and construction supervision. In another case, WMCA leaders said that they had made repeated complaints to the contractor about the poor quality of the structure but without any impact, because the contractor did not listen to them. That system ended up experiencing leaks that were verified by the OEM. Furthermore, the OEM noted a tendency of refusal to pay for O&M when farmers saw problems in the structure and considered the O&M cost too high for them to bear.

25. The second cause of the problem related to political rivalry among different factions of WMCA members led by different politicians. In one WMCA, members disagreed on the location of a dam to be constructed, and the newly elected WMCA chairman—an ex-union parishad chairman—pushed hard for the construction in spite of the conflict, because he needed the subproject for his reelection campaign. In another case, political rivalry resulted in distrust between two factions of the WMCA membership. When the leaders of one faction won the election to run the WMCA, members of the other faction refused to pay fees due to their distrust concerning the use of the funds collected.

26. The third cause was a moral hazard of “free-riding.” In one case, when the subproject benefited a large number of end-users with high homogeneity (all of them were small landowners, with 30% of them having 1–1.25 ha of land and the remaining 70% less than 1 ha of land), the WMCA had difficulty enforcing fee collection. Membership in this WMCA had dropped from 600 to 400, and only 100 had paid any fee for O&M in 2002.

27. The fourth cause related to the nature of WMCA leadership. Some WMCAs that had performed poorly had leaders who were absentee landlords; contractors; or business persons with shops selling pesticides, livestock feed, or fuel. Since their primary income was not from agriculture, they did not have enough incentive to ensure O&M. In one case, the original priority of WMCA leaders (business persons) was road construction. After they learned that the project could offer only water control systems, they changed their demand for a road to that for an embankment, which was then used as a substitute for road. These business persons did not have a real interest in sustaining the water control system.

28. Finally, there was confusion about who should be responsible for repairing damage to the water systems. Formally, the ownership of the water systems was transferred to the WMCAs 1 year after construction, and the WMCAs were then expected to take care of the systems. In practice, the WMCAs continued to wait for LGED to come when the damage involved a cost too high for them to bear. While there was a policy that the Government would help in case of “major damage,” there was no definition of what constituted “major” or “minor” damage (para. 58).

3. Results and Impacts

a. Achievements

29. At its completion, the project had constructed 248 water control systems. Although this number was below target, the original target (400) was considered overly ambitious, and the actual achievement was seen as substantial. Furthermore, the project had contributed to the formation and further development of government policies, including in particular the National Water Policy, approved in 1999.

30. The OEM observed the project’s positive results and impacts in some subprojects visited. First, cultivation of farmland increased due to (i) recovery of lowlands originally covered by annual floods before the project; (ii) improved drainage; and (iii) expansion of irrigation, which allowed cultivation in dry seasons. Second, a large area of farmland was shifted from a single crop per year to double cropping, as the water systems controlled annual floods, improved drainage, and/or increased water available in the dry season. Third, rice yields increased significantly in areas with improved drainage or better water supply in the dry season. Fourth, improved access to water supply all-year-round enabled a major shift in the cropping pattern from rice production to high value crops such as eggplant, garlic, onion, and other

vegetables. These changes, including in particular the shift from rice to vegetable production, substantially increased the demand for wage labor, and the daily wage more than doubled in these villages.⁹ Landless laborers interviewed appreciated the increased job opportunities and higher wages. The leasing price of land also increased, which benefited mainly the landlords.¹⁰

b. A Win-Win Result

31. At the best subproject sites visited, a win-win result was observed. First, landowners benefited from increased crop yields, rising land prices, reduced crop losses caused by floods or water stress, and/or recovery of lowlands originally covered by floods. The OEM noted that the larger the holding of farmland that a landowner had in the subproject areas, the more project benefits gained. Second, tenants benefited from better crop yields, increased cropping intensity, and the shift to more profitable cash crops. On the negative side, they had to pay higher rental fees.¹¹ Finally, landless casual laborers benefited from increased job opportunities and higher wages due to the rising demand for labor in the subproject areas caused by the recovery of lowlands for farming; increased cropping intensity; and, more importantly, the shift from rice to vegetables, which require much more labor than rice production.

c. O&M Problems Remained

32. In spite of the above achievements, the bottom-up approaches used under the project (such as using NGOs to establish WMCAs, and transferring to them O&M responsibility) did not seem to have solved the problems commonly observed in conventional projects. First, the water systems constructed under the project experienced the same problem of weak ownership and poor sustainability as in conventional projects. Although the requirement of WMCAs contributing cash for subproject investment was a laudable innovation, the amount of the contribution (less than 3%) was too small to have a significant impact. In the areas visited, farmers continued to see the water systems as a government investment. LGED staff also considered that, since more than 97% of the investment costs were from a government grant, it was LGED instead of WMCA that should control the resources and make the decisions, including those on subproject design, implementation, and contractor selection.

33. Since the subprojects were financed primarily by government grants, and since the water systems were built by contractors hired by LGED, it was natural for the end users to expect continued assistance from the Government when the systems experienced damage. This explained the OEM's observation of end users' continued dependence on government financing for O&M. One WMCA leader explained to the OEM how they could convince LGED to come and fix the water system if there was any damage: "Since you spent so much money to build the system, why shouldn't you spend a little more to fix it?"

34. The OEM also heard end users' complaints about poor construction quality, which was due to (i) lack of effective mechanisms to exclude unqualified contractors;¹² (ii) difficulties in

⁹ In one village, the daily wage had almost tripled from Tk25–30 before the subproject to Tk80–100 after its completion. In another village, the daily wage doubled from Tk30–40 to Tk60–80, with a rate as high as Tk120 (\$2.07) during peak seasons.

¹⁰ In one village, the leasing price of land more than doubled from Tk1,000–1,500 to Tk4,000 per acre after the project. In another village, lease prices tripled from Tk400 to Tk1,200 per 26 decimals of land.

¹¹ At the subproject sites visited, tenants typically bore all input costs and paid landowners a portion (50% in most cases) of the harvest, or a fixed rental fee.

¹² While standard ADB guidelines for prequalification of contractors were in place, application of the guidelines was not always effective, as reported by the PCR, External Evaluation, and Inception Report (para. 5).

resisting political interventions in contractor selection and supervision, especially when contractors were well connected with politicians;¹³ and (iii) the WMCAs' lack of authority and effective means to control contractors. WMCAs could monitor construction quality and make complaints, but they had no authority to stop the construction even if they were unhappy about its quality.

C. Evaluation of New Approaches

1. New Approaches Used

35. The project adopted a number of new approaches to enhance end users' ownership of the water control systems constructed. First, end users' contribution of cash for subproject investment was required as a precondition for subproject approval. Second, a WMCA was established at each subproject site with assistance from field staff (engineers and socioeconomists) from LGED's local offices as well as facilitators hired through NGOs. Third, the ownership of the water systems was formally transferred to the concerned WMCAs 1 year after the completion of construction, and the WMCAs were trained to be responsible for O&M of the systems.

36. Community consultation, participatory planning, and beneficiary training were required by the project design but not implemented as planned. At the subproject sites visited by the OEM, consultation and institutional building efforts were concentrated on WMCA leaders. The OEM did not find sufficient evidence of beneficiary participation in subproject design and implementation, although some WMCA leaders monitored construction and lodged complaints about its quality.

37. The project did not involve the active participation of local governments, which did not provide any counterpart funds for investment or play a role in O&M of the water systems, although some union parishad chairpersons pushed hard to lobby for subprojects in their areas. Overall, the project was implemented by LGED and its local (district and subdistrict) offices. NGOs were engaged as required by the project design, but their actual role was minimal (para. 42).

2. Role of Actors

38. This section analyzes the roles of policymakers, subproject providers, and end users in information flow, resource control and decision making, service delivery mechanisms, and accountability.

a. Information Flow

39. While facilitators were hired through NGOs to conduct beneficiary consultation and facilitate WMCA establishment, detailed information about the project (such as investment cost of a subproject, its financing, and O&M requirements) was limited to WMCA leaders, who did not always disseminate information to members. Interviews with ordinary WMCA members revealed that many of them did not have clear information and knowledge about relevant issues, such as the specific responsibilities and costs of O&M activities. In one case, even the members of a newly elected WMCA committee had no idea how much money was required for O&M, how

¹³ Such views were expressed by some project staff and farmers interviewed. However, no hard evidence was given to prove specific cases.

much had been collected, and how much had been spent, as they had been ordinary members of the WMCA before they won the election, and the former WMCA chairman did not inform members about such information.

40. WMCA members' lack of project information, however, did not seem to negatively affect subproject implementation, and the OEM observed no complain about that. What seemed to matter most was that those who ran the WMCA had an incentive to make it work well and the capacity to collect the funds necessary to operate and maintain the water system. At the best subproject sites, where a few large farmers played a key role in collecting funds and ensuring O&M, it struck the OEM that it might not be necessary to require the establishment of a formal and standard WMCA. If existing local institutions, especially their formal or informal leaders, had strong incentives and capacity to organize end users to contribute to subproject investment and O&M, they could be used as an agent to achieve the project's objectives of constructing and sustaining water systems.

b. Resource Control and Decision Making

41. Since cash contributions from WMCAs accounted for less than 3% of a subproject investment, resources available for the investment were controlled by LGED; so was decision making. The OEM noted that decisions related to contractor selection, subproject design, and construction were made by LGED local offices based on guidelines set by ADB and the PMO. End users' lack of control of investment funds and of decision making contributed to their lack of real ownership of the subprojects and thus their weak incentive to take care of O&M.

c. Delivery Mechanism

42. While NGOs were used under the project as required by the project design, they played a minimal role in actual subproject implementation, due partly to their lack of water resource management experience, and partly to their lack of strong interest in and close connection with local communities in the subproject areas. The facilitators were hired through NGOs but actually selected, trained, and supervised by LGED's field offices. It was LGED's field staff (engineers and socioeconomists) together with facilitators and contractors that delivered subprojects. It was interesting to note that at the best subproject sites visited, a few large farmers played a key role in forming and managing WMCAs, collecting fees from end users, managing O&M, and ensuring the sustainability of the water systems. It appeared that, under certain conditions, it might be more cost effective to strengthen local influential persons as a service delivery mechanism instead of hiring and training outsiders (such as facilitators), who would leave after project completion. The use of NGOs did not make any difference and in fact did not seem to be necessary under this project.

d. Accountability

43. Since facilitators and contractors were selected and paid by LGED, they responded to LGED instead of to beneficiaries. WMCA leaders could (and some did) monitor subproject construction and complain about its quality when it was poor, but they had no authority to hold contractors accountable for it. The OEM was told that LGED staff did not always have incentives strong enough to hold contractors accountable, especially for those well connected with politicians.

3. Impact of New Approaches

44. This section examines if the new approaches used under the project offered an effective solution to the conventional problems of less relevant project interventions and poor sustainability observed in many rural development projects.

a. Relevance of Project Interventions

45. The project's primary interventions were (i) construction of small-scale water resources systems to control floods, improve drainage, conserve water, and expand irrigation area; and (ii) establishing and strengthening WMCAs to properly maintain these systems. The first intervention was relevant, and the positive impacts of the investment were observed by the OEM (para. 30) and appreciated by villagers interviewed. The second intervention of establishing a standard WMCA at every subproject site regardless of existing local institutions might not be relevant. At the best subproject sites visited, it was a few large farmers who played a key role in contributing a major portion of the O&M funds, collected fees from others, and managed O&M. These large farmers might have done the same with or without the establishment of the WMCA, due largely to their own interest in sustaining the water systems. In other cases, the establishment of WMCAs did not solve the problem of poor O&M of the water systems (paras. 48, 56).

46. It appeared that, if more thorough fieldwork had been conducted at the project design stage, project designers might have recognized many end users' willingness to pay for subproject investment and the full cost of O&M if they had no access to free assistance from external sources. Furthermore, thorough fieldwork might have raised designers' awareness of the negative impact of free government investment in the past on end users' dependence on the Government, and the risk of end users' continued ignorance of O&M in spite of the formal transfer of ownership of the water systems to WMCAs.

b. Sustainability of Project Benefits

47. In spite of the innovation of cash contributions from WMCAs for subproject investment and the formal transfer of the water systems to the WMCAs, O&M of the systems remained a major concern. Based on information given by various reports (para. 5), continued collection of O&M funds was observed in only 80 of the 280 WMCAs established under the project. LGED's PCR noted that only 140 subprojects had O&M plans with a total budget of Tk3.1 million, equivalent to 18% of the required amount (Tk17 million) for O&M of these subprojects estimated by engineers. The funds actually collected from the 140 subprojects amounted to Tk1.7 million in 2001—equivalent to 10% of what was required.

48. The above data are consistent with the OEM's field observations. At many subproject sites visited, the OEM noted that WMCA members paid only membership shares and mandatory savings for the microcredit programs and no O&M fees for the water systems. In two cases where some members paid for O&M, the fee was extremely small (Tk5 or less than \$0.1 per month per household). The tendency of not collecting O&M funds reflected end users' lack of real ownership of the water systems, and their expectation on future government assistance, which might come when the ignorance of routine O&M and deferred repair of damage eventually led to the need for major rehabilitation of the systems.

D. Issues, Underlying Causes, and Alternatives

1. Positive Roles of Large Farmers

49. The OEM noted significant variations in the performance of the WMCAs visited. A WMCA tended to be weak when (i) a subproject was initiated and pushed primarily by a union parishad chairperson, and the village leaders were not particularly keen on the subproject; (ii) the subproject site covered too many (7–12) villages with a large number of small end users with high homogeneity; (iii) collection of O&M funds from numerous small end users was difficult due to the “free rider” problem; and (iv) conflicts among village leaders led to distrust about the use of O&M funds by rival leaders and their followers.

50. In contrast, a WMCA tended to work well when (i) its leaders were the largest beneficiaries of the water system; these large farmers were not absentee landlords and had strong incentives not only to lobby for the subproject investment but also to ensure its sustainability, because they had the most to lose if the water system failed; and (ii) the number of such large beneficiaries was small, and contributions from them constituted a major portion of the required funds for O&M. In such cases, the large farmers played a critical role in initiating the subproject, contributing the required cash for the investment, organizing the WMCAs, collecting user fees, and managing O&M effectively. The OEM noted that these large farmers were powerful in their villages, with effective means to enforce the collection of investment contribution and O&M funds from other beneficiaries. Without explicit financial penalties, social pressure seemed to work effectively in some villages visited. The OEM was told that no one could deny the request when an elder told a person that he/she should pay.

51. In spite of the concentration of project benefits among the large farmers, landless poor and tenants also benefited considerably in these subproject areas due to increased crop yields, intensified cropping patterns, and changing from rice to high-value crops. As a result, the demand for labor increased, leading to higher daily wages paid to the landless laborers (paras. 30–31).

52. Several lessons could be derived from the project experiences. First, under particular conditions, indirect poverty reduction through private sector participation or incentives for the nonpoor including large farmers could be more effective than direct interventions targeting exclusively the poor. Second, capture of project benefits by the nonpoor was perhaps unavoidable, as it was impossible to implement a subproject in a village without the involvement of local leaders and influential persons. It might be more realistic not to bypass the nonpoor, but rather to design appropriate incentives so that their best interest, given these incentives, is to contribute to poverty reduction in their villages.

53. Careful analysis is therefore needed to gain full understanding of the local conditions in a subproject site before its selection, including the social structure of the local communities, incentives of various players, and the likely changes induced by the subproject investment. Observations from this project showed that the best impact on poverty reduction was brought about by increased demand for labor induced by changes in cropping patterns, such as higher cropping intensity; expansion of cropping areas due to recovery of flooded lowlands; and, most effectively, change from rice to cash crops, which require much more labor.

54. If formal and informal village leaders could be used as agents for rural development projects, training for and use of local leaders might be more effective than hiring and training external facilitators, NGOs, or government staff. Many facilitators engaged under this project

were originally inexperienced youth hired by NGOs solely for project implementation. While they gained experience through training and practice under the project, many of them left after expiration of their contracts. The training and use of government staff also had the problem of weak sustainability, as they would not have sufficient travel funds to visit subproject sites after project completion, when they had to operate within their routine budget.

55. Selection of local leaders needs to be most careful. To ensure the sustainability of subproject investment, it may be wise to avoid local leaders or influential persons that are interested in only the approval or construction of a subproject but not its O&M and sustainability, such as (i) absentee landlords whose primary income is not from agriculture and who care less about O&M of a subproject; (ii) contractors or other businesspersons, whose primary interest is to “get” business from construction instead of O&M; and (iii) local politicians without farmlands located in the subproject areas, whose primary objectives are political popularity and future votes; similarly, they are interested in subproject approval and not O&M.

2. The Persistent Issue of Inadequate Maintenance of Infrastructure

56. In spite of the project’s success in making WMCAs pay cash contributions for subproject investment and formal transfer of the ownership of the water systems to WMCAs, the project suffered from insufficient O&M of the water systems—a persistent issue commonly observed in the conventional rural development projects. As discussed earlier, only 80 of the 280 WMCAs continued to collect O&M funds, and the amount collected was only 10% of what was needed for proper maintenance (para. 47).

57. Two factors may explain the persistence of this issue. First, a moral hazard of waiting for free assistance from external sources instead of self-reliance might have been fostered by the long history of free government assistance for construction and maintenance of water systems in the past. Many WMCA leaders said that they would wait for free assistance from the Government in case of damage instead of using their own money, even in the case that free government assistance, even if eventually available, would be very late, and the deferral of repair would lead to higher costs—the longer they waited, the heavier crop losses they would suffer, and the higher the future cost of repairs.

58. Second, there was confusion related to who should be responsible for damage restoration. While the subproject agreements between WMCAs and LGED’s district offices required WMCAs to repair minor damage and LGED, major damages, the agreements did not define clearly what constituted “major” or “minor” damage, and therefore left room for misinterpretation or confusion. The OEM was told that government assistance would be provided in the case of natural calamity beyond the designed capacity of the system (i.e., once in 20 years). This, however, was not the perception of WMCA leaders. In more than one case, WMCA leaders interviewed defined “major damage” as any damage that caused crop losses and required Tk20,000 (\$340) or more to repair. Another common practice was that WMCAs did only minor maintenance work and waited for LGED to do canal reexcavation. In a few subprojects visited, major maintenance work was needed only 3 years after subproject completion, and the WMCAs considered it the responsibility of the LGED, because the cost of the major maintenance was too high for them to bear.

59. It seems that similar projects in the future should set a policy of no government grant for repairing damage—whether minor or major—once the systems are transferred to WMCAs. Such a policy should be announced clearly from the very beginning, leaving no room for misinterpretation and providing no incentives for deferring repair. WMCAs should be told frankly

that the investment funds from a project are external loans that require repayment by future taxpayers. It is not fair to give taxpayers' money repeatedly to one community when so many poor communities in Bangladesh suffer similar flooding, drainage, and draught problems but never receive any government investment. Thus, a subproject to a community should be a one-time grant from the Government, and the community should take full responsibility for all cost of O&M, including repair of major damage. Acceptance of such a policy should be set as a precondition for subproject approval.

60. To ensure WMCAs' capacity for damage repair, future projects should encourage them to build up an emergency fund for immediate repair of damage by collecting additional funds in years of good harvest or good prices. A sound financial management system should be established in WMCAs to ensure proper recording of money collected and funds used so as to build up members' trust of leaders and willingness to pay.

61. A policy of WMCAs being responsible for the full cost of O&M may provide them with strong incentives to actively participate in subproject design and monitoring of construction quality, which, in many cases, influences the cost of O&M. Implementation of such a policy, however, may require the transfer of resource control and decision making power to WMCAs in terms of selecting engineers and contractors for subproject design and construction.

3. Alternative Measures to Enhance Project Sustainability

62. It seems that a deeply rooted cause of insufficient O&M was the moral hazard of "using other people's money," as both project staff and end users considered the subproject investment largely a grant from the Government. Consequently, WMCAs accepted a water system even if they were not happy about its construction quality, since a little benefit was better than nothing when the subproject was largely (97%) free to them. Project staff did not have incentive strong enough to hold contractors accountable even if they received complaints from WMCAs relating to the construction quality, as upsetting contractors who were well connected with politicians might bring risk to the career development of government staff.

63. It seemed that innovations are needed to search for appropriate incentive structures and mechanisms to make project staff and end users treat project funds as their own money. It is possible that, with correct incentives, these players will invest wisely (careful planning for the investment to avoid overdesign of water systems), finance full O&M, ensure sustainability, and do all these tasks in a cost-effective manner.

64. Pilot testing of the innovative measures is needed before large-scale implementation. For example, a policy could be announced that a matching grant from the Government would be available for subproject investment only after a WMCA invests its own money in a subproject. For such a policy to work, cash contribution from WMCAs should be large enough (such as one third or more) to eliminate manipulation by contractors, who might pay a small amount of beneficiary contributions to "buy" subprojects and then recover their cost by using poor materials in subproject construction.¹⁴

¹⁴ The OEM was told that some contractors paid the 3% cash contribution on behalf of WMCAs to get subproject approval, although no hard evidence was collected.

CASE STUDY: NEPAL
Third Livestock Development Project (Loan 1461-NEP)

A. Introduction

1. Selection of the Project for Case Study

1. The Third Livestock Development Project was selected for case study because of its participatory approach in project planning, formation of farmer and women's groups, engagement of nongovernment organizations (NGOs), and involvement of private financial institutions in project implementation. This project received certificates from the Asian Development Bank (ADB) and the Government of Nepal for outstanding project performance in 2000 and 2002. It was the first agriculture project in Nepal that initiated NGO engagement, and its experience contributed to the development of government policies and guidelines on working with NGOs.

2. Fieldwork of the Operations Evaluation Mission

2. The Operations Evaluation Mission (OEM) visited project areas during 2-24 March 2004. The OEM held discussions with the Nepal Rastra Bank (NRB, which is the central bank in Nepal), the Department of Livestock Services (DLS), the Project Management Office (PMO), participating financial institutions (PFIs), NGOs, as well as ex-consultants for project implementation. Meetings with other agencies involved in rural development in Nepal were also held to enhance the OEM's understanding of the country and sector context. The OEM made two field trips to visit 9 of the 28 districts covered by the project, and interviewed field staff of DLS' district offices (DLSOs), NGOs, PFIs, local government authorities, agroprocessing enterprises, as well as residents in the project areas—both poor and nonpoor, those who benefited from the project and those who did not. Due to security concerns and consequently rigid travel restrictions, the OEM was unable to visit subproject sites in remote areas. As compensation, the OEM invited farmers from remote areas to district headquarters and interviewed them there. For comparison, the OEM also visited two districts that were not covered by the project. Table A7.1 provides a list of project areas visited.

Table A7.1: Subproject Sites Visited

District	Village	Subproject & Interviewees
Kathmandu	Thankot	Slaughterhouses
Lalitpur	Lalitpur	DLSO
Rupandehi	Bairahawa	Dairy industries, dairy farmer, slaughterhouses, DLSO, paravets
Palpa	Anand Ban	Goat women's groups, paravets
	Tansen	Dairy industries, DLSO, NGOs/CBOs, financial institutions, DDC
	Dumre	Dairy industries, dairy farmers
Syangia	Bandi Pokhara	Goat women's groups
	Syangia	DLSO
	Phendikhola	Dairy buffalo and cattle farmers
Parbat	Bhhatkhola	Dairy buffalo and cattle farmers
	Khurkot	Dairy buffalo farmers
	Parbat	Dairy industries, DLSO
Kaski	Bharatpokhari	Goat women's groups
	Pokhara	DLSO, NGOs/CBOs, financial institutions, DDC
Kavre	Kavre	Farmers, local institutions, VAHWs
Bhaktapur	Bhaktapur	Farmers, local institutions, VAHWs

CBO = community-based organization, DDC = Dairy Development Corporation, DLSO = District Office of Department of Livestock Services, NGO = nongovernment organization, VAHW = village animal health worker.

3. The OEM's fieldwork was negatively affected by the security conditions in Nepal, which at the time of the OEM's visit was experiencing considerable political turbulence and an escalation of the insurgency. A ceasefire agreement that had been agreed to by the Government and the insurgent leaders in January 2003 terminated in June 2003. Since then, the conflict affected increasing portions of the country. In late February 2004 (just before the OEM visit), the insurgents declared a nationwide general strike of 6 days that closed businesses and banned vehicle movement. In addition, insurgents announced the imposition of a 17-day (7–24 March 2004) "economic blockade" in all 16 districts of the Western Region—precisely a region to be visited by the OEM. The blockade aimed at closing main roads to isolate the districts' headquarters. A 1-day general strike was declared in Rupandehi District on 7 March, causing the OEM to interrupt its visit and move to another district. Ambushes of army and police

vehicles frequently took place on main roads of the Western Region, as well as clashes between rebels and army forces in remote parts of the districts. A curfew between 9 pm and 4 am was imposed in Tansen, Palpa District, and the OEM had to finish field visits earlier so as to return to town before dark.

4. To cope with the constraints, the OEM used the general-strike days to carry out interviews in cities and towns with NGOs, PFIs, and government agencies. Site selection was dramatically restricted to villages that were close to district headquarters and main roads. In some cases, movement within villages was also restricted based on advice from local authorities, especially when households were scattered. As a result of the constraints, the OEM ended up visiting villages that, due to their closeness to roads and cities, had favorable conditions for farmers to access markets and government services, and for project staff to implement project activities. Less triangulation was possible during the Nepal trip as compared with the OEM's fieldwork in other countries; in some cases information given by NGOs and project staff was collected without double checking.

3. Local Realities in the Project Areas

a. Livestock in Nepal

5. At the time of the project design, livestock was very important in Nepal, accounting for 31% of the agricultural gross domestic product and providing the largest on-farm source of household income (about 20%) in most of the country. Off-farm activities were another important income source, accounting for over one third of household income at the time of project appraisal (Report and Recommendation of the President [RRP]). Land distribution was less skewed in Nepal, with the absence of extremely large landlords, although the landless population remained, including in particular households from low caste. Most of the households interviewed by the OEM had very small landholdings, which supported only a few months of family living. The OEM noted that many rural families had members working in cities or in India, with remitted income supporting their families.

b. Concerns of Rural Residents

6. Insufficient drinking water was the number one concern cited by many interviewees. Shortage of fodder in the dry season was another major concern affecting livestock production. Lack of access to credit was common in rural areas, as most households could not meet the strict collateral requirements set by banks. While lending by private moneylenders was readily available, the high interest rates severely restricted demand for private loans. As an alternative, microcredit schemes were common among farmer and women's groups, though with tiny size due to insufficient funds. Some of these schemes were created and run by communities without external assistance.

c. External Assistance

7. Many aid agencies and NGOs operated in rural Nepal. While these agencies had numerous programs spread all over the country, the actual number of direct beneficiaries covered by them seemed to be small. Many farmers interviewed by the OEM said that the project allowed them to receive free or subsidized inputs from external sources for the first time, although the OEM learned that their districts had been covered by other programs or projects prior to the project. Meanwhile, the OEM observed overlapping of group leaders serving in more

than one group simultaneously, such as being the head of a crop group organized by the Department of Agriculture, and a board member of a livestock committee under this project. Many group leaders showed signs of being spoiled, complaining about the reduction or termination of the free or subsidized inputs when the project was terminated in their districts.

d. Local Communities

8. Meanwhile, the OEM observed strong community groups organized by natural leaders without outside assistance. These groups were formed to address a specific issue crucial to their members. For example, a water committee was formed to collect funds for operation and maintenance (O&M) of a drinking water system, a marketing-cooperative was established to sell milk for members because the state-owned milk company refused to buy milk from individuals, and a savings and credit group was organized to collect savings from members and lend to each other at low interest rates without collateral. In these cases, group leaders demonstrated their capacity to organize collective action effectively, such as collecting fees and conducting O&M.¹

e. Constraints to Livestock Development

9. The OEM identified major problems that severely restricted livestock development in Nepal. To start with, the mountainous topography and poor roads made travel to remote areas very difficult, with high transportation cost. The situation was exacerbated by worsened security and frequent strikes, during which vehicle movements were banned. The transportation difficulties restricted farmers' access to markets, especially those for fresh and perishable products such as milk. The OEM learned that many households in remote areas did not sell products, relying on subsistence farming. This led to a shortage of cash and affected the access of many households to veterinary services, which were usually paid for in cash. Many farmers in remote areas relied on home treatment when animals were sick. Insufficient demand for commercial services, in turn, restricted the growth of private veterinary services in remote areas. Access to public veterinary services was equally limited in these regions due to the absence of government service centers or subcenters, which were located in areas with relatively good transportation. In villages accessible only after hours of trekking, farmers had to pay for the visit of a government veterinary doctor who lived in the nearest town, although the services were supposed to be free. The topography problem further restricted information dissemination. While farmers and small entrepreneurs interviewed by the OEM expressed their eagerness to learn new technology and their willingness to pay for training, they depended on government agencies that had limited coverage as the only source of information.

10. The transportation challenge and security concerns also restricted the capacity of government and NGO staff for project implementation and monitoring, especially in terms of field visits. This may have contributed to the lack of reliable information—a common problem affecting the quality of project design in Nepal. As reported by the *Country Synthesis of Evaluation Findings in Nepal*² prepared by ADB, project design was weak due to insufficient knowledge about local conditions in project areas.

¹ In Bharatpokhari, Kaski District, the OEM visited a water committee that collected from water users NRs480 per household in addition to a contribution of 1 month of free labor to invest in a drinking water system. The committee also collected a monthly fee of NRs10 from each household and hired a worker to take care of O&M, with a monthly payment of NRs300 for the worker.

² ADB. 1999. *Country Synthesis of Evaluation Findings in Nepal*. Manila.

f. Milk Holidays

11. Furthermore, a widespread concern expressed by almost all farmers interviewed was the presence of milk holidays—periods of 1–3 days a week during which the processing industries did not accept milk from farmers. The OEM noted that marketing difficulties in the flush (wet) season and shortage of milk supply in the lean (dry) season coexist in the areas visited. While farmers were concerned mostly about the milk holidays in the wet season, the serious concern of the dairy processing enterprises was the shortage of milk supply in the dry season.

12. The OEM learned that the dairy industry in Nepal was highly concentrated. Until the early 1990s, the Dairy Development Corporation (DDC)—a public corporation comprised of several firms operating in different regions—monopolized the processing of milk and dairy products. By 2004, about 100 small plus a few large private dairy processing industries operated all over the country. However, DDC still had a dominant market share of about 50%.

g. Underlying Causes

13. It seemed that the oversupply of milk in the wet season and the shortage of milk in the dry season were caused by the same price for both seasons set by DDC. While milk production was naturally higher in the wet season due to more productive pasture, the same price in both seasons failed to reflect the lower cost of milk production in the wet season and the higher cost in the dry season, when fodder was rare and costly, and cows and buffalos were less productive. Since demand for milk remained more or less constant through the year and the milk processing capacity was fixed in the short term, if there had been a free market, the shortage of fresh milk in the dry season would have led to higher prices in the lean season to encourage milk production, and the abundant supply of milk in the wet season would have driven the price down in the flush season, making inefficient producers withdraw from production. A balance between supply and demand would have been achieved without imposing milk holidays, which affected all producers.

14. However, since DDC was a big player, controlling half of the market, private firms had to follow it in paying a price higher than what should have been. In the dry season, which lasts from February to August, about 7 months, firms competed fiercely to meet the demand of their regular consumers in towns. The difficulties of keeping the milk supply in dry seasons discouraged small dairies from expanding their capacity, which, in turn, contributed to the milk holidays in the wet season.

h. Efforts Used

15. The problem of DDC controlling market prices had been recognized by both the Government and aid agencies. Privatization of a regional company under DDC (Pokhara Milk Supply Scheme or PMSS) had been initiated by a previous project but not been achieved. Under the Third Livestock Development Project, a deadline of privatizing PMSS by the end of 1997 was targeted. In spite of tremendous efforts made by the Government, the target remained unachieved by the time of the OEM's visit in March 2004.

16. Meanwhile, the OEM observed a vibrant private sector of small dairies in areas outside the operations of DDC. For example, in Madanpokhara, Palpa District, farmers had multiple choices of selling milk to several small private dairies. Competition among the small dairies led

to better prices, guaranteed purchase of milk in the wet season, and other benefits to farmers, such as collateral-free loans with low interest rates. The dairies created these measures in order to maintain stable relationships with producers so as to ensure a steady supply of milk all-year-round. Farmers told the OEM that milk holidays had been eliminated completely in that area.

3. The Project

17. The project was the third of a series of projects financed by ADB in the livestock sector in Nepal. The first project was approved in 1979 and initiated infrastructure development for DLS' extension network. The second project, approved in 1985, rehabilitated and upgraded facilities constructed under the first project and focused on increasing livestock production. The project concerned with here, approved in 1996, further expanded areas covered and emphasized not only production but also agroprocessing and marketing. A fourth project was approved in late 2003 expanding the project areas to the remote Mid Western and Far Western regions. The first and the second projects were postevaluated by ADB, with ratings of "unsatisfactory" and "partly satisfactory," respectively.

18. With the overall goal to reduce rural poverty, the third project aimed to (i) improve livestock productivity, (ii) develop market outlets for livestock products, (iii) reorient DLS towards facilitating private sector growth, (iv) establish livestock farmer groups, and (v) expand DLS' capacity in project coordination. The project included 5 components and 11 subcomponents to achieve these objectives, with many quantified targets. The executing agencies were NRB in charge of the credit component and DLS for all other components.

19. The total project cost was estimated at \$27.9 million at appraisal, including a credit component of \$11.4 million. The project was financed by an ADB loan of \$18.3 million. Lending was 40 years from ADB to the National Government. For the credit component, the loan was onlent to PFIs for 5–7 years, which, in turn, onlent to farmers for animal purchase with a ceiling of NRs30,000 per loan. The project was to be implemented in 6 years from 1997 to 2003, and was extended by 1 year to 31 July 2004.

B. Evaluation of Project Performance

1. Project Design

20. The project design did not seem to be based on a solid understanding of the key constraints in the sector and the country. None of the problems identified by the OEM (paras. 9–16) were analyzed in the RRP. Although the dominant role of DDC in milk processing was recognized, it was not highlighted as a major factor restricting livestock development in the country. Instead, key constraints identified in the project design were "the high rate of land degradation" and "shortage of trained people at all levels" (RRP).

21. Consequently, some interventions proposed in the project design did not seem to be relevant. For example, to promote livestock marketing, the project design did not focus on eliminating the price distortions caused by DDC—the primary factor discouraging private investment in dairy processing.³ Instead, heavily subsidized equipment was granted to selected

³ In view of the failed efforts to privatize PMSS by the previous project due to strong political resistance and practical difficulties, the project could have focused on the urgent need and the less difficult task of eliminating price distortions by at least requiring that DDC set different prices for different seasons instead of setting the unrealistic deadline to privatize PMSS by end of 1997 (para. 15).

enterprises as the major instrument to promote marketing. The OEM observed the allocation of refrigerators and freezer pans to small dairies on a grant basis, and of slaughtering tables and other equipment to a large slaughterhouse. Since only a portion of the enterprises received free inputs under the project,⁴ the OEM noted complaints about favoritism. More importantly, the recipients interviewed said that the free refrigerators and pans had little impact on their investment decisions, as they would have started their firms with or without such support. After 7 years of project interventions, the key issue of milk holidays remained widespread in the project areas.

22. To improve livestock productivity, the project focused on providing “intensive packages” to “pocket” areas by concentrating the allocation of subsidized inputs to members of groups organized under the project. A “pocket” was selected based on a particular area’s potential in livestock production, such as a “goat pocket” for goat production and a “buffalo pocket” for buffalo development. Within a pocket, a committee of 5 groups was created with 10 members each. Two representatives from each group formed a 10-person “board” for the committee. Heavily subsidized inputs were allocated from the DLSO to the committees, and through them to group members, including improved forage seeds and animal medicines to members on a grant basis; training courses without charge; transportation subsidies for animal purchase; and goats, which were expected to be returned after 1–2 years without interest charge. Since only group members were entitled to these inputs, nonmembers’ access to improved technology and training was restricted, which seemed to be inconsistent with the project’s objective of increasing livestock productivity.⁵

2. Project Implementation

a. Selection of Project Sites

23. As required by the project design, a livestock action team (LAT) was established in each project district as the “main thrust” of participatory planning. The LAT comprised staff from district offices of various line agencies as well as representatives from NGOs, PFIs, and beneficiaries. The LATs played a major role in project implementation, being responsible for selecting “pocket” areas and serving as coordination bodies. After the selection of a pocket area, meetings with potential beneficiaries were held at the village level to identify beneficiaries; groups and committees were established as instruments to implement project activities.

b. NGO Engagement

24. NGOs were engaged to facilitate the formation of groups and committees. Instead of using national organizations, which were usually based in Nepal’s capital city and worked in many districts, the project recruited 48 district-based NGOs with small contracts (NRs50,000 per NGO for 3 years). The OEM noted that some of the NGOs were actually community-based organizations (CBOs) with direct beneficiaries as their members. The OEM’s interviews with several NGOs engaged under the project found that the performance of the NGOs differed significantly, due partly to variations in their nature. In the case when an NGO was formed for

⁴ The project supported 42 of the 81 small dairies as of 31 July 2003 (see Annual Report 2003 submitted by the PMO).

⁵ The project seemed to have repeated a mistake experienced under the second livestock project, under which farmers joined groups because only group members had the access to concessional benefits offered by that project. Postevaluation of the second project found that less than half of the groups remained active at the time of the evaluation.

the purpose of taking advantage of available external funds, when it had no revenue sources other than funds from external projects and no previous relationship with the communities that were assigned to them to work with by the project, the NGO worked merely as a contractor, focusing on fulfilling the required tasks and physical targets, and left the local communities after the expiration of its contract. In contrast, if a NGO/CBO was formed to address an issue crucial to its members, if it was assigned to work with farmers in its own area with its own members as the targeted beneficiaries, and if it had multiple revenue sources of its own without depending on external sources, it worked as a partner of the project instead of merely a contractor. More important, it continued to serve its members after project completion.

c. Credit Program

25. The OEM noted appropriate modification of project design on the credit component during implementation. The original project design engaged only two large banks, which did not perform well due to their lack of interest in lending to small farmers. These banks had sufficient liquidity of their own but no systems for nor experience with working with small farmers. The ADB credit line was not attractive to them, as the interest rate charged was only slightly higher than domestic market rates. After the midterm view, \$2 million of the credit line was cancelled in view of the slow disbursement. Another 17 small, private PFIs were engaged, including 2 NGOs, 8 cooperatives, and 7 development banks. These small PFIs did not have sufficient liquidity, as they were not allowed to take savings deposits from the public. They had a strong incentive to participate, as the ADB credit line provided them with good opportunities to expand their business. Since they could charge farmers high interest rates, the rate offered by NRB represented an attractive interest spread of about 10%. Finally, lending under the project was less risky, as NRB reimbursed 80% of the loans they lent to farmers. These PFIs did not consider lending to farmers overly risky, as they had already engaged in such lending prior to the project.

d. Goat Distribution Program

26. One major activity under the project was the distribution of goats to poor farmers and women through groups—an instrument widely used in Nepal by many aid agencies, NGOs, and government line agencies as a major intervention to reduce poverty. In the early years of the project, a standard goat program distributed goats to a committee of 50 members in a phased manner. In the first round, only 20% of the members received goats. By returning the same number of goats to the committee after 1 or 2 years, the second round of 20% group members would receive goats. If the program continued to run as planned, all group members would receive goats in five rounds. Due probably to an eagerness to see quick impacts or time pressure to disburse project funds, however, a new model was adopted in the late years of the project, which distributed goats simultaneously to all members in a committee. Recipients were required to return the goats to DLSO, which would then redistribute the goats to other committees organized in other communities.

27. The OEM noted that the goat program was a useful instrument to target the poor. In one “pocket” area, the OEM interviewed 16 group members and 6 nonmembers as well as a community leader, and found that the poor in that village had clear priority for being selected to join beneficiary groups and receive goats. The goat program could be effective if all (or most) recipients returned the goats as planned, because (i) most rural women knew how to handle a small number (1–3) of goats at low cost, and (ii) goats could be multiplied in a few years with low mortality if managed well with sufficient feed.

28. In spite of the good potential, the OEM observed a number of factors restricting the success of the goat program. First, a moral hazard discouraged the return of goats as required in the absence of incentive measures or strong peer pressure. Many of the goat recipients interviewed by the OEM showed reluctance to return goats after 1–2 years, citing various excuses including in particular a high rate of mortality such as miscarriage. Many of them seemed to believe that the Government should be merciful and forgive them if they could not repay. The new model of distributing goats to all members at the same time further reduced the peer pressure for timely repayment. In only one case did the OEM observe 100% repayment of goats after three rounds. That case occurred in a district outside the project areas, and the goat program was run by a DLSO using their regular budget. Factors contributing to the good repayment were very special, including (i) favorable conditions for goat raising with sufficient forage and low mortality (that area was famous for goat raising); and (ii) strong peer pressure for timely repayment because only 20% of the group members received goats, which were allocated to members by lottery. In the case when a group leader was the last one to receive goats, he/she had strong incentive and sufficient authority to push everyone to repay on time. The peer pressure was also due to the social structure in that particular village, where many households were related to each other.

3. Results and Impacts

a. Quantified Targets

29. Quantitative targets set by the project design included (i) direct beneficiaries numbering 55,000 families (about 300,000 people), (ii) increased farm income by 30%, and (iii) increased livestock productivity including 70% increase in cow milk, 23% in buffalo milk, 30% in chickens and pigs, 20% in buffalo and eggs, and 15% in goat meat and mutton.

30. The Annual Report of 2003 prepared by DLS contains volumes of data on project achievements in terms of inputs, activities, and outputs, such as expansion of forage; seeds produced; laboratory services offered; loans disbursed to farmers, small dairies, and meat shops that received training and inputs from the project; number of groups formed and the number of their members; as well as the numbers of training courses and trainees. In contrast, no data were given in terms of achievements in project objectives, such as increases in household income and improvement in animal productivity.

31. In terms of outreach, the project identified 311 “pocket” areas and established 1,174 groups with 15,312 members. Since nonmembers, even if they lived in the same village within a “pocket”, were excluded from direct benefits (such as improved forage seed, free medicine, transportation subsidies, goat distribution, and training), the Project reached 15,312 direct beneficiaries, about 28% of the target of 55,000 families (para. 29).

b. Milk Holidays

32. In spite of the project’s efforts to promote livestock marketing, such as training and equipment for small dairies and slaughterhouses, milk holidays remained a major concern in most of the areas visited, with the exception of an area where, in the absence of DDC operations, competition among small dairies successfully eliminated milk holidays (para. 16).

c. Goat Distribution Program

33. The goat distribution program seemed to have reached the poor in the areas visited (para. 27), although the number of direct beneficiaries was limited due to the lack of incentive measures for timely repayment of goats as planned. The project could have achieved the dual objectives of targeting the poor and reaching more direct beneficiaries if the project design had developed appropriate incentive measures for goat repayment, such as a small bonus for timely repayment, interest charges for late repayment, and generating strong peer pressure by allocating goats to only a portion of group members each round through lottery, or making the group leader the last one to receive goats (in such a case, a small bonus is needed to reward group leaders for ensuring repayment).

d. Veterinary Services

34. The OEM observed that veterinary services were readily available in commercial areas where farmers had access to both government service centers and private paravets. In contrast, access to veterinary services in remote areas depended heavily on village animal health workers (VAHWs), who received 1 month of training and could handle only minor cases. The OEM noted that the project's strategy of training local human resources was a good alternative for generating a system of primary veterinary services. However, the quality and sustainability of VAHWs in the remote areas seemed to be weak due to a number of factors. First, many VAHWs did not receive regular refresher training. Second, some good VAHWs left when they found better employment in towns, especially the young ones with good education. Third, the small size of the veterinary business in the remote areas was not sufficient to support a clinic, which had to combine with an input supply or grocery store, and not many VAHW had the financial capacity to start such stores. In one district, the OEM was told that only about 40% of the VAHW trainees started veterinary services after the training.

35. The OEM found that the project's policy of selecting group members, women, or poor farmers from low caste for VAHW training, although with a good intention, did not seem to be a good policy with good results. The OEM was told that it was difficult for low-caste VAHWs to provide services to farmers from high castes due to the prevailing culture in the project areas. The requirement of selecting trainees from only members of beneficiary groups reduced the choice of candidates. Some female trainees left veterinary services for family reasons after the training. In some cases, the policy of free training and training allowance attracted the wrong participants and political interventions in the selection of trainees.

36. It seems that the project could have developed better policies to improve the selection of candidates for VAHW training, giving preference to people who had strong incentive and financial capacity to establish and sustain veterinary services in remote areas after the training, such as farmers with a relatively large number (such as 6–7) of animals and a high demand for veterinary services for themselves, their families, and relatives. Sharing of the training costs could be required to exclude the wrong candidates and discourage political intervention so that limited public resources could be used to train only those who were seriously interested in becoming VAHWs and were committed to long-term provision of veterinary services in remote areas.

C. Evaluation of New Approaches

1. New Approaches Used

37. A set of new or bottom-up approaches was used under the project. A LAT was established in each project district as the “main thrust” of participatory planning. Village meetings were held to identify the poor and select them as direct beneficiaries. Beneficiary groups were established, and training was provided to group members as support for community development. NGOs were engaged to facilitate group formation and beneficiary training. PFIs participated in delivering loans to farmers for animal purchase. The project did not involve local government participation. Although in 2003 (close to the end of project implementation), a new government policy required the approval of LAT work plans by district governments, their actual role under the project was more nominal than real. The most interesting innovations under the project were the engagement of district-based instead of national NGOs, small contracts for a large number (48) of NGOs, and the use of CBOs to serve their own members.

2. Role of Actors

38. This section analyzes the roles of policymakers, service providers, and beneficiaries in information flow, resource control and decision making, delivery mechanisms, and accountability under the project after the adoption of the new approaches.

a. Information Flow

39. Information about project implementation flew upwards from DLSOs to the PMO, DLS, and ADB through regular progress reports. The downward flow of information about the project was limited to group leaders and members. While each LAT included two farmer representatives, they seldom reported to other farmers on what was discussed in the LAT meetings. Ordinary villagers interviewed by the OEM appeared to know little about the project. Their lack of project information, however, did not seem to have negatively affected project implementation.

40. Information about market prices and technology was limited in the areas visited by the OEM, which observed strong demand for improved technology, as expressed by farmers' willingness to pay for practical training, such as that on how to take care of pregnant animals. Unfortunately, access to training was restricted to group members. The project could have reached more beneficiaries if training had been open to all villagers who were willing to pay an affordable fee to show their genuine demand. The charge for training might have increased resources available for the continuity of the training program, discouraged the wrong participants (those who attended the training in view of the training allowance), and created pressure for trainers to further improve the relevance and quality of the training.

b. Resource Control and Decision Making

41. Resource control was largely in the hands of the executing and implementing agencies. Most of the project funds were controlled by the PMO, which allocated annual budgets to DLSOs and organized training in accordance with project design. At the district level, DLSOs controlled the majority of the project funds, with a very small portion of the funds allocated directly to the bank accounts of beneficiary committees. Formally, the funds allocated to the

committees were for predetermined activities, such as animal life insurance scheme or transportation subsidies for animal purchase. In practice, many committees used the funds for their own savings and credit programs, which were in high demand. The informal practice seemed to have increased the financial resources controllable by beneficiary groups, and may have enhanced the likelihood of continued operation of the credit schemes after project completion.⁶

42. Consequently, the power of decision making was in the hands of policy makers and project providers. At the project preparation stage, staff from ADB designed the project and determined project activities in consultation with DLS and other stakeholders. During implementation, the PMO developed guidelines and planned annual activities based on the project design; the LAT selected “pocket” areas based on the guidelines; local communities selected beneficiaries with assistance from field staff of DLSOs and NGOs. The OEM noted that the inclusion of two farmer representatives in each LAT did not lead to farmers’ participation in decision making, because the representatives were appointed by the head of DLSO with the role of providing farmers’ views in technical discussions. The most active members of the LAT were the head of DLSO and the officer from the district agricultural office. These key actors initiated proposals with concurrence from other LAT members; the OEM was told that there were seldom disagreements in LAT meetings.

c. Delivery Mechanisms

43. At the field level, DLSOs were the primary mechanism for (i) delivering training to beneficiary groups as well as selected entrepreneurs, paravets, and VAHWs; (ii) allocating medicines, forage seeds, goats, and other subsidies to beneficiary groups as well as subsidized equipment to selected dairy enterprises and meat shops; and (iii) contracting NGOs and monitoring their performance. NGOs delivered services during their contractual periods by facilitating group formation and beneficiary training. PFIs delivered loans to farmers and collected repayments. At the grassroots level, beneficiary groups and committees distributed goats and other concessional inputs to members. Many groups also delivered microcredit to their members using their own money as well as the informally transferred project funds (those that were allocated to them for designated activities but actually used as microloans to members—see para. 41).

d. Accountability

44. Accountability under the project was largely upward. For example, PFIs were accountable to NRB, which reimbursed 80% of PFI loans to farmers. NGOs were accountable to DLSOs, which selected NGOs and monitored their performance. DLSOs were accountable to the PMO and DLS, which allocated annual budgets to DLSOs. Downward accountability was found in only a few cases, such as the savings and credit schemes run by beneficiary groups almost independently. The accountability seemed to be high in groups with small size (10–20 members), where members knew their leaders very well. CBOs with beneficiaries as their own members seemed to be more accountable to beneficiaries as compared with NGOs from outside.

⁶ The OEM did not see a negative impact in the shift of project funds away from the designated use, especially the animal life insurance scheme, which was highly risky, as it comprised a very small number (less than 50) of participants with high homogeneity (all were animal owners from one or two villages). Any outbreak of disease could easily wipe out such insurance schemes.

3. Impact of New Approaches

45. This section analyzes the impact of the new approaches on project performance in terms of relevance of project interventions and sustainability of project benefits.

a. Relevance of Project Interventions

46. The relevance of project interventions depends heavily on how well the project designers understand local conditions in a particular project area, such as key sector issues as well as the political, economic, social, and cultural environment, including in particular the formal and informal institutions. While beneficiary participation conducted during the project design stage may facilitate the collection of local knowledge influencing project design, the bottom-up approaches used during the project implementation period, such as the LAT, group formation, and NGO engagement, did not seem to have significantly improved project relevance, which remained weak. The OEM noted a number of less relevant interventions under this project. For example, without recognizing that the price distortion generated by DDC was the key cause that discouraged private investment in dairy processing and thus restricted dairy marketing, the project distributed subsidized equipment to a selected set of enterprises as the primary instrument to promote marketing, resulting in continued milk holidays after 7 years of project implementation. Without appreciating farmers' high demand for new technology and their willingness to pay for training, the project followed the conventional practice of using free training and improved forage seeds as "carrots" to induce group formation and restricted nonmembers' access to training. The project's impact on technology dissemination was therefore limited. Finally, insufficient understanding of local institutions in the project areas contributed to the creation of new beneficiary groups in areas where informal groups already existed and worked effectively.

b. Sustainability of Project Benefits

47. O&M was not an issue under this project, which did not create any infrastructure or facilities with public or collective ownership. Sustainability of project benefits, however, depends on the sustainability of the delivery mechanisms established under the project, such as PFIs, NGOs, beneficiary groups, and VAHWs. The OEM noted that continued lending to farmers was likely in 17 of the 19 PFIs as long as NRB continues to provide them with access to loans after project completion, which is likely as NRB has a revolving fund generated from repayments of earlier loans.⁷ Sustainability of the NGO services was unlikely with the exception of CBOs, which continued to serve their clients, who were also their members. The other NGOs had already left the pocket areas after the expiration of their contracts.

48. The sustainability of beneficiary groups established under the project is mixed. The savings and credit schemes seemed to have the best prospect of continuity because the schemes enjoyed the highest demand from members and were run by the groups that set their own rules and used their own money. The informal practice of transferring some project funds to the credit schemes (para. 41) probably strengthened the financial capacity of the groups to continue the lending after project completion. In contrast, the other group activities, such as distribution of animal medicine and forage seeds, are likely to stop after project completion, when no more funds are available. The size of goat distribution programs is likely to be reduced

⁷ The credit line was 40 years from ADB to NRB and 5–7 years from NRB to PFIs.

sharply after project completion, when DLSOs will have to operate within the limit of their routine budget.

49. Sustainability of the VAHW services seems to be weak. In some districts visited, only about 40% of the trainees established clinics after the training. Some trainees did not start veterinary services due to a lack of real interest—they attended the training primarily for the training allowance; some trainees did not have the financial capacity to establish a clinic; some received a veterinary kit but could not refill it when it was finished.

D. Issues, Underlying Causes, and Alternatives

1. Selection of NGOs

50. One innovation of the project was the engagement of CBOs as NGOs in project implementation. While NGOs might have better expertise and experience, a CBO seemed to have the following advantages over an NGO that was not from the subproject area: (i) the CBO might be more acceptable to local people, as CBO members were from the subproject area; (ii) the CBO might be more accountable to its clients, who were also its members; and (iii) the CBO would remain in the subproject area and more likely continue its service after project completion.

51. If a CBO already exists in a subproject area, it may be better to use it instead of engaging an outside NGO for the following reasons: First, if the objective of engaging NGOs is to build up local capacity for long-term development, CBOs should be engaged even if extra costs are needed to train the CBO and build up its expertise. Second, if the objective is improving the delivery of project services, engaging NGOs may lead to quick establishment of the services due to their experience, but the services may be terminated as soon as the NGOs leave. Thus, the use of CBOs may still be a better choice if the project aims at establishing the services on a long-term basis.

52. NGOs may be needed in areas without CBOs or other formal or informal groups. To ensure continuity of NGO services after project completion, it may be important to engage NGOs that work more as a partner than as a contractor. The project's experience in NGO selection provided useful lessons learned (para. 24). First, there is a need for careful examination of the history of an NGO, especially the purpose of its formation. It may be wise to avoid NGOs that were formed for the purpose of taking advantage of external funds. Second, it may be useful to examine the NGO's relationship with the local communities in the subproject area. It may be wise to work with NGOs that already had a close linkage with the local communities prior to a project, as such NGOs are more likely to represent the interest of the local communities. Lastly, it may be wise to examine the NGO's sources of revenues and work with those that have their own income generation activities instead of depending completely on external support.

2. Formation of Beneficiary Groups

53. Formation of beneficiary groups was a major activity under the project, which organized 1,174 groups with 15,312 members. The OEM noted that farmers were capable of organizing groups and of operating them effectively without outside help, especially when they were facing issues critical to their members, such as maintaining drinking water systems, selling milk for members, or providing easy access to microloans (para. 8).

54. In contrast, the OEM noted that groups organized by outsiders (NGOs or government staff) for the purpose of project implementation required intensive supervision as well as subsidized inputs or grants, such as free forage seeds and animal medicine, priority in receiving veterinary services from government service centers, transportation subsidies for the purchase of animals, as well as free training and goats without interest charges. Some interviewees said that they would not join the groups without these “carrots”; others said that their groups met only when visitors (NGOs and government staff) came. The OEM noted that some groups already stopped meeting at the time of its visit because the project had been completed in their region.

55. Furthermore, the OEM observed multiple groups within a same village organized by different government agencies, and was told that there was a tendency for each government agency to organize its own groups instead of using existing groups established by other agencies. The underlying incentives seemed to include (i) fulfilling project targets as required; (ii) receiving budget for group formation; and (iii) attributing the credit for group formation to themselves instead of to other agencies. In some cases, a new group was created by “revitalizing” an old group that had ceased operation after the completion of a previous project.

56. A lesson might be derived from the experience of this project. If the objective of group formation is for the mutual needs of the group members, local communities will have strong incentives to organize it on their own. Externally-financed projects may provide training if there is such a demand, but no concessional benefits will be required. If the objective of group formation is to implement project activities, implementation agencies should be encouraged to use existing groups instead of creating new ones so as to reduce costs, which include the time of group leaders and members.

57. Future projects may develop measures to discourage the creation of groups unnecessarily. For example, instead of setting targets on the number of groups organized or the number of group members, project monitoring may focus sharply on the results and impacts of project interventions as well as their sustainability, such as the number of beneficiaries receiving goats, the number of goats returned, and the number of goats multiplied in the households after 1–2 years. These numbers should be available in villages with completed subprojects.

3. Incentives for Private Sector Participation

58. The project involved 17 small, private PFIs to deliver small loans to farmers for animal purchase. These PFIs had strong incentives to participate because they needed liquidity to expand their business and because they were attracted by the high interest spread (para. 25). By providing incentives to benefit the PFIs, the project achieved a win-win result, as the PFIs expanded their business, and the project achieved its purpose of providing loans to small farmers.

59. Future project may design appropriate incentives to attract the participation of private entities or individuals and, through them, achieve the overall goal of poverty reduction. For example, small dairies may be encouraged to expand their business if a level field for fair market competition can be created by restricting or eliminating DDC’s power in setting milk prices. Better-off farmers including in particular those with a large number of animals and strong incentive to become VAHWs may be selected for VAHW training. Appropriate incentives may be provided to encourage them to start a veterinary business and sustain it. It is possible that the impact on poverty reduction is better achieved by ensuring poor farmers’ access to veterinary services on a long-term basis instead of selecting a few poor to participate in VAHW training.

60. Similarly, natural leaders (formal and informal) could be used to facilitate technology dissemination at the village level, such as selling improved forage seeds and organizing villagers to participate in training. These services should be made open to all who are willing to pay for at least a portion of the cost. To ensure that the poor also have access to new technology, future projects may allocate some project funds to the poor in the form of coupons for them to buy the improved seeds or pay for training courses. The natural leaders may be used to identify the poor in their villages and distribute the coupons, with checks and balances developed to control local corruption.

CASE STUDY: KYRGYZ REPUBLIC
Rural Financial Institutions Project (Loan 1529-KGZ)

A. Background

1. Selection of the Project for Case Study

1. The Rural Financial Institutions Project was selected for case study under the special evaluation study because of its involvement of the private sector in the delivery of rural credit to small borrowers. The project had many interesting features: It was a single-component project rarely seen in rural development projects; it aimed at establishing rural financial institutions instead of merely disbursing loans; it did not target the poor as borrowers but worked through the middle-income class; and it deviated from a standard credit union (CU) model yet worked effectively (para. 56).

2. Fieldwork of the Operations Evaluation Mission

2. The Operations Evaluation Mission (OEM) visited the Kyrgyz Republic during 12–26 April 2004. In the capital (Bishkek), the OEM interviewed officials and experts from the National Bank (the central bank in the Kyrgyz Republic), the Financial Company for Support and Development of Credit Unions (FC), German Technical Cooperation (GTZ), the World Bank, as well as commercial banks and consulting firms involved in rural finance. In addition, the OEM conducted two trips and visited 12 CUs in three oblasts (provinces). Since the OEM aimed at obtaining insights into issues identified through case study instead of surveying a representative sample of CUs, it purposefully visited some of the best CUs including five of the ten CUs that were considered as the best and selected for pilot test of savings deposit taking. The CUs visited included the largest (CU Dosbek) with 698 members, and the oldest (CU Aravan), which was established in 1996 during project preparation as a pilot. Table A8.1 provides a list of the CUs visited by the OEM.

Table A8.1: Credit Unions Visited by the OEM

Name of Credit Union	Year Established	Location	No. of Full-Time Staff	No. of Members	No. of Current Borrowers
Aravan	1996	Aravan, Osh	5	349	293
Juldash-Ata	2001	Aravan, Osh	4	232	185
Asil Ajar	1998	Kara-suk, Osh	4	60	52
Dosbek	1998	Uzgen, Osh	14	698	471
Capital Osh	1999	Osh City, Osh	4	121	112
Akkan-Suu	1999	Madi, Osh	4	146	125
Kopilka 777	1998	Balykchi, Issyk-Kul	9	145	117
Chet Baisorun	1999	Ananievo, Issyk-Kul	4	185	150
Kemenger	1998	Karakol, Issyk-Kul	4	80	56
Sart-Ake	1999	Kizil-Suu, Issyk-Kul	5	255	220
Uchkun-Ton	1998	Bokonbaevo, Issyk-Kul	8	181	124
Tokmok Trust	2000	Tokmok, Chui	7	261	208

3. During fieldwork, the OEM interviewed 26 CU borrowers, 22 nonborrowers, 28 CU officers, and 11 representatives from regional offices of the National Bank, FC, as well as other major players in the rural financial sector in the Kyrgyz Republic, such as the Foundation for International Community Assistance (FINCA), the Kyrgyzstan Agricultural Finance Corporation (KAFC), and the AKB Kyrgyzstan Bank (a large commercial bank in the country). Interviews with officials and experts lasted for 2 hours or more in an open-ended manner, and that with ordinary people (CU members and nonmembers) ranged from 20 minutes to over 1 hour. Visits to CU offices lasted for 2–3 hours, and the OEM examined financial data and borrower files in addition to detailed discussions with CU presidents, accountants, heads of credit committees, and other CU staff.

4. Two basic aspects are worth noting in the methodology used by the OEM. First, some visits to CUs were unannounced, and all meetings with borrowers and nonborrowers were spontaneously arranged on the spot, in offices of CUs, in borrowers' shops, next to the roadside, in villages, or next to fields where farmers were working. In most cases, interviews with ordinary people were conducted on an individual basis without the presence of officers from government, FC, or CUs so as to minimize the chance of interviewees being coached. Second, triangulation was applied to the extent possible, in that all information and opinions received were checked with others. These methods helped to improve the reliability of the information collected.

3. Local Realities in the Project Areas

a. Key Constraints

5. The project was prepared in 1996–1997 when the country started to recover after severe economic recessions in 1991–1995 brought about by the disruption of the traditional export markets and payment systems after the collapse of the Soviet Union in 1991. According to the Report and Recommendation of the President, the country's gross domestic product declined by 45% from 1991 to 1995; per capita income was reduced from \$1,020 in 1992 to \$690 in 1995; unemployment increased sharply in both urban and rural areas; and rural poverty increased from 48% in 1993 to 58% in March 1996. Given the dominant share of agriculture in the overall economy (40% of gross domestic product and 50% of exports), there was an urgent need to boost agriculture as an engine for overall economic recovery.

6. Agricultural recovery, however, was restricted by a severe lack of working capital. Two of the four largest banks in the country—the Elbank and Agroprombank (the latter provided 90% of agricultural lending during the Soviet era)—collapsed in 1996, resulting in a total lack of banking services in 25 of the 42 raions (districts) in the country. Lending to agriculture from the informal sector (borrowing from relatives, friends, money lenders, or traders) was minimal at that time, as reported by a survey conducted in 1996 covering 140 households, 140 farms, and 140 nonfarm enterprises. The survey found that only 5% of the sample households and 2% of the nonfarm enterprises borrowed from the informal sector. The OEM was told that about half of the irrigated land was idle in 1996 due to the severe lack of capital to purchase minimal inputs (seeds and fuel) for farm operations.

b. Negative Influence of Soviet Culture

7. Pressed by the urgent need to channel funds to the rural sector to enable agricultural production, the Government provided a credit line through the Ministry of Agriculture and Water Resources as well as oblast and raion governments. A Presidential Decree in November 1995 created cooperatives to channel in-kind assistance (farm inputs) to farms. These efforts, unsurprisingly, met with poor repayment and low outreach, as cash and in-kind assistance from the Government were seen by farmers as grants or subsidies without the need for repayment, due largely to the strong influence of the Soviet culture.

c. New Measures

8. With support from the World Bank, the Government established KAFC as an alternative to channel loans to farmers on a commercial basis. KAFC was fully owned by the Government, and licensed as a nonbank financial institution. It received a credit line of \$16 million under the Rural Finance Project of the World Bank in 1997, and another loan of \$15 million under phase II of that project in 1999. As KAFC targeted large- and medium-sized farms and enterprises,¹ the Rural Financial Institutions Project financed by the Asian Development Bank (ADB) intended to target small borrowers in rural areas, with the majority of loans ranging from som3,000 (\$75) to som15,000 (\$375).

¹ Loans from KAFC ranged from som15,000 (\$375) per individual borrower under group lending schemes, som0.5 million (\$12,500) for individual farmers, and up to som10 million (\$250,000) for small and medium enterprises (see Cordero, Mariano, et al. 2004. Draft Consultant's Report on *Rural Finance Markets in Kyrgyzstan*, Manila. February).

d. Other Features

9. Other interesting features of the project areas are worth discussion. First, the country is extremely mountainous, with 90% of its area at 1,400 meters or more in elevation. The mountainous geography and scattered population may partly explain the apparent lack of strong demand for microsavings services (para. 39) as observed in countries with high population density such as Bangladesh. Second, farmers are all educated, as the country has an impressive literacy rate of 99%. During its field visit, the OEM found that many CU presidents were formerly professionals with college degrees. They had lost their jobs as engineers, teachers, or government officers during the economic recession in 1991–1995, and established CUs as permanent employment. Lastly, the country experienced two rounds of bank collapses in 1994–1996 due to its massive debt burden and inappropriate interest rate structure. Another nine banks were closed by the National Bank following the Russian financial crises in late 1990s. These crises resulted in a severe lack of public confidence in banks.

4. The Project

10. With a long-term development goal to rebuild a sustainable rural financial system, the project set its short-term objective at increasing the level and availability of savings mobilization and lending services in rural communities. In addition to project management, the project had only one component—the establishment of a CU system in the Kyrgyz Republic. The project provided a credit line of \$8.4 million equivalent to match CU members' share capital. FC was established as an apex union to provide supervision and other services to CUs. Technical support, furniture, and equipment were provided to the National Bank and FC, as well as training for capacity building and support for project implementation.

11. Total project cost was estimated at \$22.1 million at appraisal, financed by an ADB loan of \$12.5 million equivalent, which included a credit line of \$8.4 million for onlending to CUs; \$2.36 million for training, vehicles, equipment, and furniture; \$352,000 for consulting services; and \$1.04 million to cover a portion of the recurrent cost. The CUs were expected to contribute \$8.4 million of share capital, and the Government was to finance the remaining \$1.2 million.

12. The Executing Agency was the National Bank, which coordinated overall project implementation and disbursed the ADB loan proceeds to FC. FC was established initially within the National Bank, with a target to be transferred to the CUs in the third year of project implementation.² The project was to be implemented in 7 years from April 1998 to March 2005.

13. In collaboration with ADB, GTZ provided \$4 million in 1999 as technical assistance to facilitate the implementation of this project. GTZ support (consultants, training, and other funds) was used to assist FC in developing strategies and business plans, capacity building for implementing the plans, and development of a regulatory framework for CUs. At the CU level, GTZ focused on developing 10 model CUs with training and information technology, and qualifying them to take savings deposits on a pilot basis.

B. Evaluation of Project Performance

1. Project Design

14. Based on a good understanding of the country and sector conditions, the project design correctly focused on the urgent need to channel funds to rural areas to enable agricultural recovery.

² This target date was postponed to March 2005.

Recognizing the high risk of the Soviet culture influence (para. 7), the project designers used the private sector to deliver credit instead of channeling loans through a national agency or local governments. Considering the innovative nature of this approach, the project designers pilot tested it by establishing three CUs during the project preparation stage. The pilot experience led to the recognition of additional risks, including the lack of a consistent accounting system in the project areas. The designers probably recognized that the establishment of a new financial system required long-term effort. Limited by the prevailing regulations in ADB, however, the designers provided an implementation period of only 7 years—the longest among available loan modalities in ADB.

15. In contrast to many credit projects that restrict the use of their credit line for specific sectors or regions with preset interest rates, the project design allowed considerable flexibility to enable decision-making at the CU level. The project provided no restriction on end-borrowers' use of loans, although a business plan was required for loans larger than som20,000 (about \$1,150 in 1997). CUs could be located in towns or villages; members could be farmers, businesspeople in towns, teachers, pensioners, or anyone who contributed a minimum of som1,000 (equivalent to \$57 in 1997) as share capital. Each CU set its own internal policies, including interest rates, lending terms, repayment schedule, and collateral requirements. Although guidelines were set by FC, application of the guidelines was not rigid (para. 23), as CUs had the authority to set their own policies.

16. The requirements for establishing a CU were low: a minimum of 10 members and som30,000 (\$1,724 equivalent in 1997) from members as share capital would enable a CU to be created, licensed, and entitled to borrow from FC on a matching ratio of 1:1 (loan to share capital). A member, by purchasing a minimum share of som1,000 (\$57), could join a CU and borrow from it up to 3:1 (loans to share capital). The borrower could borrow repeatedly provided that his/her previous loan was fully repaid.

17. At the time of project appraisal, the annual interest rate of the ADB loan (in US dollars) was zero to the National Bank, which paid a 1% service charge annually. As the National Bank lent the loan to FC in local currency and bore the risk of foreign exchange variations, it charged FC an annual interest rate of 6.79%. FC lent the credit line to CUs at an annual rate of 32%. The CUs, in turn, lent the loans to endborrowers at an annual rate of 45%. According to the project design, the interest spread was 25.21% for FC and 13% for the CUs. In reality, the interest rate to end borrowers was up to 70% or more in some CUs in the initial years, partly due to a high inflation of 31% at that time, and partly due to the severe shortage of cash in the project areas.

18. Influenced by a standard CU model or “best practice,” the project designers imposed a savings-based CU model and an apex union—the FC—to oversee the CUs. FC was established in April 1997, shortly before project approval, with the mandate to (i) promote the development of CUs; (ii) channel the credit line to CUs; and (iii) provide support, regulation, and supervision for CUs. Quantified targets were set, requiring the establishment of 280 CUs with 28,000 members by the end of the project.

2. Project Implementation

a. Fast Growth of CUs and Underlying Causes

19. The task of promoting CUs proved to be easy, and the target of establishing 280 CUs by the end of the project was exceeded by a large margin within a much shorter period. As of 31 March

2004, the project created 446 CUs, of which 301 had active licenses.³ The 301 CUs functioned well with a total of 25,438 members—an average of 85 members per CU.

20. The CUs experienced rapid growth especially in the early years when regulation and supervision were loose. A number of factors might explain the fast growth. First, the Government had a strong incentive to promote CUs in view of the urgent need to channel funds to the agriculture sector to facilitate its recovery. Oblast and raion governors were told to establish a CU in every village within their jurisdictions (this requirement, however, was unrealistic and not achieved). Second, there was widespread unemployment in the project areas. Many former government employees and professionals, such as accountants, teachers, and engineers, although with high education and good management skills, had lost their jobs during the economic downturn and were eagerly looking for self-employment. Third, due to a severe shortage of cash in the project areas, those who controlled access to credit were seen as most powerful. The power to allocate credit was a strong incentive for establishing a CU. Fourth, the project offered a large interest spread (para. 17), which was seen by many CU presidents interviewed as a lucrative business opportunity. Fifth, the requirements for establishing a CU and obtaining a license were low, making it relatively easy for a middle-income individual to persuade his/her family members, relatives, and friends to form a CU with 10 members, and collect som30,000 from them. Lastly, the information about the CU and its requirements was widely disseminated in the country through public media such as newspapers, radio, TV, and government promotions. Many CU presidents interviewed said that they learned about the CU requirements from newspapers, and established their CUs as a best opportunity to employ themselves as well as their family members and relatives.

21. While the founders of CUs were attracted by the lucrative employment opportunities and the power to allocate credit, the majority of other CU members were attracted by the easy access to credit, since a capital share of som1,000 would enable one to borrow a loan of up to som3,000. The other lending requirements were considered acceptable: Paperwork was light; collateral was not difficult (para. 36); processing was quick (ranging from 2 days to 2 weeks in the cases interviewed); and the repayment schedule was suitable for most farmers (repaying interest charges monthly and principal at the end of the loan period, which ranged from 1 to 2 years in most cases interviewed). Finally, some wealthy people joined the CU in view of the high dividends paid to capital shares.

b. High Repayments and Underlying Causes

22. Loan repayment from CU members was high. According to the quarterly report submitted by FC, the ratio of portfolio at risk (cumulative amount of overdue loans divided by current loan portfolio) averaged 2.1% for the 301 CUs as of 31 March 2004. This was consistent with the OEM's observation, which noted high repayment (over 95%) in most of the CUs visited.

23. Many factors might have contributed to the high rate of repayment. First, collateral was required for all loans. According to the project designers, collateral should be required only for loans of som7,000 or above (which was increased to som20,000 in later years). In all CUs visited, however, the OEM noted that collateral was required for all loans, regardless of size. Since each CU had the power to determine its own lending policy, not all requirements set by the project were binding on the ground. The OEM noted that the use of rural land as collateral was not accepted by banks and CUs in the areas visited, reportedly due to the lack of an active market for rural lands, because nonresidents were not allowed to purchase rural lands in the country. However, since most farmers had houses, furniture, and animals, which were accepted by CUs as collateral, the lack of land collateral did not become a binding constraint. In one case, a CU president interviewed said

³ Similar to the case in private sector operations, failure of CUs and their closure was common in the Kyrgyz Republic. While new CUs were established every year, a total of 145 CUs were closed as of 31 March 2004.

that he could not sell the furniture he collected from a borrower who failed to repay a loan due to unforeseeable events. (In spite of repeated advertisement that involved extra cost, no buyers were interested in the furniture.) Even under such a case, the collateral requirement seemed to have fulfilled its primary role of encouraging loan repayment, because that borrower did lose his property when he failed to repay, sending a correct message to warn other borrowers.

24. Second, many CUs created various incentive measures to encourage timely repayment, such as (i) a harsh penalty for late repayment (doubling interest charges) and its strict enforcement,⁴ and (ii) a reward for timely repayment, such as reduced interest rates for second and consecutive loans if a borrower repaid loans on time. In the CUs visited, the annual interest rate for a new borrower ranged from 30% to 32% whereas an old borrower with a good repayment record could borrow at an annual rate as low as 24%.

25. Finally, all CUs visited had reserves for loan losses, ranging from 1.5% to 2% of total loans to members. Overall, the 301 CUs had som4.7 million reserved for loan losses as of 31 March 2004, equivalent to 1.46% of total loans to members. When the number of defaults was small due to strict enforcement of the penalty and incentive measures (para. 24), the loan loss reserves were sufficient to cover the nonrepayment.

26. The FC, however, seemed to be problematic. The high level of interest spread (over 25% at appraisal; reduced to about 10% at the time of the OEM's visit due to falling interest rates in the country), the monopoly power (being the only one channeling the ADB credit line to CUs), and the lack of accountability⁵ not only allowed inefficiency in FC operations, but also attracted political interventions in the selection of FC heads and staff. It was reported that the former head of FC recruited an extra number of staff (including those unqualified) for political patronage. In the early years of project implementation, FC lent to CUs without collateral. The high interest spread and low entrance requirement, in the absence of strict monitoring and supervision due to a lack of experience, resulted in fraud in some CUs, which falsified membership and share capital to obtain loans from the FC, and invested the loans in high-risk businesses. This issue was first reported in July 2002. By 1 August 2002, a report found 21 "problematic CUs" with fictitious members and share capital, which had borrowed a total of som14.76 million (\$340,160) from FC. As ADB reacted quickly and set tough financial performance targets for FC, supervision of lending to CUs was tightened sharply, and collateral was required for loans to CUs.⁶ In spite of the improvements and significant efforts made by ADB, GTZ, and the National Bank, the fundamental causes underlying the FC problems—monopoly, lack of accountability, and excessive interest spread—had not been solved at the time of the OEM's visit. Furthermore, FC's mandates of promoting CUs, channeling funds, and supervising CUs continued to be seen as creating conflicts of interest.

3. Results and Impacts

27. The OEM observed the following positive results in the areas visited: First, access to rural credit improved significantly. The OEM interviewed small traders in bazaars, farmers in fields, and residents (including nonborrowers) in villages. All of them said that access to credit was much easier now than in 1996, before the project. The improvement seemed to be related to the increased number of players in the rural finance market, and, consequently, intensified market competition. In several CUs visited, presidents said that they had been the only CU in their regions when they

⁴ Two borrowers interviewed experienced the penalty of doubling interest charges due to late repayment.

⁵ While members borrowed from CUs against collateral, and CUs borrowed from FC against collateral, FC borrowed from the National Bank without any collateral. Better alternatives are proposed in paras. 58–60.

⁶ Ideally, lending to CUs should be performance-based instead of against collateral, which was costly in terms of time and resources. Given the lack of performance rating for CUs, however, collateral was used to ensure repayment.

started, but now had to compete with other CUs more recently established. In more than one case, the CU presidents said that their accountants, after working for them for a while, left them and started their own CUs. Widespread information about the availability of various financial institutions seemed to have contributed to the intensified market competition. Borrowers interviewed said that they compared the advantages and disadvantages of different financial institutions before making a decision on borrowing.⁷

28. Second, market interest rates dropped sharply in the areas visited. In CU Sart Ake, the annual interest rate dropped from 72% in 1999 to 32% in 2004. A similar trend was observed in other CUs visited. In FINCA, which was one of the largest suppliers of microcredit in the country, monthly interest rate fell from 5% in 1997 to 2.5–3% in 2004 (3% for group lending and 2.5% for individual lending). While declining inflation and weakened local currency might partly explain the drop in interest rates, CU presidents interviewed attributed it to intensified market competition among credit suppliers. Although CUs were free to set their interest rates, they had to follow the market trend in order to keep clients. Table A8.2 compares the annual interest rates in CU Sart Ake with inflation rates and exchange rates from 1997 to 2004. While inflation fell and exchange rates were weakened during this period, the changes of these rates did not follow the same pattern, with interest rates dropping constantly by 12 percentage points yearly from 1999 to 2002 while changes in inflation and exchange rates were not consistent.

**Table A8.2: Annual Interest Rate, Inflation Rate, and Exchange Rate
(1997–2004)**

Year	Interest Rate ^a (%)	Inflation Rate ^b (%)	Exchange Rate ^b (Som/US\$)
1997	–	23.4	17.4
1998	–	10.4	20.8
1999	72	35.9	39.0
2000	60	18.7	47.7
2001	48	6.9	48.4
2002	36	2.0	46.9
2003	34	3.0	43.7
2004	32	3.8	43.2

^a Since each CU set its own interest rate, an overall interest rate for all CUs was not available. Interest rates in CU Sart Ake are used as an example. No interest data were available for 1997–1998 because this CU started operation in 1999. Interest rates in other CUs visited had a similar pattern.

^b ADB. 2004. *Key Indicators 2003*. Manila; and ADB. 2003. *Asian Development Outlook 2004*. Manila.

⁷ Most borrowers interviewed compared the service from CUs with that from FINCA and KAFC. FINCA required weekly repayment of both interest charges and principal. Its loans were therefore suitable for traders instead of farmers, who did not have a weekly income. Furthermore, FINCA charged a monthly interest rate of 2.5–3% (equivalent to 30–36% annually) and required group lending, which was seen as a disadvantage by better-off farmers, who did not want to be responsible for nonrepayment of others. KAFC had the lowest interest rates (17–18% per annum) but required solid collateral (houses with high value) and strict documentation, which was difficult to obtain. Moreover, the loan size of KAFC was large (a minimum of som 15,000 for each individual under group lending, som 0.5 million for individual lending, and up to som 10 million for enterprises). In comparison, the size of CU loans (mostly som 3,000–som 9,000) fit well with small farmers. Furthermore, the collateral requirement of CUs was flexible, accepting animals and furniture. Some farmers interviewed used both KAFC (for large loans) and CU (for small loans).

29. Third, the project, to a certain extent, contributed to employment generation. Directly, at least 1,200 full-time jobs were created in the 301 CUs, because most CUs employed 3–5 full-time staff (CU Dosbek—a large CU with 698 members—employed 14 staff). Indirectly, many CU borrowers used loans for agricultural production or commercial activities (shops and trading), which required additional labor. Based on FC’s report, the 301 CUs had 25,438 members, with a total loan portfolio of som320 million (\$8 million) as of 31 March 2004. Since most members borrowed repeatedly (many CU members interviewed by the OEM had borrowed 3–5 loans in the past 3–5 years), the accumulated number of loans should be large. FC reported that about 64% of the loans were used for agricultural production, 23% for trade and services, 4% for industry, and the remaining 8% for other purposes. This report was consistent with the OEM’s observation in the CUs visited. Many borrowers interviewed used the loans to buy animals (sheep, goats, cows, horses) or inputs (seeds, fertilizer, fuel) for spring operation for cotton, wheat, and potato production. It was interesting that some borrowers interviewed, while managing their shops in towns, used loans for cotton or livestock production on their farms.⁸ These town people did not have time to attend to their farms and animals, which were taken care of by hired rural laborers. Partly due to the increased demand for labor, the OEM observed increased labor prices in the villages visited.

30. Finally, the agriculture sector improved from near-collapse in 1995 to significant recovery in 2002, with cotton exports more than doubling from \$21.2 million in 1999 to \$45.3 million in 2002. Rural poverty, though still widespread, was reduced from 58% in 1996 to 51% in 2001. In sharp contrast to the dismal picture in 1996, when about half of the irrigated land was not used due to a severe shortage of working capital, land-leasing fees increased from zero in 1996 to som6,000 per hectare in the villages visited by the OEM.

31. The OEM noted that the above achievements could not be solely attributed to the project and ADB. Nevertheless, the project, by providing strong incentive and low entrance requirements, motivated numerous private individuals to establish CUs and participate in the delivery of rural credit to small borrowers. It might be safe to say that, in conjunction with the efforts of the Government and other organizations (such as the World Bank, bilateral agencies, and nongovernment organizations), the project contributed to the improved access to rural credit, removal of the key constraint of shortage of working capital, and, consequently, agricultural recovery in the project areas.

C. Evaluation of New Approaches

1. New Approaches Under the Project

a. Features of CUs

32. The project had a number of interesting features. First, it did not target the poor as borrowers. Many borrowers interviewed by the OEM were prosperous town people who owned shops, or better-off farmers with large farms and hired laborers. The OEM considered this approach appropriate in view of the realities in the project areas, as interviews with poor farmers found that the poor were not interested in borrowing due to a lack of cash income to serve loan repayments, a lack of skills to manage debt, and a severe fear of losing their property if they failed to repay loans.

33. Second, the project set no restriction on the use of loans. Formally, a business plan was required for loans of som20,000 or above. In the CUs visited, business plans were prepared by CU staff together with borrowers, apparently for fulfilling the formal requirement, which did not serve as a restriction on the use of loans. The majority of borrowers interviewed used loans for crop production (cotton, wheat, potato) or animal purchase (sheep, goats, cows, horses). Some urban

⁸ It was common that residents in towns owned farmland in villages in the project areas.

borrowers used loans for shops and trade. And a very small number of borrowers (such as teachers with monthly salaries) used loans for consumption, such as education fees for children. Again, the OEM considered this approach appropriate, as it was consistent with the project's objective of increasing the availability of lending services to local communities.

34. Third, most CUs were not built on a common bond basis, and members did not appear to be owners of the CUs. Although the initial 10 members (founders) of the CUs were well connected with each other (many of them were family members, relatives, or friends), the majority of the CU members did not know each other, especially those in large CUs with hundreds of members. Some borrowers interviewed said that they lived in villages 20–35 kilometers (km) from the CUs that were located in towns. They learned about the CUs when they passed by the CU offices and were attracted by the easy access to credit. They paid share capital and became members because these were the conditions to access loans. They were interested in the services offered by the CUs instead of ownership.

35. Fourth, some CUs were essentially run as family businesses. Of the 12 CUs visited by the OEM (including 5 of the 10 best CUs in the country), 6 showed clear signs that they were formed and run as family businesses. In some cases, key officers (president and accountant) of the CUs were family members, such as husband and wife, father and son, or mother and son. In one case, all of the four full-time staff in the CU belonged to one family, with son as the CU president, daughter as the accountant, mother as the cashier, and father as the head of the credit committee. In another CU, a husband was the president, with his wife as the accountant, a cousin as the head of the credit committee, and a niece as the cashier. The family-run CUs, however, did not seem to negatively affect the project's short-term objective of increasing lending services in rural communities, nor its long-term goal of rebuilding a sustainable rural financial system. In contrast, some of the family-run CUs showed good signs of sustainability (para. 52).

36. Fifth, collateral was required for all loans—no matter how large or small. This requirement was necessary partly due to the fact that most CU members did not know each other, and they acted more like clients than owners of the CUs. The collateral requirement was relatively easy and flexible. Most CUs visited accepted houses, animals, or furniture as collateral, and most CU members had such properties. Thus, the OEM did not consider this requirement problematic; it was widely accepted by CU members and worked effectively in encouraging loan repayment.

37. Lastly, the CUs established under the Project were not savings-based. Although the savings-based model was imposed in the project design, the reality in the Kyrgyz Republic during the transitional period did not allow such CUs to emerge. The prevailing laws in the country prohibited CUs from taking savings deposits—not even from their members. The National Bank was reluctant to initiate any change in such a regulation in view of the negative social and political impacts caused by the two rounds of bank failures in the country in 1994–1996, the collapse of deposit-taking CUs in other transitional economies, and the lack of public confidence in banks in the country. Furthermore, the National Bank considered the share capital required for CU membership as an alternative form of savings mobilization, although this view deviated from the prevailing theory about CUs, which distinguishes share capital from savings.

b. Factors Restricting Savings Deposits

38. There were other factors restricting the creation of savings-based CUs, including an apparently insufficient demand for savings deposits observed by the OEM, which visited 5 of the 10 best CUs that had been selected for pilot testing of savings deposit taking. In spite of the enthusiastic talk of some officers in FC and CUs about the general advantages of savings deposit taking, members in the CUs visited did not show strong interest in the deposit services available to

them. By the time of the OEM's visit in April 2004, only 29 (1.8%) of the 1,638 members in the five CUs used the deposit services, with an aggregate amount of deposits of som664,500 (see Table A8.3). The OEM noted that this amount was heavily skewed by one outlier—CU Tokmok Trust, which had 13 depositors and a total amount of deposits of som 630,000, accounting for 95% of the aggregated deposits in the 5 CUs. In CU Dosbek—the largest CU with 698 members—there were only four depositors and som 8,500 deposits. In Aravan, the oldest CU with 349 members, there were only six depositors, of which four were CU officers. In CU Kopilka 777 with 145 members, there were only three depositors, including the CU president and another full-time staff.

Table A8.3: Savings Deposits in Credit Unions Visited by OEM
(Data up to April 2004)

Name of Credit Union	No. of Depositors	No. of CU Members	Depositors as % of Members	Savings Deposits		Year Deposit Taking Started
				Amount (som)	As % of Total	
Aravan	6 ^a	349	1.7	6,000	0.9	Mar 2004
Dosbek	4	698	0.6	8,500	1.3	Dec 2003
Kopilka 777	3	145	2.1	6,500 ^b	1.0	Dec 2003
Chet Baisorun M	3	185	1.6	13,500	2.0	Jan 2004
Tokmok Trust	13	261	5.0	630,000	94.8	Dec 2003
Total	29	1,638	1.8	664,500	100.0	

^a Of the 6 depositors, 4 were CU officers.

^b Of the total deposits of som6,500, som5,000 was deposited by the CU president; another som1,000 was from a full-time staff member.

39. While the short period of deposits taking thus far (started in December 2003 after 1 year of preparation and training) might partly explain the small number of depositors, the OEM identified other possible factors that might have restricted the demand for deposit service in the project areas: First, population density in the project area was low, and it was not financially feasible to establish a CU in every village. In contrast, many CUs visited were located in towns and served villages 20–35 km away. It was inconvenient for village residents to deposit a small amount (such as som1–10) of savings on a frequent (daily or weekly) basis to the CUs that were located 20–35 km away, although they would travel such a long distance to the CUs when they need to borrow (which was once a year in many cases). Thus, the demand for microsavings commonly found in densely populated countries such as Bangladesh was not observed in the project areas. Some interviewees said that they kept small amounts of money in houses and used larger amounts of money to buy animals. The OEM noted that an animal was a preferred form of savings in the areas visited, because (i) all households (including the poor) owned animals, and (ii) buying and selling animals were common and easy in local markets. One could buy a young animal when he/she had extra money, and sell the adult in times of urgent need for money.

40. Second, while the service of time deposits was available in the five CUs visited, the majority of the CU members were borrowers without extra money that could be left idle for a fixed period. Many of them said that they would not have borrowed if they had had such money. While the CUs also had prosperous members with excess money, these members had already invested such money in share capital to earn dividends. Some of them preferred investing in share capital, which could be used as leverage to access more loans in times of need.

41. Finally, public confidence in banks remained low in the country, and residents in towns had access to savings services offered by the state-owned Settlement and Savings Company and by large commercial banks (such as AKB Kyrgyzstan), which might be seen as safer than the CUs that were run by private families with weaker financial backup than banks. These financial institutions offered an annual interest rate on time deposits up to 10% depending on maturity, and few CUs could offer better rates than that. Moreover, the CU requirement of contributing share capital to become a member before accessing its services made it less attractive to town residents who had alternative access to savings services.

42. In the future when more CU members become prosperous and have extra money, it is likely that the demand for savings deposits will rise, especially if the CUs improve their skills and develop new products that fit well the cash flow patterns of their members. It is also likely that market competition among financial institutions will accelerate this process. Nevertheless, it seemed clear to the OEM that the standard model of savings-based CUs did not fit the realities in the project areas at the time of project design. As a result, the CUs established under the project worked essentially as private retailers channeling the ADB credit line to small borrowers in the rural areas on a commercial basis—a practical approach that worked effectively. The OEM noted that KAFC, created under the World Bank project, operated effectively for the past 6 years without any savings deposits or share capital. It worked essentially as a retailer channeling the World Bank credit line to large and medium farmers. Without being savings-based, KAFC enjoyed the reputation of being the largest supplier of rural credit in the country; its contribution to agricultural recovery was well appreciated in the Kyrgyz Republic.

2. Role of Actors

43. The following sections analyze the role of policymakers, service providers, and end borrowers in (i) information flow, (ii) resource control and decision making, (iii) delivery mechanisms, and (iv) accountability.

a. Information Flow

44. Information flowed upwards from CUs to FC, the National Bank, and ADB through regular reports, which contained rich data including not only the number of CUs and CU members, but also balance sheets, loan portfolio analyses, income statements, and other relevant information.⁹ Information also flowed downwards from ADB and the National Bank to FC and CUs—primarily information about project policies and regulations. The OEM noted that most project information, such as availability of the ADB credit line, minimal requirements for establishing a CU, lending rates to CUs, and ratios of matched loans to share capital, was disseminated widely through mass media such as newspapers, TV, and radio, and was well known to CU members as well as the general public. Internal policies set by CUs, such as lending rates for members, collateral requirements, repayment schedules, penalties for late repayments, incentive measures for timely repayment, as well as dividends on share capital, were well known to CU members through announcements on walls and discussions at meetings. General assemblies were held annually in each CU as required, and the OEM was told that about 50–70% of the members attended the assemblies in the CUs visited. While most of the CU members interviewed seemed to know about decisions made at the meetings—such as decisions on dividends and institutional capital—they did not seem to know or recall the amount of profit made by their CUs. In some cases, they did not even know the names of their presidents. In these CUs, members' lack of full knowledge about CU profit and presidents seemed to confirm the OEM's assumption about the nature of the CUs—some of them were

⁹ The OEM noted that technical assistance and training provided by GTZ as well as close supervision from ADB staff contributed to the well-prepared reports.

essentially family businesses, with members acting as clients interested primarily in services provided instead of as owners interested in CU management. Again, the OEM did not consider this as negative, although it deviated from the standard model or theory about CU (para. 56).

b. Resource Control and Decision Making

45. At the top, ADB controlled loan resources and designed the project in consultation with the National Bank and other stakeholders. ADB set lending policies including in particular the ratios of matching loans to share capital, monitored project implementation, responded to issues that emerged, and adjusted lending policies and monitoring requirements during the course of project implementation. The National Bank, being the one controlling the government counterpart funds, set policies and regulations for CUs and supervised FC operations. FC, with loans from ADB and technical assistance from GTZ, ADB, and the National Bank, lent loans to CUs. Initially, lending to CUs was based on a ratio of 1:1 of matching loans to share capital. ADB had insisted on such a ratio for 5–6 years in spite of repeated requests from FC and CUs to increase the ratio to 3:1 so as to obtain more loans from ADB. To encourage CUs to build up their institutional capital, a new ratio of 4:1 of matching loans to institutional capital was introduced in 2003. While ADB intended to use the new ratio to replace the old one, in all CUs visited, the OEM noted that the new ratio was used simultaneously with the old ratio. In other words, a CU could borrow at the old ratio of 1:1 against its share capital and, in addition to that, borrow from FC at the new ratio of 4:1 against its institutional capital. The new ratio provided a strong incentive for CUs to increase their institutional capital. Many CUs visited allocated most (if not all) of their annual profits to institutional capital instead of allocating it as dividends to members, as had been the case in the early years. As a result, institutional capital increased sharply in the 301 CUs (para. 52).

46. At the field level, credit decisions were made by CUs, which used share capital contributed by members, institutional capital accumulated from retained earnings, and matching loans from FC to lend to members. Each CU set its own policies including interest rates, lending terms, collateral requirements, repayment schedules, as well as matching ratios. Although a ratio of 3:1 was set by the project design as the ceiling that a member could borrow against his/her share capital, in the CUs visited, the OEM noted that some members borrowed at a ratio of 10:1 against their share capital. Presidents of these CUs explained that these members were reliable borrowers with good repayment records and solid collateral (buildings in towns with high value). FC staff explained that, since CUs had the power to set their own policies, they could deviate from the standard ratio if they had good reasons. Again, the OEM did not consider this as negative, as the CUs knew their borrowers better, and were accountable for the use of their own money.

47. At the household level, CU members controlled their own capital, and were free to determine the use of the loans from the CUs that they borrowed against collateral and the amount of their share capital. Decisions made by households included whether or not to borrow, where to borrow, the amount and length of loans, and the use of loans. When making a borrowing decision, many borrowers seemed to consider (i) the repayment requirement vs. their cash flow, (ii) interest charged by alternative financial institutions, (iii) collateral requirements, and (iv) paperwork and processing time. Farmers with a large number of animals tended to have few concerns about repayment requirements, as they could easily sell one or two small animals (sheep or goats) to pay for the monthly interest charges, and sell large animals (cows or horses) to repay the principal at the end of the loan period.

c. Delivery Mechanisms

48. While the ADB credit line was disbursed through the national Government to FC, and FC channeled the credit to the CUs, it was the CUs that delivered loans to end borrowers at the household level. As discussed earlier, many CUs were run by private entrepreneurs as family businesses (para. 35). The project's innovation of using the private sector as the delivery mechanism proved to be effective and efficient (paras. 53–55).

d. Accountability

49. At the household level, CU members were accountable for their investment decisions as well as their loans, as they were subject to a penalty of doubled interest charges if they did not repay on time, and would lose their collateral (houses, furniture, or animals) if they failed to repay loans. Accountability at the CU level was also clear. As the CUs borrowed from FC using collateral, they would suffer losses if they failed to repay loans. In the case of the fraudulent CUs (para. 26), presidents were brought to court. The OEM noted that the CUs had strong incentives to adhere to the regulations set by FC, the National Bank, and ADB in order to maintain continued access to the ADB loan, which was the only source of capital available to the CUs in the initial years of the project, and the cheapest credit available at the time of the OEM's visit. Accountability at the FC level, however, was less clear; FC borrowed the ADB loan from the National Bank without any collateral.¹⁰ The worst result of mismanagement in FC would be the loss of one's job, as was the case experienced by the former FC head, who was removed following the CU fraud in 2003. At all levels, the accountability was upwards, without clear evidence of downward accountability to end borrowers. Although assemblies were held annually in the CUs visited, these meetings did not appear to be a mechanism for members to hold CU presidents accountable. Some CUs were run as family businesses (para. 35).

3. Impact of New Approaches

50. The following sections examine the impact of the new approaches on project relevance and sustainability.

a. Relevance of Project Interventions

51. The project's use of private individuals instead of government agencies for credit delivery seemed to be relevant and appropriate. The high interest spread offered by the project motivated active participation of private individuals, and many CUs were established all over the country. The substantially increased players (301 CUs) in the rural credit market enhanced rural residents' access to credit services, and the urgent need to channel funds to the agriculture sector to facilitate its recovery was met without repeating the conventional problems of poor repayment and low outreach when line agencies or local governments were engaged to channel government funds or in-kind assistance to farmers (para. 7). The project's design of savings-based CUs and the top-down imposed FC as an apex, however, was less relevant. Given the lack of a legal basis for CUs to take savings deposits and an apparently insufficient demand for savings deposits in the rural Kyrgyz Republic in the transitional period (paras. 38–41), the savings-based CUs did not emerge as anticipated. Without sufficient demand from CUs for apex services, the externally imposed FC did not function well. It worked more as a mechanism to channel the ADB credit line to CUs without sufficient incentive or capacity to provide supervision and other services to CUs.

¹⁰ For better alternative, see para. 59 for discussions.

b. Sustainability of Project Benefits

52. The project's use of private individuals for credit delivery provided a solid base for sustainability of project benefits. As the CUs were established and run by private individuals (or families), and many of them considered the CU as the best employment, they had strong self-interest to continue CU operations. Recognizing that the ADB loan was set for closure in March 2005, most of the CUs visited exerted their utmost efforts to increase institutional capital so as to (i) maximize borrowing from the ADB credit line (in response to the new policy of borrowing at a ratio of 4:1 of matching loans to institutional capital—see para. 45), and (ii) build up their own resources. Aggregated data showed that, as of 31 March 2004, institutional capital adequacy (the ratio of institutional capital to total assets) in the 301 CUs was 14.5%, higher than the target of 12% set by ADB. If the ADB loan would be closed in March 2005 as planned, the CUs visited said that they would continue to operate using their own institutional capital as well as members' share capital. They might also borrow from FC, which had a revolving fund generated from repayments of earlier loans, because the ADB loan to FC was for 20 years, while loans from FC to CUs were for 1–4 years. The CUs might also borrow from other aid programs or commercial banks, albeit at an interest rate higher than what was charged by the ADB credit line. Although many CUs would have to reduce their operational size due to the reduced credit availability, and some CUs might fail and be closed (especially those without sufficient capital), the majority of the CUs, especially those that had operated for 4–5 years with sufficient institutional capital, would likely continue. There was ample evidence that the primary benefit of the project—farmers' easy access to credit—would continue in the rural Kyrgyz Republic in the future.

D. Issues, Underlying Causes, and Alternatives

1. Indirect Poverty Reduction Through Middle-Income Class

53. The incentives provided by the project, including the attractive interest spread and low entrance barrier, motivated numerous private individuals to establish CUs and participate in rural credit delivery. The OEM noted that many CU founders were nonpoor including prosperous town people who had the financial capacity to contribute the initial share capital (som30,000 or \$1,724 in 1997) required for CU establishment. While many of the later members were from low-income households who benefited from easy access to credit, those who benefited most from the project were the CU presidents (mostly founders) and their families, who took advantage of (i) good salaries and stable employment (which were particularly attractive when unemployment was widespread in the country during the economic downturn); (ii) high dividends on share capital, especially in the early years when most profit in a CU was distributed as dividends;¹¹ (iii) the power to control credit delivery; and (iv) easy access to large loans.¹²

54. The capture of a large amount of project benefits by the better-off groups, however, did not seem to be overly negative. The OEM noted that many CU presidents/founders were well educated, with good management skills, strong motivation and entrepreneurship, and adequate financial assets. It was due to the efforts of these middle-income people that CUs were established and run effectively. Rural households' access to credit was improved; interest rates fell; and the quality of rural financial services improved, with processing time shortened and paperwork simplified. Sustainability of the rural credit services was likely, as the CU presidents and their employees had strong self-interest to continue CU operations. While low-income members of the CUs benefited

¹¹ While the rate of dividends to share capital was the same for all members within a CU, well-off members benefited more than low-income members, because the former had much larger share capital than the latter.

¹² Although the ratio of 3:1 was set by the project design as the ceiling for CU members to borrow against their share capital, in the CUs visited, some members borrowed at a ratio as high as 10:1 (para. 46).

directly from easy access to credit, some poor also benefited indirectly although they did not borrow, as they were hired by the better-off members (including people in towns), who borrowed the ADB loan and expanded their businesses or farm operations.

55. One lesson might be derived from this project: Indirect poverty reduction through the design of appropriate incentives for the middle-income class might work effectively under certain conditions, which could include the anticipated employment generation for poor laborers after the better-off group had benefited from project interventions and expanded their businesses. One key element seemed to be the use of labor-intensive technology by the better-off group.

2. Deviation from Standard Model

56. It appeared that the CUs established under the project deviated significantly from a standard CU model or a commonly accepted “best practice,” by which a CU should be savings-based, members should have a common bond, and lending to members should not require collateral. In contrast, most members in the CUs visited by the OEM did not have a common bond (para. 34). Loans to members—no matter how large or how small—were against collateral, which was similar to the cases in other commercial lending in the Kyrgyz Republic. Without taking savings deposits, the CUs had been operating well, using share capital contributed by members and institutional capital accumulated from retained earnings as leverage to borrow from the ADB credit line, and using all these funds to lend to borrowers and earn interest spread. Regardless of their name, the CUs under the project functioned essentially as private-run retailers channeling the ADB credit line to rural borrowers at the household level. If the ADB credit line would be closed in the near future, it is likely that many CUs would continue to lend to members using their institutional capital and share capital, and would borrow from FC’s revolving fund or other banks (para. 52). In contrast, FC, established based on the theory that CUs should have an apex over them, did not work well, evidencing inefficiency, lack of accountability, and doubtful sustainability.

57. Two lessons may be derived from this project: First, relevant project interventions are best designed based on the realities in the project areas instead of being based merely on theory, a standard model, or a “best practice.” Since a particular country at a particular period has its particular situation, it may be unrealistic to assume that there is a standard model applicable to all situations. As it is said, the best practice is the absence of a best practice.¹³ The project’s experience suggests that deviations from theory or a standard model are not necessarily bad. They might lead to better understanding of the model or further development of theory. Second, short-term objectives and long-term goals are better distinguished based on the realities prevailing in the project areas at the time of project design. In the case of the Kyrgyz Republic at the time of appraisal, savings-based CUs were not possible due to the lack of a legal environment, low public confidence in banks after the banking crises, and insufficient demand for savings deposits (paras. 38–41). It might have been better if a short-term objective had been set to establish private businesses to channel the ADB credit line to small rural borrowers so as to address the urgent need of facilitating agricultural recovery. After a long period of economic recovery and growth, when more and more people become prosperous with extra money, when public confidence in banks recovers, and when demand for savings deposits arises, the long-term goal of building savings-based CUs can be pursued.

¹³ Mansuri, G. and V. Rao. *Community-Based and -Driven Development: A Critical Review*, World Bank Policy Research Working Paper 3209, February 2004.

3. Channeling Cheap Funds from Aid Agencies with Minimal Distortional Impacts

58. Like many credit projects, the project provided the ADB loan to the Kyrgyz Republic at very low cost—zero interest rate and 1% services charge annually. Since the Central Government bore the risk of exchange rate variations when the loan was onlent to the FC in local currency, an annual interest rate of 6.79% was charged to FC. This interest rate was substantially below the 32% annual rate charged to CUs, and the rate of 45% or more charged to end borrowers (para. 17). As is the case in other credit projects, ADB required that lending to end borrowers be charged by market interest rates so as to avoid distorting the financial market in the country. The resulting high interest spread (25.21% in 1997) was given to FC—the intermediate between ADB and CUs—in the name of capacity building. As discussed earlier, the excessively high interest spread attracted political interventions and allowed inefficiency. In conjunction with FC's monopoly position, the lack of a mechanism to hold FC accountable for its lending decisions, and the weak supervision system and staff capacity, problems in FC contributed to fraudulent CUs in 2003 with bad loans (para. 26). The mandates of FC, by combining promoting CUs, channeling credit line, and supervising CUs, were problematic, with conflict of interest.

59. Similar projects in the future may consider the following alternative: The task of promoting CUs was proven to be unnecessary under this project, because the high interest spread provided sufficient incentive for private individuals to establish CUs.¹⁴ The remaining two tasks (channeling credit line to CUs and supervising CUs) may be separated as follows. The task of channeling the ADB credit line may be given to two or more qualified commercial banks on an open bidding basis—those that offer the smallest interest spread to channel the credit line to CUs will be given the job. Market competition among eligible banks may provide a mechanism to discourage political interventions, eliminate monopoly, and generate pressure to improve services and reduce costs. It is also possible that the commercial banks will provide collateral when they borrow from the National Bank.

60. The remaining interest spread may be retained by the National Bank and used to finance the establishment of a solid supervision system for CUs, including (i) setting up an independent supervision unit to oversee CUs and finance their operations; (ii) standardizing accounting and reporting systems in all CUs, and financing the training and licensing of CU accountants; and (iii) establishing an audit system and financing its operations, including audits of CUs.

¹⁴ In fact, ADB worked hard to curb the rapid growth of CUs in order to control their quality and to effect tighter supervision.

**MANAGEMENT RESPONSE ON THE SPECIAL EVALUATION STUDY
ON EFFECTIVENESS OF PARTICIPATORY APPROACHES:
Do the New Approaches Offer an Effective Solution to the Conventional Problems
in Rural Development Projects?**

On 17 February 2005, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

1. Management supports participatory approaches as an important dimension of its commitment to improving quality, building capacity, and enhancing sustainability. Management agrees with the need to improve incentives for promoting project quality, demonstrated by its commitment to managing for development results and the new Human Resources Strategy.

2. The Special Evaluation Study (SES) points to the need to improve application of participatory approaches, especially by enhancing the quality of participation during both project design and implementation, particularly in inherently complex sectors like rural development. Working with multiple stakeholders helps to understand local realities, identify primary causes of development problems, and promote ownership, so participatory activities during implementation may facilitate downward accountability, capacity development and sustained impact. Management supports these sentiments and welcomes the Report's recommendations to revisit ADB's 1996 staff guidelines on '*Mainstreaming Participatory Development Processes*' to achieve improved results. However, we wish to raise a number of issues related to methodology, conclusions, and recommendations in the SES.

A. Role of Participation

3. The SES assesses the effectiveness of participatory approaches as a solution to conventional problems in isolation from other economic, social, political, including institutional factors. This implies a singular element of project design and its related processes can resolve entrenched, perennial problems of project sustainability. Such an approach ignores the multiplicity of conditions that need to be met to obtain successful project outcomes. For example, effective project outcome requires flexible, demand-responsive, and substantial investments to build the capacity of community-based organizations. Local government agencies need to have sufficient motivation, budgets and autonomy to manage the process effectively.

4. ADB has never advocated participatory approaches as a panacea for all the problems related to sustainability, particularly in the intrinsically complex field of rural development. It is, therefore, no surprise that the SES found that participatory or bottom-up approaches do not offer an automatic or effective solution to conventional problems.

B. Concept of and Approaches to Participation

5. Firstly, the study is structured as a contrast between participatory approaches and “top-down supply-driven approaches” to rural development. Instead, comparison of similar projects that did and did not employ participation would have permitted a more focused analysis of the contributions and limitations of participation.

6. Secondly, the SES employs a limited concept of participation.¹ By equating its definition of participatory approaches to a “standard package” of activities, the SES quickly dismisses the significance of participation when this “package” did not yield greater project relevance and sustainability. We would have benefited from a deeper analysis on the quality of engagement of stakeholders in a process that facilitates their influence and shared control over development.

7. Thirdly, heavy reliance on the principal-agent model diverted analysis from the interactions of a range of local stakeholders by artificially separating them into agents and (passive) beneficiaries, and focusing only on the latter. As a result, the SES does not offer a systematic analysis on how a participatory approach has influenced stakeholders other than project beneficiaries. As a result, the SES dismisses as irrelevant any benefits resulting from engagement of members of local government in decision making.

8. Finally, the SES overlooks the fact that participatory development has been evolving within and outside ADB since the 1990’s. Participatory approaches have advanced from having a primary focus on community to engagement of stakeholders at multiple institutional levels. Without considering this evolution, the SES’ recommendations are out of sync with ADB’s current practices of participation. Many of the alternatives suggested by the SES, including some forms of participatory monitoring, are in fact considered today as mainstream participatory approaches to strengthening ‘downward’ accountability, and are already being applied in ADB projects.

C. Conclusions and Recommendations

9. The utilization of a limited definition of participation and the related methodological problems identified creates an internal inconsistency in the SES. On the one hand, it questions the usefulness of ‘bottom-up’ participatory approaches while promoting other forms of participatory approaches. The SES does not offer sufficient analysis—particularly on the quality of participation and other enabling conditions—to support its conclusion that participatory approaches add limited value to project success and sustainability. Management will, however, carefully consider, where relevant, the insights provided by the SES, within the broader context of ADB’s current realities. Furthermore, initiatives are underway to provide improved guidance to staff on participation.

¹ ADB defines participation as “a process through which stakeholder influence and share control over development initiatives, and over the decision and resources that affect themselves.” Mainstreaming Participatory Development Processes [1996], page 2.

**OPERATIONS EVALUATION DEPARTMENT COMMENT ON MANAGEMENT RESPONSE
TO THE SPECIAL EVALUATION STUDY ON EFFECTIVENESS OF PARTICIPATORY
APPROACHES: Do the New Approaches Offer an Effective Solution
to the Conventional Problems in Rural Development Projects?**

Following the 8 March 2005 meeting of the Development Effectiveness Committee of the Board of Directors, at which the committee considered *Special Evaluation Study on Effectiveness of Participatory Approaches: Do the New Approaches Offer an Effective Solution to the Conventional Problems in Rural Development Projects?* and Management's response to the report, OED issued the following comment to the Management response:

1. OED is pleased that the Management agrees with the overall conclusion of the SES that the participatory approaches examined by the SES do not, by themselves, offer an effective solution to the conventional problems in rural development projects. OED also appreciates Management's willingness to carefully consider the insights provided by the SES. OED also notes that Management welcomes OED's recommendations to revisit ADB's 1996 staff guidelines on "*Mainstreaming Participatory Process*" with a view to making the guidelines practical with realistic expectations. The OEM appreciates Management's initiatives to provide improved guidance to ADB staff on participation.

2. The SES concluded that the participatory approaches examined did not result in successful development outcomes. The conventional problems in rural development projects are complicated without ready, easy, and standard solutions. What is needed is an enabling environment where efforts to find more appropriate local solutions to local problems can be nurtured. It is in this spirit that the SES recommendations, although at an early stage of conceptualization, were raised to invite discussion and debate. Participatory innovations should be pilot tested followed by solid evaluation before replication. OED wishes to clarify the following issues relating to the Management Response.

3. First, the SES assessment on the effectiveness of participatory approaches was not conducted in isolation from other economic, social, political, and institutional factors. The SES contains significant analysis of the economic, social, political, and institutional conditions in the project areas visited. In each of the country reports (Appendix 4–8 of the SES), there is a section on "Local Realities in the Project Areas," which provides detailed analysis of the economic, social, institutional, and political situations, forming a basis for the SES assessment of the effectiveness of the participatory approaches under the particular settings in each country.

4. Second, as an evaluation study, the SES assesses the effectiveness of the participatory approaches based on those which were actually practised and observed in the field. While ADB defines participation as "a process through which stakeholders influence and share control over development initiatives, and over the decisions and resources that affect themselves," in the project areas visited, the OEM did not observe such a process. Four of the six projects

examined adopted a standard package of participation by hiring NGOs, organizing beneficiary groups, conducting consultation workshops, providing beneficiary training, and/or developing village development plans. These participatory approaches improved information flow and created delivery mechanisms, but did not empower beneficiaries by giving them control over project resources or determining subproject investment.

5. Third, the methodology used in the SES was shared with staff from other ADB departments at the beginning of the SES in May 2003 through formal circulation of the initial position paper and informal discussions with staff from RSDD, ERD, and regional departments. A seminar attended by ADB staff from RSDD, ERD, SERD, OER, and OED was conducted in September 2003 at the end of Phase I of the SES to present the initial findings of the Phase I work, which examined two projects in the Philippines. The SES methodology was influenced by recent studies in the World Bank, including in particular the World Development Report 2004, which unbundle the service delivery chain into three sets of actors—policymakers, service providers, and beneficiaries. In addition, the SES followed a principal-agent model used in economics and political science to analyze incentive structures.¹ OED considers this methodology appropriate for analyzing the incentives faced by these major players, as the relationships among them determines the effectiveness of public services provided via policymakers (see World Development Report 2004). The SES applied this methodology to analyze the roles of not only beneficiaries, but also policymakers and project providers, including in particular the role of local governments.² Questions in the approach and methodology did not arise until after the SES was completed. This experience suggests that OED should find ways to formally discuss the methodologies used with concerned departments in ADB at an early stage of complex evaluations.

¹ Some studies conducted by the World Bank employ the principal-agent model in their analysis of development projects, see Pritchett, Lant and Michael Woolcock. 2002. *Solutions When the Solution Is the Problem: Arraying the Disarray in Development*. Center for Global Development. Working Paper No. 10. Washington D.C.

² For example, see SES analysis on local governments' contribution of counterpart funds for subproject investment in the Philippines (para. 44), their lack of authority in determining subproject investment (para. 48), the limited role of village governments in formulating village development plans (para. 52), the role of local governments and village committees in channeling project credit in PRC (para. 54), local governments' lack of sufficient budget and strong incentive to ensure O&M funds in the Philippines (para. 78), and the involvement of local governments in all projects examined (paras. 8-10, Appendix 3).

BOARD OF DIRECTORS

DEVELOPMENT EFFECTIVENESS COMMITTEE

CHAIRPERSON'S SUMMARY OF THE COMMITTEE'S DISCUSSION ON 8 MARCH 2005 OF THE SPECIAL EVALUATION STUDY ON EFFECTIVENESS OF PARTICIPATORY APPROACHES:

Do the New Approaches Offer an Effective Solution to the Conventional Problems in Rural Development Projects?

1. The discussion at the Development Effectiveness Committee (DEC) meeting affirmed the continued importance of participatory approaches in managing for development results at project, sector, and country levels. However, it also brought out a potential for confusion or differences in perception when addressing the specific objectives of participation. The discussion reflected a variety and range of views among DEC members as to the nature, purpose, modalities, and desirable extent of implementing participatory approaches at various stages of a project.
2. Nevertheless, a consensus could be reached that ADB could, and should, do a better job of employing participatory approaches, starting at project conceptualization; that ADB staff needed better guidance on best practices in participation; and that beyond such guidance, there remained a need for a significant change in ADB's organization culture, incentives, and ways of doing business before participation could become a more meaningful norm in its operations.
3. The OED study confirmed that a thorough understanding of local realities is prerequisite to the successful design of project interventions and that participation should be used as a significant means to support the time and resource intensive process of achieving such local knowledge. At the same time, the study provoked a debate on structural and behavioral models of participation by which the process could graduate from bottom-up information flow to ownership and control by project beneficiaries. A DEC member emphasized that participation was not limited to a bottom-up process but involved a system of multidirectional partnerships among stakeholders.
4. Most DEC members endorsed the key conclusions and recommendations of the study. They would find it a useful reference when reviewing new loan proposals to the Board that involved participatory approaches. They agreed that a "one size fits all" template for "mechanically" carrying out participation in ADB projects would not be effective. While participation was expected to be an explicit activity in the project framework, its effectiveness depended on local on-the-ground conditions and the objectives, stages, and incentives for local participation. In this context, a DEC member emphasized that the study should be considered by Management and staff as an encouragement to use opportunities provided by projects to explore new or different participatory approaches, risk mistakes, evaluate successes, and promote proven best practices through staff guidelines. A key lesson was that use of a participatory approach needed to be well planned, with a well-defined, project-specific objective in mind. In this context, a participatory approach could be used to identify alternatives in project design.
5. However, one member of the DEC wished to disassociate himself from the study because he believed that the study's underlying premise about the nature and purpose of

participatory approaches did not adequately represent the fundamental role of participation in the development process.

6. The majority of DEC members urged ADB Management to consider the study as an important input to a planned revisit of the 1996 staff guidelines on mainstreaming participatory development processes. The purpose of such a review should be to improve the guidelines to help staff better understand the advantages and opportunities provided by participatory approaches in order to optimize the benefits of beneficiary participation in project conceptualization, design, preparation, and implementation. Management was encouraged to advise staff that in implementing the guidelines, flexibility to respond to local conditions, and a significant degree of common sense, should prevail. Management was advised that adequate staff training should accompany the guidelines lest lack of training result in application of a participatory approach that raised unrealistic expectations in beneficiaries. Finally, DEC members asked to be informed, through OED, of the timetable and progress of the review of the staff guidelines.

Agus Haryanto
Chairperson
Development Effectiveness Committee

15 March 2005