

**RESEARCH IN ALTERNATIVE LIVELIHOODS FUND (RALF)
RESEARCH PROJECT PROPOSAL**

RALF Project Number	RALF01-08
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SECTION A: ADMINISTRATIVE INFORMATION

1. Project Title	Innovative financial mechanisms for improving the livelihoods of rural Afghans currently economically dependent on opium poppy
2. Start and Finish Dates	July 1st 2004– December 31st 2006
3. Target areas in Afghanistan	Badakhshan Province
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SECTION B: PROJECT PROFILE

8. Project Summary (600 words)

This project responds to one of the main reasons why farmers turn to poppy production. Many farmers, and particularly sharecroppers need access to credit and other financial services after years of civil war and drought. In poppy growing areas, credit supply is dominated by opium traders who draw farmers into dependence on the poppy crop. This project will develop practical alternatives to the opium-related credit system. Its purpose is to: *Identify, assess and disseminate financial mechanisms that enable rural Afghans economically dependent on opium poppy to adopt alternative livelihoods options.*

The project takes an integrated approach whereby innovative financial mechanisms are designed in close co-ordination with other AKDN rural programmes, i.e. microcredit, enterprise development, business development services, vocational training, natural resources management, gender and community development and health and education programmes.

The research hypothesis is that access to benign forms of finance, alongside other appropriate support services and the availability of legal development opportunities, will encourage rural Afghans away from involvement in poppy production/consumption.

The first phase of the research will identify what type of financial assistance is needed, by whom and in what form. It will address the sustainability of credit provision (through simultaneously looking at savings, and the wider provision of finance through commercial and private mechanisms), when designing appropriate financial products. The second component of the research will follow the successes and failures of the implementation of the identified financial innovations by AKDN through its existing programmes, and use these experiences to build awareness and capacity of Afghan institutions.

The project will be centred in Badakhshan, but its outcomes will be replicable across most of Afghanistan.

The project will complement the Aga Khan Foundation's commitment to ensuring access to financial services for rural Afghans dependent or potentially dependent on opium poppy. AKF has initiated a programme of development of microcredit products in northern Afghanistan, including Badakhshan. This research directly complements AKF's on-going work in Badakhshan and its results will be transferred into action through AKF's existing alternative livelihoods programmes, which aim at promoting new on-farm, off-farm and non-farm economic activities as well as at providing support services such as capacity building, finance and community development. The research moreover supports the agenda of the Government of Afghanistan in terms of poppy eradication.

The project will support the AKF, other organisations with similar aims and RALF's objectives through the following Outputs:

- a) determining the present formal and informal financial services situation, the incidence and importance of indebtedness, and its influence on the decision to be involved in poppy production/consumption;
- b) identifying and implementing a range of innovative potential microfinance mechanisms appropriate to the actual situation of rural Afghans and their culture that enable farmers and traders to develop viable, licit alternatives to poppy;
- c) using participatory methods involving communities, NGO and government staff to rigorously monitor, evaluate and document the process and impact of implementation of chosen financial mechanisms;

- d) sharing the experiences as they emerge to build awareness and capacity among Afghan institutions, so that the lessons from successes and failures can be rapidly incorporated into government and NGO policies and programmes.

Badakhshan has been identified as the research focus area, due to its high incidence of poppy production (>12,000ha) and relatively good security situation. AKF has a strong presence there, and a programme of Rural Development, natural resource management, enterprise promotion, community development, infrastructure rehabilitation, health and education. These provide replicable opportunities for rural Afghans, but are dependent on their having the financial capability to take advantage of them.

Project activities start with **two reviews**: one of the financial services system in Afghanistan, and one of financial mechanisms suitable for conditions in the poppy growing areas of Afghanistan.

A **field survey** of selected villages in Badakhshan will determine the situation of formal and informal financial services available to farmers, input suppliers and traders, and of indebtedness/microfinance needs in the area..

A **stakeholder workshop** will use the expertise of participants to identify the most promising financial mechanisms, culminating in an **Action Plan** for implementation of the mechanisms. This workshop, and others described below, will be capacity- and ownership-building events.

The **design phase** of the project will determine the specific features of the identified financial products and services to be implemented on a pilot basis. These features will be client-responsive to best suit the needs of potential beneficiaries and will take into account issues of sustainability and potential replicability.

The AKF rural development programme will pilot the **implementation of the Action plan**.

The project will set up and facilitate a **participatory monitoring and evaluation programme** with villagers, while the perspective of other stakeholders will be captured through **peer review workshops** in which stakeholders from private, public and NGO sectors visit field sites and jointly evaluate field activities and their impact before returning to report and discuss findings. The process and outcomes will be **documented** as a research paper.

The experiences gained will be shared with other Afghan institutions through information dissemination and capacity building events. They will also be used to make **recommendations to policy makers** on policy for financial services in rural Afghanistan.

SECTION C: BACKGROUND/PURPOSE

11. Background / Literature Review

This project addresses the following issues:

- Rapid expansion in opium poppy cultivation, especially in the last three years.
- Drought over the last 4 years, combined with years of civil war, which has had lasting negative effects on rural livelihoods.
- Resulting high indebtedness and asset depletion, particularly among poorer farmers who depend increasingly on poppy production as a means of survival.
- Lack of access to affordable credit and other financial services appear to be a major constraint to rural development and poverty reduction.
- Existing credit systems tend to be informal and exploitative, perpetuating a vicious circle of indebtedness and greater deprivation.
- Lack of accessible and economically viable livelihoods alternatives.

In addition, law enforcement for the eradication of opium poppy production is expected to be applied more forcefully in the near future. As this is likely to impact on rural livelihoods significantly, new and creative interventions, particularly in the area of finance, are essential for the long-term alleviation of poverty in Afghanistan.

The RALF programme aims to develop and promote alternative livelihood options for rural Afghans currently economically dependent on opium poppy. The project provides an alternative to one of the main reasons why farmers are dependent on the opium economy – the lack of a functioning finance system. The high incidence of debt and the near monopoly of opium traders as a source of credit, mean that farmers, and particularly sharecroppers, are drawn into opium cultivation by default. One of the outcomes of the RALF programme (Output 2) is “tested and available technologies and support services”. Access to benign sources of finance is a key support service that will encourage farmers away from their dependence on poppy.

However, such services provided in isolation will not be sufficient. At the same time there must be access to viable alternatives. The Aga Khan Foundation (the main collaborator in this project) is providing these alternatives through its Rural Development programmes in Badakhshan, Baghlan and Bamyan Provinces. AKF has gradually adapted its programme implementation strategy from initial humanitarian relief (food security and reconstruction) towards piloting alternative livelihood options, and is currently consolidating a coherent strategy aiming at reduced poppy production. Its main pillars are:

Micro area approach: Concentrate development interventions in culturally and ecologically homogenous community clusters/areas covering 5 to 15 villages. Achieve a high impact in terms of poppy reduction, social organisation and competence building and from these micro areas expand the positive learning towards the adjacent areas.

Integrated Development: Address livelihoods in a comprehensive way, covering assets, vulnerability, PIPs as well as participatory livelihood strategy development. AKF’s main asset is the synergy potential between its different and well established sectors – which include: Community Development, Natural Resources Management (implementing projects for enhanced productivity and market oriented diversification), Micro and Small Enterprise Development (supporting market chain development in subsectors like than weaving, fruit processing, off season production and sales with a BDS approach as well as vocational training), Rural Microcredit Programme (RMP, running a lean micro credit programme on business terms), Health (active in health education, health services and planning support to poppy demand reduction of heroin addicted household members), education (primary education and building up non formal education) and humanitarian relief for the most vulnerable strata of the communities (through AKF’s sister agency FOCUS). For the RALF

project, the Community Development sector would facilitate close collaboration between NRM, MSE, RMP and other programmes aiming at well targeted piloting of innovative finance services for concrete alternative livelihood options in poppy growing areas. The alternatives to poppy cultivation being promoted by AKDN include:

- Apricot drying
- Tthan / woollen cloth weaving
- Vegetable production and storage
- Poultry units
- Honey production
- Retail trade and establishment of local marketplaces
- Livestock rearing
- Carpentry
- Service businesses, e.g. repair of motorcycles and generators

The project intends to design financial products and services to support these income-generating alternatives as well as additional productive activities to be identified in the course of the proposed research, in conjunction with those that may arise from related RALF projects.

AKF follows **guiding principles** such as balanced opportunities for both gender, sustainability of its interventions, people centered, participatory methodology or human/institutional empowerment for self-reliance and self-determination. AKF recently approached NRI to provide complementary expertise especially in alternative rural financing mechanisms that are necessary to better manage transition from humanitarian and granted support towards sustainable, not (or less) directly subsidised development. A short consultancy to make an initial assessment of rural finance options has just been carried out (April/May 2004). At the same time it was realised that there is an excellent opportunity for synergy between the aims of RALF and those of AKF. Adding a research component to the development activities of AKF would enable far greater analysis of the process, and a good opportunity to document and disseminate the lessons learned for the benefit of other development organisations (government and NGO).

What is the collaboration between NRI and AKF

NRI will provide research expertise using participatory methods in the areas of rural finance, rural livelihoods and farming systems. It brings experience of these from many different situations in different countries and cultures. NRI will therefore be responsible for leading the design, implementation, monitoring and documentation of the research aspects of the project. However, these will - at all points in the project cycle - be done in collaboration with AKF staff. The project intends to include other Afghan stakeholders in the research process in order to build capacity not only within AKF but in Afghanistan more widely.

The main roles of AKF are a) to complement the research by providing an implementation "laboratory" within which innovations can be quickly tested, assessed, modified and incorporated, b) through their Rural Development programme in Badakhshan, providing technical alternatives to poppy that can be accessed if appropriate finance is available, and c) leading in the promotion of lessons learned through awareness and capacity building activities with Afghan institutions.

How will the financial services identified by this project be used?

Financial services, in their own right and in combination with other initiatives, are likely to be utilised in the following ways:¹

¹ Insights emerging from recent NRI short consultancy, i.e. field visit to Afghanistan 24 April-7 May 2004.

- to support individual farming family investment in viable alternatives to poppy, including those from the options available under the AKDN rural development programme, i.e. on-farm, off-farm and non-farm income-generating activities, as mentioned above; as well as those that may arise from other related RALF projects.
- to encourage collaborative ventures into viable alternative enterprises, particularly amongst women (including widows) working in joint enterprises such as handicraft production, vegetable growing, poultry and small animal rearing, wool processing, etc.
- to help landless farmers to recover their mortgaged (as a result of debt) land through provision of affordable loans and flexible savings – the latter aiming at allowing farmers to build up enough capital to repay past debts and recover land and other productive assets.
- to support productive activities in households where a member is an opium addict. This is expected to be carried out in co-ordination with health rehabilitation initiatives in order to support re-insertion of recovered addicts into the community.
- to alleviate over-indebtedness amongst poor households, including those now dependent on poppy cultivation as a means of survival, through debt-restructuring mechanisms aimed at attaining food security and initiating small-scale productive activities.
- to promote group-based savings and credit schemes in selected rural villages of Badakhshan, in collaboration with *shuras* and Village Development Councils, placing special attention to issues of social relations and Islamic principles involved in financial arrangements, in order to avoid rupture of existing social fabric.
- to help households build productive assets, such as agricultural tractors, mini-buses for transportation of commuters, and land acquisition for business establishments. For this, appropriate leasing services and savings schemes will be identified.
- to enhance community development already initiated by AKDN programmes in Badakhshan, through complementary finance to existing revolving funds generated by Seeds/Wheat Banks in several rural communities of the region.
- to provide financial services for funerals, weddings and other household expenses, which may adversely affect family finances.
- to support input supplies, processing and marketing of legal alternatives to poppy.

How will the project help to leverage farmers out of poverty?

- Present credit is only available at high cost (our recent study in Badakhshan shows implicit interest rates of 100% or more over 6 months).² This cost of borrowing is one way in which farmers are kept in debt and in poverty. Less costly forms of credit and the provision of other financial services (such as savings, leasing, debt structuring), in combination with supportive activities like capacity-building and community development, would alleviate this situation.
- Recent surveys (AREU, Solidarities and FAO/NRI)³ have all shown the big differentials between rural wealth groups in their financial ability to take advantage of improved agricultural practices and non-farm economic activities. The project will identify financial

² Field visit undertaken between 24 April to 7 May 2004.

³ AREU monitoring report of March 2004.

mechanisms to enable all wealth groups to have financial access to production, processing and marketing options without undue financial risk to themselves. Finance is insufficient on its own, which is why our integrated approach and the technical support of a programme such as the AKDN Rural Development Programme are important.

- Access to finance, and through it to improved production and processing options, will be coupled to links to the private sector components of the “commodity system” (input supplies, processing facilities and marketing), as well as to business development services, vocational training, gender and community enhancement, enterprise development, natural resources management, and health rehabilitation. The finance and livelihood development needs of these components of the system will also be considered by the research proposed here, so that improved services to farmers result.

These mechanisms collectively will provide the conditions needed to convince farmers that – although they may not be as lucrative as poppy – there are alternatives that are financially and technically achievable and acceptably secure economically and legally.

The Natural Resources Institute (NRI) is an internationally renowned organisation with a long history of involvement in development and research in over 100 countries, including a recent study of rural livelihoods in Eastern Hazarajat for FAO. NRI staff bring first hand experience in rural finance of different types and from different countries. This is coupled with in-depth expertise in the application of participatory methods for livelihood analysis and monitoring of change at community and district levels. Important considerations related to financial and economic development that emerge from NRI experience are mentioned below.

The Aga Khan Development Network is committed to long term, holistic development in Afghanistan. With this objective and within the AKDN, the Aga Khan Foundation has established a rural development programme with staff, structures and resources assigned to Bamyan, Baghlan and Badakhshan Provinces of Central and NE Afghanistan. Badakhshan is a major poppy production area. AKF is keen to have rapid impact on its mandate area, including a reduction in poppy production.

The experience of NRI and AKF comprises:

Microfinance and rural finance: Flexible and client-responsive financial products and services are paramount. These include tailor-made loan repayment schedules based on farmers’ seasonal income and life cycle patterns; use of social capital as collateral; individual and group delivery of services; voluntary and easy-to-access small savings products; financial officers physically and socially close to poor farmers; simple and efficient monitoring and management systems; participatory market research approach to product development and rapid response to clients’ real and perceived needs and preferences. NRI expertise includes practical, advisory and research work in Bangladesh, Bolivia, Colombia, Peru and Thailand with over 150 microfinance institutions implementing a wide range of models. A critical examination of the suitability of these models in the context of Afghanistan will help identify appropriate financial mechanisms to reach the poor effectively. AKF has initiated a commercial Microcredit Programme in 2004. With its already well established regional offices and trained officers, the Programme can quickly respond to new models and mechanisms identified through the proposed research.

Debt restructuring models: Models to restructure personal debt include debt consolidation, debt relief and write-offs. NRI has worked on alternative approaches in the contexts of Bangladesh (as a result of flooding) and of some Latin American countries. Experience in this area will be applied to the AKF working locations in Afghanistan to identify appropriate debt restructuring options for the country.

Insurance schemes: An all-inclusive insurance package is currently being piloted by NRI consultants in Zambia. This is expected to increase access to formal finance by previously excluded smallholder farmers, due to reductions in credit risks and transaction costs. The package consists of insurance – primarily covering weather risks – production credit and collateralisation of produce, and is expected to ease access to commodity finance as well as lead to improvements in crop marketing. The suitability of this model can be studied in the context of Afghanistan, where drought crises signify major shocks to rural livelihoods.

Warehouse receipt systems: Conceptually, these systems enable poor producers to offer agricultural commodities as loan collateral to banks, with the loan typically enabling farmers to sell their crop when prices are higher, rather than at harvest (when their need for cash is greatest). Although the establishment of such systems often takes a significant amount of time, warehouse receipt models might be considered as medium-term options for Afghanistan under certain conditions. NRI has long-standing expertise in this area, including work in Ghana, Ethiopia, Zambia, Kenya and India.

Business development services (BDS): NRI has recently worked on three specific institutional approaches to the provision of BDS: (1) the delivery of services through government agencies, i.e. government-driven approach; (2) the forging of partnerships between donors and national institutions; and (3) the promotion of independent BDS providers such as business centres, clusters and networks, and business incubators. Lessons from NRI's work in 20 countries in Africa, Asia and Latin America can help identify useful alternatives for Afghanistan. AKF is about to establish a BDS center in Baharak and has trained young BDS providers to follow up on enterprise promotion activities in the Province.

Crop and livestock diversification and improvement: A recent consultancy by NRI in Bamyan Province for FAO has identified knowledge of production and processing options, links to service providers (inputs, finance, markets, technical support), skills development and more secure water supplies as key agricultural livelihood drivers for smallholder farmers. AKF is running a comprehensive NRM development Programme in 7 Districts of Badakhshan. The institution has therefore an important reaction potential to newly identified micro-finance options, as well as the previously mentioned production alternatives to poppy (to be added to as they arise from RALF or other initiatives).

Rural non-farm and off-farm economy: A three-year research project has been undertaken by NRI and local partners on the factors that enable rural households to access non-farm employment and income opportunities, including the establishment and development of small businesses. These studies used complementary quantitative and qualitative methods, including examination of the role of social capital in accessing economic opportunity. Countries studied include India, Uganda, Armenia, Georgia and Romania. Understanding existing economic opportunities and constraints in Afghanistan would help improve the design of appropriate financial mechanisms for smallholder farmers in particular. AKF is actively involved in enterprise promotion as well as in vocational training aiming at enhanced access to off-farm income.

Local economic development: The development of local economies is complex and not restricted to their localities. There are important linkages between micro, meso and macro levels that lead to local market development and livelihoods improvement, including social collaborative action and improved information flows. AKF can contribute insights on these issues and inform decisions on alternative models for Afghanistan.

The proposed research is designed to work alongside AKDN's dynamic development programme, assisting it to analyse, document and disseminate lessons that would otherwise be less available to other organisations.

12. Project Goal

To develop and promote innovative alternative livelihood options for rural Afghans currently economically dependent on opium poppy.

13. Project Purpose

The purpose of the research is to: *Identify, assess and disseminate viable financial mechanisms that enable rural Afghans economically dependent on opium poppy to adopt alternative livelihood options.*

Demand for a functioning financial system can be gauged from the following statement from the UN Office on Drugs and Crime publication “The Opium Economy in Afghanistan” (UNODC, 2003 p113), that *“The use of opium as a source of credit is closely linked to the lack of a functioning financial system”*. The informal financial system (the only one accessible to rural Afghans) is dominated by opium traders in major opium producing areas. Pain (2004 and Mansfield (2004)⁴ also cite the opium economy as a source of vulnerability for sharecroppers who have no access to other sources of credit. The recent Social and Economic Survey of 5 Districts of Central Afghanistan by UNAMA/Solidarites (Solidarites, 2003) and the AREU-coordinated study of livelihoods in 7 Provinces of Afghanistan (AREU draft synthesis paper, 2004) both demonstrate that indebtedness is widespread among the rural populations and they are therefore vulnerable to an expansion of opium production. This project will provide alternative financial mechanisms, alongside alternative opportunities for using that finance.

The proposal is in line with the recent draft government “Policy and Strategy Framework for the Rehabilitation and Development of Agriculture and the Natural Resources Sector of Afghanistan” issued in February 2004, which states that *<<Rural finance is urgently needed to facilitate expanded use of chemical fertilizers, quality improved seeds, farm machinery for mechanization, and improvement of irrigation systems. Likewise, credit is required for Afghan traders currently engaged in the import of farm inputs to enable them expand the scope of their involvement in the sector. Availability of farm credit would also reduce farmer’s dependence on government funding for their development activities and their dependence on local moneylenders that are currently exploiting the rural communities>>*.

The research is clearly focussed on rural Afghans, with a particular focus on those who are poor and vulnerable to the draw of poppy production, such as indebted sharecroppers. It would also link farmers to other stakeholders, such as processors, input suppliers and traders that require a favourable business environment (including credit/micro-finance and business development expertise) for their sustainable involvement in, and support to, licit activities.

The project contributes to the aims of the National Drug Control Strategy and the Afghan Traditional Authority, supported by DFID’s Transitional Country Assistance Plan, by providing the environment for rural Afghans to adopt alternatives to opium poppy.

The main collaborators in the project are the Aga Khan Foundation and the communities served by its Natural Resources Management Programme in Badakhshan Province. However, a range of other stakeholders – including the Ministry of Agriculture and Animal Husbandry MAAH, the Ministry of Rural Rehabilitation and Development (MRRD), the Ministry of Women’s Affairs and the Ministry of Irrigation and Water Affairs, as well as international and local NGOs – will be involved in dissemination and lesson-learning activities. The project is expected to

⁴ Pain, A (2004) “The impact of the opium poppy economy on household livelihoods: evidence from the Wakhan corridor and Khustak valley in Badakhshan”. Mansfield, D (2004) “Coping strategies, accumulated wealth and shifting markets: The story of opium poppy cultivation in Badakhshan 2000-2003”.

influence rural finance policy and its implementation. Sustainability will be addressed through the incorporation of the successful outcomes of the project into policy and process of government institutions and NGOs. A strong dissemination component is written into the project to ensure this.

SECTION D: OUTPUTS/UPTAKE PATHWAYS

14. Outputs

1. A report on the present financial needs and sources of finance in Badakhshan.
2. An assessment and design of potential financial mechanisms for the provision of appropriate financial products and services in Badakhshan.
3. An action plan for implementation of designed financial mechanisms on pilot basis.
4. Workshops proceeding reports on discussions about design, implementation, progress and possible impacts and outreach of selected financial options.
5. User-friendly formats and reports, so that the lessons from successes and failures can be rapidly incorporated into government and NGO policies and programmes.

15. Target Institutions

Aga Khan Foundation: AKF has a programme of Rural Development in Bamyán, Baghlan and Badakhshan Provinces. This includes a wide range of agricultural services, as well as community development, micro/small enterprise promotion, rural infrastructure and micro-finance/micro-industry components, natural resource management, community development, and health and education programmes. It is therefore in a very strong position to complement the research with: a) a well-funded supporting environment; b) an excellent uptake pathway for research outputs. The Foundation has been involved from the start in the development of this proposal and agrees to its outputs and activities. AKF staff will be intimately involved in the research, implementation of innovative outcomes, monitoring and evaluation of the project as well as with sharing of experience and dissemination of findings with interested stakeholders and institutions.

While the AKF was the only institution directly contacted during the development of this proposal, it is anticipated that uptake will also take place through the following: The Ministry of Agriculture and Animal Health, Ministry of Finance, the Ministry of Rural Rehabilitation and Development (MRRD), the Ministry of Women's Affairs, the Ministry of Irrigation and Water Affairs, FAO and other UN development agencies, international and local NGOs, especially domestic Afghan organisations, involved in NRM, and economic and social development, including those specialising in Women's Affairs (such as SWCA, CCA, CARO, AfghanAid, ACTED, OXFAM, Solidarites, ICRC, BRAC and others).

See list of acronyms below.

16. Target Areas and Stakeholders

The target area for the research is Badakhshan Province. This is chosen as a major producer of opium poppy (>12,000 ha), as an area of focus of the Natural Resource Management programme of the Aga Khan Foundation, and for its relative security. However, the project's awareness and capacity building components will ensure that the lessons learned will be made available to Afghan institutions across the country.

Stakeholders:

- Rural Afghans involved in or potentially involved in the opium poppy economy. These will be involved in participatory surveys and in participatory assessment of different financial mechanisms, as well as being the ultimate beneficiaries of mechanisms aimed at enabling them to adopt NR options other than opium poppy.
- Private service providers (income suppliers, traders, processors) who contribute to the

success or failure of alternative enterprises, and who themselves require financial services and a favourable medium-term business environment

- Government departments involved in natural resource management, economic development and social welfare at the policy and implementation levels. Departments such as MAAH, the Ministry of Rural Development, the Ministry of Women's Affairs and the Ministry of Irrigation and Water Affairs will be involved in planning and in peer reviews of the different financial mechanisms. They will be a key audience for policy recommendations and for implementation manuals. This will serve as an important capacity-building exercise for the relevant Ministries, which currently have very weak implementation abilities.
- The Microfinance Investment Support Facility for Afghanistan (MISFA) and associated microfinance institutions. Greater capacity building within this institution will ensure multiplying effects and uptake amongst microfinance institutions and NGOs interested in financial issues in Afghanistan.
- International and local NGOs, especially domestic Afghan organisations, involved in NRM, and economic and social development, including those specialising in Women's Affairs (such as SWCA, OXFAM, Afghanaid, CCA, CARO and others)
- Until government capacity is strengthened, NGOs, and especially Afghan NGOs, will continue to play a major role in development. They are therefore included as a contributor to assessment of financial mechanisms as well as being an audience for dissemination materials
- UN agencies, including FAO. Projects such as the FAO Eastern Hazarajat Livelihoods Project are excellent pathways for spreading and applying the lessons learned from this proposed research.
- Village Development Councils and shura committees will directly benefit from the project, as they will be closely involved in the design and implementation of financial options to ensure that social fabric and Islamic principles are preserved. Capacity-building is also expected to be enhanced at this level.
- Those involved in the provision of financial services – local and external. Some of these, such as opium traders, shop-keepers and land-owners may be negatively affected by project activities.

17. Uptake Pathways

There will be a strong and rapid dissemination component to the project. Dissemination will take place throughout the duration of the project, so that interim findings are made quickly available (with the necessary confidence limits) to the stakeholders listed above, as well as final conclusions of the study.

The formats of dissemination products will be tailored to different audiences, and may include radio, video, CD, and hard copy reports and manuals in local language(s) and English. Workshops and study tours for uptake pathway organisations will complement these dissemination outputs with hands-on experience and commentary from affected rural Afghans.

There will be direct uptake by the collaborating institution (the Aga Khan Foundation) in its development programmes in Badakhshan, Baghlan and Bamyān Provinces. Through the dissemination activities, other development NGOs (including Afghan NGOs) will be in a position to incorporate successful financial services and mechanisms into their programmes

The project will also influence government policy through the supply of relevant information and through exposure to the impact of the research/development programme in the field. This may need following up with capacity building for managerial and front-line staff.

All those involved in front-line work with communities will benefit from local language manuals detailing the implementation of different mechanisms based on the experience of the project.

18. Expected Impact: Livelihoods and poverty of current poppy growers

In exploring rural households' decision making concerning opium cultivation and their channels for accessing financial services, emphasis will be placed on understanding the different strategies of households and communities according to their circumstances and asset endowments. This will allow the tailoring of financial products and delivery mechanisms to the needs of different rural groups, including the poorest.

The project is aimed at improving the financial assets (access to, and security of, finance) of current poppy growers and households living in poppy-growing areas to enable them to escape their dependency on the poppy economy and adopt productive alternatives, particularly high value options and means for value addition. This in turn increases their medium-term security, especially as punitive measures against poppy growers and processors increase. Some financial mechanisms will empower and relieve socio-economic dependence of the target groups and increase social capital, through association in groups. Experience elsewhere has shown that involvement in such groups – where they are stable for some time – can lead to many developmental opportunities within and outside the NR sector.

The findings of the project will be particularly applicable in the main poppy growing Provinces, but will also have application in non-poppy areas as well, where there is indebtedness and poor individual collateral.

The strategy of disseminating interim as well as final findings, and influencing policy as well as implementation means that impact should be rapid where the will exists to make changes.

19. Monitoring and Evaluation

The project depends on very strong M&E processes being installed from the start, so that different stakeholders can rapidly assess, accept, reject or modify mechanisms in the light of experience. This monitoring and evaluation will be conducted at different levels:

- participatory monitoring and evaluation of the performance and acceptability of different mechanisms at the community level
- reflection on process and performance by project collaborators (AKF + NRI)
- stakeholder workshops involving NGOs, MAAH and shura and Village Development Council leaders (peer reviews involving joint field visits and facilitated evaluation)
- RALF annual workshops

One of the project Outputs is to determine the present formal and informal financial services situation, the incidence and importance of indebtedness, and its influence on the decision to be involved in poppy production/consumption. This will act as a benchmark against which progress can be monitored.

Through the above benchmark, along with project situation survey reports and workshop outcomes the following objectively verifiable indicators will be measured:

1. At least 2 rural finance mechanisms are demonstrated as successful in Badakhshan Province.
2. At least one government organisation and at least one NGO (preferably Afghan) have incorporated project-developed finance mechanisms into their regular programmes.
3. AKF and MAAH staff have clear understanding of the present financial services situation in Badakhshan, and its implications for involvement in poppy production/consumption.

4. Government and NGOs, especially Afghan NGOs, have a joint understanding of lessons learned (successes and failures) from assessment activities.
5. Documentation of process and outcomes is widely available to relevant government and NGO actors.
6. Government rural finance policy includes outcomes from project.
7. NGOs, especially Afghan NGOs, are using project outcomes in their programmes.
8. The causality of change will be assessed by employing before/after techniques when comparing with baseline survey results, and by use of control groups where feasible.
9. Specific indicators of change include: number of households undertaking alternative livelihood activities (whether on-farm, off-farm or non-farm), asset building and recovery (land, equipment, housing, business establishments), food security, reduced levels of past debts, women enterprises and improved productive skills.

20. Appraisal Issues and Risks

No technical or environmental harm will result from the project. Reduction of opium production resulting from the adoption of alternatives has a great potential social and economic benefit for users and addicts both within and outside Afghanistan. While producers may be worse off economically in the short term through not reaping the high financial rewards from the illegal production of opium, their medium-long term security will be enhanced, particularly if punitive measures against producers and processors are stepped up.

Access to financial services for women, and especially widows, could be very important as they aspire to develop NR-based small-scale businesses such as rug and carpet making, poultry and vegetable production and tailoring.

Financial services at the local level are part of the social fabric, and have positive as well as negative effects on social capital. The research outputs (alternative financial mechanisms) will have to be applied sensitively in order not to damage the beneficial social capital. Some stakeholders who have been suppliers of credit, such as opium traders and shop-keepers, and who also wield considerable local power, will be negatively affected.

Every credit system involves certain elements of risk. Based on AKF's experience in implementing a rural microcredit programme, most intensely in Badakhshan, the following risks need to be taken into account:

- **Defaults:** there is a high risk of defaults on loans due to the current strict guidelines that prevent those involved in poppy production from becoming clients of AKF's programme. If a client is found to be involved in the poppy industry, the loan is cancelled and immediate repayment is demanded. This typically results in the client defaulting on the loan.
- **Demand:** Again, because of the strict criteria that limit AKF's loan-making ability to those 100% not involved in the poppy trade, there is a more limited demand for the products. The local economy, especially in Badakhshan, is very dependent on the poppy economy.
- **Indebtedness:** A large percentage of clients turn out to be already highly indebted. In many cases, the collateral provided by the client is already owed to someone else through some sort of informal credit system (run by local commanders, etc). This means that loan repayment is often slower than anticipated and in some cases not possible.
- **Addiction:** AKF has developed microcredit products that are directed specifically for families in which opium addiction is an issue. These are high risk products because addiction complicates the loan process and drives people to seek other forms of informal credit, increasing their debt burden.

- Health: poor health in target areas, in part brought about by poor health facilities and high levels of addiction, complicate the loan repayment process and the ability of clients to effectively use their loans.
- Education: low levels of education in target areas impact clients' ability to effectively manage loans and repayment schedules, and understand the consequences of default.
- Access: the remoteness of many target areas is an important risk factor, making it very difficult to access some clients and effectively monitor loan usage. Moreover, it increases the need for office infrastructure and staff in locations where only a few clients live but who are not otherwise easily accessible. This means that the overall financial sustainability of a microfinance enterprise is less certain.

SECTION E: ACTIVITIES

21. Activities

The activities proposed start with **two reviews**: one of the financial needs and services system for rural Afghanistan, and one of potential financial mechanisms that would be suitable for assessment under the conditions in the poppy growing areas of Afghanistan.

These reviews will be complemented by an in depth **field survey** of selected villages in Badakhshan to determine i) the actual situation of formal and informal financial services, ii) indebtedness in the area and iii) the specific needs of the communities and individuals in improved financial services as well as their alternative livelihood options. Criteria of village and target group selection will be developed to embrace the major contrasts in social and economic status and natural resource endowments, as well as different levels of involvement in opium production. It will explore the link between poverty and opium production/consumption – in particular, the survey will determine the influence of indebtedness on decision-making to enter the opium poppy economy. The survey will result in practical recommendations for potential financial mechanisms that will adequately address the current situation. A **stakeholder workshop** will then be held to present and jointly evaluate the findings of the survey and the reviews using the collective expertise of stakeholders (Afghan and International NGO, government, private sector, community development committees etc.) to identify the most promising of the potential financial mechanisms. This workshop, and others described below, will be capacity building events, as well as building partnerships and ownership of the actions.

A **design package** of appropriate and innovative financial products and services will be produced to be implemented in Badakhshan on a pilot basis. Regular **monitoring and evaluation** of chosen options will re-assess and modify, as needed, specific features of the selected financial mechanisms.

An **Action Plan** for implementation of the financial mechanisms will then be drawn in collaboration with the partner organisation.

The staff, facilities and financial resources of the Aga Khan Foundation in Badakhshan will be used to implement the mechanisms chosen as part of its development programme. Field staff will be **trained** on the implementation of the selected financial mechanisms and then oversee the testing process in the selected villages.

The research project will set up and facilitate a **participatory monitoring and evaluation programme** with villagers. **Community workshops** will be held at various implementation phases and at the end of the testing period, where the selected mechanisms will be examined, discussed and properly adjusted to the needs of villagers, and in collaboration with AKF staff. These workshops are essential means of knowledge transfer.

The perspective of other stakeholders will be captured through a **peer review workshop** in which stakeholders from different organisations visit field sites and jointly evaluate the activities on the ground and their impact before returning to report on and discuss their findings. The process and outcomes of both these activities will be **documented** as a research paper.

Dissemination is a strong part of this project, which aims to spread the lessons learned quickly and widely so that other organisations can benefit and incorporate the experiences gained. Thus from month 12 onwards, the project will **prepare dissemination materials** for different audiences in user friendly format, **pre-test** these, finalise them, train partner institutions in their content and use, and finally **distribute** them. Included in dissemination will be **recommendations to policy makers** on policy for financial services in rural Afghanistan and

particularly poppy-growing areas.

A final **workshop** will be held in year 3 to discuss and disseminate findings with a wide range of stakeholders in the country, and to build the capacity of other organisations to engage in innovative financial mechanisms.

22. Implementation and Management

NRI will lead the planning and implementation of the research, with the full agreement, collaboration and participation of AKF, who will provide local expertise, facilities and resources to assist with field work and workshops.

The field assessment of the options and their modification will be led by NRI, but will involve, in a participatory way staff from AKF, other NGOs, government departments, the private sector and villagers.

AKF will lead the complementary development work, in which the different financial services options are implemented as part of their regular developmental programme in the project location (Badakhshan Province).

NRI brings wide experience with innovative financial mechanisms from a number of countries, including India, Bangladesh, Latin America and Eastern and West Africa of which micro and rural finance, debt restructuring models, insurance schemes, warehouse receipt systems and business development services are critical components. The NRI team also includes experience in livelihoods analysis from Eastern Europe, South Africa and Afghanistan. On the productive side, crop diversification and improvement processes, livestock upgrading, natural resource management and issues of rural non-farm and off-farm economy are major knowledge areas. The NRI team has long experience in poverty analysis and community development approaches, including the application of participatory methods to surveys, workshops and monitoring and evaluation.

AKF contributes an established presence in, and knowledge of, Badakhshan Province. The NGO has its own funds and staff to run its development programme which complements and adds value to the research proposed here; some funding will be directed to specific areas in order to ensure that the implementation of the chosen financial options is successful.

AKF has been implementing alternative livelihood programmes to poppy growing in Badakhshan, funded by DFID and INL. AKF will hence coordinate participation of its different sector teams in the proposed project, i.e. Community Development, Micro and Small Enterprise promotion, Natural Resource Management and Rural Microfinance Programme and others. The AKF's operational management will therefore ensure that project outcomes are achieved in an effective and timely fashion.

One of the planks of overall AKF policy for Afghanistan is to "Establish community-based area development programmes aimed at improving people's livelihoods and prospects". The AKF integrated approach to development represents a commitment to improved micro-finance and micro-credit programmes in Afghanistan.

Acronyms

ACTED	Agency for Technical Cooperation and Development
AKDN	Aga Khan Development Network
AKF	Aga Khan Foundation

AREU	Afghanistan Research and Evaluation Unit
BDS	Business Development Services
BRAC	Bangladesh Rural Advancement Committee
CARO	Centre Afghanistan Rehabilitation Organisation
CCA	Cooperation Centre for Afghanistan
CD	Community Development
DFID	Department for International Development
FAO	Food and Agriculture Organization
ICRC	International Committee for the Red Cross
INL	International Narcotics and Law Enforcement Agency
MAAH	Ministry of Agriculture and Animal Husbandry
M&E	Monitoring and Evaluation
MCP	Microcredit Programme
MISFA	Microfinance Investment Support Facility for Afghanistan
MoiWE	Ministry of Irrigation, Water and the Environment
MRRD	Ministry of Rural Rehabilitation and Development
MSE	Micro and Small Enterprise
NGO	Non Governmental Organization
NR	Natural Resources
NRI	Natural Resources Institute
NRM	Natural Resource Management
PIPs	Policies, Institutions and Processes
RMP	Rural Microcredit Programme
SWCA	Saving Women and Children in Afghanistan
UNODC	United Nations Office for Drugs and Crime
VT	Vocational Training

Attachment 1: Logical Framework

RALF Project Number	RALF01-08
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Project Title	Innovative financial mechanisms for improving the livelihoods of rural Afghans currently economically dependent on opium poppy
Lead implementing institution	Natural Resources institute, Chatham, UK

Narrative Summary	Objectively Verifiable Indicators	Means of Verification	Assumptions and Risks
Goal: To develop and promote innovative alternative livelihood options for rural Afghans currently economically dependent on opium poppy	By end of programme: 1. Channels and essential services secured for rapid promotion and uptake of successful technologies	RALF progress reports MAAH reports Reports of other development projects	Farmers and other rural people adopt livelihood technologies developed through RALF projects
Purpose: To identify, assess and disseminate financial mechanisms that enable rural Afghans economically dependent on opium poppy to adopt alternative livelihoods options	By end of project: 1. At least 2 rural finance mechanisms demonstrated as successful in Badakhshan Province 2. At least one government organisation and at least one NGO have incorporated project-developed finance mechanisms into their regular programmes	Final Technical Report RALF workshop proceedings MAAH reports NGO reports	Security situation allows the project to operate effectively through to December 2006. AKF allocates sufficient funding for the implementation phase of the project in Badakhshan Capacity of government departments is sufficient for them to incorporate innovative financial mechanisms
Outputs: 1. To determine the present formal and informal financial services situation, the incidence and importance of indebtedness, financial needs and its influence on the decision to be involved in poppy production;	By end of month 3: 1. Aga Khan and MAAH staff have clear understanding of the present financial services / household needs situation in Badakhshan, and its implications for involvement in poppy production	Project situation survey report	Access to all areas of Badakhshan is open and secured. Rural people are sufficiently open about their financial needs and involvement in the poppy economy.

Narrative Summary	Objectively Verifiable Indicators	Means of Verification	Assumptions and Risks
<p>2. To identify and design a range of potential financial mechanisms for the provision of micro-finance and other financial products and services appropriate to rural Afghans, using experience from Afghanistan and elsewhere</p>	<p>By end month 6:</p> <ol style="list-style-type: none"> 1. At least 3 potential financial service options identified for testing with Aga Khan Foundation 2. A design package is produced detailing the specific terms and conditions of selected financial products and services. 	<p>Project survey report of options</p> <p>Report of design of financial products and services</p> <p>Stakeholder workshop proceedings</p>	<p>Staff from AKDN various programmes participate actively in workshops and discussions to identify and design appropriate financial options</p> <p>Partnerships with other stakeholders are forged and they contribute effectively to the design of financial alternatives.</p>
<p>3. To produce an action plan for implementation of chosen financial mechanisms on a pilot basis in Badakhshan</p>	<p>By end of month 7:</p> <ol style="list-style-type: none"> 1. Action Plan in place for the application of options in Badakhshan 	<p>Action Plan report</p> <p>Internal workshop proceedings</p>	<p>Security and weather conditions in Badakhshan allow implementation phase.</p> <p>AKF provides additional funding for implementation of pilot projects.</p>
<p>4. To use participatory methods involving communities, NGO and government staff to rigorously monitor, evaluate and document the process and impact of implementation of chosen financial mechanisms</p>	<p>Ongoing. By end of year 2:</p> <ol style="list-style-type: none"> 1. Government and NGO staff have joint understanding of lessons learned (successes and failures) from assessment activities 2. Documentation of process and outcomes available in government and NGO offices 	<p>Peer review workshops</p> <p>RALF Annual project workshops</p> <p>Dissemination materials</p>	<p>Government and NGO staff agree to joint monitoring and evaluation activities</p>
<p>5. To disseminate experiences as they emerge using user-friendly formats and media, so that the lessons from successes and failures can be rapidly incorporated into government and NGO policies and programmes</p>	<p>From month 9 of project:</p> <ol style="list-style-type: none"> 1. Appropriate dissemination materials available with different stakeholder audiences across Afghanistan <p>From year 2</p> <ol style="list-style-type: none"> 2. Government rural finance policy includes outcomes from project 3. NGOs using project outcomes in their programmes 	<p>Dissemination materials</p> <p>Policy documents</p> <p>NGO reports</p>	<p>Political will exists to confront opium traders hold over rural credit</p>

Narrative Summary	Objectively Verifiable Indicators	Means of Verification	Assumptions and Risks
Activities:			
1.1 Literature review of financial services and rural debt situation in Afghanistan 1.2 Survey of communities and target groups/individuals in poppy growing areas of Badakhshan	Review available by end month 2 Survey completed by month 3	Literature review Survey report	
2.1 Literature and network survey of potential financial mechanisms 2.2 Stakeholder workshop to assess potential mechanisms 2.3 Production of design package of selected financial options 2.4 Preparation of Action Plan	Review available by month 2 Workshop held by month 4 Product Design by month 6 Action Plan in place by month 7	Literature review Workshop proceedings Design package, description of alternative rural finance mechanisms Action Plan, implementation plan of selected financial options	
3.1 Implementation of alternative rural finance mechanisms 3.2 Facilitation of participatory monitoring and evaluation of financial mechanisms by villagers 3.3 Peer reviews of efficacy of financial mechanisms by government and NGO staff 3.4 Documentation of monitoring and evaluation processes and of outcomes	Training plan, modular description of prioritized alternative rural finance mechanisms. Start of implementation by month 8 Information from participatory monitoring and evaluation activities analysed by month 20 Peer review workshops held by month 23 Documentation of process and outcomes available by month 24	Progress reports PM&E datasets Workshop proceedings Paper on process	AKF provides additional funding for successful implementation phase, as needed, e.g. staff, credit line, equipment, etc.
4.1 Preparation and production of dissemination materials for different audiences	Draft dissemination materials available by month 26	Draft dissemination materials	

Narrative Summary	Objectively Verifiable Indicators	Means of Verification	Assumptions and Risks
4.2 Testing materials with relevant audiences	Materials tested and modified by month 28	Modified materials	
4.3 Final workshop	Dissemination and discussion of results with stakeholders Month 28	Workshop proceedings	
4.4 Distribution of dissemination materials to different audiences	Dissemination complete by end of project	NGO and government reports	

Attachment 2: Work plan: Activities and Milestones

RALF Project Number	RALF01-08
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Project Title	Innovative financial mechanisms for improving the livelihoods of rural Afghans currently economically dependent on opium poppy
Lead implementing institution	Natural Resources Institute, Chatham, UK

Project Year	Year 1												Year 2												Year 3					
Calendar Year	2004						2005						2006																	
Calendar Month	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12
Project Month	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30
Activities & Milestones:																														
Activity 1: Literature review of financial services and rural debt situation in Afghanistan	x	x																												
<u>Milestones:</u> Review available		X																												
Activity 2: Survey of villages in poppy growing areas of Badakhshan		x	x																											
<u>Milestones:</u> Survey completed			X																											
Activity 3: Literature and network survey of potential financial mechanisms	x	x																												
<u>Milestones:</u> Review available		X																												
Activity 4: Stakeholder workshop to assess potential mechanisms			x	x																										
<u>Milestones:</u> Workshop held				X																										
Activity 5: Production of Design Package			x	x	x																									
<u>Milestones:</u> Action Plan completed					X																									
Activity 6: Preparation of Action Plan					x	x																								
<u>Milestones:</u> Action Plan completed						X																								
Activity 7: Implementation of alternative rural finance mechanisms							x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
<u>Milestones:</u> Implementation progress assessed							X					X					X				X					X		X		

Project Year	Year 1												Year 2												Year 3											
Calendar Year	2004						2005						2006																							
Calendar Month	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12						
Project Month	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30						
Activity 8: Facilitation of participatory monitoring and evaluation of financial mechanisms by villagers									x	x	x	x	x	x	x	x	X	x	x	x	x	x	x	x	x	x	x	x	x							
Milestones: Information from participatory monitoring and evaluation activities analysed by month 20																				X																
Activity 9: Peer reviews of efficacy of financial mechanisms by government and NGO staff																							x													
Milestones: Peer review workshop held																							X													
Activity 10: Documentation of monitoring and evaluation processes and of outcomes								x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x												
Milestones: Process documentation available																								X												
Activity 11: Preparation and production of dissemination materials for different audiences								x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x										
Milestones: Draft dissemination materials available																					X					X										
Activity 12: Testing materials with relevant audiences																									x	x	x	x								
Milestones: Modified materials available																												X								
Activity 13: Final stakeholder workshop																												X								
Milestones: workshop proceedings																												X								
Activity 14: Distribution of dissemination materials to different audiences																												x	x	X						
Milestones: Distribution of dissemination materials complete																														X						