

INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND

COLOMBIA

**COMPETITIVENESS ENHANCEMENT AND BUSINESS
CONSOLIDATION OF SMALL FARMERS FOR ILLICIT CROP
SUBSTITUTION**

(CO-M1089)

DONORS MEMORANDUM

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CO-M1089: Competitiveness Enhancement and Business Consolidation of Small Farmers for Illicit Crop Substitution

Illicit drug crop cultivation is recognized as a major destabilizing factor for economic and social development in Latin America. In Colombia, government programs to eradicate illicit crop production in the last ten years have emphasized coercive measures and subsidies, which are heavily dependent on an ongoing provision of fiscal resources. The Multilateral Investment Fund (MIF) has been carrying out a pilot project since 2008 to test a market incentive for illicit crop substitution in Colombia (CO-M1025). The impact evaluation of this pilot project by the Bank's Office of Evaluation and Oversight validated the success of a method based on forging direct links to high-value markets to help an initial sample of 3,000 small farmers attain considerably higher returns on legal crops than on illicit crops. The pilot project's strategy of forging direct links to high-value markets consists of: (i) direct sales to large supermarket chains such as Carrefour and Almacenes Éxito, and to large-scale export customers such as Illi Caffé and Mori; (ii) quality certification of products and development of premium-quality products (premium cocoa and coffee, gourmet chocolate, hearts of palm, and multiflora honey); and (iii) use of branding in the "Products of Peace" market.

The *objective* of this project is to fine-tune and adequately scale—to 10,000 small farmers in 16 selected high-poverty regions—this illicit crop substitution method based on offering market incentives, which the government will later use more broadly as part of its illicit crop substitution policies. These regions, selected from among those identified by the government as "consolidation zones," are noted for their levels of stability, security, and economic recovery, and the government recognizes the value of the work carried out by UNODC as an honest broker in these regions. This proposal is based on lessons learned by the MIF in scaling, which indicate that the MIF should participate in support phase for adapting models and institutions as needed for scaling: (i) the experiences of the "Intra 21" program with the International Youth Foundation; (ii) the MIF's experience in microfinance industry development, assisting in the institutional adaptation and formalization process; and (iii) the most significant scaling processes of the portfolio for local economic development in terms of geographic expansion, those in Rafaela and Córdoba, Argentina.

This project responds to a number of opportunities: (i) from a market perspective, unmet demand for product diversification and a considerable increase in sales has been found in established marketing channels; (ii) from a policy perspective, the government has launched an interagency initiative for planning and managing more integrated policies in the regions in question; and (iii) from a technical perspective, the impact evaluation of the pilot project found highly favorable outcomes in the returns attained by the population addressed, as well as a relatively greater impact among smaller-scale farmers, a condition conducive to successfully scaling the project for lower-income farmers. The *knowledge objective* of the project is to document the effectiveness of an adapted, scaled model of market incentives for illicit crop substitution. The main effectiveness *indicators* are: (i) an average increase of at least 20% in sales revenues for each product sold; (ii) an average increase of 20% in employment on participating farms; and (iii) a 45% increase in number of hectares devoted to legal crop cultivation.

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ABBREVIATIONS

DPS	Departamento para la Prosperidad Social [Department of Social Prosperity]
FINAGRO	Financial Fund for the Agricultural Sector
LED	Local economic development
PEU	Project execution unit
PSR	Project status report
UNODC	United Nations Office on Drugs and Crime

COLOMBIA
COMPETITIVENESS ENHANCEMENT AND BUSINESS CONSOLIDATION OF SMALL FARMERS
FOR ILLICIT CROP SUBSTITUTION
(CO-M1089)

EXECUTIVE SUMMARY

Beneficiary country:	Colombia						
Executing agency:	United Nations, acting through the United Nations Office on Drugs and Crime						
Beneficiaries:	150 organizations encompassing 10,000 families of small farmers in 16 regions of Colombia affected by illicit drug cultivation and high poverty rates. The 10,000 farmers who formerly raised illicit crops are committed to cooperating with the Government of Colombia and transitioning to legal crops. Most of the selected beneficiaries are heavily affected by poverty and have varying degrees of access to high-value markets.						
Financing:	<table> <tr> <td>MIF (nonreimbursable):</td><td>US\$2,000,000 (24%)</td></tr> <tr> <td>Local counterpart:</td><td><u>US\$6,172,000 (76%)</u></td></tr> <tr> <td>Total:</td><td>US\$8,172,000 (100%)</td></tr> </table>	MIF (nonreimbursable):	US\$2,000,000 (24%)	Local counterpart:	<u>US\$6,172,000 (76%)</u>	Total:	US\$8,172,000 (100%)
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Local counterpart:	<u>US\$6,172,000 (76%)</u>						
Total:	US\$8,172,000 (100%)						
Objectives:	<p>The <i>goal</i> of the project is to help transform production in 16 regions of Colombia by providing real market incentives to complement government policies related to illicit crop substitution.</p> <p>The <i>purpose</i> is to fine-tune and adequately scale, in 16 regions of Colombia, a proven method of illicit crop substitution based on technical assistance and an improved business climate for linking small farmers to high-value markets, which the government will later use more broadly as part of its illicit crop substitution policies.</p> <p>The project has <i>four components</i>: (i) public-private agreements for strengthening the targeted regions; (ii) business development in high-value markets; (iii) formation of associations and structuring of collective goods; (iv) generation of knowledge on processes for scaling and disseminating the model in order to influence public policy.</p>						
Execution timetable:	<table> <tr> <td>Execution period:</td><td>36 months</td></tr> <tr> <td>Disbursement period:</td><td>42 months</td></tr> </table>	Execution period:	36 months	Disbursement period:	42 months		
Execution period:	36 months						
Disbursement period:	42 months						

Special contractual clauses:	The following will be conditions precedent to the first disbursement: (a) signing of cofinancing agreements with participating enterprises; (b) selection of the project coordinator; (c) submittal, to the Bank's satisfaction, of evidence that the executing agency has approved and put into effect the Operating Regulations; (d) formation of the Steering Committee; and (e) submittal of the project's annual work plan to the Bank for approval.
Exceptions to Bank policies:	None
Environmental and social review:	The Environmental Safeguards Unit reviewed the project profile at its weekly meeting 39-14 of 4 October 2012, and classified the project as a category "C" operation with the following recommendations: (i) an interagency agreement with farmers' communities, given the possible presence of paramilitary and guerrilla forces; (ii) implementation of bilingual and/or intercultural communication systems; and (iii) a crop transition plan for small farmers. The project has incorporated these suggestions by selecting regions that are part of the consolidation areas of the Department of Social Prosperity (DPS). These regions are defined precisely by the absence of active conflict (paramilitary and guerrillas) and the government-led development of interagency agreements within the framework of consolidation processes. The project also considers the development of public-private agreements with producers' organizations. If needed, informational manuals and materials will be culturally and linguistically adapted. Various levels of intervention are proposed to ensure sustainability in the transition from illicit to legal crops, in view of the experience, interests, and degree of development of the groups of small farmers.
Coordination with other donors:	UNODC works with the DPS, the Ministry of Agriculture and Rural Development, the Fund for Agricultural Sector Financing, the Government Consolidation Unit, the Technical Secretariat of the Office of the Vice President for the Prevention of the Recruitment of Children, the Carrefour Foundation, and oil companies Oxy and Pacific Rubiales.

I. BACKGROUND AND RATIONALE

A. Eradication of illicit crops in Latin America: a question of long-term profitability

- 1.1 Illicit crop cultivation and the drug trade are recognized as major destabilizing factors for economic and social development in Latin America.¹ In 2000, Colombia was identified as the world's leading exporter of cocaine, accounting for 70% of world production.² Since then, the Government of Colombia, supported mainly by the Government of the United States and the European Union, has stepped up its efforts through government programs to eradicate illicit crop cultivation and drug production, with an emphasis on coercive measures and subsidies that are highly dependent on an ongoing provision of fiscal resources and international cooperation.³ The Colombian legislature has assisted in this process by enacting laws that directly penalize persons or entities associated with any level of the value chain for the production and sale of coca. Multiple studies have shown alternative development programs to be effective in supporting small farmers in the transition from illicit to legal crops.⁴
- 1.2 Alternative development programs and the legislative effort to reduce the land area used for illicit crops in Colombia have gained international prominence and renown as a result of the outcomes attained. The coca crop monitoring effort conducted in 2011 as part of the Illicit Crop Monitoring Programme of the United Nations Office on Drugs and Crime (UNODC) found that illicit crops in Colombia covered an area of 144,000 hectares in 2000. Ten years of programs and legislative efforts to curtail illicit crops resulted in a 57% reduction to 62,000 hectares in 2010. Still, despite a steady downward worldwide trend between 2007 and 2011, in Colombia this trend has stagnated somewhat since 2010, offset by an increase in coca cultivation in some parts of the country.⁵
- 1.3 Statistics on illicit crops in Colombia provide empirical evidence on the difficulties the country still faces in its effort to eradicate cocaine production over the long term. Despite major legislative efforts and illicit crop substitution

¹ United Nations Office on Drugs and Crime (UNODC), July 2012.

² Drug trafficking is a major concern due to its correlation to high levels of violence and its association with groups operating outside the boundaries of the law.

³ In general, the Colombian government's programs to eradicate drug production are of two types: involuntary eradication and voluntary eradication. Involuntary eradication programs include military and police surveillance, spraying from aircraft, and manual destruction of crops. Voluntary eradication programs include direct stipends and conditional cash transfers tied to a change in crop cultivation, and direct support for production.

⁴ For a thorough review of alternative development programs in Colombia, see "Desarrollo Alternativo en Colombia y Participación Social: propuestas hacia un cambio de estrategia," Ricardo Vargas Mesa, Bogotá, Colombia. September 2010.

⁵ In fact, the land area used for coca cultivation in late 2011 was 64,000 hectares (1.6% of all arable land in Colombia), compared to 62,000 hectares in late 2010. Whether this represents an actual break in the downward trend of the previous decade cannot yet be determined.

programs, some 100,000 families in Colombia still subsist on illicit crop cultivation⁶

- 1.4 However, given the distorted nature of markets associated with illicit crops⁷ and the low levels of profitability for small farmers,⁸ legal crops such as coffee, cocoa, sugar cane, and oil palms are thought to have the potential to be more profitable under normal market conditions and to generate greater income for small farmers on a sustainable basis. The main underlying issue is that most small farmers in the regions targeted for illicit crop substitution lack business capacity and product differentiation, and the business climate is not yet conducive to responding to market incentives in order to achieve a significant move toward legal crop cultivation, along with regional strengthening efforts. Lastly, fiscal subsidies and stipends, while important, do not represent business incentives per se for the long-term eradication of illegal drug production.
- 1.5 This creates a long-term market failure whereby the government strives, without the experience needed, to gain effective access to markets in order to compete profitably with alternative development products. These circumstances pose the pressing need to strengthen productive structures in areas of alternative crop cultivation.

B. “Strengthening Business and Agroindustrial Capacity of Alternative Development Producers,” a pilot project (ATN/ME-10392-CO)

- 1.6 The MIF, in collaboration with UNODC, has been testing the effectiveness of a market incentive for illicit crop substitution in Colombia since 2008. This pilot project validated a method based on forging direct links to high-value markets, leading to high returns for an initial sample of some 3,000 small farmers in at-risk areas. The pilot project’s strategy of forging direct links to high-value markets consisted of: (i) direct sales to large supermarket chains such as Carrefour and Almacenes Éxito, and to large-scale export customers such as Illi Caffé and Mori; (ii) quality certification of products and development of premium-quality products

⁶ Plus an undetermined number of people associated with the harvesting and transformation processes.

⁷ The cocaine market provides farmers a minimal profit margin (1.5%). The largest profit margins go to international traffickers and dealers in the United States. World Drug Report 2011. Estimates of the United States Office of National Drug Control Policy.

⁸ Farmers who only sell coca leaves make about US\$294 a month in average net income, which is near the poverty line. This shows that coca does not bring great profits to small farmers in productive regions. Income levels are higher for those involved in the process of converting the coca leaf into cocaine base, but are relatively low for converting it to coca paste. As a result, unlike in previous years, a declining number of farmers are processing coca paste because net income is not enough to offset production costs (the cost of chemicals weighs down production costs). Meanwhile, the coca paste conversion process is being taken over by intermediaries in order to homogenize the production process. Source: UNODC, July 2012.

(premium cocoa and coffee, gourmet chocolate, hearts of palm, and multiflora honey); and (iii) use of branding in the “Products for Peace” market.⁹

- 1.7 The impact evaluation of the pilot project by the Bank’s Office of Evaluation and Oversight¹⁰ found targeting to be effective and outcomes significant at both the institutional level (farmers’ associations) and the economic level (return on product lines) in the target population. In short, the evaluation confirmed that the organizations supported by the MIF were located in areas with a medium to high prevalence of illicit crops. As for institutional development, estimates indicate a positive impact on productive associations: Compared to a control group, the beneficiary farmers’ associations in the pilot project were more likely to meet the requirements of the national tax and customs authority for selling/exporting their products, and were more likely to reach interagency cooperation agreements with other public and private entities, including arrangements for access to financing.
- 1.8 As for economic variables, the impact evaluation estimated beneficiary organizations to have higher sales revenues (139 to 166 million Colombian pesos), higher productive capacity measured in hectares (57 to 144 hectares), and higher product quality measured by the number of quality seals per product (0.66 to 1.09), compared to organizations not benefitted by the project. The evaluation also reflects the program’s increasing impact among farmers at a lower degree of institutional and productive development, which indicates true potential for success in scaling it up. Simulations found that the program’s positive impact was largely due to the complementarity of the MIF program with government programs.

C. Challenges and opportunities for the project

- 1.9 The opportunity to scale up the pilot project is supported by the unmet demand for alternative products as well as a significant potential supply. A recent study of potential markets in the area of the pilot project revealed the opportunities presented by emerging markets, for both product diversification and a considerable increase in sales through established distribution channels. The approximately 542 producers’ associations in Colombia exhibit varying levels of institutional and productive development,¹¹ and government programs have limited capacity to develop a strategy based on market incentives that could meet the growing demand for alternative development products and achieve economic sustainability. Only 22% of the alternative development programs supported solely by the government in the past seven years have posted positive economic returns. In late 2011, the Colombian government identified 10 strategic

⁹ Operation ATN/ME-10392-CO, project completion report, 2011.

¹⁰ Working Paper Series: *Creating New Opportunities for Rural Producers: Impact Evaluation of a Pilot Program in Colombia*, prepared by Sandra Roza under the supervision and coordination of Yuri Soares and Verónica González Díez, with support from Carlos Morales (mimeo).

¹¹ UNODC 2008. Baseline report on producers’ associations.

geographic areas as those most affected by illicit crops, known as “consolidation zones.” The government is implementing a coordinated political solution for illicit crop substitution in these areas, one that entails strengthening associations of legal producers and supporting their legal crops, thereby laying the institutional groundwork for regional economic development. The public-policy context fosters expansion and represents a clear sign of commitment from the Colombian government.¹²

- 1.10 This project is thus a response to three simultaneous opportunities. From a technical perspective, the impact evaluation of the pilot project, which serves as the basis for designing this project, found significant positive outcomes in returns attained by the targeted population. The evaluation also found a relatively greater impact among smaller-scale producers, which provides a favorable expectation for successfully scaling the project toward lower-income farmers. From a market perspective, an updated market study conducted as part of the pilot project found unmet demand in established marketing channels for both product diversification and a considerable increase in sales. These highly favorable outlooks are based on the vitality of the Products of Peace “solidarity market” in Colombia and importers’ obvious interest in premium-quality products. From a policy perspective, the scaling opportunity is further supported by the Government of Colombia, which has launched an interagency initiative for more integrated policy planning and public management in the “consolidation zones” targeted by this project. This step is conducive to scaling the project and a clear sign of the government’s commitment to the proven model.

D. Problem to be addressed

- 1.11 Despite these market opportunities and an environment conducive to project scaling, a persistent problem is that the vast majority of small farmers in regions producing illicit crops lack the business capacity and a conducive business climate to responding to market incentives in order to achieve a significant move toward legal crop cultivation, along with regional strengthening efforts.
- 1.12 This problem has a variety of causes. First, the strategies used by the public sector in areas affected by illicit cultivation, such as reinforcement measures or conditional cash-transfer assistance programs, have not been effective in helping small farmers address their business needs or the deficiencies in the business environment (such as legal uncertainty, oligopolies in trade channels, and unreliable product transportation). Second, the vast majority of small farmers in these regions face a number of business obstacles in accessing high-value markets, and their production is limited to a local scale and self-consumption. Product development and differentiation, quality control, and trade links to high-value markets are generally limited. Third, independent small farmers are isolated and disconnected from larger-scale merchants. Organizations of small farmers

¹² Source: National Consolidation Plan, Colombia’s Department of Social Prosperity, 2012.

remain weak and lack the capacity to improve their purchasing and negotiating power. Individual initiatives to bring products to market tend to fail due to an inability to attain economies of scale.

E. The project

- 1.13 The program seeks to transform a successful pilot experience into an ongoing process of inclusion, consolidation, and graduation of associations of alternative development producers in regions that formerly produced illicit crops. The strategy is to carry out an ongoing process whereby measures are taken to expand the intervention model to a greater number of organizations in order to help generate processes for the strengthening and economic development of regions on a sustainable basis. A proven market-access model for alternative development producers will be used, with two additions: (i) a successful exit or graduation process for organizations achieving economic stability in the first pilot project; and (ii) an entrance strategy for new organizations, to train and prepare them to partake in the opportunities offered by the market.
- 1.14 This proposal is based on lessons learned by the MIF in project-scaling processes from the Intra 21 program, carried out through a strategic partnership with the International Youth Foundation, especially in Medellín, Colombia; Buenos Aires, Argentina; and Ceará, Brazil. The MIF assisted these three projects by providing technical-cooperation funds to help adopt and scale the models tested in the pilot phase, which made it possible for models to be adjusted and institutional changes to be made as needed for scaling purposes or for policy considerations. Specifically for local economic development, some of the most prominent scaling processes in the MIF's historic portfolio, such as those in Rafaela and Córdoba, Argentina, have shown MIF assistance to be effective for expanding local economic development models to broader regional policies. Aside from market access and capacities, the proposal is also based on the MIF's experience in microfinance; following a number of pilot initiatives for developing new products and markets, the MIF has supported the development of the microfinance industry through interventions to adapt financial products as well as interventions related to institutional development, formalization, and strengthening of the framework necessary for scaling purposes.
- 1.15 The MIF's experience in scaling projects and the analyses conducted for this operation show that scaling entails a number of adaptations to the program model, such as: (i) strengthening interagency collaboration between the public and private sectors, which yielded a favorable outcome according to the impact evaluation; (ii) expanding organizational capacity by subcontracting technical-assistance resources and forming strategic partnerships with leading entities and key entities in each region; (iii) orienting the intervention model toward a multitier model where program type varies according to an organization's degree of preparedness; and (iv) emphasizing outcome management and the impact evaluation to validate the assumptions of the scaling strategy.

- 1.16 On the basis of these lessons learned, this program seeks to develop knowledge and conditions conducive to public-private partnerships, as needed to fine-tune and scale the illicit crop substitution method based on market incentives for 10,000 small farmers in 16 selected high-poverty regions¹³ as a necessary complement to the government's illicit crop substitution policies. These regions were selected from among those identified by the government as "consolidation zones," and their levels of stability, security, and economic recovery are conducive to the project. Complementarity with the government's work in these areas—and recognition by the Colombian government and small farmers' organizations of UNODC as an honest broker within the framework of the project—are crucial to project viability.
- 1.17 **Gender.** The project has looked at the need to strengthen the position of women as heads of household, small business owners, and leaders of local government. A study found that 25% of the leaders of small farmers' associations are women. The literature accords women a key role in maintaining social cohesion in consolidation regions and in making decisions for transitioning production toward legal crops. As such, the project includes specific actions to promote women's leadership within beneficiary farmers' associations, and greater participation of women entrepreneurs as owners of small productive units benefitted by the project. In accordance with this diagnostic assessment, adopting a stronger gender-based perspective as part of the project model can help achieve project outcomes, and the project includes specific activities for gradually strengthening the role of women in transitioning production toward legal crops.

F. Additionality of the MIF

- 1.18 The nonfinancial additionality of the MIF is based on the opportunity to fix a market failure and provide experience-based technical value. In this regard, the program's contribution lies in: (i) providing a successful, scaled market solution in a market as highly distorted as that of illicit crops; (ii) building on the MIF's experience in integrating public- and private-sector initiatives within a framework of effective governance; (iii) supporting scaling processes on the basis of lessons learned from the MIF's past experience in such processes, to help adjust the model to the more heterogeneous characteristics of beneficiary small farmers, so that the government can subsequently use it more broadly as part of its illicit crop substitution policies.
- 1.19 The financial additionality of the MIF is based on the project team's fundamental role in leveraging sufficient resources to finance this scaling process, involving public entities (DPS), public-private entities (Financial Fund for the Agricultural Sector (FINAGRO)), and private entities (Oxy, Pacific Rubiales) at a leveraging ratio of three dollars to each dollar invested. The MIF's presence, starting with the

¹³ For reference material on the project's impact in high-poverty areas, see the MIF's geographic targeting system: <http://geocommons.com/maps/186406#>.

previous pilot experience and continuing with this reinvestment for scaling, has been at the heart of the collective will to finance this project.

II. PROJECT DESCRIPTION

A. Objective

- 2.1 The *goal* of the project is to help transform production in 16 regions of Colombia by providing real market incentives to complement government policies related to illicit crop substitution. The *purpose* is to fine-tune and adequately scale, in 16 regions of Colombia, a proven method of illicit crop substitution based on technical assistance and an improved business climate for linking small farmers to high-value markets, which the government will later use more broadly as part of its illicit crop substitution policies.
- 2.2 *Expected outcomes:* Expected impacts include: (i) a 30% average increase in sales revenues per organization of products sold (hearts of palm, honey, chocolate) in large stores in the domestic market; (ii) a 20% average increase in sales per organization of products sold in international markets (cocoa, coffee); (iii) a 20% increase in household income for small farmers participating in the project; (iv) a 20% average increase in employment on participating farms; (v) a 45% increase in the number of hectares used for legal crop cultivation by beneficiary small farmers; and (vi) a 15% increase in sales on domestic and international markets. Expected outcomes include: (i) at least 10,000 small farmers using best practices for finances, quality management, and marketing in their businesses; (ii) at least three new international markets established; (iii) two new domestic markets opened up by project activities; (iv) four new product lines launched and brought to market; (v) agreements signed by at least 30 farmers' organizations to improve access to financing for production (FINAGRO), access to markets (marketing services or quality certification), or government services; (vi) at least 20 business deals carried out in high-value markets; and (vii) graduation of seven organizations from the project, with these organizations receiving services at 130% of total cost.
- 2.3 The project has four components: (i) public-private agreements for strengthening the targeted regions; (ii) business development in high-value markets; (iii) formation of associations and structuring of collective goods; (iv) generation of knowledge on processes for scaling and disseminating the model to influence public policy.

B. Components

Component I: Public-private agreements for strengthening the targeted regions (MIF: US\$468,000; counterpart: US\$1,611,000)

- 2.4 *The purpose* of this component is to systemically pursue public-private agreements, which proved successful in the pilot phase. This component will help

complement policies and plan alternative development programs in regions producing illicit crops through processes led by the private sector on a selective basis and in accordance with a diagnostic needs assessment in each region. This component will finance the following *activities*: (a) design of a methodology for preselecting and selecting alternative development organizations and establishing a baseline; (b) creation and legal registration of program operating committees (public sector, private sector, and beneficiary organizations) and regional and local subcommittees; (c) training of leaders, while promoting women's participation in entrepreneurial activities and business associations, to generate social/entrepreneurial, economic, and political competencies; (d) strengthening of administrative processes of producers' organizations in accordance with their level of business development; (e) strengthening of organizations' accounting and financial unit through financial management tools; and (f) advising and support to pursue alternative financing for improved production and business processes.

- 2.5 The expected *outcomes* are: (a) agreements reached and governance structure established for each of the 16 selected regions; (b) at least six agreements for collaboration between the public sector, nongovernmental organizations (NGOs), large corporate investors, and research centers; (c) 400 regional leaders trained to conduct regional governance processes based on legal crop cultivation; (d) 200 women leaders trained to participate in the formation of cooperatives; (e) at least 70% of rural leaders of organizations performing their roles and committed to the business development of their organization; (f) financing of at least three projects submitted by the organizations; and (g) at least 50% of the partnerships and agreements executed.

Component II: Business development in high-value markets (MIF: US\$888,000; counterpart: US\$2,339,500)

- 2.6 The *purpose* of this component is to transfer and adapt the technical assistance model for linkage with high-value markets developed during the first phase. This component will finance the following *activities*: (a) description of products currently offered by associations and organizations, identifying the technological gaps and needs of each organization; (b) implementation of production improvement plans to narrow and/or close technological and quality gaps in primary production, using manuals developed during the project's pilot phase; (c) improvement of postharvest processes; (d) development of new products (research and development); (e) reduction of environmental impacts on organizations' agroindustrial production processes; and (f) implementation of strategies to increase organizations' sales on domestic and international markets.
- 2.7 The expected *outcomes* are: (a) 6,000 small farmers trained with various levels of technical assistance in new product development, quality management and certification; marketing, logistics management, and access to rural financing; (b) 6,000 small farmers provided with capacities to sell branded products on high-value markets (cocoa, coffee, gourmet chocolate, hearts of palm, honey, and

yucca); (c) at least two partnerships formed with science and technology entities and others in the public and private sectors; (d) at least 70% fulfillment of production improvement plans previously established and coordinated with the organizations; (e) at least 30% of association members involved in postharvest handling processes are certified as food handlers; (f) 70% of the organizations have carried out at least one activity for environmental conservation; and (g) 20 business deals carried out in high-value markets.

Component III: Formation of associations and structuring of collective goods (MIF: US\$48,000; counterpart: US\$531,400)

- 2.8 The *purpose* of this component is to strengthen the formation of associations as a catalyst for the inclusion of new actors in high-value markets. These partnerships will help secure preferential prices on inputs, fertilizers, product marketing and transportation, collective branding, and collective sales agreements with key actors in the market. This component will finance the following *activities*: (a) creation and startup of the logistics and trade platform for the organizations' new products; and (b) creation of a brand or seal to represent the products of all the organizations, whose intellectual property will be assigned to the trade platform established by the project.
- 2.9 The expected *outcomes* are: (a) a unique brand developed to sell products in high-value markets; (b) at least six organizations selling their products through the logistics and marketing platform; (c) a business service network formed in strategic partnership with SwissContact Colombia; (d) at least six groups of producers developed regionally as part of the project for product categories such as differentiated cocoa and yucca; (e) 10% of organizations with new products have adopted the brand; and (f) 10% of people surveyed in the target market recognize the product brand and, of these, 80% have a favorable opinion of the products.

Component IV: Generation of knowledge on processes for scaling and disseminating the model to influence public policy (MIF: US\$180,000; counterpart: US\$488,000)

- 2.10 The *purpose* of this component is to develop and transfer knowledge to provide incentives to small farmers and strengthen government and private-sector strategies for illicit crop substitution in Colombia. This component will finance the following *activities*: (a) strengthening of the project's monitoring system, by improving data collection instruments and integrating them with the monitoring systems of government programs; (b) updating of the existing baseline for farmers' associations and monitoring of institutional changes promoted through the project; (c) strengthening of the data collection system for ongoing evaluation of the project and its impacts; and (d) development and implementation of a communication plan to disseminate the model and transfer knowledge in order to influence public policy.

- 2.11 The expected *outcomes* are: (a) a documented model based on an impact evaluation that validates the project's scaling theory, adaptation of the model, and maintenance of its effectiveness; (b) at least five public or private entities (regional consolidation units, governments, chambers of commerce, universities, NGOs, international cooperation entities, organizations, etc.) show interest and have the resources to replicate and disseminate the model in whole or in part; (c) the project maintains an influx of new interested organizations (50 per year); and (d) market recognition of project services and the brand, with at least a 50% loyalty rate among graduating organizations.
- 2.12 The knowledge objective of this program is to document the effectiveness of the scaling of the incentives model targeted to the market for illicit crop substitution. To this end, the monitoring and evaluation system will be strengthened by improving data collection instruments and allowing them to be integrated with the illicit crop monitoring system (SIMCI) and the monitoring systems of the DPS's government programs. A thorough case study—including primary outcomes, lessons learned, and testimonials from beneficiaries and participants—will also be prepared to broadly disseminate the success achieved and report on public policies.
- 2.13 The study will be released to the following audiences: (i) local governments and governments in other regions affected by illegal drug production; (ii) organizations of small farmers and other community organizations in regions affected by illegal drug production; (iii) government entities responsible for developing and implementing national policies on illegal drugs; and (iv) potential buyers of products, including major retailers and international brands.
- 2.14 The *message* to be disseminated will aim to show how alternative development programs can be successful examples of scaling to complement policies for the eradication of illicit crops in Colombia. The **channels** for disseminating project outcomes will be: (i) events held to disseminate project outcomes locally, nationally, and internationally; (ii) audiovisual materials developed to replicate the model; and (iii) updating and monitoring of—and inclusion of participating organizations on—the website created by the previous project (www.agroindustriacolombia.com). *Execution of this component* will be based on UNODC's extensive experience in knowledge management and strategic communications.

III. COST AND FINANCING

- 3.1 The project's total budget is US\$8,172,000, of which US\$2 million (24%) will be contributed by the MIF and US\$6,172,000 (76%) will come from the counterpart financing to be provided by the United Nations, acting through UNODC, and agreements established with private enterprises.

DESCRIPTION	MIF (US\$)	Local contribution (US\$)	Total (US\$)
Component I: Public-private agreements for strengthening the targeted regions	468,000	1,611,000	2,079,000
Component II: Business development in high-value markets	888,000	2,339,500	3,227,500
Component III: Formation of partnerships and structuring of collective goods	48,000	531,400	579,400
Component IV: Generation of knowledge on scaling processes	180,000	488,000	668,000
Administration	221,292	1,202,100	1,423,392
Baseline, monitoring, and evaluation	40,200	0	40,200
External audit	25,000	0	25,000
Contingencies	9,508	0	9,508
Subtotal	1,880,000	6,172,000	8,052,000
Contribution to the impact evaluation fund (5%)	100,000	0	100,000
MIF agenda (2%)	20,000	0	20,000
Total	2,000,000	6,172,000	8,172,000

- 3.2 **Project sustainability.** The project's financial sustainability is based on a fee-for-service business model related to brand usage, product development, quality certification, logistics, and trade. Prices will be based on the aforementioned characteristics, and will range from 40% above cost for the organizations at the initial stage to 120% above cost for organizations that have graduated.
- 3.3 Moreover, the project builds on the capacity created by the previous project in an entity providing services for all organizations, which will be responsible for continuous improvements in production, quality management, and an ongoing sales strategy for alternative development products grouped under an umbrella brand.
- 3.4 **Sustainability workshop.** A sustainability workshop, to be organized jointly by the executing agency and the MIF, will be held six months before the end of the project's execution period. The leading stakeholders will take part in this workshop, and the objective is to evaluate progress and identify measures and actions needed to ensure that activities continue even after project funds are depleted.

IV. EXECUTING AGENCY AND EXECUTION MECHANISM

- 4.1 **Executing agency.** The United Nations Office on Drugs and Crime (UNODC) has been working in Colombia for the past 20 years on illicit crop substitution and alternative development. With the MIF, it executed operation ATN/ME-10392-CO, "Strengthening Business and Agroindustrial Capacity of Alternative Development Producers," which has become a benchmark success for

gradual expansion of this project. The project calls for a strategic partnership with SwissContact, which will provide technical advisory services to the project, especially for the cocoa chain, to support the unit responsible for development, quality, and sales. SwissContact's role is to provide advisory support and exchange technical knowledge and assistance personnel, even though SwissContact assumes no responsibility vis-à-vis the MIF for project execution.

- 4.2 *The mission of UNODC* is to support governments in finding sustainable economic practices as alternatives to illicit crop cultivation and organized crime. To this end, UNODC has identified the following entities as primary partners: (i) the Department of Social Prosperity (DPS), which will support execution of the project in the context of its post-eradication programs and represents the primary audience for the processes to influence policy; and (ii) the Financial Fund for the Agricultural Sector (FINAGRO), which will provide support in financing the production of small farmers benefitting from the project.

- 4.3 **Execution mechanism.** The project will be administered by the project execution unit (PEU), which will be located at UNODC offices in Colombia and will consist of a project coordinator, an administrative assistant, and a financial assistant. The members of the PEU will be selected in accordance with the criteria established by the Bank. The PEU will be supported by the business platform team and the technical production specialists of the project's member entities (DPS, Oxy, Pacific Rubiales, and SwissContact) in accordance with the productive sectors included in the project and their respective locations.

The PEU will be responsible for: (a) preparing and executing semiannual work plans on the basis of the groups' action plans; (b) coordinating project activities, including development of a management control system to support the model to be implemented; (c) procuring and supervising goods and services; (d) requesting disbursements of the financing; (e) submitting financial statements and management reports to the project's Steering Committee so that they can be forwarded to the Bank; (f) monitoring the performance indicators set forth in the logical framework; and (g) preparing semiannual management reports. The executing agency will form a Steering Committee for the program, which will serve as an instrument for interagency coordination and will help monitor the performance indicators set forth in the logical framework. The Steering Committee will consist of at least five members: the UNODC project coordinator, who will chair the committee; a representative of DPS; two representatives of the other member entities, and at least one representative of the farmers' groups, to be selected by the executing agency.

- 4.4 **Disbursement by results.** Project disbursements will be contingent upon verification of the fulfillment of milestones, in accordance with the means of verification agreed upon between the executing agency and the MIF. The fulfillment of milestones does not relieve the executing agency of its

- responsibility to fulfill the indicators in the logical framework and project objectives.
- 4.5 In accordance with **risk- and performance-based project management**, disbursement amounts will be determined by the project's liquidity needs for up to six months (advance of funds). These needs will be agreed upon between the MIF and the executing agency, reflecting the activities and costs programmed during the semiannual planning process. The first disbursement will be contingent upon fulfillment of the conditions precedent, and subsequent disbursements will be contingent upon fulfillment of the following two conditions: (i) the MIF verifies the fulfillment of milestones, as agreed in the semiannual planning process; and (ii) the executing agency has justified 80% of the cumulative advances of funds.
- 4.6 **Currency for disbursements and expenditures: exchange rates.** The Bank will disburse the contribution in United States dollars, or, at the request of the executing agency, in its equivalent in local currency or other freely convertible currencies, provided that they are available and acceptable to the Bank, at the Bank's sole discretion. The Bank will apply the exchange rate indicated below to calculate and convert the dollars or the convertible currencies into other currencies, in accordance with international accounting practices acceptable to the Bank, and pursuant to the exchange rate described below, as needed.
- 4.6.1 Disbursements: The U.S. dollar equivalent of other freely convertible currencies will be calculated by applying: (i) the current market exchange rate on the date of the disbursement, or (ii) the exchange rate corresponding to the current understanding between the Bank and the respective country for purposes of maintaining the value of this currency or other nonconvertible currencies in the Bank's possession.
- 4.6.2 Expenditures: The equivalent in the currency of the contribution of an expenditure made in the national currency of the executing agency will be calculated in accordance with the current market exchange rate on (i) the date of submission of the request for recognition of expenditures to the Bank, or (ii) the effective payment date of the expenditure, as indicated by the Bank.
- 4.7 **Procurement.** For procurement activities, the executing agency will be governed by the Bank's procurement policies (documents GN-2349-9 and GN-2350-9). Because the diagnostic needs assessment of the executing agency (<http://mif.iadb.org/projects/prjrisummary.aspx?proj=CO-M1089&lg=EN>) found a low level of need/risk, the project team has decided that, in accordance with Appendix IV of the aforementioned policies, the executing agency, as a member of the private sector, will use its own procurement methods compatible with the Bank's policies. Annual ex post reviews of the project's procurement activities will be conducted.

- 4.8 Before any procurement activity for the project, the executing agency will submit the project's procurement plan to the MIF for approval, and this plan may establish any ex ante technical reviews that are important to the project's objectives. This plan must be updated every six months and whenever any change occurs in procurement methods and/or the good or service to be procured.

V. MONITORING AND EVALUATION

- 5.1 **Monitoring mechanisms.** The MIF will be responsible for monitoring and supervising the project in the Bank's Country Office in Colombia, located in Bogotá, in coordination with MIF headquarters to address strategic sector-specific matters.
- 5.2 The project execution unit (PEU) will prepare the annual work plan for each year of project execution, and this plan will set forth the expected outcomes for the year, based on fulfillment of the logical framework; a timetable of activities including estimated dates on which the agreed milestones are expected to be fulfilled; and projections for procurement processes and disbursements related to fulfillment of project milestones.
- 5.3 **Baseline and monitoring system.** UNODC and the DPS have already gathered benchmark data on the organizations participating in various illicit crop substitution programs, including data at the organizational level and aggregate business-related data. These data will be complemented by government data (RED UNIDOS) at the individual level (data on small farmers) on poverty rates, household income, and living conditions.
- 5.4 **Project status reports (PSRs).** The executing agency will be responsible for submitting PSRs to the MIF within 30 days after the end of each semiannual period or more frequently, as requested by the MIF through notification to the executing agency at least 60 days in advance. The PSR will report on progress in project execution, fulfillment of milestones, outcomes attained, and contribution to the achievement of project objectives, in accordance with the logical framework and other operational planning instruments. It will also report on problems encountered during the execution and possible solutions. Within 90 days after the end of the execution period, the executing agency will submit to the MIF a final PSR, which will prioritize outcomes attained, the sustainability plan, findings from the final evaluation, and lessons learned.
- 5.5 A ***closing workshop*** will be scheduled to take place at least three months before the end of the execution period, with the participation of the members of the project team, representatives of beneficiaries and the sector, and any other person agreed upon with the Bank/MIF. The objective of this workshop will be to jointly evaluate the outcomes attained, identify actions needed to increase the project's impact, further tasks to ensure the sustainability of actions in progress, and identify and disseminate lessons learned and best practices.

- 5.6 **Financial management and supervision.** The executing agency will establish and be responsible for maintaining proper financial records, internal control, and filing systems for the project, in accordance with the financial management standards and policies of the Bank/MIF. The diagnostic needs assessment of the executing agency found a low level of need/risk related to financial management. The auditor will submit a report reviewing procurement processes integrated with disbursements, which will accompany each disbursement request submitted to the Bank.
- 5.7 The executing agency, subject to the Bank's prior no objection, will hire independent auditors to conduct the ex post reviews of procurement processes and supporting documentation for disbursements. The scope of these ex post reviews will include an analysis of the reports prepared by the executing agency as part of its financial management of the project. These reviews will be financed with funds from the MIF contribution, and will be procured in accordance with Bank procedures. During project execution, the MIF may modify the frequency of the ex post reviews of procurement processes and supporting documentation for disbursements, and the need for additional financial reports may be modified by the MIF, based on the findings of the ex post reviews conducted by the external auditors.
- 5.8 The executing agency will submit annual financial statements, to the Bank's satisfaction, within 90 days following the closing date of each year, and within 120 days following the date of the last disbursement, the annual financial statements on the project's income and expenditures, which will be reviewed by external auditors acceptable to the Bank.
- 5.9 Evaluations. During the project, two evaluations (midterm and final) will be carried out by independent consultants hired by the executing agency, with the Bank's no objection and with operation funds.
- 5.10 The midterm evaluation will be carried out when 50% of the MIF contribution has been disbursed or at 18 months into the project, whichever occurs first. The final evaluation will be carried out 90 days before the end of the execution period. The terms of reference for these evaluations will be prepared by the executing agency and approved by the Bank. The midterm evaluation will address: (i) the project's execution mechanism, interagency collaboration, and the participation of the various entities in project activities; (ii) mechanisms for selecting the beneficiaries of technical assistance; (iii) steps taken to facilitate project sustainability; (iv) performance of consultants and instructors hired by the project; (v) degree of fulfillment of programmed activities, and status of indicators in the logical framework; (vi) effectiveness of actions carried out and beneficiary satisfaction; (vii) status of each group supported by the program; (viii) institutional capacity of the executing agency and other entities involved in the program; (ix) fulfillment of the counterpart's *pari passu*; and (x) farmers' compliance with environmental

and occupational safety standards. This report will indicate the corrective actions needed to ensure proper program execution.

- 5.11 The final evaluation will address the following: (i) sustainability of actions undertaken; (ii) degree of fulfillment of project objectives; (iii) degree of fulfillment of the project's knowledge-development and communication objectives; and (iv) lessons learned from execution. The final evaluation will be carried out when 95% of MIF resources have been disbursed, and will address: (a) degree of fulfillment of program purposes and objectives, particularly the success of the trade platform and the increase in the billing rate for products sold under the new brand; (b) farmers' satisfaction, as determined by survey; and (c) sustainability of the trade platform responsible for managing the brand and actions promoted by the program after the MIF's contribution comes to an end, including compliance with environmental and occupational safety standards. The final evaluation will be based on the impact evaluation, which will also address the following: (i) sustainability of actions undertaken; (ii) degree of fulfillment of project objectives; (iii) degree of fulfillment of the project's knowledge-development and communication objectives; and (iv) lessons learned from execution.
- 5.12 **Impact evaluation.** The project calls for the first evaluation to be carried out by the MIF of the proposed scaling process on which the project is based, and which holds that a successful model can be scaled without diluting its impacts by adapting the model and developing the necessary institutional capacities. This impact evaluation, based on complementing available data sources for the target groups and a control population, will be based on the successful use of the impact evaluation prepared during the project's pilot phase. The Development Effectiveness Unit will be responsible for the impact evaluation and for administering the technical and bidding processes needed to conduct this evaluation. The generation of empirical data on illicit crop substitution, assigned to UNODC by the Colombian government, has been at the root of influence on public policies and private-sector practices in areas where illicit crops are produced. The objective of the evaluation will be to verify effectiveness in adapting the model, elasticity of the treatment effect as groups at a lower level of institutional and productive development are incorporated into the project, their impact on the transition toward legal crops—as measured by the increase in the land area devoted to legal crops as compared to the area devoted to illicit crops—and the impact on reduction of poverty in beneficiary households, both of which, for technical reasons, could not be evaluated during the impact evaluation in the pilot project. Through the evaluation, the team may also conduct an analysis of the program's overall rate of return, as an alternative and future benchmark for public-sector programs linked to the allocation of fiscal resources.

VI. BENEFITS AND RISKS

- 6.1 **Beneficiaries.** The beneficiaries of the project are 150 organizations encompassing 10,000 families of small farmers in 16 high-poverty regions of Colombia affected by illegal drug production.¹⁴
- 6.2 **Risks.** The project entails the following risks: *Market risks:* (a) that the demand for products in the segment known as the “solidarity market” is not maintained; mitigation measure: the project calls for activities to promote the strategic relationship with large supermarkets serving this market and the launching and promotion of a unique brand for this market; (b) exports may be adversely affected by exchange rate fluctuations or changing demand in target markets; mitigation measure: the project calls for developing highly differentiated products that are not heavily dependent on the terms of trade, and which offer prospects for growing demand in target markets; and (c) while program data indicate that scaling is sustainable among small farmers, these farmers may not receive enough benefits to make crop substitution sustainable among the entire population of farmers to be served; mitigation measure: the project calls for actions to promote the model and incentives that have proven successful for sustainable illicit crop substitution.

VII. SOCIAL AND ENVIRONMENTAL STRATEGY

- 7.1 The project abstract was submitted for Environmental and Social Review at meeting 39-14 of 4 October 2012, and was classified as a category “C” operation with the following recommendations: (i) an interagency agreement with farmer communities, given the potential presence of paramilitary and guerrilla forces; (ii) implementation of bilingual and/or intercultural communication systems; and (iii) a crop transition plan for small farmers.
- 7.2 The project has incorporated these suggestions by selecting regions included in the DPS’s consolidation zones. These regions are defined precisely by the absence of active conflict (paramilitary and guerrillas) and the government-led development of interagency agreements within the framework of consolidation processes. The project also considers the development of public-private agreements with producers’ organizations. If needed, informational manuals and materials will be adapted to the local indigenous culture and language. Also, various levels of intervention are proposed for the transition from illicit to legal crops as an essential element of the intervention model, in view of the experience and interests of the small farmers’ groups.

¹⁴ These regions are Cauca, Antioquia, Bolívar, Chocó, Magdalena, Santander, Norte de Santander, Putumayo, Huila, Guaviare, Caquetá, Arauca, Córdoba, Sucre, Nariño, and Tolima. These regions were selected by the Colombian government and UNODC for their high levels of drug production.

- 7.3 Potential negative direct and indirect impacts will be identified: (a) in the action plans to be prepared for each group; (b) again in component II, for bringing products to market; training activities will also include efforts to raise awareness on the importance of sustainable production.
- 7.4 For export activities, the project promotes compliance with environmental and occupational safety standards related to sustainable agriculture, such as Good Agricultural Practices (GAP) and EurepGAP, *inter alia*, depending on the products' target markets. The selection criteria for farmers' groups also include compliance with applicable environmental and occupational safety standards in the country for the respective products. Lastly, specific evaluations of compliance with these standards will be monitored during the production, transformation, and marketing cycle.