Validation Report

Reference Number: PVR–226
Project Number: 26459
Loan Number: 1814
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People’s Republic of China: West Henan Agriculture Development Project

Independent Evaluation Department
Asian Development Bank
ABBREVIATIONS

ADB – Asian Development Bank  
EIRR – economic internal rate of return  
FIRR – financial internal rate of return  
PMO – project management office  
TA – technical assistance

NOTE

In this report, “$” refers to US dollars.

Key Words

adb, asian development bank, mianchi water supply company, people’s republic of china, sanmenxia hubaia water supply, yima water supply, west henan agriculture, validation

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I. PROJECT DESCRIPTION

A. Rationale

1. The economic environment of West Henan in People’s Republic of China (PRC) was severely constrained by its high population density, hilly to mountainous terrain, scarce arable land, harsh climatic conditions, and limited water resources. Average per capita annual income was CNY1,864 ($225). The incidence of poverty (at $1 per day) in the region was high—12% as against less than 10% for the PRC. Of the 32 counties in West Henan, 12 counties were nationally designated in absolute poverty. The region was suitable for the cultivation of a number of temperate fruits and nuts and a variety of medicinal plants. The region was also becoming a major supplier of beef, mutton, and pork because of the availability of underutilized pastures. Cattle and small livestock adapted well to local conditions. The shortage of medium- and long-term rural credit and inadequate potable and irrigation water supply were constraining the development of horticulture and livestock. The West Henan Agriculture Development Project was designed to help remove these constraints.

B. Expected Impact

2. The project was envisioned to directly benefit about 204,900 households (almost 900,000 people). Nonfarm job opportunities in pig breeding and water supply were expected to
be created. About 340,000 people were to be lifted above the rural poverty line of $1 per day and the urban poverty line of $2 per day. At full development, household incomes were to increase significantly, with incremental household net incomes averaging CNY1,631 in horticulture and CNY1,983 in livestock.

C. Objectives or Expected Outcomes

3. The primary objective of the project was to promote pro-poor economic growth by increasing the incomes of predominantly poor farmers in West Henan. In terms of outputs, it was expected that the total annual production would be 72,600 metric tons (t) for fruits, 2,640 t for medicinal plant products, and 197,900 t for vegetables. Livestock development was to expand annual production by 122,400 sheep, 122,400 goats, 17,955 cattle, and 68,000 pigs (porkers). Pilot livestock enterprises were to produce 24,600 breeding pigs, 25,000 piglets, and 12,440 fattened and culled pigs. The project was envisaged to supply 83 million cubic meters (m³) of water to various users annually.

D. Components and Outputs

4. The project consisted of three components:

(i) **Horticulture development**, which supported the rehabilitation, development, and improvement of fruit tree crops (apples, Chinese dates, kiwi fruit), medicinal plants (gingko and eucommia), and field and greenhouse vegetables

(ii) **Livestock development**, which supported household cattle and pig breeding and raising, purebred piggeries, and sheep and goat breeding and raising, using crop residues and underutilized grasslands

(iii) **Water and irrigation scheme**, which provided pumping and conveying facilities to draw and transfer water from the Yellow River to Yima City and Mianchi County to meet their acute rural, urban, and industrial water demands, and to supply water for orchard irrigation and livestock uses

5. In September 2004, Asian Development Bank (ADB) approved the following major changes in the project scope based on the findings of the midterm review: (i) modification of household development activities under the horticulture and livestock development components; (ii) cancellation of two subprojects under the livestock and water components; and (iii) inclusion of 11 new subprojects under the horticulture and livestock components.

6. Under each of the three components, the project was able to achieve the following outputs:

(i) **Horticulture Development.** At project completion, 7,933 hectares (ha) of tree crops were developed or 115% of the target after the major change in scope. The development of field vegetables covered 2,528 ha or 90% of target; and 3,474 greenhouses were established or 85% of target. In addition, 236 ha of seedling nurseries were developed. For the Xin’an Flower Farm, 6,000 m² of greenhouse area with a computerized control system for the flower nursery was completed, operating with an incremental annual production of 70,000 baskets of flowers. The Bureau of Agriculture and the Bureau of Forestry organized three programs each year for project farmers, providing technical support through technical extension service stations and agriculture specialists. The total number of households that benefited from this component was 39,904 or 42% of target after
the major change of project scope due to the reduction in beneficiary households from field vegetable and gingko development. The scale of farming per household greatly increased in Henan since the project was implemented. The original household farming scale design was too small and no longer practical or economically effective.

(ii) **Livestock Development.** A total of 33,226 households received subloans under the project for livestock breeding and raising. They comprised 18,544 households for cattle; 7,463 households for goats; 3,088 households for sheep breeding and raising; and 4,131 households for dairy production. Of the 11 new subprojects included after the major change in scope, 5 enterprises were implemented. The Dingyuan and Yutai dairy cow embryo transfer and milk farms were established, operating mainly as dairy farms with 1,100 head and 1,000 head of elite-breed cows for milk production. The Yizhong cattle slaughterhouse and beef processing enterprise was established with a processing capacity of 30,000 heads per year. The Xinda purebred piggery was expanded, producing 6,400 purebred breeding animals, 5,400 fattened hogs, and 400 culled sows annually. The Mianchi beef cattle fattening farm became operational and was exporting 2,000 heads of live cattle each year. The Bureau of Livestock organized training three times annually for project farmers and provided the necessary technical support. Some 65,700 households benefited from the livestock development component or 260% of the target after the major change of scope.

(iii) **Water and Irrigation System.** The target of developing a facility for delivering 83 million m³ of water per year was completed with the construction of the Huaiba water lifting and conveying system, including 4 pump stations, 395 meters of lifting, 12.4 kilometers (km) of conveyance system, and the Xiduancun regulating reservoir with a holding capacity of 29.7 million m³. The Yima Water Supply Scheme, including a water treatment plant with a treatment capacity of 33,000 m³ per day and 11.8 km expansion of the water reticulation system, started in 2003. The Mianchi Water Supply Scheme, including a water treatment plant with capacity of 60,000 m³ per day and 50 km expansion of the water reticulation system, was completed in 2007. The water supply component was strategic in mitigating the serious water shortage and in promoting local development in Mianchi County and Yima City. However, the water supply system developed under the project would mainly serve local industrial enterprises rather than agricultural irrigation due to the high cost of Huaiba water.¹

E. **Provision of Inputs**

7. The overall project cost was $179.8 million, 3% higher than the 174 million estimate after the major change of scope. ADB financing remained the same at $64.3 million. The provincial, municipal, and county governments contributed $33.7 million of counterpart funds from annual budgets. Project enterprises provided $44.9 million and project beneficiaries $29.7 million. An additional $7.1 million was borrowed from local banks. Counterpart funds from local governments at all levels account for only 19%, substantially lower than the 35% estimate upon the change of scope due to lack of fiscal revenue sources.

8. Of the $64,300,000.00 ADB loan proceeds, $64,299,999.69 was disbursed. Overall, loan disbursement lagged behind the project’s physical progress mainly due to delays in processing

¹ In the original project design, the water supply system was also to provide water for orchard irrigation.
withdrawal applications at various levels of project management offices (PMOs) and financial bureaus.

F. Implementation Arrangements

9. Project implementation began on time. Overall, implementation was on schedule except for the construction of the water supply infrastructure due to delays in endorsement of the dam design by a dam safety panel and finalization of the relocation arrangements of 367 families from the reservoir site. On request of the executing agency, ADB approved a loan extension of 1 year in November 2005. The loan extension was due to the outbreak of SARS (severe acute respiratory syndrome), time taken for the approval of the major changes in project scope, and delay in completing the Xiduancun Reservoir and Mianchi Water Supply Plant. All major project activities were completed before the extended loan closing date.

10. The project was implemented in line with the arrangements set at appraisal. The provincial PMO implemented the project in conjunction with the relevant technical agencies. Project implementation involved a number of agencies in counties, including the Bureau of Agriculture, Bureau of Livestock, Bureau of Forestry, Bureau of Water Resources, the Poverty Alleviation Development Office, and finance bureaus, as well as enterprises and households.

11. Loan covenants were generally complied with except for water tariffs. The project agreement called for setting of water tariff levels that were adequate to recover the full investment, operation and maintenance costs, and a reasonable return on the investments made by Mianchi Water Supply, Sanmenxia Huaiba Water Supply, and Yima Water Supply. At project completion, Mianchi Water Supply and Sanmenxia Huaiba Water Supply have yet to start full operation and comply with the covenant on tariffs. Yima Water Supply complied with the covenant from 2003 to 2005, but needed to increase the tariff return at project completion to sufficiently recover costs.

12. The project hired three domestic consultant firms to provide assistance and instruction in monitoring and evaluating project benefits and for external monitoring of resettlement. No international consultants were hired for the project. The domestic consultants, contractors, and suppliers generally performed satisfactorily. No major problems were encountered with their performance during project implementation.

13. The project had two preparatory technical assistance (TA) projects\(^2\) that were used in the formulation of the project design (PCR, para. 8). There was no discussion in the PCR on the assessment of the TA projects. ADB Project Administration Instruction (PAI) No. 6.07A specifies that “a project preparatory TA resulting in a loan should be evaluated in the PCR for the loan project.”\(^3\)

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II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

14. The PCR rated the project *highly relevant*. At appraisal, the project was highly relevant to the PRC’s development priorities and ADB’s strategy for the country. The first design included an agro-processing component that was canceled in the end due to commercial risks involved and environmental concerns. The final project design addressed the constraints in the development of West Henan province. The major changes in scope after the midterm review were timely and have improved the project’s linkage to Henan’s provincial policy and development plans. It has, however, also resulted in a significant reduction of household beneficiaries from horticulture development.

15. Only 5 of the 11 new subprojects under the horticulture and livestock components were implemented, the rest were canceled. The revised project design did not foresee the inappropriateness of supporting the subprojects that were eventually canceled. This reduced the relevance of the livestock and horticulture components. The facility for supplying stable source of water to the targeted areas was met but the water companies are still operating way below their design capacity and have not yet achieved financial sustainability in operations. Furthermore, due to the high cost of Huaiba water, the water supply system developed under the project would serve mainly industrial enterprises rather than inclusive of agricultural irrigation. Meanwhile, enterprises and industries widely use industrial self-supply wells drawing groundwater. If tariffs are significantly increased, industrial users may resort to groundwater rather than water supplied from Mianchi Water Supply and Yima Water Supply. While the project was indeed highly relevant at appraisal, the cancellation of six new subprojects, the uncertainty of the financial viability of the water supply component, and the supply of water provided mainly to industrial enterprises rather than irrigation to inclusive agriculture (especially for orchards), reduced the relevance of the project. Considering all these, this validation downgrades the PCR’s rating and rates the project as relevant.

B. Effectiveness in Achieving Project Outcomes

16. This validation concurs with the PCR that the project was *effective*. The project helped increase agriculture production and rural incomes. Most of the targets and expected outcomes were achieved. An increase in annual production of fruits, vegetables, cattle, goats, sheep, purebred sows, and milk was sustained during project implementation (PCR, para. 34, Appendix 7). The target of developing a facility for delivering 83 million m$^3$ of water per year was met with the construction of the Huaiba water lifting and conveyance system. However, water companies still face a common situation wherein water demand is much lower than design capacity.

17. Extensive training in horticulture development and animal husbandry benefited farmers. Farmers became more aware of environmental protection and consciously applied improved farming techniques and waste treatment techniques, consequently reducing pollution and increasing yields. Average net per capita income of project beneficiaries increased by 14.7% annually from 2000 to 2007 (para. 22).

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4 Original design of the project included supplying water also for orchard irrigation. See report and recommendation of the President (RRP) para. 69 and project completion report (PCR) para. 17.
C. Efficiency of Resource Use in Achieving Outputs and Outcomes

18. This validation concurs with the PCR that the project was efficient. At completion, the financial internal rate of return (FIRR) for the project as a whole was reevaluated at 14.0%, indicating that the project was financially viable. The economic internal rate of return (EIRR) for the project was reevaluated at 18.7%, which indicates that the project was also economically viable. Recalculated FIRR for the entire horticulture development component was 19.4%, higher than the estimate of 16.7% at appraisal. The EIRR was 22.7%, higher than the estimate at appraisal of 18.1%. For the livestock development subprojects, the recalculated FIRR values ranged from 11.6% to 22.8%, compared to the appraisal estimate of 17% to 21%. Recalculated EIRR values ranged from about 13.4% to 29.7%, compared with those estimated at appraisal of 19.3% to 23.1%. The reevaluated FIRR for the entire water supply component was estimated at 3.9%, lower than the 11.7% estimated at appraisal due to higher costs than anticipated, much lower demand than estimated due to the cancellation of the irrigation component, and the effects of the 2008 global financial crisis on industrial users. However, EIRR was 16.3%, comparable to the 16.2% estimated at appraisal.

19. The estimated overall project cost increased by $5.4 million after the major change of scope. The increase was mainly due to yuan appreciation but offset by the cancellation of six subprojects estimated at $26.8 million. Some savings from these cancellations were used to support additional household development and additional subproject activities. ADB financing for the project remained the same at $64.3 million.

20. Other than the delay caused by the SARS outbreak in 2003 and the time it took to approve the major changes in scope, the project was on schedule. All project activities were completed before the extended loan closing, indicating efficiency of process.

D. Preliminary Assessment of Sustainability

21. This validation agrees with the PCR that the project is likely sustainable. Financial and economic analyses of project components indicate viability of the project. Sufficient institutional support sustained the outcomes achieved. Given the complexity and logistical challenges of the project, the Henan provincial government and implementing agencies performed satisfactorily and are likely to support measures to sustain project benefits. For water companies to achieve sustainable operations incremental water demand should be adequate and water price should be increased to levels that will ensure cost recovery. Local government should also formulate a sound strategy for water management and pricing. Overall recovery of household subloans was respectable at 96%. At the project level, the proportion of the project’s debt financing fell to 40% from 47% at appraisal due to the increased contributions from farmer households and enterprises and reduced scope of the project.

E. Impact

22. Overall, the impact of the project was significant. The project promoted economic growth and contributed to the growth of rural incomes in project areas. It directly benefited 105,640 households or 94% of target households after the major change in scope (PCR, Appendix 8). The PCR reported that the average per net capita income of project beneficiaries increased by

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5 This was higher than the recalculated after tax average cost of capital, which was 3.5% based on actual capital mix and costs of various sources of financing.

6 As discussed in paras. 18–19. See also Appendix 7 of the PCR.
14.7% annually from 2000 to 2006 (PCR, Appendix 8). Sample surveys of monitoring agencies reported that project implementation contributed to net income growth of beneficiary households ranging from 110% to 289% from 2000 to 2007, higher than the income growth of non-beneficiary households that were in the range of 59% to 247% (PCR, Table A8.3 in Appendix 8). Based on official statistics, the total number of people living in absolute poverty in nine prefectures in the project areas decreased by 58% in 2007.7 A total of 490,300 people formerly living in poverty were reported to have been lifted above the absolute poverty line.8 In addition, the average poverty reduction rate in the project areas has been higher than that in Henan Province as a whole. All these indicate that the project has contributed to improving rural incomes and alleviating poverty in the project areas. However, these outcomes cannot be attributed to the project alone. The Henan provincial government also implemented other poverty reduction programs that might have contributed to income growth among poor households in the area (PCR, Appendix 8, para. 9). Furthermore, the World Bank has provided support for the development of the province. The improvement therefore in economic welfare of households was more likely a result of these combined program interventions in the project area. How much of that impact was solely from the project was not estimated.9

23. The construction and partial operation of the Huaiba water supply component contributed to local industrial development. Reliable water supply was provided not only to residents but also to key enterprises. The water supply component also gave the local government an advantage in attracting external investments.

24. The project had no significant adverse effects on the environment. All industries drawing water from the water supply scheme have installed wastewater treatment systems, and their discharges were reported to have met national environmental standards. Mitigation measures were included in the horticulture and livestock components to minimize negative environmental impacts or to improve environmental conditions. Manure and organic fertilizers were used extensively in the project areas. Livestock plants and farms usually have installed methane digesters to treat animal waste and wastewater. Overall, the project generated positive benefits in terms of soil conservation, carbon sequestration, reduction of greenhouse gas emissions, and improved water efficiency.

III. OTHER PERFORMANCE ASSESSMENTS

A. Performance of the Borrower and Executing Agency

25. The PCR rated the performance of the borrower and the executing agency as highly satisfactory and this validation agrees. The project encountered delays in processing withdrawal applications at PMOs and financial bureaus. Despite these delays, the Henan provincial government and the various levels of government provided good support to the project. The provincial PMO, established under the Provincial Financial Bureau, had experienced personnel as staff. Project implementation was timely (except for the water supply component) and without cost overrun although with reduced outputs. This was a remarkable achievement considering that the project involved many agencies and subprojects spread out over 20 counties. The

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7 Based on data from the Henan Provincial Poverty Alleviation and Development Office.
8 Defined as CNY625 per person per year in 2000 and CNY785 per person per year in 2007.
9 Estimating impact exclusively attributable to the project requires more rigorous statistical and econometric procedures to measure the situation that would have prevailed had the intervention not occurred. This requires a separate study beyond the scope of the PCR.
satisfactory project implementation, without relying on consultants, demonstrated in-house technical capability of line agencies.

B. Performance of the Asian Development Bank

26. This validation agrees with the PCR’s overall rating of ADB’s performance as *satisfactory*. It carried out nine project administration missions. The project was delegated to the PRC Resident Mission for administration on 27 December 2002, which improved the communication between ADB and the executing agency and facilitated quick resolution to pending issues. Procurement and disbursement training conducted at the start of the project helped PMOs comply better with ADB guidelines. ADB accepted the need for flexible participatory approach in site selection and project interventions, which gave participant farmers greater involvement in the decision-making process. Some delays in the approval of subprojects proposed in the midterm review, and in the processing of loan withdrawal applications, particularly reimbursements, did not significantly affect project outcomes.

C. Others

27. There were no issues on governance, and anticorruption and fiduciary aspects of the project. The government submitted a completion report of the project.

**IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS**

A. Overall Assessment and Ratings

28. Overall, the project was *successful*\(^\text{10}\) (see table). It was *relevant*, *effective* in achieving outcomes, *efficient*, and *likely* to be sustainable. Project implementation was satisfactory. The project was able to achieve its development objective of promoting pro-poor economic growth by increasing the incomes of poor farmers in West Henan. Most of the targets specified after the major change in scope were met except for the six projects that could not be implemented. Access to stable supply of clean water greatly improved the quality of life for the people of Yima. The additional water supply promoted local economic development and has become strategically important for the Mianchi County and Yima City.

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<tr>
<th>Criteria</th>
<th>PCR</th>
<th>IED Review</th>
<th>Reason for Disagreement and/or Comments</th>
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<tbody>
<tr>
<td>Relevance</td>
<td>Highly relevant</td>
<td>Relevant</td>
<td>The cancellation of six new subprojects reduced the relevance of the project at completion (para. 15).</td>
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<td>Effectiveness in achieving outcome</td>
<td>Effective</td>
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<td>Efficiency in achieving outcome and outputs</td>
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<td>Preliminary assessment of sustainability</td>
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<td>Likely sustainable</td>
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<tr>
<td>Overall assessment</td>
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\(^{10}\) Overall weighted average score based on Independent Evaluation Department rating is 2.0, which is equivalent to an overall “successful” rating.
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<tr>
<td>Borrower and executing agency</td>
<td>Highly satisfactory</td>
<td>Highly Satisfactory</td>
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<tr>
<td>Performance of ADB</td>
<td>Satisfactory</td>
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<td>Impact</td>
<td>Not rated but discussion and analyses of data show significant impact.</td>
<td>Significant</td>
<td>See paras. 22–24.</td>
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<td>Quality of PCR</td>
<td>Satisfactory</td>
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B. Lessons

29. This validation agrees with the lessons presented by the PCR. Having a clear, transparent, and systematic poverty targeting mechanism is important in ensuring that project resources reach poor households. The project reached its target of at least 40% poor households using its targeting mechanism. The flexibility in project design helped the project respond to market changes and align its activities with the PRC’s rapid socioeconomic development. The restriction of the government in establishing a revolving fund constrained the maximum use of loan funds. Loan funds repaid were not revolved and fully used to promote agriculture development and benefit poor households by providing them with additional resources. Since then, the Ministry of Finance regulation had been revised, following ADB’s discussion with the Ministry of Finance after the PCR, to allow such practice for future projects.

C. Recommendations for Follow-Up

30. The following recommendations provided by the PCR are valuable in sustaining the gains and impact of the project: (i) the need to increase water prices to generate adequate revenue and encourage efficient use of water resources; (ii) the need for close attention by the Mianchi county government and the Sanmenxia Hubaia Water Supply for the bottom cleaning of the regulating reservoir at Xiduancun; (iii) computerization of the county finance bureau and township finance office subloan portfolios and integration into relevant government accounting systems; and (iv) the establishment of a mechanism at the provincial and county finance bureaus to monitor the enterprises’ performance and their subloan repayments.

31. The general recommendations of the PCR are valuable to ADB operations. Setting up a revolving fund to maximize project impact through repayment of end users is usually part of project design in many ADB agriculture and rural projects. However, this was not incorporated in the design because it was in conflict with government regulation. At appraisal, ADB may explore the feasibility and requirements for establishing such fund. Furthermore, poor farmers who did not have cash on hand were not in a position to avail of subloans on a reimbursement basis. For similar projects in the future, the PCR recommends that 50% of the subloans be disbursed to the farmers in advance. The Independent Evaluation Department further recommends that the loans granted to farmers be based on their cash flow and repayment capacity. This means that appropriate screening and evaluation of farmers’ repayment capacity based on their cash flow need to be conducted prior to loan disbursement. To ensure that loan portfolios are protected from the delinquencies and defaults, systematic and rigorous monitoring of subloans need to be firmly in place and stronger accountability of finance bureaus should be established.
V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Evaluation Design, Implementation, and Utilization

32. The project tapped two consulting and/or research firms to monitor project benefits.\textsuperscript{11} A monitoring and evaluation system with 12 monitoring and evaluation centers was established, and 1,440 project and non-project beneficiary households were identified for sampling to facilitate performance monitoring and evaluation.\textsuperscript{12} The system tracked socioeconomic data and specifically the income growth of household beneficiaries. Periodic monitoring reports were generated and submitted to ADB. Overall, the benefit monitoring and evaluation system was satisfactory. However, the monitoring system of subloans at the county and town levels was weak. The county finance bureau and township finance office loan portfolios were not systematically computerized and integrated into relevant government accounting systems. Systematically organizing portfolio data would contribute to better management of risks and information flows. Furthermore, limited monitoring and reporting was conducted on the environment mitigation measures during construction. More could have been done to ensure that environmental safeguards were adequately complied with, including agricultural projects (PCR, Appendix 9, para. 9).

B. Comments on Project Completion Report Quality

33. The PCR was consistent with PAI 6.07A. It was well written, clear, and concise. The discussions were adequate and well supported with detailed analyses and data in the appendixes. The assumptions underlying the EIRRs and FIRRs were plausible. Lessons and recommendations were sound and derived from the analyses and findings. However, no assessment was made on the two preparatory TA projects that resulted in the loan. Overall, this validation rates the quality of the PCR satisfactory.

C. Data Sources for Validation

34. The data sources for this validation comprised the report and recommendation of the President, PCR (ADB and government), minutes on the management review meetings of the proposed loan, loan review mission reports and midterm review report.

D. Recommendation for Independent Evaluation Department Follow-Up

35. Project performance evaluation of the project may be considered to fully assess the performance of all project components.

\textsuperscript{11} These were Henan Statistical Information Consulting Center and Henan Chance Marketing Research.

\textsuperscript{12} Each center monitored 80 project beneficiary households and 40 non-project beneficiaries.