

WORLD BANK/WWF ALLIANCE - ACTIVITY CONCEPT NOTE
ACTIVITY: "Alternative Forestry Financial Institutions Feasibility Study"
To Assist GOI Assess Priority Policy & Operational Issues in Forest Sector Finance
& to Revitalize and Restructure the Forest-Based Industries

Date Prepared: February 28, 2006

1. Geographical Focus: Indonesia, National Level

2. Objective: To assist Ministry of Forestry to develop and test the feasibility of financial mechanisms that can help to expand & accelerate plantation development to support a sustainable & revitalized industry in the future.

3. Timing: Start Date: March 2006 **Completion Date:** May 2006

4. Issues Addressed: Indonesia's forest sector is facing crisis, due to rapid forest resource loss and degradation that threaten the livelihoods of rural people and the sector's continued contribution to export earnings and economic development. Industrial restructuring and development of alternative timber resources are needed to bridge the growing gap between demand for forest products and sustainable supply. Due to recent political changes, an increase in the seriousness of dialogue, convergence of findings from analytical work, and efforts to build constituency and increase political pressure, we now see signs of progress and potential for major improvement. This optimism is tempered by awareness of the ongoing, well-known governance issues. The Ministry of Forestry (MOFR) recently requested Bank assistance in the forest sector with: (i) forest law enforcement; (ii) monitoring; and (iii) industrial restructuring and plantation development. In June 2005, a Bank mission responded to this request and helped to develop this study concept, as part of a step-wise deepening of engagement with the GOI on forestry issues.

MOFR and most stakeholders recognize the problem of over capacity and the obstacles to revitalization posed by continued illegal logging. There is also recognition that the future of the wood processing sector will depend on an expanded (at least doubled) plantation program. In many areas, there is considerable potential to involve the rural poor in plantation production on both community and individually owned land. These production systems will need innovative partnerships between communities and companies and will need to be supported by extension and market information services to ensure equitable outcomes. Expanding plantations will be challenged by conflict over land resources and the need to address issues of due process related to gazettal to help ensure legality of products in international markets. Constraints to mobilizing financial resources for forestry investment in Indonesia reflect the current uncertainty and transitional state of the sector, as well as lack of trust and long term planning horizons. Although the GOI has substantial financial resources in the Reforestation Fund (>\$1 Billion), these funds are not targeted or disbursed effectively to provide sufficient incentives for plantation development. Further, returns to plantations are believed insufficient to attract commercial investment, though governance, security, and trust issues also come into play. This proposed study aims to help the GOI develop strategies and mechanisms in identifying financial mechanisms that can help to expand and accelerate plantation development to support a sustainable and revitalized industry in the future.

This feasibility study of "Alternative Forestry Financial Institutions" aims to assist the GOI to: analyze priority policy and operational issues involved in forest finance; develop mechanisms to mobilize and direct resources toward high quality opportunities with a priority on poverty-reducing, community-managed schemes; explore the feasibility of formulating institutional arrangements for successful and sustainable support to an efficient and transparent system for financing forestry sector development; develop a strategic response to balancing remaining sustainable supplies with demand, expanding tree plantations to revitalize the industry in the future, and capturing opportunities to reduce poverty by involving communities in timber growing and management.

This effort supports the Alliance's third target of increasing the area of production forests under sustainable management, by improving the enabling conditions for quality plantation investments, and

clarifying the role of communities. This will also help to reduce threats of illegal logging and encroachment in protected areas, so supports the other two objectives indirectly.

5. Activity and Outputs: This activity will use consultants working with the Ministry of Forestry to develop a strategy and an plan for a financial institution and/or mechanism that would create incentives for appropriate plantation establishment. An important secondary benefit for this feasibility study is to identify and create entry points for studies and dialogue for broader forest industry sector restructuring, and improved forest management. Expert consultants will develop interim results and hold workshops to engage GOI and stakeholders in selecting options and moving forward with implementation. This feasibility study should draw on and synthesize previous studies and analyses, rather than primary data collection. The study involves an initial phase to clarify issues and approaches with key stakeholders. The second phase will include detailed reports on 4 main topics, as follows.

- A. Introductory/Scoping Phase.** Undertake initial document review and meetings with stakeholders to determine platform and boundaries for deeper analysis. The consultants will summarize existing legal, financial and political constraints to plantation development and community based plantations, as well as the specific needs for follow on feasibility studies. For each of these areas, the consultants will develop terms of reference for additional studies or inputs that are practical and policy relevant to discussions underway within the Ministry of Forestry. Consultations will include DirJen BPK within the Ministry and the Forestry Faculty at IPB, which has conducted an early study on this topic. If necessary, further consultation with other related parties will be determined based on the results of consultation with DirJen BPK and Forestry Faculty-IPB. The output of this phase will be a brief report and recommendations for the scope and boundaries of additional studies.
- B. Evaluate Physical and Financial Investment Options.** This Task should focus on determining conditions and interventions that will help to improve plantation financing based on the principle of “The right tree in the right place for the right reasons, meaning the right end markets.” The task will address issues including: plantation models and strategic locations, land availability, marketing arrangements and prospects, and future trends and likely market developments. The task will also examine alternative financing approaches and the pros and cons associated with each.
- C. Analyze and Propose Legal And Governance System For Fund Management and Accountability.** To ensure that any plantations established under this mechanism have a firm legal basis so that results reach intended beneficiaries, the study will: examine legal and governance issues concerning land use; identify opportunities and barriers to improved plantation investments and wider development of plantation area; and determine criteria and indicators that must be met to ensure successful financing of plantation projects. To develop a viable financial institution, the study will: analyze options for the legal framework and institutional governance of the alternative forestry financial institutions; develop recommendations for specific institutional arrangements, based on consultations with stakeholders; and establish appropriate monitoring and evaluation framework for eligibility, disbursement, and results. Further, a legally binding sanction for funding misuse and non performance will also be developed. (Note: This is important to avoid past incidents in which the Ministry of Forestry lost the case against 21 HTI companies which were non-performing).
- D. Develop Eligibility Criteria (Targeting Mechanisms).** This task will examine approaches for identifying beneficiaries and financial mechanisms that will enable resources to reach the right target groups, engaging in the right activities (environmental, social and financial viable) for the right reasons (informed and market responsive) with the right financing. The study will: identify target communities and cooperative organizational models that can benefit from financial interventions to meet plantation development objectives; determine areas with potential for pilot projects, building on current initiatives where success can contribute to wider recognition and replication; build on opportunities to engage IFC in pilot projects (based on their objectives and criteria); and link these targeting approaches and criteria with financial mechanisms developed under Task B.
- E. Explore Funding Sources, Options and Costs.** The feasibility study will focus on establishing institutional means to ensure the right funds going to the right projects based on the right information and right returns on investment in the right time frame. The study will: determine the overall cost of plantation and forest rehabilitation under various visions of the future; quantify options together with

an assessment of costs, risks, returns on investment, and time scale; determine the appropriate areas (physical locations and plantation types) where donor funding or subsidized financing can improve outcomes or financial viability; review and recommend specific financial mechanisms most appropriate in different settings, including micro credit, KDP-type approaches, regional development banks; and build constituency for improved financing forest sector rehabilitation, restructuring, and revitalization.

Expected outputs: Brief report, summarizing analysis, findings and recommendations (details annexed) in a format and style designed to reach senior policy makers. The consultants will also produce a presentation (electronic file) with findings and recommendations synthesized in a brief, accessible format. Two major workshops will be held at the beginning and end of the activity. The proceedings of these will be summarized and annexed to the report.

Resources and Timing. Phase 1 Resources: International (1) and Indonesian (2) consultants for 3 weeks. Support for meetings and expert consultations. World Bank technical advice and supervision. Should be completed by end February 2006. Phase 2 Resources: International (2) and Indonesian (3) consultants for 6-8 weeks. Stakeholder workshops for presentation of interim results. Support for meetings and expert consultations. Possible brief field trip. World Bank supervision. Should be completed by end May 2006.

6. Expected Impacts. The Bank and Ministry of Forestry see this study as part of a process of building a constituency and operational plans for a longer term strategy for Indonesian forest sector revitalization, based on sustainably harvested plantation timber. The feasibility study is expected to:

- Deepen the ongoing forest sector dialogue and broaden it to include more financial sector stakeholders, within and outside of government.
- Provide an opportunity for detailed examination of the forestry sector incentive framework and the investment fundamentals.
- Understand the institutional checks and balances that will help assure success, and to assure that the investments are made in line with targets and commitments
- Determine the key areas of risks associated with financial institutions and investments and identify strategies to minimize risks, including achieving wider buy in from key stakeholders
- Establish necessary legal and financial steps, milestones, and criteria that will allow the GOI to determine how to better manage and attract forest sector investments for the long term
- This emphasis on the plantation sector is hoped to create leverage for change in the management and utilization of natural forest areas.

7. Related WWF, World Bank Projects or Other Projects: WB-WWF Alliance in Indonesia supports work on the 10 Step Anti Illegal Logging Program and the Forest Monitoring and Assessment System (FOMAS), both parts of the Bank's efforts to engage the Ministry on forestry policy reforms in a comprehensive and strategic manner. Other related products include EU FLEGT, DFID-MFP, CIFOR/Forest Trends "Regional Timber Trade Policy Dialogue"

8. Potential Partners: Ministry of Forestry, Bank Indonesia, Ministry of Finance, Institut Pertanian Bogor, DFID-MFP, WWF Indonesia Forest Program, CIFOR, ICRAF EU/FLEGT, IWGFF.

9 Indicative Budget	WBOJ Start Up Funding	WWF WB Alliance Funding	TOTAL Feasibility Study
	Phase 1 (Jan Feb) Task A	Phase 2 (Mar - May) Tasks B, C, D, E	
Grants/consultants: \$	\$25,600	\$81,500	\$107,100
Workshops: \$	\$2,400	\$20,000	\$22,400
Travel and perdiem: \$	\$8,880	\$27,000	\$35,880
Other: (specify) \$	\$1,000	\$3,500	\$4,500
Total: \$	\$37,880	\$132,000	\$169,880
Likely supplementary funding* #	\$8,400	\$9,000	\$17,400
Funding sought from Just in Time BB	\$29,480		\$29,480
Balance sought from WB WWF Alliance: \$		\$123,000	\$123,000

* Partner inputs include activities and experts funded by CIFOR, DFID-MFP, & ICRAF

In kind inputs include WBOJ, WWF/I and Min Forestry activities, experts, or administrative staff

10. Activity proponent(s)

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- WWF-World Bank Alliance will execute the project. The alliance will appoint a project coordinator and agree on the consultants that will carry out the feasibility study.