

PROPOSAL TO RESTRUCTURE THE
FOREST DEVELOPMENT PROJECT
(LOAN No. 4683-RO)
FOR ROMANIA

PROJECT DATA SHEET

Date: February 13, 2008		Task Team Leader: Peter A. Dewees			
Country: Romania		Sector Manager: Juergen Voegelé			
Project Name: Forest Development Project		Country Director: Orsalia Kalantzopoulos			
Project ID: P067367		Environmental category: A			
Borrower: Romania					
Responsible agency: Ministry of Agriculture and Rural Development (MARD)					
Revised estimated disbursements (Bank FY/US\$m)					
FY	2005	2006	2007	2008	2009
Annual	1,122,397	662,667	4,305,994	10,284,594	8,624,348
Cumulative	1,122,397	1,785,064	6,091,058	16,375,652	25,000,000
Current closing date: June 30, 2009					
Revised closing date: n/a					
Does the restructured Project require any exceptions to Bank policies? Have these been approved by Bank management? Is approval for any policy exception sought from the Board?					No n/a No
The Project Development Objectives of the original project were: to maintain and improve environmentally sustainable management of state and private forests so as to increase the contribution to the national and rural economies derived from Romanian forest resources.					
The revised Project Development Objectives would be: (i) to improve the management of state-owned forests through capacity building and technical innovation for environmentally-sustainable and cost effective forest management, and (ii) to support the establishment of pilot systems for forest management among underserved private forest owners.					
The revised outcomes are described in the Project Paper.					
Does the restructured Project trigger any new safeguard policies? No					
Revised Financing Plan (US\$m.)					
Source	Local	Foreign	Total		
Borrower	2.01	0.00	2.01		
IBRD/IDA	24.44	0.56	25.00		
Others	4.89	0.00	4.89		
Total	31.34	0.56	31.90		

A. Introductory Statement

1. This Project Paper seeks the approval of the Executive Directors to restructure the Forest Development Project to reflect considerable changes in Romania's forest policy framework, introduced since the Project was originally approved, and to take account of the fact that funds are no longer adequate, nor is the Project design appropriate, for achieving the Project's Development Objectives, as originally articulated. The proposed changes would modify the Project's Development Objectives and would adjust performance targets to focus more narrowly on what the Project can actually achieve given the current institutional and policy framework for sustainable forest management, and to take account of the involvement of the private sector in providing business advisory services to the timber industry. The changes proposed are largely an outcome of Government's decision to reconstitute a substantially larger area of state forests to their former private owners, and of the fact that the private sector has taken a stronger role in information service provision, than had been envisaged at Appraisal.

2. The following changes in the Forest Development Project and the associated legal documents are proposed: (i) the Project Development Objectives would be modified to reduce the sector-wide scope of planned interventions; (ii) envisaged support for the establishment of the Forest Sector Business Information Center would be dropped; (iii) support would be provided to design a Forest Geographic Information System as part of the Forest Management Information and Monitoring System (FMIMS); the planned program of forest roads rehabilitation would be scaled back; and (iv) support for private forest owners would be shifted to focus on groups of private owners of the smallest forest holdings, who generally lack capacity or the means for achieving economies of scale in forest management. The project's closing date and loan amount are to remain unchanged. The proposed changes have been requested by the Government of Romania in a letter from the Ministry of Public Finance to the Bank, dated October 18, 2007.

B. Background and Reasons for Restructuring

3. The Romania Forest Development Project was approved on December 19, 2002. It became effective on October 27, 2003. The Project's original Development Objectives were derived from the Romanian National Forest Policy and Strategy, approved by Government in 2000, and were "to maintain and improve environmentally sustainable management of state and private forests so as to increase the contribution to the national and rural economies derived from Romanian forest resources."

4. The Project was originally designed to assist the Ministry of Agriculture and Rural Development (MARD) to: (a) establish systems to ensure sustainable management of private forest lands, through building of the capacity of the Department of Forests and its Forest Inspectorate, supporting the development of private forest owners associations, and establishing a forest management information and monitoring system; (b) mitigate the consequences of restitution on the management of State forest lands by assisting the National Forest Administration (NFA) to maintain, develop and finance its important role in managing protection forests, and reduce the environmental impacts and improve the economic efficiency of managing State production forests by piloting new, environmentally sensitive, forest road construction practices; (c) support increased productivity and competitiveness of forest industries, through establishing and operating a Forest Sector Business Information Center (ForsBIC); and (d) build public support for sustainable forest management by implementing a public awareness program targeting key stakeholders with an emphasis on new private forest owners.

5. These objectives, and the Project components designed to meet them, are no longer entirely relevant. The critical policy environment which has changed, and which was not envisaged at Appraisal, was the significant expansion of the restitution program, designed to return large areas of state forests to their pre-1949 private owners. At Appraisal, it was envisaged that no more than a third (around 2 million ha) of Romania's 6.4 million ha of state forests would be formally restituted, following passage of Law 1/2000. Passage of a new restitution law in 2005 (Law 247/2005), greatly increased the area to be restituted, which is now expected to total around 4.5 million ha – or nearly 70 percent of the forest estate. The changed policy environment has been complicated by new institutional and policy challenges posed by Romania's Accession to the European Union.

6. The vastly expanded program of restitution has had profound implications for the forestry sector – both with respect to public ownership and for the institution charged with responsibility for managing state forests, the National Forest Administration, as well as for new private forest owners, many of which have only limited experience or capacity to undertake forest management.

7. There are several areas where this change has had a significant impact on the objectives and activities which were to be supported by the FDP. For example, it was envisaged that there would be significant scope for working with private forest owners, but in practice, the largest owners grouped themselves into Private Forest Districts, and hired former NFA staff to run them, with minimal needs for inputs or investment from Government. The Ministry has proposed instead to shift its emphasis to working with groups of private owners of the smallest forest holdings, who generally lack capacity for management or an understanding of the means for achieving economies of scale in forest management. These are the toughest stakeholders to work with for precisely these reasons, and so much of the focus of this component is being reoriented toward developing pilot operations, and lessons learned. Simply because of the vast number of new private forest owners and because of the weak institutional capacity for dealing with them, resources were not sufficient within the Project for developing and implementing a truly national program of support for local forest owners associations.

8. Substantial private sector investment in the forest products industry has also taken place in conjunction with restitution and with expansion into European markets. The timber products market is increasingly sophisticated. Forest product market information is readily available through various private networks, and so the envisaged support for a publicly-funded forest industry information mechanism is no longer seen to be a priority.

9. With respect to the establishment of a national sustainable forest management standard, in practice, forest certification has already been adopted both by the National Forest Administration (which has certified over 1 million ha of forests to Forest Stewardship Council standards), as well as by private forest owners in several Private Forest Districts. The view now is that there is a need for a diversity of standards for sustainable forest management, rather than a single national standard (as had been envisaged at Appraisal).

10. Finally, new technologies and the vastly expanded demand for information about the status of forest management are opening up new opportunities for technical innovation which had not been considered at Appraisal. Government is keen to develop investments in improved

systems for collecting, recording, and reporting forest management information, to which Project management is seeking to be responsive.

11. Other aspects of the Project remain highly viable. In particular, the Project has provided valuable support for preparing a Strategic Development Plan for the NFA and a comprehensive training program for the Department of Forests of MARD, in preparing and disseminating 'Best Practice Guidelines for Forest Roads Construction and Rehabilitation,' and in introducing new methods of roads engineering in the pilot forest roads rehabilitation program.

12. On balance, the Forest Development Project is providing useful lessons for critical stakeholders – Ministry forestry staff, the NFA, new private forest owners, and the timber industry – but it was not conceived, designed or financed in a way which could substantially affect performance under the new and expanded restitution regime. As the Project was originally conceived, forest policy and management decisions were largely the purview of the state, and Project investments could be seen to be catalytic in moving state forest management forward in a way which would have addressed sector-wide objectives. Because key stakeholders are, now, the greatly increased number of new private forest owners, the Project is not appropriate for moving forward sector-wide reforms under this ownership regime.

13. Given this fact, without significantly increased financing and without an additional and comprehensive program of activities – both of which are unlikely – the FDP is unlikely to meet its original objectives of significantly improving sector-wide performance. This fact was confirmed during the May 2007 Midterm Review, which proposed that the Project's Development Objectives should be modified to describe what the Project was likely to accomplish. After considerable internal discussion in Government, agreement was reached to move forward with proposed revisions.

14. The substantial changes in the institutional and policy framework have had a direct impact on the pace of Project implementation as well, which was slow to get off the ground. Progress was hindered because of effectiveness delays, far reaching institutional changes (including the subordination of the Forest Inspectorates to the Ministry of Control followed by their reversion to Ministry of Agriculture and Rural Development (MARD), as well as various Ministerial restructurings), and management disruptions caused by the election cycle (which resulted in delays in the approval of investment-related activities by MARD). Implementation delays were also structural, and were related to the design of the Project, particularly the Bank's environmental safeguard requirements which required completion of the 'Best Practice Guidelines for Forest Roads Construction and Rehabilitation' (which involved extensive internal and external consultations) before any substantive measures could be undertaken with respect to the forest roads rehabilitation activities, which account for around 60 percent of the loan proceeds. Because of delays, Implementation Performance ratings were downgraded to Unsatisfactory in mid-2007.

15. One of the outcomes of the delays has been that the costs for forests roads rehabilitation have been far greater than that envisaged at Appraisal – an outcome of both currency appreciation and domestic inflation – and this will likely affect the extent to which roads rehabilitation activities can be completed.

C. Proposed Changes

16. **Revised Project Development Objectives.** Government has proposed that the Project's Development Objectives should be revised more accurately to reflect what can be achieved given the financing which is available, and within the prevailing policy, institutional, and legal framework. The revised Development Objectives of the Project are proposed to be,

“... (i) to improve the management of state-owned forests through capacity building and technical innovation for environmentally-sustainable and cost effective forest management, and (ii) to improve the management of private forests by establishing pilot forest management institutions and systems for underserved private forest owners.”

17. **Revised Project Description.** Overall, the project will support implementation of four project components, rather than the five originally envisaged at Appraisal. The scope of the project is expected to change, as follows:

Part A. Establish Systems to Ensure Sustainable Management of Private Forest Lands

18. This component will continue to provide the support envisaged at Appraisal, with several exceptions. Support for the Forest Inspectorates is being scaled in a manner which is consistent with the current institutional framework, which involves 9 regional offices of the Forest Inspectorates, and which does not involve silvic district offices.

19. The expected national program of support for private forest owners is to be scaled back to a series of pilot initiatives. The target groups for these initiatives are private forest owners who operate small and fragmented holdings, who are not easily serviced via the more formal structures which have developed, such as Private Forest Districts. Government has chosen to focus on around a dozen pilot forest owners associations, largely comprised of underserved private forest owners, on developing lessons learned from working with these associations, and on preparing a strategy for further support for this particular group of private forest owners. Plans to develop national standards for sustainable forest management are being dropped, to allow for a diversity of national standards development.

20. The development of the Forest Management and Information Monitoring System (FMIMS) is to proceed as planned, but Government intends to complement the work which is underway by developing designs for a Forest Geographic Information System (Forest GIS) which would eventually be incorporated into the FMIMS. This is not a significant change in the original component design.

Part B. Mitigate the Consequences of Restitution on Management of State Forest Lands

21. New forest roads construction and railway infrastructure rehabilitation activities originally envisaged at Appraisal are being dropped. Project activities are being limited to the rehabilitation of existing forest roads. The forests roads which are being rehabilitated have been reduced in scope from those envisaged at Appraisal from 425 km to 220 km.

Part C. Support Increased Productivity and Competitiveness of Forest Industries

22. This component, which was designed to support the establishment of a part publicly-funded Forest Sector Business Information Center (ForsBIC), to provide independent business development and advisory services, is being dropped because of the availability of privately financed information services of this type.

23. Other Project components (Part D. Build Public Support for Sustainable Forest Management and Part E. Project Management and Monitoring) are unchanged.

24. There would be no significant changes in the Project's institutional arrangements, in financing mechanisms, in Project management (in financial management, or in disbursement/procurement arrangements), or changes to the Project's Closing Date. The implementation schedule has been changed to backload disbursements, in line with planned contracting for forest roads.

25. Reallocation of proceeds. Funds which had been originally allocated for the establishment of the Forest Sector Business Information Center are being reallocated to finance the design of the Forest Geographic Information System. The project cost and financing plan has been revised to accommodate the partial reallocation of the loan proceeds. The revised components and costs are indicated below.

Component	Original (US\$M)	Revised (US\$M)
1. Establish systems to ensure sustainable management of private forest lands	8.43	8.81
2. Mitigate consequences of restitution on management of state forest lands	14.49	14.49
3. Support increased productivity and competitiveness of forest industries	0.38	0.00
4. Build public support for sustainable forest management	0.60	0.60
5. Project management and monitoring	1.10	1.10
Total	25.00	25.00

D. Analysis

26. The proposed change in the Project's Development Objectives focuses the Project more critically on where good success can be achieved within the prevailing institutional and policy framework. The change narrows the range of the outcomes envisaged to those which are reasonably achievable within the Project period, given the financing which is available, and is an acknowledgement of the need to focus interventions on pilot initiatives and on areas which can generate lessons learned.

27. With respect to specific proposed changes in Project activities, these are relatively minor. Dropping of the small ForsBIC component is a rational choice, given the fact that the services envisaged for ForsBIC are already being offered by private providers and do not require public financing. The increased emphasis on improving the FMIMS, by reallocating funds earmarked for ForsBIC, reflects the need for improved regulatory oversight for the larger number of private forest owners and the larger range of technical options available for doing so, which were not available at Appraisal, but does not change substantively the approach towards FMIMS development envisaged. The change in emphasis to support underserved private forest owners reflects a strategic choice to develop institutional options for this particular group of forest owners, for whom economies of scale and service delivery have been problematic. Other groups of forest owners are already being serviced by other institutions. The move toward recognizing a range of sustainable forest management standards is consistent with prevailing international best practice for forest certification and is a pragmatic response to the emergence of multiple certification systems.

28. With respect to the forest roads rehabilitation component, this activity has developed strong learning dimensions to it, and has introduced new roads design and engineering practices to Romania. In addition, the development of the 'Best Practice Guidelines,' and their use in the pilot roads activities, has introduced new standards of environmental stewardship in forest roads development. All of these

outcomes have been highly desirable, and are not diminished by reducing the length or number of roads to be rehabilitated. As the PAD pointed out originally, the roads component was conceived of as a pilot activity anyway, and it retains this character regardless of the proposal to scale back the initial targets.

29. The Project's original economic analysis suggested returns to the FDP were likely to be high and especially robust, and established that returns would be most sensitive to reduced timber prices and to a reduction in the area to be restituted. With respect to timber prices, in real terms, these have increased by at least 2 percent annually since the Project was approved.¹ With respect to the area restituted, this has greatly exceeded initial expectations, and, provided that outcomes are consistent with those expected at Appraisal, returns from activities associated with restitution are also expected to be robust.

30. With respect to dropping of the ForsBIC component, economic returns to this activity were not calculated at Appraisal because most of the benefits were expected to be non-quantified. By reallocating these funds to preparation of the FMIMS activity, returns are also expected to increase because of improved regulatory oversight, which is the envisaged outcome.

31. Of greater concern is the higher cost of forest roads rehabilitation. The original economic analysis calculated returns of 24 percent to this component. This was based on an assessment of expected returns to individual roads subprojects, and assumed constant real pricing over the expected 50 year life of the forest roads. The Project team has revisited this assessment. The proposed reduction in targets from 425 km of forest roads to 220 km of forest roads represents a *de facto* increase in the unit costs of roads rehabilitation of 93 percent. Changing the cost/benefit analysis to reflect this reduces the IRR from 24 percent to 14 percent – still an acceptable rate of return. An analysis of a sample of roads rehabilitation sub-project of their sensitivity to price increases confirms the magnitude of the change in estimated returns. If one incorporates modest price increases into the analysis -- a reasonable assumption in the face of increasing global demand for wood and paper products – the returns increase to around 17 percent for a 2 percent annual increase in the price of wood (typical for pine logs), and to 21 percent for a 5 percent annual increase (typical for oak logs).

E. Expected Outcomes

32. Because of the reallocation of funds, expected outcomes will modestly change. Most of these are changes in intermediate outcomes.

34. **Changes to outcomes to Part A:** Outcomes with respect to work with the Forest Inspectorates are consistent with those envisaged at Appraisal, but the project will be working within the prevailing institutional framework for doing this, which involves only 9 regional inspectorates (rather than the 16 inspectorates and 100 silvic districts envisaged at Appraisal). Outcomes with respect to work with private forest owners are being scaled back to focus on developing 12 pilot initiatives for working with associations of underserved private forest owners, to develop lessons learned from working with these associations, and then to develop a strategy for further support for this particular group of private forest owners. Project support for the development of a single national standard for sustainable forest management is being dropped. Other planned outcomes remain unchanged.

35. **Changes to outcomes to Part B:** Outcomes with respect to the development of a series of pilot forest roads activities envisaged at Appraisal remain unchanged, which are to reduce the environmental impact of forest roads and to improve the economic viability of wood harvesting in state owned

¹ Between December 2002 and May 2007, for pine logs. Other species show higher annual rates of increase – 3.9 percent for spruce and 5 percent for oak logs. Derived from the timber producer price index (Germany), UNECE database.

production forests. Targets, however, are being reduced from 425 km envisaged at Appraisal to 220 km, and are solely for roads rehabilitation (rather than for new construction or railway rehabilitation).

36. **Changes to outcomes to Part C.** As Part C, the establishment of the Forest Sector Business Information Center, is being dropped from the project, outcomes which envisaged a strong public sector role in facilitating business activities of the forest sector are being dropped. This role is being taken on by the private sector.

37. **Changes to outcomes to Parts D and E.** Outcomes envisaged at Appraisal remain unchanged.

38. Progress in meeting the Development Objectives with respect to state-owned forests – better environmental and economic outcomes, and improved capacity for managing state forests – is being monitored by evaluating uptake and impact of the ‘Best Practice Guidelines for Forest Roads Construction,’ monitoring of forest roads rehabilitation performance against those guidelines (both in the pilot roads rehabilitation program and in any new forest roads rehabilitation efforts), and the economic benefits of reduced log harvesting costs associated with roads rehabilitation. Implementation of the Strategic Development Framework for the National Forest Administration, as well as the capacity for undertaking improved forest monitoring are also being tracked as intermediate outcomes.

39. Progress in meeting the Development Objectives with respect to underserved private forest owners is being monitored by tracking progress with the pilot initiatives, by assessing the extent to which ‘lessons learned’ from pilot activities are being acted on, and by tracking implementation of the strategy prepared with project support for dealing with this group of private forest owners.

F. Benefits and Risks

40. Benefits of implementing this restructuring include fiscal savings, better services to new private forest owners, improved regulatory capacity, and better targeting of Project interventions to address specific learning outcomes.

41. Risks are expected to be quite low.