International Finance Corporation

OEG REVIEW - IMPLEMENTATION OF THE 1991 FOREST STRATEGY IN IFC'S PROJECTS

VOLUME I

JUNE 23, 2000

OPERATIONS EVALUATION GROUP
DIRECTOR: WILLIAM E. STEVENSON
TASK MANAGER: AFOLABI OJUMU

Study Team

Core Team: Afolabi Ojumu
Rafael Dominguez
Cherian Samuel
Dominique Zwinkels

Consultant: John Gilliland

The empirical findings in this report are based on information which private sector companies assisted by IFC have provided OEG in respect of their activities and operations. Because of the confidentiality of this information, identifying data about individual companies have been disguised or aggregated as appropriate in accordance with the requirements of IFC's policy on disclosure of information.

OEG REVIEW - IMPLEMENTATION OF THE 1991 FOREST STRATEGY IN IFC'S PROJECTS

TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS

ASR	Annual Supervision Report (predecessor of PSR)
CAMENA	Central Asia, Middle East & North Africa Department
CTE	Technical and Environmental Department
DGO	Director-General, Operations Evaluation
FAO	Food and Agriculture Organization of the UN
FI	Financial intermediary
FPIRS	Forestry Policy Implementation Review and Strategy
FSC	Forest Stewardship Council
TMF	Primary tropical moist forest
GEF	Global Environment Facility
IDA	International Development Association
ISO	International Organization for Standardization
LAC	Latin America and Caribbean Department
NGO	Non-governmental Organization
OED	Operations Evaluation Department (World Bank)
OEG	Operations Evaluation Group
PSR	Project Supervision Report (successor to ASR)
SMEs	Small- and medium-sized enterprises
UN	United Nations
WWF	World Wildlife Fund
OP	Operational Policy
GP	Good Practices

GLOSSARY[1]

Afforestation. Establishment of a tree crop in an area from which it has long been absent.

Boreal forest. Forest located in areas with mean annual temperature of less than –4°C, dominated by pine, fir, spruce, larch and birch, and covering large areas of Canada, Russia and Scandinavia.

Carbon sequestration. The process by which plants convert atmospheric carbon dioxide into organic compounds through photosynthesis. (This definition may be subject to revision in light of NASA's Boreal Ecosystem-Atmosphere Study.)

Deforestation. Change of forest with depletion of tree crown cover to less than 10 percent. The clearing of forests and the conversion of land to non-forest use.

Degradation. Reduction in the productive potential of natural resources in areas that remain classified as forests. Degradation may be permanent, although some forests may recover naturally or with human assistance.

Farm forestry. Tree planting that is carried out on private farmlands.

Forest. Ecosystem with a minimum of 10 percent crown cover of trees and/or bamboo, generally associated with wild flora and fauna and natural soil conditions and not subject to agricultural practices. Forests are in two categories:

- *Natural forest:* a subset of forests composed of tree species known to be indigenous to the area.
- *Plantation forest:* established artificially by afforestation on lands which previously did not carry forest within living memory, or established artificially by reforestation on land which carried forest before, with replacement of the indigenous species by a new and essentially different species or genetic variety.

Forest-based project. A project that utilizes forest products as its primary raw materials; also referred to as "project with direct impact on forests".

Man-made forest. Forest that was originally planted by humans but has since evolved naturally through conservation.

Non-forest project. A project, other than forest-based project, whose connection with the forest is tangential through right of way, access to mineral deposit, conversion of land, and such similar uses; also referred to as "project with indirect impact on forest".

[1] Source: *The Forest Sector: A World Bank Policy Paper, 1991*; World Bank. 1994. "Review of Implementation of the Forest Sector Policy"; Pearce, Putz, Vanclay, *A Sustainable Forest Future?* (DFID, 1999); and *State of the World's Forests (FAO 1999)*

Primary forest. Relatively intact forest essentially unmodified by human activity for the past 60 to 80 years.

Reforestation. The replacement of trees in cut forest areas.

Secondary forest. Forest subject to a light cycle of shifting cultivation or to various intensities of logging still contains indigenous trees and shrubs.

Social forestry. A term used originally to describe a type of project that included tree planting carried out as a community undertaking, sometimes including farm forestry, with the focus of producing fuelwood and poles. More recently, social forestry refers to any kind of forestry project in which poor people are the main beneficiaries.

Stumpage. Fee or price of standing trees before logging; also called royalty.

Sustainable forest management. A system of forest management that aims for sustained yields of multi-products from the forest over long periods.

Temperate forest. Forest located in areas with mean annual temperature between -4^{o}C and 24^{o}C, dominated by broad leaf tree species. Heavy human intervention or conversion into plantations characterizes temperate forest.

Tropical moist forest. Forest situated in areas receiving not less than 100 millimeters of rain in any month for two out of three years, with a mean annual temperature of 24^{o}C or higher; mostly low-lying, generally closed.

1. EXECUTIVE SUMMARY

Background

1.01 In 1991, the Bank issued a forest paper[2] (1991 forest paper) that set out its strategy for intervention in the forest sector and other sectors affecting forests. The forest paper focused special attention on the conservation of primary tropical moist forests (TMFs), and its objectives were to reduce deforestation and increase planting of trees in order to expand forest cover. In 1993, the Bank issued Operational Policy 4.36[3] (Bank's OP 4.36) that reflected the policy content of the strategy and introduced Good Practices 4.36[4] (GP 4.36) to provide staff with direction on implementing the strategy.

1.02 Since the 1991 forest paper was written primarily for Bank and IDA operations, it provided limited and unclear guidance for IFC operations. In recognition of this fact, IFC issued a memorandum to its Board[5] (1991 forest memorandum) to clarify how the 1991 forest paper would be applied to its operations, including a commitment that all IFC's projects would conform with the "spirit and intent" of the 1991 forest paper. When the Bank's OP 4.36 was introduced in 1993, IFC adopted it automatically for its forest operations. The 1991 forest paper, the 1991 forest memorandum and the Bank's OP 4.36 are collectively referenced as the "IFC forest strategy" in this paper, and implementation of the strategy in IFC's operations is the subject-matter of this evaluation.

1.03 This study is based on (i) a review of all the forest-based investments approved by IFC during FY85-98 to identify the changes induced in IFC operations on a "before/after strategy" basis; (ii) a review of selected non-forest infrastructure projects supported by IFC in FY92-98 which potentially have impacts on forests; (iii) a review of selected financial intermediary investments approved in FY92-98 to assess evidence of adherence by the intermediaries and their IFC-funded sub-projects to the requirements of the forest strategy; and (iv) case studies on a sample of 14 forest-based companies visited to assess their on-the-ground results from the perspective of the 1991 forest strategy's objectives. The sampled projects in the case studies were broadly representative of the regional distribution of IFC's portfolio at the end of FY98 of forest-based projects that relied on local resources.

1.04 In the context of World Bank Group's review of its forest strategy and policy, the purpose of this study is to answer the following questions: (a) how effective was the 1991 forest strategy? (b) what were its impacts on IFC's projects? (b) how adequate was IFC's implementation of the strategy in its operations? and (c) what are the lessons from IFC's experience to guide strategy revision and future operations? In addition, the study reviews the IFC's OP 4.36, approved in 1998, to establish its coherence with the forest strategy.

---

[2] World Bank 1991. *The Forest Sector: A World Bank Policy Paper,* was originally considered by the Executive Directors on July 18, 1991

[3] World Bank Operational Manual: Operational Policy 4.36 - *Forestry*

[4] World Bank Operational Manual: Good Practices 4.36 - *Forestry*

[5] "IFC Forestry Projects" (IFC/SecM91-119)

1.05 This study complements the Operations Evaluation Department's (OED's) evaluation of the Bank's experience under its forest strategy.

Main Findings

1.06 ***Effectiveness of strategy:*** Based on the findings of the portfolio review and case studies, the intention of the forest strategy to engage the private sector in sustainable forest management was not attuned to realities on the ground. Part of the reason has to do with economics: over half of IFC's projects approved since 1991 use Government-owned forests, and the stumpage paid in some of the cases studied is lower than the real cost of managing the forests sustainably. Hence the private concessionaires have a financial disincentive to encourage the more costly option of sustainable forest management. Part of the reason has to do with the manner in which forest concessions are operated: a concession that is not fixed to a specified area in the forest does not put any part of the forest under the control of individual private operators. In the absence of such delimited areas of control, private operators would generally not accept contractual responsibility for sustainable management of the forest. Part of the reason has to do with ownership of the forest: in general, private operators are not given the contractual right to manage sustainably forests that belong to government. The case studies found that governments want to retain ownership and management control of the forestlands for various reasons. In Sub-Saharan Africa, land tenure arrangements discourage or prohibit ownership by foreigners, whereas foreign investors controlled all the forest-based companies assisted by IFC in the region. In one Asian country, the forests belong to farm collectives organized under the country's political system and are not available for foreign ownership. In Eastern Europe, forests are considered to be part of national endowments that need to be preserved in the hands of the state. Reinforcing the status quo within these cultural and legal frameworks are powerful vested interests, who in many cases are enabled by the lack of transparency and accountability to extract private gain from the state's control of the forest resources.

1.07 The forest strategy implied a commitment by IFC project companies to work with the local people, interest groups and forest dwellers in forest areas, and that has proven to be unrealistic. Lacking ownership or contractual control over the forests, private operators did not welcome -- and have no incentive to accept -- this responsibility and the strings attached in the form of entanglement in local law enforcement and politics.

1.08 ***Impact of the strategy:*** The 1991 forest strategy did not inspire reforestation and increased tree planting in IFC projects. The projects that engaged in tree planting needed to do so for commercial reasons: to create a sustainable and economically optimum raw material resource for their operations. Similarly, IFC projects that reforested harvested areas did so to ensure the long-term sustainability of their manufacturing operations, which were capital-intensive in some companies.

1.09 However, the 1991 forest paper created a heightened awareness of the environmental sensitivity and value of natural forests as ecosystems, particularly TMFs, and has led to fundamental changes in project selection, processing, and monitoring by IFC. The forest sector also featured importantly as a driver of the steps taken by IFC during the past three years to strengthen its policies, procedures and staff resources to meet environmental requirements.

1.10 The focus of the forest strategy on TMFs neglected other forest types with differing biodiversity situations and issues. In particular, the strategy did not provide guidance specifically relevant to projects utilizing temperate and boreal forests, which comprised all of IFC's forest-based operations that were approved in the post-Strategy period.

1.11 The strategy's strong emphasis on ban of commercial logging in the TMFs had a chilling effect on IFC. In order to avoid any association with deforestation, IFC made a conscious decision to screen out this type of operation completely, and subsequently turned down several proposals submitted to it. Thus, those proposals were denied the valuable contribution IFC could have made through its at-entry structuring role, including measures to ensure sustainable resource and environmental management. The study could not ascertain whether any of these projects were implemented without IFC financing.

1.12 ***Strategy implementation:*** Overall, IFC's operations approved since FY92 have been consistent with the twin objectives of the forest strategy of abstaining from activities which add to the loss of TMFs and encouraging reforestation. IFC has diligently upheld the prohibition against financing commercial logging in TMFs, and in its mainstream operations it has not approved a single forest-based investment in this category since the strategy became operational. However, two small investments -- approved under streamlined review procedures through IFC's small- and medium-sized enterprise (SME) facilities -- financed a company engaged in transporting logs harvested under concessions in TMFs. While these investments were consistent with the letter of the forest strategy, they digressed from its "spirit and intent", and the environmental review procedures in place at the time failed to detect the inconsistency. In addition, two other small investments also approved under the facilities were in companies whose non-project operations, or those of their sponsors, involved logging in TMFs.

1.13 IFC has contributed to the establishment of project-owned large plantations, particularly in Latin America and Asia that represented almost 40% of post-Strategy approvals, and these plantations are being managed sustainably. Even in countries where the forests are owned by governments, IFC staff ensured that forest operations that supplied IFC projects were carried out in a sustainable manner and in accordance with good industry practice. IFC has also supported several projects that relied on wood wastes, wastepaper and other recycled materials, thus contributing to the conservation of forest resources.

1.14 In addition, IFC has undertaken special initiatives that supported forest conservation and sustainable management. In 1991, IFC sold its 58,000 hectares parcel of land in Paraguay (acquired in a foreclosure) for the creation of a nature reserve in perpetuity. Since 1995, IFC has been administering a $16 million grant from the Global Environmental Facility (GEF) to support SMEs promoting climate change initiatives and sustainable use/conservation of biodiversity.

1.15 In its financial intermediary (FI) investments, IFC has not generally required its borrowers to report on the sub-projects they assisted and, as a result, IFC does not know about the possible involvement of these sub-projects in the forest sector. On the basis of a file review, the study could not ascertain the extent to which IFC-supported FIs and their sub-projects in countries with threatened TMF are conducting their operations in a manner consistent with the forest strategy. Since 1994 IFC has been training the FIs on environmental risk management, including sessions on IFC's forest strategy and its prohibition against financing commercial logging in the TMFs. In the IFC-specific environmental and social safeguard policies that were approved by the Board in July 1998 and which define the current framework, special requirements were developed for FI projects, and environmental requirements and review procedures were specified for sub-projects according to a tier classification.

1.16 However, there have been process weaknesses in the implementation of the 1991 forest strategy by IFC. Specifically, IFC did not (a) disseminate the forest strategy to staff to ensure their familiarity with the objectives and relevant requirements; (b) reflect the strategy in its operations manual or provide staff with a manual similar to the Bank's GP 4.36; (c) put clear screening/appraisal guidelines in place for processing forest-impacting projects; nor (d) for relevant projects, include explicit covenants in the investment agreements to commit its project companies to their expected responsibility under the IFC forest strategy.

1.18 ***Forest certification:*** Forest certification scheme, which operates as an association of forest areas certified as being sustainably managed, can promote the aims of the forest strategy because it improves forest management, promotes the participation of stakeholders, and keeps forest management processes transparent. Its twin companion, eco-labeling, promotes brand awareness for forest products to help consumers, most of them in developed countries, recognize products from certified forests. However, the cost of certifying the forest, which is currently high, may never be recovered unless the forest products can be eco-labeled. This is why forest certification is not considered relevant by many forest-based companies whose products sell in the domestic markets or trade internationally as commodities. Furthermore, certification of forest management practice is seen as a competitive threat by forest-based companies that do not own their forest resources and are not responsible for management of the forests. On the other hand, for those companies whose operations can meet the standards, eco-labeling has tended to serve as a marketing tool for exports and a mechanism for market share increase. The recent proliferation of certification schemes is creating an unhealthy rivalry for "membership recruitment". IFC does not insist on forest certification but encourages its project companies to obtain it.

1.19 ***IFC's new forest paper:*** IFC's OP 4.36 was introduced in July 1998 and, by design, was "harmonized" with the Bank's version. Parts of the document are vague and can be misinterpreted unless the reader is aware of and acquires a good understanding of the 1991 forest paper. But a major shortcoming of the IFC's OP 4.36 is that it does not contain any reference to the forest paper, unlike the Bank's 1993 version from which it was derived, and the source and objectives behind its policy content are therefore missing.

2. Introduction

Background

2.01 The World Bank is undertaking a review of its 1991 forest strategy in order to make needed revisions and modifications for guiding future intervention in the forest sector and other sectors affecting forests. In the context of this review, the Bank's Operations Evaluation Department (OED) is conducting an independent assessment of the Bank's experience under the strategy. In turn, IFC's Operations Evaluation Group (OEG) was requested by the Director-General, Operations Evaluation (DGO) to provide a similar assessment of IFC's experience under the strategy to complement the OED's assessment. This study reviews the implementation of the forest strategy in IFC projects: the environment in which the strategy was developed; the effectiveness of the strategy in avoiding loss of TMFs, reducing deforestation, and increasing tree planting; the procedures for its implementing the strategy; and its impacts on IFC projects.

2.02 ***Brief history of 1991 forest strategy***: The basic document containing the 1991 forest strategy was the 99-page *The Forest Sector: A World Bank Policy Paper*[6] (1991 forest paper). It updated the Bank's approach to forest sector operations to take account of the changes in knowledge since its predecessor in 1978. These changes included a deeper understanding of the economic and ecological roles of forests and woodlands; the importance of non-wood forest products to forest dwellers and the rural poor in terms of employment creation, income generation and sustenance; and the role of the forests in world carbon cycle and climatic conditions. A more significant change since 1978 was the appreciation that the loss of TMFs was uniquely costly because of their extraordinarily rich biological diversity, their significant roles in regional and global climatic patterns, and the vulnerability of their soils under other forms of land use. It was on this basis that the paper treated TMFs differently, making their protection from deforestation a top priority. The 1991 forest paper also mapped a new direction for the Bank's forest strategy by introducing a multi-sectoral approach and a consultative/participatory process in its forest sector operations.

2.03 In 1993, the Bank codified the 1991 forest paper into OP 4.36. Simultaneously, it issued GP 4.36 as guidelines for implementing the 1991 forest paper and Bank's OP 4.36.

2.04 The Bank reviewed the forest paper in 1994 to assess the continued relevance of the guidance and direction it provided. The review concluded that it was too early to identify the paper's development impacts, and focused instead on whether the quality of Bank's forest sector analysis and design of non-forest projects had improved.

2.05 ***Rationale for the current review***: However, the forest sector has remained highly visible, both inside and outside of the Bank. With the continuing debate over balancing the developmental and environmental roles of forests, it was inevitable that the Bank's activities would attract close attention, necessitating regular re-examination of its lending operations

---

[6] It was originally "Bank/IDA Forest Policy Paper (R91-96/1)" and was considered by the Executive Directors on July 18, 1991.

and strategy. The present review has arisen from the confluence of several developments. Externally, the most important development has been the continued alarming loss of forest cover, currently estimated at 15 million hectares per year, and the urgency of finding a lasting solution. Environmental concerns have increased internationally and spotlighted the role of the forest sector. Biodiversity, which is a widely desired function of forest ecosystems, was the subject of one of the two pacts signed at the 1992 Earth Summit in Rio. The 1997 Kyoto Conference identified forest destruction as a major source of greenhouse gases, and carbon sequestration has continued to generate interest because of its association with global-warming. Forest certification which seeks to link trade, particularly international trade, to sustainable management of forests has continued to gain acceptance although it remains controversial.

2.06 Internally[7], some of the Bank's processes and recent initiatives point toward a re-direction of its lending operations and the search for a new strategy of engagement in the forest sector. A review of the Bank's forest projects has concluded that lending operations were being adversely affected because of the vagueness and possible misinterpretation of the 1991 forest strategy. The Bank's partnership with international bodies, like the World Wildlife Fund (WWF), the Forest Market Transportation Initiative, and the Interagency Task Force on Forests, has highlighted the need for harmonization between the Bank's procedures/guidelines and the agendas of these agencies. In June 1997, the Bank announced ambitious new global goals to bring, by year 2005, a total of 200 million hectares of natural forest under genuinely sustainable management and 50 million hectares of critical natural forest ecosystems under complete protection. Both goals would necessitate a re-orientation of forest-impacting operations.

2.07 Trends in the literature have also contributed to the need for new strategies for forest sector activities. Recent empirical results on the economic benefits of forests have challenged the common notion that the preservation of forests yields high economic returns to the local environment[8]. A controversy over the appropriate approach to the preservation of forests and biodiversity has challenged the feasibility and desirability of sustainable forest management, while other debates have been focusing on the economic forces that contribute to deforestation. A recent study has found that almost 30% of the total carbon released by humans annually may be stored in the boreal ecosystem, with the carbon being in the soils, not trees, and ready to be released by global warming[9].

2.08 ***Which forest strategy for IFC?*** The 1991 forest paper was written primarily for the Bank and IDA, and it provided limited and unclear guidance for IFC operations. In recognition of this fact, IFC issued the 1991 forest memorandum to its Board of Directors to clarify how the 1991 forest paper would apply to its operations. The memorandum is attached as Annex 1.

2.09 When the Bank's OP 4.36 (Annex 2) was introduced in 1993, IFC adopted it automatically for its forest sector operations. It remained in effect until July 1998 when IFC

---

7 See the Initiating Memorandum for the FPIRS.
8 World Bank Research Observer, February 1998
9 NASA's Boreal Ecosystem-Atmosphere Study

introduced its own OP 4.36 (Annex 3), which is similar in many respects to the Bank's OP 4.36.

2.10 For the purpose of this study, therefore, the IFC forest strategy is contained in the 1991 forest paper, the 1991 forest memorandum, and Bank's OP 4.36.

Purpose of Study

2.11 This study is an independent assessment of the implementation of the forest strategy in IFC operations during FY92-98. The study covers the environment in which the forest strategy was developed, the evolution of procedures established to promote pursuit of the strategy, the effectiveness of the strategy, its implementation by IFC, and the impact on IFC's operations. In addition, the study reviews the IFC's OP 4.36 in relation to the other forest strategy documents (i.e. 1991 forest paper and the 1991 forest memorandum) for purposes of relevance and consistency.

Scope and Methodology

2.12 The study has four components and is based on the approach that OEG agreed with IFC Management in the memorandum dated October 8, 1998 (Annex 4). The first component is a review of all forest-based projects approved by IFC between 1985 and 1998, including 14 projects approved under SME facilities. These were projects engaged in pulp and paper manufacturing, wood processing (including logs, furniture, sawnwood, and plywood), and production of engineered woods (including fiberboard and particleboard). The projects were split into two groups, namely those approved in FY85-91 before the 1991 forest paper (i.e. pre-Strategy period) and those approved in FY92-98 (i.e. post-Strategy period), to assess changes induced by or attributable to the forest strategy and to identify any implementation shortcomings. The study also reviewed the forest-based projects that IFC declined to assist in the post-Strategy period in order to confirm adherence to the strategy's prohibition of commercial logging in primary TMFs.

2.13 In order to assess the impacts of non-forest projects that could cause forest conversion or loss of forest cover, the study screened all the projects approved by IFC during FY92-98 in the agribusiness, power, other infrastructure, and oil, gas and mining sectors. The study's second component, therefore, is a detailed review of 34 of these projects located in countries with threatened TMFs[10] together with seven infrastructure projects approved under SME facilities.

2.14 As interpreted in this study, the forest strategy was intended to be applied to financial intermediaries supported by IFC, since the 1991 forest memorandum stated that "all projects financed by IFC would conform with the spirit and intent"[11] of the 1991 forest paper. The third component of the study, therefore, is a review of financial intermediaries in countries with threatened TMFs, particularly to assess their adherence to the ban in the 1991 forest paper on financing of commercial logging operations and logging equipment for use in TMFs.

---

[10] These are 20 countries identified in the 1991 forest paper as having threatened tropical moist forests

[11] para. 3. of Memorandum (Annex 4).

2.15 The fourth component is case studies prepared on a sample of 14 companies with forest-based operations that the OEG study team visited to validate on-the-ground results and assess their adherence to the 1991 forest paper. The sample was drawn from the population of 29 companies that had active IFC investments at the end of FY98 and were relying on local resources. IFC had made total investments of $389 million in 26 separate approvals in the sample companies The sample was closely representative of IFC's regional portfolio of these investments, but actual selection of the companies emphasized larger investments. All field visits took place in May 1999, and visits to two of the projects were in conjunction with supervision missions by IFC Technical Division.

2.16 The study also included interviews with IFC's technical and environmental staff and selected investment officers/consultants responsible for forest-based projects (Annex 5).The study did not evaluate the financial or economic viability of investments made in the projects or their owning companies.

2.17 Based on the foregoing, the study addresses the following questions:

- how effective was the 1991 forest strategy for IFC's operations?
- what were the impacts of the strategy on IFC's operations, especially in respect of slowing deforestation and increasing tree planting?
- how adequate was IFC's implementation of the strategy?
- are there any lessons of experience from identified effectiveness and implementation gaps of the forest strategy?

2.18 The rest of this paper is structured to address the scope of work set out above. The next chapter presents a discussion of the documents containing the IFC forest strategy and their internal administration. This is followed by an analysis of IFC's forest-based projects that have direct impacts on forests. The analysis is based on a "before/after 1991 forest strategy" approach. This is continued in chapter 5 for IFC's non-forest projects that have impacts on forests (i.e. projects with indirect impacts). Chapter 6 considers IFC's investments in financial intermediaries and attempts to analyze the impact of their sub-projects on forests. The findings of the case studies are presented in chapter 7, and they include performance ratings for achievement of the forest strategy objectives. Chapter 8 discusses the IFC OP 4.36, approved in July 1998, and chapter 9 presents the conclusions and recommendations of the study.

3. IFC'S FOREST STRATEGY AND ITS ADMINISTRATION

IFC's Forest Strategy

3.01 As mentioned above, the IFC forest strategy relevant to the study period is contained in the 1991 forest paper, the 1991 forest memorandum and the Bank's OP 4.36.

3.02 ***1991 forest paper:*** The 99-page 1991 forest paper set out the basic forest strategy of the Bank. It gave guidance on policy directions, programs and good practice, and it specified principles and conditions for Bank involvement in the forest sectors of its client countries. While the paper was originally considered by the Bank's Executive Directors in July 1991, the Board was not asked to, nor did it, comprehensively approve its contents, although it did endorse specific aspects of the paper.

3.03 The primary concerns of the 1991 forest paper were the alarming estimate that deforestation was occurring at the rate of 17 to 20 million hectares per year, most of it tropical moist forests, and the inadequate planting of trees to meet the growing demand for wood products. The paper perceived that the two problems arose from (a) externalities that lead to a divergence between the private incentives to cut or plant trees and the trees' real economic cost; (b) the need for fuelwood by the poor; (c) weak property rights, particularly of forest dwellers; (d) low pricing of wood (i.e. high private discount rates); and (e) inadequate or inappropriate government policies, particularly for granting concessions. In order to address these causes and solve the problems, the 1991 forest paper proposed that the Bank should refrain from financing commercial logging in primary tropical moist forests; adopt a multi-sectoral approach in its forest sector operations; protect biodiversity; and promote sustainable forest management that involves participation of the private sector and the local people in the management of natural forests, safeguards the interests of local people (including forest dwellers and indigenous people), and adopts environmentally sound forest conservation. The Bank was expected to enforce these requirements by seeking the commitment of its member countries to sustainable and conservation-oriented forest management as a condition for providing project finance in the forest sector.

3.04 Based on current deforestation estimates of 15 million hectares per year, however, the 1991 forest paper has not achieved its goals substantially. According to the OED Report[12], the reasons for this apparent ineffectiveness of the forest paper included its narrow focus, the inability to stimulate a mechanism for mobilizing concessional funding to compensate those who conserve forests of global value, the failure to address the governance issue, the consultative process was not broad enough to generate ownership among key stakeholders, and the paper did not sufficiently diagnose the impacts of globalization and economic liberalization.

3.05 But in response to the forest paper's ban on support for commercial logging in primary tropical moist forests, IFC has not approved any new investments based on these forests since

[12] OED. 2000. "*A Review of the World Bank's 1991 Forest Strategy and Its Implementation*" (Volume 1: Main Report)

FY92 and has turned down several proposals submitted to it in order to avoid doing any harm. Thus, the chilling effect of the ban prevented IFC from extending its at-entry structuring contribution to these proposals.

3.06 The 1991 forest paper's focus on primary tropical moist forests also diverted attention from other forest types. As described later in this report, IFC's forest-based investments in the post-Strategy period were mainly in temperate and boreal forest areas, for which the forest paper provided little guidance.

3.07 ***1991 forest memorandum:*** As the forest paper was written primarily for Bank and IDA operations, it provided limited and unclear guidance for IFC. In recognition of this fact, IFC issued the 1991 forest memorandum to its Board of Directors to clarify three important ways in which it would apply the 1991 forest paper to its operations. First, the memorandum stated that IFC would "adhere to the principles contained in the 1991 forest paper". The memorandum confirmed that IFC would not finance commercial logging in TMFs, and that all infrastructure projects (e.g. roads, dams and mines) that may lead to loss of TMFs would be subject to rigorous environmental assessments for projects that raise significant environmental issues. Second, the memorandum promised that "all projects financed by IFC would conform with the spirit and intent of the 1991 forest paper" but in a manner that reflects the particular nature of IFC's private sector business. Thus, unlike the Bank, IFC would not seek government commitment to sustainable and conservation-oriented forestry as a condition for making a forestry investment, since it could not impose conditions on governments. IFC could decide to finance projects in countries where such government commitment is weak, provided the project itself conforms with the 1991 forest paper, the sponsors commit to follow World Bank guidelines and internationally accepted practices aimed at preserving present forests, and for such projects IFC would consult with the Bank. Third, IFC's involvement in the forest sector would be directed predominantly at temperate forests, in particular the financing of sustainable use of commercial plantations and reforestation of degraded land, generally in connection with industrial projects. In addition, IFC projects would encourage the optimal use of wood resources by supporting secondary industries (e.g. particleboard, fiberboard) where the raw material is a waste product of other industrial operations.

3.08 However, the memorandum raised new, unanswered questions. The purpose of issuing the memorandum was to limit the application of the 1991 forest paper to IFC operations, and these limits were specified in the words "adhere to the principles" and "conform with the spirit and intent of". Unfortunately, these limits were not defined anywhere in IFC procedures. IFC did not prepare any guidelines or staff manual on how the forest paper would be adapted for its operations or how the commitments in the forest memorandum would be carried out.

3.09 ***Bank's OP 4.36:*** The two-page OP 4.36 (issued in 1993) reflects the policy content of the 1991 forest paper from which it was abstracted, and it itemizes the conditions stated in the forest paper which the Bank was expected to follow in its forest operations. At the very outset, it clearly states the strategic objectives of Bank's involvement in the forest sector, namely, *"... to reduce deforestation, enhance the environmental contribution of forested areas, promote afforestation, reduce poverty and encourage economic development."*

3.10 However, the abstracted form of the OP 4.36 rendered its contents vague and subject to misinterpretation, according to the experience of Bank staff. In this context, the clear disclosure it carried about its source is helpful in encouraging the reader to consult and become familiarized with the more detailed 1991 forest paper. While IFC adopted the OP 4.36 automatically for its operations, it did not prepare any interpretative documentation like the GP 4.36 that the Bank issued simultaneously with the OP 4.36 to provide a guideline and operational direction to Bank staff. The study team was informed that IFC staff applied the OP 4.36 to reflect the private sector orientation of IFC business: at best elements of such application would have varied from staff to staff in the absence of common guidelines.

3.11 ***Effectiveness of the Strategy:*** Based on the case studies, the intention of the forest strategy to engage the private sector in sustainable forest management is not attuned to realities on the ground. Part of the reason has to do with economics. The stumpage paid in some of the case studies was lower than the real cost of managing the forests sustainably, making it unattractive for a private operator to want reforestation responsibilities on a contract basis. Part of the reason has to do with the manner in which forest concessions were operated. A concession that was based on quantities of trees, rather than fixed to a specified geographic area in the forest, would not put any part of the forest under the direct and sole control of individual private operators (such as IFC's project companies). In practice, the quantities of trees under the concession are cut from different sections in the forest, and this arrangement makes its difficult for private operators to assume responsibility for sustainable forest management. Part of the reason has to do with ownership of the forest. In forests belonging to the government, the private operator is expected to pay a stumpage to cover the cost of trees removed and the government is expected to carry out reforestation. IFC's project companies are, therefore, not vested with responsibility for forest management. The case studies found that governments want to retain ownership and management control of the forestlands for different reasons. In Sub-Saharan Africa, land tenure arrangements discourage ownership by foreigners, while all the forest-based projects assisted by IFC in the region are controlled by foreign investors. In some parts of Asia, the forests belong to farm collectives organized under the political system of the country and are not open to management by foreigners who operate the forest-based project companies. In Eastern Europe, forests are considered to be part of cultural assets that should be preserved in the hands of the state. Within these cultural and legal frameworks, powerful vested interests are enabled in many cases to extract private gain from the state's control of the forest resources simply because of lack of transparency and accountability.

3.12 The implied commitments placed by the forest strategy on IFC project companies to work with the local people, interest groups, and forest dwellers in the forest area are also unrealistic. Because they lack any control over the forest, private operators have little or no business interactions with these constituencies since the government is the responsible party as the owner of the forest. In addition, foreign private operators tend to minimize any non-business interactions to avoid entanglement in local politics.

Strategy Administration

3.13 The single-sector focus of the forest strategy documentation is unique among IFC's environmental procedures and safeguard policies. Some IFC staff, particularly in the Technical and Environmental Department, have suggested that this was undesirable administratively because it could cause ambiguity and misinterpretation or be inconsistent with the other general-purpose procedures and policies. This may explain the preference of IFC's Environment Unit to use OP 4.04 (Natural Habitats) for assessing forest-impacting projects instead of the more specific OP 4.36 (see Chapter 5).

3.14 The study also found a number of shortcomings in the procedures and administrative arrangements made by IFC for implementing the 1991 forest strategy. The environment of the early 1990s probably created most of the shortcomings as policies, strategies and even procedures formulated in the Bank were deemed automatically applicable to IFC. Because of the fundamental differences between the clients of the Bank and IFC and how each organization served its clients, IFC always had to interpret these policies, strategies, and procedures to fit its role and situation. Inevitably, this resulted in apparent implementation digressions and/or shortcomings by IFC. This environment continues even today as witnessed by the manner in which the IFC's OP 4.36 was "harmonized" with the Bank's version.

3.15 A major administrative shortcoming was that none of the investment officers interviewed or consulted for this study (see Annex 5) knew about the existence or requirements of the forest strategy documents, despite the fact that most of them had supervision responsibility for forest-based projects. They could not, therefore, have addressed its requirements in their project screening and structuring work, discussed it with project sponsors or tracked adherence to it by IFC project companies in the Annual Supervision Reports (ASRs) and superseding Project Supervision Reports (PSRs).

3.16 Fortunately, the technical and environmental staff were aware of the 1991 forest paper's prohibition of financing for projects based on TMF resources. This enabled IFC to screen out these projects and thus uphold the prohibition diligently in its mainstream operations. But the study could not ascertain the extent to which these staff were familiar with forest paper's standards. IFC files showed that they tended to reflect in their work only the narrowly-defined environmental or forest logging aspects of the forest strategy and did not address, one way or the other, IFC sponsors' obligation to meet the other requirements (i.e. identification and consultation with interest groups involved in the forest areas, promoting the active participation of local people including forest dwellers, etc.). The study also found that some of these were not aware of the 1991 forest memorandum and appeared to have been relying solely on the Bank's OP 4.36. This could have arisen out of convenience as the OP 4.36 was one of several operational procedures monitored and applied by them. But, as mentioned above, the contents of OP 4.36 were vague and could be misinterpreted unless the reader acquired an understanding of the 99-page 1991 forest paper itself.

3.17 The IFC investment documentation made no explicit reference to the forest strategy nor placed any obligation on the project companies to ensure that the forest owner managed the forest in a manner consistent with the 1991 forest paper's objectives. Accordingly, many sponsors of IFC's projects were not notified of the 1991 forest memorandum. The inclusion of OP 4.36 among IFC's environmental procedures and policies could have contributed to this situation. While these sponsors were aware of the environmental procedures, they did not know that IFC has separate provisions for forest activities. In particular, they were not notified of those requirements that were not strictly environmental in nature, i.e. those dealing with stakeholders' participation in forest management processes. IFC's technical and environmental staff informed OEG that while the documentation may not reflect it, key requirements of the 1991 forest paper were always discussed with sponsors and that the foregoing procedural ambiguity did not negatively affect the outcome of projects. They further stated that the forest safeguard policies have also featured prominently among the important changes implemented by IFC since 1998 to strengthen policies, procedures and staff resources for environmental and social reviews.

3.18 In connection with investment agreement covenants that required project companies to comply with World Bank environmental policies and guidelines, the study could not find documentation evidencing that the applicable policies and guidelines were provided to the sponsors. The technical staff informed OEG that it was usual practice to hand these documents over informally during project appraisal. The Environment Division informed OEG that from January 2000, all project sponsors were being required to certify in the release letter for the Environmental Review Summaries (ERS) that these policies and guidelines have been provided to them. The policies and guidelines are now attached to investment agreements executed with project companies.

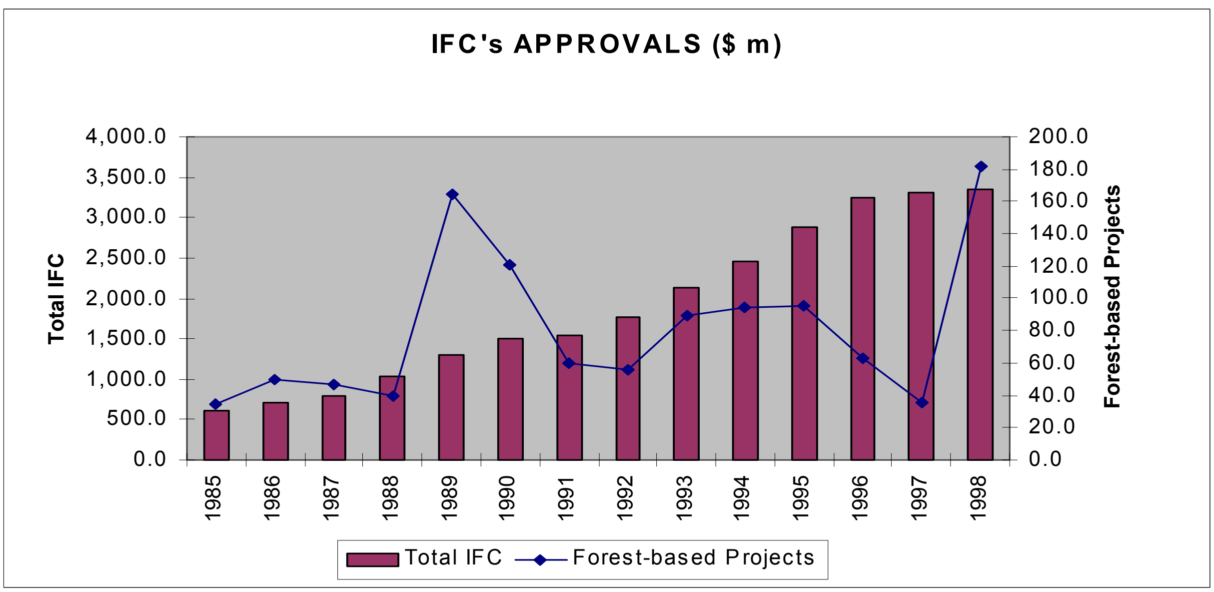
3.19 IFC did not prepare any staff manual, similar to the GP 4.36, to interpret the 1991 forest paper, the 1991 forest memorandum, and/or the OP 4.36 to guide existing and new staff in applying the forest strategy on a consistent basis across projects.

4. Projects With Direct Impacts on Forests

4.01 IFC's projects that rely on forest resources for their primary raw materials are classified for purposes of the study as those with direct impacts. These are projects engaged in (i) pulp and paper manufacturing, (ii) wood processing into logs, sawnwood, plywood, and furniture, and (iii) production of engineered wood products, such as fiberboard and particleboard.

Total Portfolio

4.02 At the end of FY98, IFC's disbursed portfolio in forest-based projects amounted to $0.3 billion out of a total disbursed portfolio of $9.0 billion, i.e. 3.3%. As shown in the chart below, while IFC's total annual approvals increased steadily between FY85 and FY98, approvals for forest-based projects fluctuated widely: somewhat flat at around $35 million between FY85 and FY88 and at $90 million between FY93 and FY95 but reaching the lowest level of around $30 million in FY97. There were two notable surges in FY89 and in FY98. The first surge was caused by a sustained large increase in the price of softwood pulp in 1989 and 1990, enticing capacity additions in the pulp and paper industry some of which were assisted by IFC. By comparison, a smaller price increase in 1993 to 1995 did not result in much industry capacity addition. The second surge was due to IFC's high level of investment activities in Eastern Europe, following the break-up of the former Soviet Union.



Source: Data from IFC's *Annual Reports*

Total Approvals and Regional Distribution

4.03 In FY85-91, IFC approved total investments of $677 million in 54 direct impact projects (including in SMEs and agency lines but excluding syndications) in 25 countries.

Table 1 shows that almost half of the projects by number and 76% by volume were in LAC, while only 1% by number and 1% by volume were in Europe. The total cost of the projects was $5 billion, with 90% in LAC. Since the 1991 forest strategy came into effect, however, the total approved investments have decreased to $578 million out of total project cost of $3.0 billion, and they were made in 65 projects in 29 countries. Although LAC was still dominant regionally, Europe accounted for 26% by number and 38% by volume. A summary of these approvals is attached as Annex 6. The sharp increase in forest-based operations in Europe in the post-Strategy period is not attributed to the 1991 forest strategy, and the projects assisted in the region relied on boreal forests, not tropical moist forests that the strategy focussed upon.

Table 1. Direct impact investment approvals, pre-Strategy and post-Strategy

	pre-Strategy (FY85-91)			*post-Strategy (FY92-98)*		
	No. of proj.	IFC Inv.	Proj. Cost	No. of proj.	IFC Inv.	Proj. Cost
Total Approvals (amounts in $m)	**54**	**677**	**5,034**	**65**	**578**	**3,008**
Regional Distribution:						
LAC	52%	76%	90%	32%	30%	45%
Africa	24%	8%	3%	22%	16%	9%
Asia	13%	13%	5%	12%	8%	9%
CAMENA	7%	2%	1%	8%	8%	5%
Europe	4%	1%	1%	26%	38%	32%
	100%	100%	100%	100%	100%	100%
Product Distribution:						
pulp and paper		82%			77%	
engineered wood		10%			13%	
processed wood (lumber, logs)		8%			10%	
		100%			100%	

Source*: IFC Annual Reports*

Product Types

4.04 Pulp and paper investments have always dominated IFC's operations in forest-based projects (see Annex 7). In the pre-Strategy period, they amounted to $556 million, which was about 82% of total approvals, but decreased slightly to $446 million, or 77%, in the post-Strategy period (see Table 1). The volume of investments in processed woods and engineered woods increased marginally, respectively from $52 million to almost $57 million and from $68 million to $73 million. These trends suggest that IFC's forest-based operations were not primary contributors to deforestation of TMFs as most of the pulp and paper projects relied on plantation/man-made forests and most of the engineered wood projects relied on recycled wastes and residues of other industrial operations.

Resources Used/Forest Types

4.05 Table 2 shows that the resources for IFC projects were mostly from plantations, supporting 47% of the investments approved in the pre-Strategy period and 41% in the post-Strategy period. About 23% of the investment volume in each of the two periods was based on natural/man-made forests, most of it being for boreal/temperate forest-based projects as tropical forest-based projects represented only 3% in the pre-Strategy period and zero in the post-Strategy period. Local recycled materials supported around 20% of the investment volume in each period. The balance of the resource came from imported materials (pulp and waste paper) and output of local upstream producers that relied themselves on local forests. Thus, about two-thirds of the investments in each period did not contribute to deforestation since they relied on regenerative and recycled resources.

Table 2. Resources, Forest Types and Ownership, pre-Strategy and post-Strategy

	pre-Strategy FY85-91		*post-Strategy FY92-98*	
	No. of projects	IFC Inv. ($m)	No. of projects	IFC Inv. ($m)
Resources:				
Total Investment Approvals[13]	**62**	**782**	**74**	**629**
Forests: Natural/man-made				
Tropical	7	3%	0	0%
Boreal/Temperate	5	20%	13	23%
Plantations	24	47%	30	41%
Imported Materials	6	10%	7	12%
Recycled Materials	20	20%	18	22%
Upstream Producers	0	0%	6	2%
	62	100%	74	100%
Forest Ownership[14]:				
Government	17	12%	23	54%
Own	17	88%	16	33%
Others (i.e. third-parties)	1	0%	6	13%
	35	100%	45	100%

Sources: *IFC Annual Reports, IFC files*

4.06 For operational and cost reasons, the pulp and paper industry and the engineered wood industry prefer plantations and man-made forests for wood supply primarily because available quantity is predictable and wood quality characteristics are more standardized, unlike wood from natural forests and TMFs that is heterogeneous and results in variable product quality. In addition, the layout of plantations can be planned to simplify logistics whereas the terrain of natural forests and TMFs is typically uneven, making wood harvesting difficult and costly.

[13] Because some projects relied on multiple resources, there was double counting of some investments: 7 in the pre-Strategy period in which IFC approved $105 million and 10 in the post-Strategy period in which IFC approved $80 million.

[14] One project in pre-Strategy period that had been double counted for Resource is counted once in Government. Two projects in post-Strategy are double counted in Others.

In the future, more projects are expected to be located in the Southern Hemisphere and be based on plantations to intensify the production of fast-growing tree species that mature in about 6 to 20 years compared with over 80 years in Canada and Scandinavia.

4.07 In terms of forest types, plantations provided wood for most of IFC's forest-based projects, representing slightly over two-thirds in each of the pre- and post-Strategy periods (see Annex 8). Temperate and boreal forests supported 28% and 36% of IFC investment approvals during the same respective periods. Tropical forests supported seven projects in the pre-Strategy period, most of them in Sub-Saharan Africa, of which only about $2.1 million of investment was still in IFC's portfolio at the end of FY98. But IFC has not approved any project that relied on tropical forests since the 1991 forest memorandum came into effect, indicating that IFC adhered fully to the 1991 forest strategy's prohibition with respect to TMFs. However, two small investments were approved in FY92 and FY96 under SME facilities in companies whose non-project operations or those of their sponsors involved logging in TMFs.

Forest Ownership

4.08 In the pre-Strategy period, 12% of IFC's investments relied on forests owned by the government while the rest relied on own forests (see Table 2 and Annex 9). However, the situation reversed in the post-Strategy period, with just 33% of the investments relying on own forest while as much as 53% were relying on government forests. The main contributor to the post-Strategy period's situation was the substantial growth in the volume of investments approved in Europe, all of which were based on government forests. Third-party suppliers have also become a more important source, providing wood to 16% of the investments in the post-Strategy era.

4.09 There are important regional differences in the pattern of forest ownership. In LAC, IFC investments almost never relied on government-owned forests. In the pre-Strategy period, 99% of the investments relied on own forests and only 1% on government forests while in the post-Strategy period 78% of the investments relied on own forests and 30% on third-party forests. In contrast, all the projects approved in Europe and most of those approved in Sub-Saharan Africa and Asia during the two periods relied on government forests. The different pattern, between LAC on the one hand and the other regions on the other, can be explained by three unrelated factors. The first was the introduction in LAC of fast growing plantation tree species that reached maturity in 6 to 20 years and made investments in plantations financially viable. Second, given the typically large investments in pulp and paper plants in the LAC region, the cost of establishing own-plantation forest was comparatively small[15], and IFC assisted in financing plantation forests for some of its project companies. The third factor was the existence of large government-owned forests in Europe (boreal forests) and Sub-Saharan Africa (plantations). Given the availability of these forests, there was no incentive or justification for private promoters of forest-based projects to establish new forests.

---

[15] A rough estimate of the capital expenditure for a 300,000 tpa pulp and paper plant would be US$540 million while the cost of establishing a plantation to supply its required wood would be US$62 million.

4.10 But, as foreseen in the 1991 forest paper, government ownership of forests does not by itself necessarily feature sustainable forest management[16]. As owner of the forests, the government has responsibility for replanting and maintenance activities, and this tended to encourage forest over-exploitation by private sector enterprises. Government ownership also tended to cause concessions to be granted at lower stumpage than the real cost of sustainable forest management, a fact that was confirmed in three of the projects that relied on government forests in the case studies. Furthermore, government ownership of forests fostered underpayment of the stumpage, tree removal in excess of the stumpage paid, and other non-transparent practices. In one of the case studies in Sub-Saharan Africa, the project company had a formal contract to purchase the trees from the government but was directed instead to deal through a middleman who, obviously, earned a "commission". These practices may have been associated with corruption and/or weak forest institutions and administration.

Projects turned down

4.11 The list of forest-based projects turned down by IFC may not be complete, but it reinforced the earlier conclusion that IFC diligently carried out the forest strategy's prohibition regarding TMFs. While only one project based on tropical forest was turned down in the pre-Strategy period, as many as eleven were turned down in the post-Strategy period (see Table 3). The study could not determine if any of these projects materialized with other financing.

Table 3. Forest-based projects turned down by IFC, pre- and post-Strategy periods

	pre-Strategy (FY85-91)	*post-Strategy (FY92-98)*
	No. of projects	No. of projects
Region:		
LAC	4	11
Africa	1	11
Asia	1	15
Europe	0	5
CAMENA	0	0
	6	42
Resources:		
Natural Forests	0	7
Tropical Moist Forests	1	11
Plantation	4	10
Others (incl. baggase, recycled materials)	1	14
	6	42

Source: List maintained by the Technical and Environmental Department

[16] Para. 3.12 of the 1991 forest paper states: "The evidence suggests that in many instances government policies and/or corruption lead to overly lenient granting of concessions in areas which should not be logged. Frequently, there is also a systematic under-pricing of concessions, thereby reducing logging company extraction cost and making it more profitable to log. At the same time, government reluctance to offer long-term concessions that would encourage loggers to replant or engage in more sustained harvesting and management practices aggravates the incentive for quick "mining" of trees."

4.12 But the list portrays the chilling effect of the 1991 forest strategy's ban on commercial logging in the primary TMFs, as IFC decided to reject all such operations in order to avoid the risk of association. To that extent, the projects turned down were denied valuable contributions that IFC could have made through its at-entry structuring role, including adherence to all of IFC's environmental procedures and social reviews.

Forest Certification

4.13 Forest certification was pioneered by the Forest Stewardship Council (FSC) in 1993. Since then, other systems[17] have sprung up more recently with national coverage (such as in Finland, New Zealand, the UK) or regional coverage (such as the Pan-European Forest Certification). The International Organization for Standardization (ISO) has also prepared a technical report for adapting its ISO-14001 for forest product companies in order to expand the range of operations it covers. IFC does not require independent certification of forest management operations, but it encourages its project sponsors to obtain it. Three IFC projects have obtained certification (one in LAC and two in Sub-Saharan Africa) and several forests on which IFC projects rely in Eastern Europe have forest certifications.

4.14 While these systems differ on processes and procedures, they have two common activities, namely certification of the sustainable management of the forest and "eco-labeling" of the forest products. Under most systems, the objective of forest certification is to improve forest management, but some systems like FSC's require active involvement of stakeholders, independent validation of the process and public disclosure of the results in order to make the process transparent. However, the usefulness of forest certification depends on the validity and appropriateness of the standards applied. Another major dilemma for policymakers and forest products companies is that forest certification is a cost-incurring activity. The cost of certifying the forest and keeping its operations in continued sustainable management[18] is currently high for developing countries because of reliance on foreign certifiers. Some forest certification systems hope to bring down the cost through development of local expertise.

4.15 Eco-labeling creates brand or image awareness that enables consumers to recognize products made out of timber coming from sustainably managed forests. It is a revenue-generating activity because it permits premium pricing of the products, for which the market is mostly in developed countries. It is companion to forest certification because eco-label can be applied to only products from certified forests. Thus, forest-based companies whose products sell in the domestic markets or trade as commodities because they cannot be branded consider forest certification to be irrelevant. But for those companies whose operations can meet the standards, eco-labeling has tended to serve as a marketing tool for exports and a mechanism for market share increase or for assuring continued market access. It may also act as a non-tariff trade barrier.

---

17 At its 40th Session in April 1999, the FAO Advisory Committee on Paper and Wood Products noted that 90 certification initiatives were presently underway.

18 It is estimated that it would cost Ghana $23.8 million over 10 years to maintain sustainable forest management while the associated revenue increase for the same period would be $14.1 million – Ofosu-Asiedu, A.: "Experience and state of the art in sustainable forest management of the humid tropical forest" – paper presented at the XI World Forestry Congress (13 to 22 October 1997) in Antalya, Turkey

4.16 There are other limitations with the forest certification systems. The imposition of responsibility for sustainable forest management on manufacturers of forest-based products is at variance with realities on the ground in respect of forests belonging to governments (see Chapter 6). Private operators do not have control over these forests and are not given responsibility for their management. The large number of certification systems in place or being developed is creating keen rivalry for "membership recruitment". Under this competitive climate, the WB/WWF Alliance has been misconstrued as an exclusive endorsement of the FSC system, and sponsors of rival systems have complained directly to IFC. It will be desirable if these certification systems can harmonize their standards, processes and procedures around agreed basic principles of sustainable forest management. This is a cause worthy of the Bank Group's support.

Special Initiatives by IFC

4.17 IFC has also undertaken special initiatives that support forest conservation and sustainable management. In 1991, IFC sold a 58,000 hectares parcel of land in Paraguay to the Nature Conservancy and a Paraguayan NGO, Fundación Moisés Bertoni para la Conservación de la Naturaleza at a price that was $3 to 5 million below the estimated market value. The land, which was acquired by IFC through a foreclosure, covers one of the few remaining large stands of dense humid sub-tropical forest in Latin America and is contained within a larger area that was once the habitat of the nomadic Ache Indians. It is unique for its biodiversity, including species that have disappeared from the Atlantic rainforest, and it is home for several endangered mammals and rare birds. The land is deeded for nature reserve in perpetuity but open to the Ache Indian population for hunting and gathering.

4.18 In December 1995, IFC and Global Environmental Facility (GEF) established an SME program to provide long-term, low interest loans of up to $1.0 million each to selected private sector enterprises for addressing climate change and the sustainable use and conservation of biodiversity. The experimental program was funded with a $16 million GEF grant, and it is being administered by IFC. Almost US$10 million has been committed in 14 enterprises that included nine forest projects (see Annex 10). The funds are lent to intermediaries, who on-lend them to qualified sub-projects. A total of 100 sub-projects have been supported under the initiative, which is expected to demonstrate the commercial viability of forest conservation projects.

5. PROJECTS WITH INDIRECT IMPACTS ON FORESTS

5.01 For purposes of this study, projects categorized as having indirect impacts on forests are those that do not use forest products as raw materials but have an impact on forests through their development activities, such as construction of access roads, clearance of overburden from a mineral deposit, clearance of a right-of-way or conversion of forest to agricultural land. In general, these projects are in the mining, power, other infrastructure (telecommunications/ transport/utilities), and agribusiness sectors. In addition, projects with a significant business in providing forest product transportation and handling services (e.g. trucking, rail and port facilities) fall into this category.

5.02 The 1991 forest memorandum specifically notes that all infrastructure projects which may lead to loss of primary TMFs will be subject to rigorous environmental assessments as set out in IFC's *Environmental Review Procedure* for projects that raise significant environmental issues. IFC's environmental review procedure associates "significant environmental impacts" with projects that should be processed as Category A. However, the procedure in effect in 1991 only required that Category A projects be visited during appraisal to gain first-hand knowledge about them. After the 1993 revision, the *Environmental Analysis and Review of IFC Projects* enhanced the requirements for Category A projects and mandated preventive, mitigatory and compensatory measures for any adverse impacts.

5.03 From the population of post-Strategy approvals in these sectors, a sample of 34 projects was selected for detailed review because they appeared to have potential indirect impacts on forests and were located in countries identified by the 1991 forest paper as having threatened TMFs (see Table 4). Almost 40% of the sample was processed as Category A and the balance as Category B or lower. About 35% of the projects was in agribusiness, with almost 30% each in the telecommunication/transport/utilities, and the oil/gas/mining sectors. IFC's investments in the 34 projects amounted to $1.4 billion, equivalent to 7.2% of IFC's total investments during the period. All the seven infrastructure and transportation investments approved by IFC under its SME facilities were included in the review.

Table 4. Projects with Potential Indirect Impacts on Forest in countries with TMFs, post-Strategy approvals

	Environmental Category A	Environmental Category B and lower	IFC Inv. ($m)
Sector:			
Oil/Gas/Mining	8	1	378
Power	1	2	121
Telecomm/Transport/Utilities	2	8	624
Agribusiness	2	10	254
	13	21	1,377
SMEs		7	5
As % of Total IFC Investment approvals			7.2%

Source: IFC's database for projects

5.04 The basis of the classification used above is key for implementing the forest strategy as intended. The language in the 1991 forest memorandum suggests that all infrastructure projects that may lead to loss of primary tropical moist forests must be categorized and processed as Category A projects. The Environmental Unit staff disagrees with this interpretation and maintains that the basis for classification is provided in the Environmental Review Procedure. The staff does not believe that the requirements of the forest strategy and the procedure need to be harmonized.

5.05 The staff has also been applying OP 4.36 only in connection with restrictions on commercial logging in TMFs, using OP 4.04 (Natural Habitats) more generally to analyze the indirect impacts of infrastructure projects on forests because “natural forests” are also “natural habitats”. Despite the overlap between OP 4.04 and OP 4.36, it would appear logical to use OP 4.36 for all situations affecting the forests as intended, supplementing it with OP 4.04 where the situation calls for specific impact analysis not covered in OP 4.36, i.e. where there is sensitive natural habitat in the forest under consideration.

5.06 In the review of projects assisted under the SME facilities, the study found two small investments approved in a company with a major part of its business in transporting logs harvested by its customers under concessions in TMFs. These investments were consistent with the letter of the forest strategy because they did not finance *per se* commercial logging operations or the purchase of logging equipment for use in TMF. They digressed from the “spirit and intent” of the strategy since the business of the company supported TMF logging operations. The environmental review procedure in place at the time failed to detect the inconsistency.

6. FINANCIAL INTERMEDIARY PROJECTS WITH IMPACTS ON FORESTS

6.01 The 1991 forest memorandum stated that "all projects financed by IFC will conform with the spirit and intent of the 1991 forest paper"[19]. This is interpreted in this study as extending the application of the 1991 forest memorandum to the operations of IFC financial intermediary (FI) projects. Accordingly, the study covered FIs and their sub-projects to verify that the FIs refrained from financing the purchase of logging equipment for use in primary TMFs and that their sub-projects were notified that any equipment financed by the FIs could not be used for commercial logging in TMFs. The FI operations selected for this purpose were in countries identified in the 1991 forest paper as having threatened TMFs, and they included credit lines, leasing, portfolio equity funds and private equity/venture capital funds (see Table 5). In aggregate, these investments represented about 7% of IFC's total volume approvals during the period and almost 21% of total approvals in these countries.

Table 5. Financial Intermediary operations in countries with threatened TMFs

(Amounts in $ million)	No. of Projects	Project. Size	IFC Inv. Gross	IFC Inv. Net
Credit Lines	51	2,811	1,618	818
Leasing	34	660	419	330
Portfolio Equity Fund	2	131	13	13
Private Equity/Venture Cap. Fund	27	1,774	227	227
	115	5,376	2,277	1,388

Source: IFC database

6.02 According to the Environmental Division, it is not possible to determine if the FIs have operated within the constraints of the 1991 forest paper and the 1991 forest memorandum because (a) IFC's environmental programs that address financial intermediary investments have been evolving and (b) IFC has always delegated environmental due diligence on sub-projects to the borrower FIs. The 1991 and 1993 *Environmental Review Procedures* addressed FI lending and generally held that sub-projects should carry out an environmental analysis consistent with IFC requirements (including the forest strategy) which the borrower FIs would review to assure compliance. In the IFC-specific environmental and social safeguard policies approved by the Board in July 1998, special requirements were developed for FI projects and environmental requirements were specified for sub-projects according to a tier classification. The Type I classification, which is new, is for FI investments where IFC funds are not targeted to specific sub-projects and they are required to comply with host country environmental and social laws and regulations only, not with any IFC safeguard policies. But within this category, micro-finance institutions are prohibited from dealing in products made from wood from unmanaged forests, which would include TMFs. The FI investments in Type 2 classification are directly targeted at specific sub-projects and they are required to comply with both the host country and IFC environmental

[19] Para. 3 of the Memorandum

procedures and social reviews. There is a sub-project exclusion list that covers, among others, financing for commercial logging operations and purchase of logging equipment for use in TMFs. FI (Type 3) classification is for investments in which IFC is lender of record to the sub-projects, and the sub-projects are treated like IFC's direct investments.

6.03 The Environmental Division indicated further that IFC began in 1994 to train FIs on environmental risk management in order to strengthen the environmental due diligence delegated to them over sub-projects. The training is directed at all FI projects, it includes discussion of the forest strategy, and it emphasizes the prohibition against commercial logging in TMFs. A written summary of key points in the forest strategy (and other IFC's environmental and safeguard policies) applicable to the private sector is provided to FI clients, along with a copy of OP 4.36. Appraisal and supervision checklists that are also provided to them identify forestry as a sensitive issue requiring consultation with IFC. However, the 1991 forest paper and the 1991 forest memorandum *per se* were not discussed in the training workshops or published materials.

6.04 IFC has introduced an annual reporting requirement to support the above environmental procedures and training programs, although this has also evolved. Prior to FY96, FI legal documents did not require environmental reporting to IFC. Since then, the Environmental Division and Legal Department have worked to ensure more consistent legal documentation for FIs, including annual reporting requirement that contains information on sub-projects for FI Types 2 and 3.

6.05 However, the main weakness of the foregoing system is that IFC has not always required FIs to report on each sub-project. To that extent, complete information about their involvement in the forest sector is lacking. Given its sizeable exposure in the countries with threatened TMFs, IFC is vulnerable for its lack of knowledge about the environmental performance of the FIs and their sub-projects. With the procedures and training arrangements already put in place, the next logical step for IFC is to begin systematic collection of basic information on sub-projects assisted by its FIs.

6.06 IFC has not been able to monitor and supervise adequately the environmental due diligence delegated to the FIs. OEG has learned that only a small percentage of the sub-projects submit the required annual reporting requirements and a large number of the reporting requirement submitted to IFC is either incomplete or not useful. Field visits by IFC to verify on-the-ground compliance with applicable host country requirements or IFC's environmental and social policies are not carried out regularly and consistently at the present time as contemplated in the 1998 procedure, even for FI (Type 2) projects.

7. CASE STUDIES

7.01 Field visits were made to 14 forest-based companies in order to assess results on the ground and their consistency with the IFC forest strategy. The sample was representative of IFC's regional portfolio in the forest sector at the end of FY98 (see Annex 12), although actual project selection focused on companies with larger investments for relevance within the travel budget. The sampled companies rely on local forest resources and had active IFC investments at the end of FY98. Between FY85-98, IFC made 26 approvals amounting to US$389 million in these 14 companies. The profile of the companies is provided in Annex 14 and summarized in Table 6 below.

Table 6. Case Studies – profile of projects visited

	No. of Companies	Investments No.	Investments % *	IFC Inv. ($m) $m	IFC Inv. ($m) % *
By Region:					
LAC	4	8	20%	219	31%
Europe	5	7	39%	75	33%
Asia	3	5	36%	42	32%
Africa	2	6	25%	53	36%
	14	26		389	
By Sub-sector					
Pulp and paper	9				
Lumber, logs, etc	3				
Engineered wood	2				
	14				
By Ownership of forest					
Government	9				
Own	4				
Third-party	1				
	14				
Timing of IFC investments					
pre-Strategy	4				
post-Strategy	10				
	14				

* i.e. investments in forest-based projects in FY85-98

Source: Compiled by the study team from sample data

7.02 The primary focus of the case studies was to assess the extent to which the projects have achieved the five objectives of the forest strategy contained in Bank's OP 4.36[20]. Where the project relied on government or third-party forests, efforts made by such parties towards achievement of the objectives were counted for the projects. The objectives are (i) reducing deforestation, (ii) enhancing the environmental contribution of forested areas, (iii) promoting

[20] See para. 1 of Bank's OP 4.36. These objectives are repeated in IFC's OP 4.36.

afforestation, (iv) reducing poverty, and (v) encouraging economic development. The criteria adopted in the study for these objectives are summarized below:

- **Reducing deforestation** – whether fewer trees were being felled from natural forests than would have been the case if the project never existed, whether plantation timber was being made available to industrial wood users and fuelwood users who would otherwise have resorted to natural forest timber;

- **Enhancing the environmental contribution of forested areas** – whether the project made any environmental contributions to forested areas, either through replanting of its own requirements or of native species in natural forests, helping to prevent erosions, and protecting watersheds;

- **Promoting afforestation** – whether the project developed new forests either by converting damaged, degraded, or agricultural land to forestland, or by encouraging the establishment of new plantations;

- **Poverty reduction** and **encouraging economic development**[21] – whether the project generated direct and indirect employment and provided income opportunities for local communities as well as other financial and social benefits.

7.02 The extent to which the sampled projects achieved the objectives or made contributions toward them is rated as follows: (1*) not achieved* - where the objectives were not achieved; (2*) partly achieved* - where some contributions have been made, (3*) fully achieved* - where substantial contributions have been made, and (4) *achieved beyond expectation* - where more than substantial contributions have been made. The numerical ratings permitted averaging of the scores for each objective and project for purposes of pattern analysis and synthesis.

Case Study Findings

7.03 ***General:*** Only four of the sampled companies, in which IFC made investments before 1991, were aware that IFC had a forest strategy. All the remaining 10 companies were not aware of any strategy because IFC did not disseminate it to their sponsors/managers. For example, the Environmental Information Memorandum prepared on seven of the projects did not make specific reference to the forest strategy. The ASRs/PSRs prepared on eight companies did not track adherence with the forest strategy. Only four ASRs/PSRs included comments on the status of the forests.

7.04 ***Results of Performance Ratings***: Table 7 summarizes the ratings of the companies on each of the objectives.

---

21 These two objectives are combined because of the similarity in their impacts on the targeted population.

Table 7 : Case Studies - Summary of Findings

Project Name	*Reducing Deforestation*	*Enhancing Environmental Contribution of Forested Areas*	*Promoting Afforestation*	*Poverty Reduction/ Encouraging Economic Development*	*Overall Average*
1. LAC 1	4	4	4	4	**4.0**
2. LAC 2	4	4	4	3	**3.8**
3. LAC 3	4	4	4	3	**3.8**
4. LAC 4	4	4	4	3	**3.8**
5. AS 1	3	3	4	4	**3.5**
6. AS 2	3	4	4	3	**3.5**
7. AF 1	3	3	3	4	**3.5**
8. EU 3	3	3	3	4	**3.3**
9. AS 3	3	3	4	3	**3.3**
10. EU 1	3	3	3	3	**3.0**
11. EU 2	3	3	3	3	**3.0**
12. EU 4	3	3	3	3	**3.0**
13. EU 5	3	3	3	3	**3.0**
14. AF 2	2	3	3	2	**2.5**
Average	**3.2**	**3.4**	**3.4**	**3.2**	**3.3**

Source: Prepared by OEG study team

Overall Performance

7.05 All the projects have substantially or fully *achieved* the objectives of the 1991 forest strategy. The projects are reducing deforestation because their operations generate trimmings, wood residues, etc., which are made available as fuelwood where needed. The project companies and/or the owners of the forests on which they rely are fully replanting harvested areas, which is necessary for the long-term sustainability of the projects' operations. Some of the projects are expanding their forested areas while others have no scope for afforestation, and all the projects are contributing to the economic development of their communities through job creation and the support for upstream/downstream private enterprises.

7.06 The highest overall rating was scored by a project in LAC, a pulp and paper company that owns its plantation forests. It was sponsored by a financially strong local business group that placed great importance on protecting the environment. IFC has made three investments in the company. A project in Sub-Saharan Africa scored the lowest rating. The company was established to utilize a large government plantation forest, but it was beset by problems from the outset, with small local market, the plant location at considerable distance from the market, and management turnover being the more important ones.

7.07 On a product group basis, the two engineered wood companies in the sample rated the highest. They are located in Asia and have relatively large operations in their respective communities. The two companies rely on forests owned by farm collectives organized and coordinated by the government. Despite the fact that the stumpage fixed by the government for wood supplied to one of the companies is lower than the real cost of sustaining the forest, the payment made to the farmers is higher than the average income level in the area. Together, the forests of these companies employ around 500,000 people, and some of the trees are planted on hillsides to prevent erosion. On the other hand, the three wood processing companies in the sample (two in Europe and one in Sub-Saharan Africa) scored the lowest ratings. Their operations are relatively small and they, too, rely on government forests.

7.08 The four LAC companies that owned their forests scored the highest ratings, individually, on a regional basis and on a forest ownership basis. This was primarily because they took keen interest in forest management and conservation to sustain their commercial operations for the long-term and they were interested in afforestation. Their operations also involved much larger financial stakes, which was a motivating factor for them to arrange captive raw material sources.

7.09 Among objectives, enhancement of environmental contribution to the forested area and promotion of afforestation jointly scored the highest rating. This was primarily due to the fact that all the projects are undertaking full replanting of their harvested area as well as protecting watershed areas in their forests. The companies in LAC are expanding the size of their forests, while those in Eastern Europe have vast forest resources that are larger than their current requirements.

7.10 However, there are marked differences between projects that own their forests and those that rely on third party owners. The forest-owning companies are in LAC, they do not wish to rely on third party suppliers, and their promoters are indigenes. Their projects have larger plants and they want to be able to control their raw material supply. In addition, the cost of setting up their own forests was small in relation to the large investments already made in their plants. On the other hand, the projects that do not own their forests are mainly in Europe and Sub-Saharan Africa and they do not wish to own the forests, apart from the fact that they cannot afford it. The scale of their operations is relatively much smaller, and most are foreign investors in the countries in which they operate.

7.11 A notable regional difference was also found among projects that rely on government forests. In Sub-Saharan Africa, the governments are unwilling to allow the companies to own their forests because of land tenure arrangements that forbid foreigners, like shareholders of these companies, from owning land. In Eastern Europe, land is considered to be cultural assets, and its ownership is therefore kept in the hands of government. In both cases, the government assumes the responsibility for forest management.

Discussion of the Objectives

7.12 ***Reducing deforestation*** – In four companies (29% of the sample), this objective was *achieved beyond expectation*. The companies, all in LAC, had exemplary performance in forest conservation, two companies maintained a percentage of their forestland as preservation areas, provided fuelwood to the community from their plantations, and sponsored regular forest education programs. Another nine companies (64% of the sample) were rated as *fully achieved* on this objective.

7.13 ***Enhancing Environmental Contribution to the Forest Area*** - Five companies (36% of the sample) scored *achieved beyond expectation* rating. These companies are involved directly in forest replanting activities, take proactive measures to protect watershed areas in the forest and implement effective measures to control soil erosion. The four LAC companies that owned their forests help prevent erosion by establishing plantations in the flood plains, use environmentally friendly harvesting methods, and adopt quick turnaround time between harvesting and replanting to prevent incursions by forest encroachers. One Asian project has planted trees on hillsides to prevent erosion. A project in Sub-Saharan Africa now undertakes replanting activities, despite the fact that it pays the stipulated stumpage to the government-owner, which has not been able to maintain the replanting schedule.

7.14 All the other eight companies (57% of the sample) were assigned *fully achieved* ratings because full replanting activities are carried out by the government-owners of the respective forests.

7.15 ***Promoting Afforestation*** - Seven companies (50% of the sample) were actively promoting afforestation. Four of them, in LAC, did so out of self-interest because they needed the afforested areas for operational expansion. The other seven companies in the sample did not need to promote afforestation. In all of the Eastern Europe project companies and one Sub-Saharan Africa project company, the resources in their current forest areas vastly exceed their requirements. In another Sub-Saharan Africa project company, there are no lands to expand plantation forest areas.

7.16 All the LAC and Asian projects *achieved* this objective *beyond expectation*. The LAC projects have been actively planting native species seedlings on degraded land and providing free seedlings and technical support to farmers who wanted to do the same on their farms. In one LAC project, over 300 hectares of degraded land have been planted with native tree species. One Asian project was instrumental in the conversion of 30,000 hectares of degraded agricultural land to economic plantation forests.

7.17 ***Poverty Reduction/Economic Development*** - All the companies in the sample, except one, scored *fully achieved* or higher ratings on this objective. They provide large direct employment in their forest operations (nurseries, planting and harvesting, cutting, trimming, and loading), and indirect employment to transport contractors. Moreover, some of the projects provide housing for employees and primary schools for their dependents. A LAC project, whose rating was *achieved beyond expectation*, provided direct employment to 350 people and indirect employment to 650 people who are contractors in transportation, harvesting and planting. The company also supports the business of ten charcoal producers who relied on it for trees and employ 300 part-time workers (mostly women). An Asian project that was also rated *achieved beyond expectation,* supported 500,000 tree farmers and could support additional 275,000 farmers when new plantations are developed. A Sub-Saharan African project was rated *partly achieved* because of its small employment base, although it is the main employer in an area where job prospects are quite limited.

8. IFC's OP 4.36

8.01 IFC's OP 4.36 was introduced in July 1998. It was modeled after and "harmonized" with the Bank's OP 4.36, in order to limit changes to only those necessary to reflect the particular nature of IFC's private sector business. The two documents are compared side by side in the *IFC Environmental and Social Policies and Procedure and Policy on Disclosure of Information*[22]. IFC's OP 4.36 is included among the safeguard policies for purposes of operational implementation.

8.02 By design, IFC's OP 4.36 shares the characteristics of the Bank's version. It also shares its major shortcoming, which is that some of its contents are vague and are subject to misinterpretation unless the reader has acquired an good understanding of the strategy in the 1991 forest paper itself.

8.03 But IFC's OP 4.36 also differs from the Bank's OP 4.36 in some important ways. The most significant one is that IFC's OP 4.36 does not make any reference to the 1991 forest paper. Thus, IFC has procedurally severed itself from the 1991 forest paper and the undertakings made in the 1991 forest memorandum. The missing reference denies the reader the awareness of background information in the 1991 forest paper that could eliminate the shortcoming noted above. For example, the provisions of IFC's OP 4.36 are confusing about the responsibilities of project companies that do not own their forest resources. It excludes the undertaking given in the 1991 forest memorandum to consult with the Bank in situations where government commitment to sustainable forest management is weak or non-existent. In addition, IFC has so far not issued any implementation guidelines to its staff, similar to GP 4.36 issued for the Bank's OP 4.36.

8.04 Besides the above, there are apparent gaps in the coverage of IFC's OP 4.36, and some of its language lacks clarity. There is no explicit statement that its provisions apply to FI operations, although there is a reference to that effect in Annex A (Exclusion List) of the *Procedure for Environmental and Social Review of Projects*. Its application to forest-impacting projects that can affect TMFs is ambiguously worded, unlike the provisions of the 1991 forest paper and the 1991 forest memorandum. It is also not categorically clear that it does not permit support for the establishment of commercial plantations on lands that were deliberately degraded in order to qualify for IFC financing, similar to the language in OP 4.04 (Natural Habitats).

8.05 However, the new document has been widely disseminated to IFC staff and a copy is being provided to project sponsors as part of the investment agreement. The study could not ascertain if it is being disseminated to IFC's existing project companies or, more generally, whether existing companies are expected to comply with it.

8.06 Administratively, there should be internal consistency in the processes and procedures involving IFC's OP 4.36. Investment agreements prepared or revised for relevant projects

---

[22] See item 5 in Attachment 1.

after June 1998 still do not mention the application of IFC's OP 4.36 specifically, referring instead in general terms to World Bank policies and guidelines.

9. CONCLUSIONS AND RECOMMENDATIONS

9.01 The conclusions of the study are presented below, organized in the form of answers to the questions that the study set out to investigate.

Conclusions

9.02 ***How effective was the 1991 forest strategy?*** According to the OED Report, the forest strategy has not succeeded in combating global loss of forest cover. Current estimates are that up to 15 million hectares of forest cover are lost every year, a mere 12 percent decline in loss rate since 1991.

9.03 The forest strategy's intention to engage the private sector in sustainable forest management has not been achieved because (a) the low stumpage paid for government-owned forests is lower than the real cost of sustainably managing the forests and does not provide adequate financial incentive for private operators to engage in sustainable reforestation responsibilities; (b) private operators are not given control over the forests on which their operations rely; and (c) many governments around the world still desire to retain ownership and control of their forestlands.

9.04 IFC project companies have not been able to fulfil the commitment of involving local people, interest of forest dwellers, and consultation with the interest groups in their forest areas because they have no control over the forests. Thus, they have no business interactions with these groups, and they shy away from non-business interactions in order to avoid becoming embroiled in local politics.

9.05 ***What were the impacts of the forest strategy on IFC's operations?*** The forest strategy was not instrumental in catalyzing the reforestation and tree planting activities of IFC projects. These activities are undertaken purely for reasons of commercial self-interest, i.e. reliability of future raw material supply for long-term sustainability of their operations.

9.06 The forest strategy's ban on support for commercial logging in TMFs pushed IFC out of these operations completely. IFC was thereby unable to play its usual at-entry structuring role in enhancing the environmental performance of projects that were turned down.

9.07 Because of its focus on TMFs, the strategy easily diverted attention from other forest types, particularly temperate and boreal forests on which most of IFC's investments in the post-Strategy period rely.

9.08 But the 1991 forest strategy paper raised environmental awareness about forests, particularly primary TMFs, in IFC operations. This has contributed to fundamental changes undertaken by IFC in the selection, processing and monitoring of its projects.

9.09 ***How effective was IFC's implementation of the 1991 forest strategy?*** The study shows that, at least in its direct financing operations, IFC has upheld the forest strategy's prohibition on commercial logging in primary tropical moist forests. IFC stopped assisting these operations as soon as the 1991 forest strategy came into effect. IFC has also declined assistance to such projects since then; unfortunately no information is available as to whether these projects proceeded with other financing arrangements. One minor exception involved a transport service provider to logging concessionaires, and financing has been provided to two companies whose other operations or those of their parents companies involved logging in TMF. These investments did not breach the letter of the strategy but arguably were not consistent with its intent in that they indirectly facilitated logging in TMFs or supported companies whose primary businesses involved logging in TMFs.

9.10 IFC has assisted the establishment of large plantations in LAC and Asia, thereby contributing to tree planting. Even in projects that relied on forests owned by governments, IFC ensured that adequate arrangements were made for reforesting harvested areas, primarily to ensure the long-term sustainability of the operations that IFC supported. In addition, IFC has assisted several projects that rely on wood wastes, wastepaper and other recycled materials, thus contributing to forest conservation.

9.11 In addition, IFC has undertaken special initiatives that supported forest conservation and sustainable forest management. IFC helped to create a nature reserve in Paraguay when in 1991 it sold its 58,000 hectares of land to Fundación Moisés Bertoni para la Conservación de la Naturaleza at below market price. IFC is also administering a GEF $16 million grant to promote SMEs in climate change initiatives and sustainable use/conservation of biodiversity.

9.12 However, there were implementation weaknesses, mostly of procedural nature, which may have arisen because of the poorly defined policy environment of the early 1990s. Dissemination of the strategy documents to staff was deficient. There seems to be confusion about the required environmental classification for infrastructure projects that may cause loss of TMFs, and staff has been using OP 4.04 as substitute for OP 4.36. IFC did not consider issuing a staff manual to interpret the 1991 forest strategy, which could have guided both existing and new staff in applying the strategy on a consistent basis across different projects. In the case of FIs, IFC has not always required them to report on subprojects, so complete information about their involvement in the forest sector is lacking. However, IFC has been training the FIs on environmental risk management since 1994, and the workshop included discussions of the forest strategy. Until 1996, small projects approved under the small enterprise fund facilities were not subjected to careful screening in relation to indirect impacts on TMFs.

9.13 All the companies in the case studies that were first assisted by IFC after 1991 did not know or were not notified about the forest strategy. If this small sample provides any indication, then probably most of IFC's projects approved between 1992 and 1998 did not know about the 1991 forest strategy.

9.14 ***IFC's OP 4.36:*** Since the IFC's OP 4.36 was modeled on the Bank's OP 4.36, it shares the identified major shortcomings of the latter, namely, vagueness of its contents and the likelihood of misinterpretation. In addition, the IFC's OP 4.36 contains no reference to the 1991 forest paper.

9.15 There are two key areas in which the IFC's OP 4.36 lacks clarity. The first is the absence of specific reference that it is applicable, where relevant, to FI operations. Although the *Procedures for Environmental and Social Review of Projects* include such reference, it is desirable to repeat it in the new IFC's OP 4.36 for the sake of completeness. The second area lacking clarity concerns requirements applicable to non-forest projects with impacts on TMFs. Whereas the 1991 forest memorandum is explicit in specifying the intensity of the review procedure for TMF-impacting infrastructure projects, OP 4.36 confines itself narrowly to forest-using projects.

9.16 With the introduction of the IFC's OP 4.36, it is necessary to conform references to it in IFC's processes, procedures, and guidelines for the sake of internal consistency.

9.17 ***Forest certification:*** The study found that the cost imposed by certification of forest on the forest owners may not be recouped if the forest products cannot be eco-labeled or are most sold in the domestic economy. This may be outweighed by the benefit which forest certification creates in improved forest management, participation of stakeholders and transparency. Eco-labeling is currently considered as an export marketing tool.

9.18 As forest certification has continued to gain acceptance, there is a proliferation of systems covering national and regional territories, and increased rivalry among them for membership recruitment. The rivalry has led to the World Bank's partnership with WWF, the sponsor of FSC system, being misconstrued as an exclusive endorsement of the FSC system.

Recommendations

9.19 ***Relating to future forest strategy:*** The revised strategy must recognize the limitations which different countries place on the direct involvement of the private sector in forest activities, particularly where the forests belong to governments. Under most current limitations, primary responsibility for sustainable forest management is retained for the government. In other words, required private sector participation in sustainable forest management must be tailored to responsibilities that it can discharge.

9.20 Where IFC-assisted project relies on government-owned forests, IFC should satisfy itself, in consultation with the Bank, that the stumpage payable is adequate to enable sustainable management of the forests. IFC should also consult with the Bank on other non-transparent practices that may adversely affect the management of the forests sustainably.

9.20 ***Relating to IFC procedures:*** As a matter of top priority, IFC should embark on a wide dissemination of its forest strategy among the staff and relevant projects companies, including forest-based, forest-impacting, and financial intermediary companies. The technical and environmental staff should be encouraged to acquire full knowledge of the 1991 forest paper, and any new directives emerging from the revised IFC's forest strategy. An interpretative staff manual on the forest strategy should be prepared to guide application of the policy/procedure, assure consistency of application across different projects and units, and provide guidance to all staff, particularly new ones.

9.21 Because of the lapses found in the application of the forest strategy to investments approved under the SME facilities, IFC needs to strengthen the procedures for this delegated approval category of investments to ensure that its safeguard policies are being consistently applied to the projects. IFC also may wish to consider applying its safeguard policies to its SME advisory support initiatives, like APDF and AMSCo, in which it acts as executing agent.

9.22 The findings of the study suggest that IFC may be at reputation risk in its financial intermediary operations because it lacks knowledge about the FIs' sub-projects and it is not in a position to enforce its environmental covenants. IFC needs to create a database of sub-projects funded by the financial intermediaries it assisted. Among other things, such a database would help in tracking the activities of these sub-projects and facilitate identification of those that are likely to be engaged in commercial logging in TMFs or other activities prohibited by policy. Through selective sampling of high-risk sub-projects and field visits, IFC should monitor compliance of the Type 2 financial intermediaries with their contractual obligations in respect of IFC's safeguard policies, as well as the compliance of their sub-projects.

9.23 ***Relating to IFC's OP 4.36*****:** First and foremost, the IFC's OP 4.36 should be amended to make specific reference to the 1991 forest paper and memorandum. While its introduction is a good start, the shortcomings identified should be recognized and addressed at the earliest opportunity. The existing gaps in its coverage should also be addressed without further delay.

9.24 As mentioned above, wide dissemination of the forest strategy should be given top priority among the staff and to IFC's project sponsors, particularly of existing projects in the IFC portfolio. The policy should be referenced explicitly in the relevant investment agreements involving forest-based projects, forest-impacting projects and financial intermediaries.

9.26 A staff manual should also be developed along the lines mentioned above.

9.27 ***Relating to Forest Certification*****:** In the interest of promoting forest certification and fostering the aim of the forest strategy, the Bank and IFC should support the ongoing efforts to harmonize the several systems now in use. The Bank Group should also clarify to the world at large that it does not endorse any particular forest certification system.