

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

HONDURAS

MULTIPHASE SUSTAINABLE FOREST DEVELOPMENT PROGRAM (PRO-BOSQUE)

(HO-0218)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

INFORMATION AVAILABLE IN THE TECHNICAL FILES OF RE2

Preparation:

1. Strategy for sustainable forest businesses for Honduras (ATN/SC-8003-HO)
2. Institutional instruments for developing small forest parcels
<http://www.iadb.org/en2/home-in.html>
3. Local management of forest resources in Central America (ATN/FW-80006-RS).
Report on Honduras
4. Study on the forest economy, Honduras (ATN-SC-8003-HO)
5. Report on forest information systems to be financed through Pro-Bosque (NDF)
6. Consultants' reports on changes in policies and institutional reforms in AFE
7. Consultants' reports for the Pro-Bosque feasibility study:
Report on forest production and management
Report on the forest industry and marketing
Institutional report
Report on environmental and social aspects
8. List of municipalities in the sustainable forest economic development zones (ZODEFS), including socioeconomic data

Execution:

1. Operating Regulations

ABBREVIATIONS

AFE	Administración Forestal del Estado [National Forest Administration]
CATIE	Tropical Agricultural Research and Training Center
COHDEFOR	Corporación Hondureña de Desarrollo Forestal [Honduran Forest Development Corporation]
DA	Departamento de Administración [AFE Administration Department]
DEC	Dirección Ejecutiva del Catastro [Executive Directorate of the Cadastre]
ESNACIFOR	Escuela Nacional de Ciencias Forestales [National Forest Sciences School]
FIDE	Fundación para la Inversión y Desarrollo de Exportaciones [Foundation for Investment and Export Development]
FONAPROVI	Fondo Nacional de Producción y Vivienda [National Production and Housing Fund]
FSC	Forest Stewardship Council
INA	Instituto Nacional Agrario [National Agrarian Administration]
INE	Instituto Nacional de Estadística [National Statistics Administration]
NDF	Nordic Development Fund
OR	Operating Regulations
PAAR	Proyecto de Administración de Áreas Rurales [Rural Land Administration Project], World Bank
PATH	Programa el Administración de Tierras de Honduras [Honduras Land Administration Program], World Bank
PNRT	Programa Nacional de Regularización de Tierras [National Land Regularization Program]
SERNA	Secretaría de Recursos Naturales y Ambiente [Ministry of Natural Resources and the Environment]
SIDA	Swedish International Development Agency
SME	small and medium-sized enterprises
ZODEF	Zona de Desarrollo Económico Forestal Sostenible [sustainable forest economic development zone]

HONDURAS

MULTIPHASE SUSTAINABLE FOREST DEVELOPMENT PROGRAM (Pro-Bosque) (HO-0218)

"Sustainable Forestry Economic Development Zones" (ZODEFS)"



This map, prepared by the Inter-American Development Bank, has not been approved by any competent authority and its inclusion in the loan document has the exclusive objective of indicating the area of influence of the project proposed for financing.

Design Unit - ITS/GSV 10.31.2003



HONDURAS

IDB LOANS

APPROVED AS OF SEPTEMBER 30, 2003

	US\$Thousand	Percent
TOTAL APPROVED	2,398,015	
DISBURSED	1,944,357	81.08 %
UNDISBURSED BALANCE	453,658	18.91 %
CANCELATIONS	164,305	6.85 %
PRINCIPAL COLLECTED	688,847	28.72 %
APPROVED BY FUND		
ORDINARY CAPITAL	551,414	22.99 %
FUND FOR SPECIAL OPERATIONS	1,776,400	74.07 %
OTHER FUNDS	70,200	2.92 %
OUTSTANDING DEBT BALANCE	1,255,509	
ORDINARY CAPITAL	174,620	13.90 %
FUND FOR SPECIAL OPERATIONS	1,080,617	86.07 %
OTHER FUNDS	272	0.02 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	296,827	12.37 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	73,899	3.08 %
ENERGY	420,074	17.51 %
TRANSPORTATION AND COMMUNICATIONS	405,401	16.90 %
EDUCATION	71,293	2.97 %
HEALTH AND SANITATION	260,585	10.86 %
ENVIRONMENT	80,247	3.34 %
URBAN DEVELOPMENT	154,749	6.45 %
SOCIAL INVESTMENT AND MICROENTERPRISE	366,177	15.26 %
REFORM AND PUBLIC SECTOR MODERNIZATION	235,492	9.82 %
EXPORT FINANCING	6,908	0.28 %
PREINVESTMENT AND OTHER	26,362	1.09 %

* Net of cancellations with monetary adjustments and export financing loan collections.



HONDURAS

STATUS OF LOANS IN EXECUTION AS OF SEPTEMBER 30, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	4	53,900	44,227	82.05 %
1997 - 1998	6	172,106	96,357	55.99 %
1999 - 2000	12	206,049	77,099	37.42 %
2001 - 2002	15	180,243	18,936	10.51 %
2003	3	65,000	0	0.00 %
<u>PRIVATE SECTOR</u>				
2001 - 2002	1	13,700	0	0.00 %
TOTAL	41	\$690,998	\$236,619	34.24 %

* Net of cancellations. Excludes export financing loans.



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Honduras

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
HO0205	Sula Valley Citizenship Security	20.0	APPROVED
HO0221	Program to Foster Business Competitiveness	10.0	APPROVED
HO0220	Poverty Alleviation and Local Dev. phase II	35.0	APPROVED
HO0218	Pro-Bosque Program	17.5	
HO0212	Poverty Reduction Sector Program	30.0	
HO0219	Financial Sector Program	25.0	
Total - A : 6 Projects		137.5	
TOTAL 2003 : 6 Projects		137.5	

2004

Project Number	Project Name	IDB US\$ Millions	Status
HO0202	Vocational and Technical Education Program	30.6	
HO0208	Strengthening of Fiscal Management	15.0	
HO0207	PPP Roads Integration	50.0	
HO0195	Sustainable Tourism	25.0	
HO1001	Municipal Development Program Tegucigalpa II	22.5	
HO1002	Health Sector Strengthening	25.0	
*HO0201	Privatization Four International Airport	22.0	
HO0224	PPP Energy Sector Support	50.0	
Total - A : 8 Projects		240.1	
HO0197	Poverty Reduction Program focusing on Indigenous peoples and Afro descendants	10.0	
HO0222	Social Protection Program	30.0	
HO0223	Public Finance strengthening support	30.0	
HO0174	Sanitation and Water Investment Complem.	14.0	
HO0192	Credit Global Program	30.0	
Total - B : 5 Projects		114.0	
TOTAL - 2004 : 13 Projects		354.1	

Total Private Sector 2003 - 2004 22.0

Total Regular Program 2003 - 2004 469.6

* Private Sector Project

MULTIPHASE SUSTAINABLE FOREST DEVELOPMENT PROGRAM (PRO-BOSQUE)

(HO-0218)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Honduras		
Executing agency:	Administración Forestal del Estado – Corporación Hondureña de Desarrollo Forestal (AFE-COHDEFOR) ¹ [National Forest Administration – Honduran Forest Development Corporation]		
Amount and source:		Phase I	Phase II
	IDB (FSO):	US\$17.5 million	US\$30.0 million
	Cofinancing (NDF): ²	US\$ 6.0 million	
	Local:	US\$ 1.5 million	US\$ 3.3 million
	Total:	US\$25.0 million	US\$33.3 million
Financial terms and conditions:	Amortization period:	40 years	
	Disbursement period:	54 months	
	Grace period:	10 years	
	Interest rate:	1% for the first 10 years and 2% thereafter	
	Inspection and supervision:	1%	
	Credit fee:	0.5%	
	Currency:	U.S. dollar, Single Currency Facility	
Objectives:	The general objective is to increase the economic, social and environmental benefits of the forest sector in Honduras through the sustainable development of forested land and improvements in the sector's competitiveness and business productivity. The specific objectives are: (i) to continue to improve the regulatory and institutional framework to facilitate and promote the development and competitiveness of the forest sector; (ii) to improve the management		

¹ In the document AFE is used for AFE-COHDEFOR and any successor public institution that may be established as a result of restructuring that institution.

² The Nordic Development Fund (NDF) has included the program in its pipeline, for €6 million. The financing conditions are a 40-year term and zero interest.

and monitoring of forest lands (national, municipal and private) by regularizing land tenure and adopting competitive mechanisms for private sector participation; and (iii) to increase the productivity and efficiency of the sector all along the production chain. The success of the program hinges on institutional major changes and policies and therefore it has been designed as a multiphase operation.

Description:

Component 1. Policy and institutional framework (US\$6.1 million). This component will help to improve the investment climate and the efficiency of government action, through adjusted policies, an improved regulatory framework and a modernized institutional framework. **Subcomponent A: Policies and institutional restructuring (US\$5 million)** (i) Changes to operating policies and regulations that include: (a) the redesign of management plans; (b) long-term forest management contracts for public forests; (c) simplification or elimination of technical regulations; (d) studies on the policies to be developed in phase two. (ii) Support for restructuring the National Forest Administration (AFE) under new policy guidelines. (iii) Support for education and technical training and applied research. **Subcomponent B. Monitoring and information (US\$1.1 million).** (i) Support for government compliance monitoring. A new database with Intranet access for AFE's regional offices will be constructed. The baseline will be updated for monitoring forested and deforested land, registering ownership, volume, species, production and productivity, annual changes in forest cover and areas affected or at risk of forest fires, pests or natural disasters. (ii) Information of interest to the forest sector. An Internet portal will be established with information, mainly for the private sector, on production, prices, quality, imports, exports and financing arrangements; business opportunities; legal regulations and instruments; register of suppliers of accredited services; and models for forest inventories and forest management plans.

Component 2. Local public management to support forest development (US\$11 million). The purpose of this component is to promote the development of regional forestry, within the boundaries of sustainable forest development zones (ZODEFS). **Subcomponent A. Development of zones (US\$5 million).** The program will finance: (i) institutional strengthening for coalitions of municipalities or other entities to coordinate the development of forest zones; (ii) a forest development plan for each zone, prepared through a participative process; and (iii) investments defined in the zone plans. **Subcomponent B on regularization of land tenure (US\$6 million).** The program will finance the cadastre and land titling in an estimated area of 625,000 of land that is apt for forestry, for owners or occupiers of land with adverse possession rights, and registration of that land in the public registers of the ZODEFS.

Component 3. Development of productive projects (US\$4.2 million). The purpose of this component is to vitalize the forest sector through direct investments along the entire production chain and promote integration. A financial mechanism will be established that the private sector can apply to for cofinancing. The investments will be in primary forest production, processing of forest products, marketing and ecotourism projects in forests. The projects will be required to include technical assistance to ensure the quality of execution.

The Bank's country and sector strategy:

The Bank's strategy for Honduras is to support the government's efforts to reduce poverty by: (i) speeding up sustainable development through enhanced competitiveness and productivity; (ii) boosting the efficiency of social safety nets and the productive capacity of the poor; and (iii) building institutional capacity and improving governance. The strategy document mentions the importance of the sustainable development of the forest sector in a framework of competitiveness and specifically names Pro-Bosque as an operation that will support that strategy (see paragraphs 1.37 and 1.38).

Environmental and social review:

The program will have significant positive impacts on the environment and on social groups from different strata in the ZODEFS. The strategies to improve forest management practices will contribute to the objectives of improving the socioeconomic situation of residents and businesses and rehabilitation and maintenance of ecological processes and environmental services in forests. The potential risks and negative impacts will be limited to the extraction of forest resources if that is done without respecting the technical rules and specifications. The main preventive measures are: (i) the inclusion of good practices in the technical standards for the preparation of forest management plans and long-term contracts; (ii) a proposal for monitoring and control of illegal logging and sale of wood; and (iii) the incorporation of a specialist in poverty reduction, social inclusion and gender equity into AFE's Specialized Advisory Group (see paragraphs 4.15 to 4.26).

Benefits:

The program will have measurable benefits for forest SMEs, producers' associations, local governments and rural families living in poverty in forest zones. The socioeconomic benefits are improvements in the performance and efficiency of existing forest SME in the ZODEFS and the creation of new opportunities for family groups, communities and associations to develop their forest microenterprises and establish links to the market through integration. The social benefits include a reduction in conflict over land tenure and the provision of legal security for owners. The environmental benefits

are a reduction in deforestation rates and the benefits associated with improved conditions in watersheds.

Risks:

The program's risks are: (i) The operation will not deal directly with problems outside the sector that could undermine interest in investing in the sector. This risk will be mitigated through advisory services and dialogue with the government. The risk of the lack of demand for investments has been reduced by designing a very small pilot project component for phase one. (ii) The risk that political will for reforms in the sector and financing for AFE might not be maintained will be mitigated by establishing broad partnerships for forest development in Honduras. (iii) Uncertainty regarding tenure of what is classified as public land and processes for titling forest land could affect the goals for regularizing land ownership and the general investment climate in the sector. To mitigate this risk, the program will bring its activities in the ZODEFS with the highest percentages of private land and will finance studies and support the government in designing alternatives for the legal, social and political aspects associated with titling forest land (see paragraph 4.27).

Coordination with other development agencies:

Extensive coordination has been carried out with international institutions that support forest development in Honduras. The SIDA-IDB partnership financed a study on municipal forest development, while the Swedish Fund in the IDB and the Nordic Development Fund (NDF) financed studies to support program preparation. The IDB team has coordinated the preparation process with two teams from the World Bank that are preparing projects in Honduras on land ownership regularization and forest issues. Pro-Bosque, as a framework program for the sector, will coordinate its activities with all major projects in the forest sector, including those financed by the World Bank, CIDA (Canada), USAID (United States), GTZ (Germany), FINIDA (Finland) and DFID (Great Britain) to ensure the complementarity of investments. The NDF will finance the land ownership regularization subcomponent of the proposed program (see paragraphs 1.35, 1.42, 2.30 and 2.44).

Special contractual clauses:

The first disbursement of the loan will be conditional on the borrower, through the executing agency, presenting evidence of the following to the Bank's satisfaction: (a) that an agreement has been signed on transferring loan proceeds from the borrower to the executing agency; (b) that the program's Operating Regulations have been placed in effect; and (c) that the principal advisor for AFE has been contracted (see paragraphs 3.23 and 3.6).

In addition, the first disbursement to finance the activities included in components 2 and 3 will be conditional on the borrower, through the executing agency, presenting evidence of the following to the Bank's

satisfaction: (a) that the NDF has officially approved the financing for subcomponent 2B; and (b) that the entities responsible for executing components 2A and 3 have been selected (see paragraphs 2.30 and 3.15). The Bank will retain the sums necessary from the first disbursement to repay the amount owed by the borrower for use of the project preparation line of credit (11/LC-HO).

Poverty-targeting and social sector classification:

This operation qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, this operation qualifies as a poverty-targeted investment (PTI) under the geographic criterion (see paragraph 2.6).

Exceptions to Bank policy:

None.

Procurement:

Procurements will follow the Bank's policies and procedures. International competitive bidding will be required for goods and related services worth US\$250,000 and over, and for consulting services worth US\$200,000 and over. All bids below these limits will follow domestic legislation, provided it does not contradict Bank policies and procedures (see paragraph 3.27).

I. FRAME OF REFERENCE

A. Introduction

- 1.1 With a total area of 112,492 km² and 98,629 km² apt for forestry, Honduras is the Central American country with the greatest potential for the production of wood and nonwood products from forests. Its natural forests cover 54,000 km², distributed in four forest macro-ecosystems: pine forest, broadleaf forest, cloud forest and mangrove forest. The coniferous forests cover almost 25,000 km² while the broadleaf forests cover about 29,000 km². These forests are mainly located in the eastern part of the country (69 percent) and a zone on the Atlantic (16 percent), forming a continuous forest mass, with some remnants of cloud forest in the center and dry forest in the south. In the coniferous zones, sparse pine forests predominate (72 percent) on account of unsustainable use, recurrent forest fires and poor logging techniques.
- 1.2 There are three types of property rights over forests: public, municipal and private. The national forests are largely occupied by people who have property rights but do not have legal title. The municipal forests are often neglected by the municipalities although there is relatively better control over spontaneous settlement than in the national forests. In private forests, most owners do not process the wood personally. They either sell it as standing timber or logs, which brings them very little profit. In 2002, AFE reported that 971,300 m³ of logs had been taken from the natural forests, mostly pine (97.7 percent). Historically, the forest sector has contributed significantly to the country's GDP, for almost 10 percent in the period 1996-1998.

Table I-1. Logging in Honduras, 2002

By type of forest			By type of land ownership		
Forest	m ³	%	Ownership	m ³	%
Pine	948,700	97.7	National*	275,400	28
Broadleaf	22,600	2.3	Municipal	128,700	13
Total	971,300	100	Private	967,000	59
			Total	971,300	100

Source AFE-COHDEFOR

*Largely occupied by private parties

B. The forest industry

- 1.3 There are almost 1,000 forest SMEs in Honduras,¹ 282 of which participate in primary production, 511 in processing and the rest in sales. These companies can be found almost everywhere in the country, but are more heavily concentrated in the central corridor. The sector is highly informal and most of the operations continue to use traditional practices, particularly in the broadleaf forest.

¹ According to the definition of SMEs as being companies with under US\$3 million in annual sales.

- 1.4 The 138 sawmills registered with AFE process about 1 million m³ of wood a year. Most of the sawmills' production of about 570,000 m³ of sawn wood is for export. Some 95 small sawmills produce 17.5 percent of total sawn wood, mainly for the domestic market. The four largest industries produce 22 percent of the volume (125,000 m³). The wood processing index (sawn wood/round wood) is 57 percent, which is relatively low. Seven companies supply 45 percent of the domestic market (construction, furniture, doors and windows) and 50 percent of exports, mostly to the Caribbean.
- 1.5 Honduras' forests also provide nonwood products, particularly resins and oils, used as raw materials for wood rosin and turpentine, byproducts of pine resin which, together with liquidambar resin, are export products. In 1996, resin production peaked at 38,100 barrels (98.5 percent from pine), falling significantly to 13,700 barrels by 2001. Flora from the forests is used as a raw material for crafts, food and other products for the domestic and export markets.

C. Sector competitiveness: Problems and opportunities

1. Competitiveness

- 1.6 The National Competition Commission has identified the forest sector as one of the country's four priority sectors. The factors that determine the sector's productive potential are: (i) the existence of abundant forests with coverage of pine and high-quality broadleaf trees; (ii) large extensions of land that are apt for reforestation with quick growing species, which are currently not used or are used for low-yield grazing; (iii) the significant growth potential of forest productivity from the current level of 1-2 m³/ha/year to an average of 9-10 m³/ha/year and even up to 18 m³/ha/year on optimum land, with the possibility of multiplying these coefficients by using genetically superior plants available on the market; (iv) the possibility of tapping 'green markets' through certification, as is done by other countries in the region; and (v) academic and professional institutions with experience in the sector.
- 1.7 Despite this potential, forest production has been diminishing gradually owing to a series of factors that make for an adverse climate for private investment in forests, particularly: (i) uncertainty of land tenure in forest areas; (ii) high transaction costs; (iii) lack of knowledge of the latest technologies for forest production and lack of public and private technical assistance services; and (iv) lack of economic incentives on account of distortions in the sector's economy.
- 1.8 *Uncertainty of land tenure.* The ownership of forest land is marked by informality and illegality, particularly the 77 percent of land classified as public land (63 percent national, 14 percent municipal), which is largely occupied by individuals or communities with adverse possession rights, but who do not have formal deeds. The lack of recognition of their rights prevents occupants from

maintaining control over forest resources, making investments to protect them or to boost their productivity, or undertaking contractual commitments. On the contrary, the situation incites occupants to cut and sell the tress before AFE does and to try to prevent buyers of wood sold by AFE from gaining access to it. In some regions, this has resulted in social conflict, with serious violations of public order and the rule of law.

- 1.9 *High transaction costs* to prepare and obtain approval of management plans, licenses to log and transport wood and other restrictions on the use, processing and sale of forest products are detrimental to forest businesses. Excessive red tape has led to an AFE with high costs and many employees. In April 2003, the government took the first step by cutting almost 50 percent of AFE's staff, paring the institution down to about 400 employees. This will be accompanied by institutional restructuring, policy adjustments and a redirection of AFE's activities and role in the sector, with a view to boosting efficiency (see Chapter 3).
- 1.10 *The lack of public support and technology development services* to facilitate the development of forest businesses increases the risks and costs to investors, reduces the productivity of the forest chain and is detrimental to the operation of the products and services market. There is insufficient knowledge about modern silviculture techniques, such as clonal propagation and genetic improvement and about new areas such as forest certification and payment for the environmental services of forests. The adaptation and dissemination of commercial technologies has been modest and there is little reliable market information that would allow for business planning or doing business. There is also a lack of technical-assistance, legal, managerial and commercial services.
- 1.11 There are no long-term credit facilities for the forest sector. The National Production and Housing Fund (FONAPROVI) has funds available for medium-term loans under market conditions that could be used for the sector. However, this is not adequate for the primary sector owing to the guarantees required. FONAPROVI expects to receive financing from the IDB of US\$30 million for loans to microenterprises under the global credit program (HO-0192) slated for approval in 2004. Part of those funds might be available for the beneficiaries of the Pro-Bosque program.
- 1.12 *Economic distortions* in the Honduran forest market are mainly seen in low prices for standing timber. In 2003, although sawn pine has been selling at close to US\$149 per m³, producers receive just US\$13 per m³ for standing timber. This contrasts with the situation in Chile, where the prices were US\$113 per m³ and US\$23 per m³, respectively (2001).²

² In the mid-1990s, the wood market behaved more competitively in Honduras with the introduction of forest auctions and the price of standing pine rose to US\$38 per m³, but then fell to US\$11 per m³ in 2002 and to US\$13 per m³ in 2003.

Table I-2. Average prices and comparative margins for pine		
	Honduras (2003)	Chile (2001)
Price of standing timber (US\$/m ³)	13.0	23.0
Logger margin (%)	18.7	15.0
Price at the sawmill (US\$/m ³)	31.7	38.0
Sawmill margin (%)	69.5	25.7
Price of sawn wood (US\$/m ³)	148.7	113.0

- 1.13 Most of the difference is explained by the high margin retained by the sawmills and the lack of vertical integration between primary and secondary production. The margin allows a large number of inefficient sawmills that operate circular saws to subsist in Honduras, which supply 32 percent of sawn wood.³ Since the width of a cut made by a circular saw is 5 mm, compared to less than 2 mm with more efficient band saws, the yield of a circular saw is estimated at 45 percent compared to at least 54 percent for band saws. This means that an immediate increase of 20 percent in sawn wood production can be had by replacing a circular saw with a band saw, which also brings a significant reduction in energy and labor costs.
- 1.14 As a result of all these factors, there are severe distortions on the Honduran forest market, which create an adverse climate for investments in the sector. Only when that adverse climate is substantially reduced and the necessary support is provided will it be possible to spur investments to increase productivity, forest production and wood processing activities, all with a view to boosting competitiveness and tapping the large export markets that are available.

2. Potential export markets

- 1.15 Honduras' geographic location gives it the opportunity to gain access to the US market, whose scale would absorb almost all the increase in forest production that Honduras could achieve. The market in the southeastern United States could easily absorb several billion dollars of imports of conifers each year. Honduran pine logs can compete favorably with prices of pine in that part of the US. Considering that the transportation and handling costs for Honduran pine from the forest to a United States port are about US\$65 per m³, if the Honduran producer receives US\$26 per m³ for standing pine (double the current price), Honduran logs can be supplied at a US\$91 per m³, CIF, which compares favorably with the prices for southern pine logs of US\$107 per m³ (2001). After hurricane Mitch, the government banned the export of hardwood, but no ban was placed on pine. Therefore there must be other factors that explain the lack of exports of pine logs, despite the existing potential. In the case of various broadleaf species for furniture, etc., the export potential is even better, since they fetch a much higher price on the international market than pine.

³ Circular saws were replaced in the industry by band saws in the 1960s in other Latin American countries.

D. Evolution of the legal and institutional framework

- 1.16 Prior to 1972, it was believed that Honduras was a country with natural agricultural potential and therefore the government acted to change land use, without considering its true aptitude. There was a dramatic change in forest policy during the period 1972-1991, moving from a model based on private initiative to a model totally supported by the State. The government took over all forests, disregarding land ownership, and the entire chain of forest sector activities, logging, processing and sale of products. The period was marked by conflicts with land owners and occupiers, scant generation of profits from forests, and unproductive investments that distracted the government of its function of ensuring that the benefits of the forest would go to society. Forests continued to be treated as sources of wood, without any decisive inclusion of the idea of production based on sustainable management and reforestation.
- 1.17 To reverse these trends, in 1992, the government, with support from a sector loan cofinanced by the IDB and the World Bank, changed its policies under the Agricultural Sector Modernization and Development Act. This act: (i) returned dominion over the forest to the land owners; (ii) required management plans for using forests, regardless of who owned the land; (iii) privatized the forest industry; and (iv) assigned the functions of protecting and managing public forests to the National Forest Administration (AFE), also making it responsible for establishing regulations and controlling the management of private and municipal forests. The new legal framework forced AFE to use the public auction mechanism as a means of selling public forest resources.
- 1.18 Today, a bill for a new forestry act is before congress which, among other things, calls for long-term forest management contracts for public forests and the strengthening of the forest social system through the transfer of ownership to communities established in forests. The new act maintains AFE as the lead institution in the sector, operating with funds from the national budget. The proposed operation does not depend on the new law, although it follows the same general direction with actions that can be executed under the existing legal framework.

E. The National Forest Administration (AFE)

- 1.19 At present, AFE is composed of a Board of Directors, which is the senior authority in directing its institutional policies and is composed of the Minister of Agriculture, the Minister of Natural Resources and the Environment, the Ministers of Finance, Economic Affairs and Defense, the National Agrarian Administration, representatives of the Wood Producers' Association, the National Association of Wood Processors, the Honduran Federation of Agroforest Cooperatives and AFE's general manager. The Offices of the General Manager and Deputy Managers are

supported by the Planning Department, the Financial Administration Department, the Human Resource Unit and the Internal Auditing Office.

- 1.20 Five technical departments are responsible for AFE's operations: (i) Forest Social System; (ii) Forest Management; (iii) Protected Areas; (iv) Regulations and Control; and (v) Forest Protection. AFE has five regional offices and eight independent projects.
- 1.21 The main problem with the way in which AFE is organized is its inability to achieve its objectives and respond to the rapid changes needed for sector development, owing to its administrative inflexibility and inefficiency in the use of resources. Given this situation, the institution needs to be reinvented to make it competitive, with results-based strategic objectives that are targeted to clients. Accordingly, the conditions for restructuring AFE are: (i) a decentralized organization that is flexible, efficient and effective; and (ii) management by results, including evaluation of the goals achieved and quantification of the cost effectiveness with which resources are used.
- 1.22 As a result of the restructuring, the new AFE should be: (i) a public service institution with direct government financing; (ii) structured and operating on the basis of productive development, forest social development and protection of ecosystems; and (iii) with operating responsibilities that are periodically redefined based on the annual operating plans adopted by each area.
- 1.23 As the first step in this direction, during the first half of 2003, the government cut AFE's staff back from 1,200 to 405, with 105 employees in the central office, 249 in the regional offices and 51 assigned to the independent projects. As the second step, consulting services were contracted to define a new structure, whose implementation has begun and which will be supported and strengthened under the proposed program. The new organization will retain the Board of Directors as its senior authority with its current composition, and the Office of the General Manager as its line agency, with three operating departments: the Production Development Directorate, the Forest Social Development Directorate and the Ecosystems Protection Directorate. One of the main points will be delegation of functions to the regional offices to streamline business with producers.
- 1.24 Under the government's current regulations, AFE operates with funds that are mainly generated from forest auctions, supplemented with income from fines, sale of seized wood and logging licenses. However, during the last three years, AFE has had losses that were covered by transfers from the government in the form of loans. For 2003, its budget is US\$6.34 million, which was 48 percent executed by June. An analysis of projected budget execution for 2003 indicates that AFE will not have the income needed to cover its operating costs. This is due to the low level of wood sold at auction, which amounts to just 27 percent of the total projected for the year. Despite the cutbacks in staff, AFE will need government transfers to continue

operating to carry out its mandate, particularly because under the new programming, the auctions will be less important. Given its new function as a public service institution that generates income for the national treasury, the government will have to commit financing for it out of the national budget.

F. Role of the municipalities

- 1.25 With the promulgation of the Agricultural Sector Modernization and Development Act in 1992, the local governments were given a larger role to play in the forest sector because they were permitted to take back dominion over the municipal forests. In the following year, the General Environment Act decentralized responsibilities for environmental and natural resource protection to the municipalities. Further, the Municipalities Act gave the local governments far-reaching responsibilities over land use planning, including the zoning of rural and urban areas. The municipalities now have multiple influences in the forest sector and form an important part of the sector's institutional context. They are owners of the municipal forests (which are classified as public forests, the same as the national forests). They have agreements with AFE to manage national forests and have to cope daily with problems of governance of forested areas. The country as a total of 55 coalitions of municipalities(*mancomunidades*), which are microregional cooperation bodies with an average of eight municipalities per coalition. Many of them are addressing the challenges of planning, management and use of their municipal forests. A study on local management of forest resources in Central America, financed by SIDA/IDB (ATN/FW-80006-RS), documented the important role played by the municipalities in the forest sector in Honduras, and the challenges they face for the development and protection of local forest resources.

G. Land tenure

- 1.26 In 2002, the Honduran government announced the national land regularization program (PNRT), intended to regularize land ownership and provide deeds on a large scale. The objectives of the program are to combat poverty, strengthen the economy and national competitiveness and create an efficient property market by improving the legal security of ownership and organizing information on property. It also seeks to protect natural resources by surveying and reestablishing protected forest areas.
- 1.27 With support from international organizations, particularly the World Bank, the country is in full transition to a modern land management system. It has made significant progress in defining a policy framework for land regularization, systematizing procedures and strengthening the complex institutional structure for the processes of land legalization, deeding and registration. The key institutions in the system include the Supreme Court, which operates 28 departmental registries, the Executive Directorate of the Cadastre (DEC), the National Agrarian Administration (INE), AFE and the municipalities. The model proposed in the

PNRT includes the introduction of a master registry system, which will build and make available to the public a consolidated property information database. In future, the government intends to integrate the cadastre and national register under a single body.

- 1.28 Despite the progress made, there is uncertainty regarding the true size of public forests and a lack of clarity in the government's policy on how to proceed in regularizing ownership of that land. These circumstances have two important implications: (i) that the extent of public forests could be significantly smaller than appears in official statistics; and (ii) that recognition of legal ownership of land for occupants with adverse possession rights could result in a substantial redistribution of property rights over the country's forests.
- 1.29 The government, with support from the Rural Land Administration Project and other programs, has begun to delimit physical areas that are candidates for classification as being of forest interest that could eventually be assigned to the inalienable public forest heritage catalogue. The process will make it possible to continue with regularization in classified areas outside the catalogue, including giving deeds to residents, in accordance with the legal requirements. In addition to the technical revision involved, this process will require broad consultations and social validation, prior to approval.
- 1.30 The municipalities play a key role in land management and the new national initiative to regularize ownership recognizes that they can provide major support for regularization, particularly by promoting the process, resolving conflicts and supporting land titling (see paragraph 1.25). Also, since the property tax is municipal in Honduras, there are incentives for the municipalities to keep their property rolls up to date and the system seeks to integrate data from the municipalities and the central level through the unified registry system.
- 1.31 Land tenure for indigenous groups in Honduras is regulated in Articles 67, 65, 92 and 346 of the Constitution. Property rights are also expressed in Convention 169 of the International Labor Organization, to which Honduras is a signatory.

H. Experience of the Bank and other donors

- 1.32 The Bank has broad experience in financing forest activities under natural resources programs in Central America. In Guatemala, one important experience was the project for land management and conservation in the Chixoy watershed (871/SF-GU) where it learned lessons about the positive impact of agroforestry systems on soil and water conservation. In Nicaragua, the socioenvironmental and forest development program (970/SF-NI, 1084/SF-NI) has developed successful mechanisms through the competitive participation of rural organizations, municipalities and NGOs. Based on the good experiences of stage I, stage II of the project has strengthened the role of municipalities in execution. The Bank has also

financed various technical-cooperation projects on forests, including how to facilitate the integration of small forest owners (ATN/NP-744-RS) and a strategy for sustainable forest businesses, with a case study in Honduras (ATN/SC-8003-HO).

- 1.33 In Honduras, the Bank contributed a decade ago to changes in the forest sector, through sector operations for agricultural adjustment (607/OC-HO and 867/SF-HO), supported by the 1992 Agricultural Sector Modernization Act (see paragraph 1.17). In 1995, it financed the El Cajón watershed management project (718/OC-HO and 918/SF-HO), executed by COHDEFOR, whose activities included management of priority subbasins and forest and agroforest production. A flexible form of execution and administration was learned, based on a structure of technical assistance services provided by the private sector. It was found that the process of creating demand and supply for services limited disbursement levels in the early years of the project, but once basic capacity was built, the project achieved a high level of annual execution (project completion report HO-0035, 2003). At the start, the project took a fairly welfarist approach, which was a lesson learned that led to a change in execution to promote a sense of ownership by the communities and improve the mechanisms for sustainability. The Bank has also financed several technical-cooperation projects with the National Forest Sciences School (ESNACIFOR) in the areas of forest certification and protection against forest fires and pests.
- 1.34 The objectives of the Rural Land Administration Project (PAAR) financed by the World Bank, 1996-2003, included support for forest management and improvements in the national cadastre. Although the operation was executed slowly and did not improve competitiveness in the sector, the cadastre of the department of Comayagua was completed and 5,000 properties were registered. The registers of Comayagua and Siguatepeque were automated, and information was captured on deeds issued by 21 municipalities and the National Agrarian Administration. The project learned that greater efficiency can be achieved through the use of private sector services instead of establishing a large executing unit, which will influence the design of the new stage that is currently being prepared (see paragraph 1.42).
- 1.35 Parallel to support from the IDB and the World Bank, CIDA (Canada), USAID (United States), GTZ (Germany), FINIDA (Finland) and DFID (Great Britain) have financed major programs for forest management, community forestry, watershed management and research on tropical species and wood, such as the broadleaf forest development project, the program and protection for the biosphere of the Río Plátano, the Central American regional forest program, the program for the management and sustained use of coniferous forests in Honduras, support for community forestry, support for the government's forest policy, the TRANSORMA project and the forest development project. Pro-Bosque, as a framework program for the forest sector, will coordinate its activities with all the major projects in the

sector, to ensure that project financing follows compatible policies and the investments complement each other.

- 1.36 **Lessons learned.** The lessons learned from the operations mentioned and from other projects and studies, which have been incorporated into the program design include the following: (i) the regulatory and institutional framework of the forest sector is fundamental for development potential; (ii) financial incentives for good forest management are more efficient in conserving natural resources than micromanagement by governments; (iii) clear ownership of forest land is a condition for sustainable management; (iv) horizontal and particularly vertical integration offer many advantages for boosting efficiency, productivity and the social benefits of productive activities; (v) financial services for the forest sector are limited, particularly when no guarantees are available based on land ownership; (vi) there is strong demand by sector SMEs for technical assistance and training to grow their businesses; and (vii) active participation by the private sector, communities and municipalities, in function of their interests, is a determining factor for the success of local development. The Bank has been one of the leaders in designing methodologies to support the development of SMEs, through the operations of the Multilateral Investment Fund (MIF), with lessons learned that will be applied in the present operation, considering producers along the entire forest production chain as entrepreneurs.

I. The Bank's country strategy

- 1.37 The Bank's strategy for Honduras (2003) is to support the government's efforts to reduce poverty by: (i) speeding up sustainable development through enhanced competitiveness and productivity; (ii) boosting the efficiency of social safety nets and the productive capacity of the poor; and (iii) building institutional capacity and improving governance, including decentralization and local economic development. The strategy mentions the importance of the sustainable development of the forest sector in a framework of competitiveness and emphasizes the forest cluster as one of the clusters with the greatest potential. It recommends that special attention be paid to sustainable development of the rural economy and specifically mentions that the Pro-Bosque program will support sustainability of the sector, building up its production chains.
- 1.38 The program also contributes to other fundamental areas of the Bank's strategy, promoting decentralized forest management and offering opportunities to strengthen the presence and participation of communities to promote the social inclusion of bypassed groups.

J. The country's sector strategy

- 1.39 The current administration published the 2002-2006 Government Plan and established the principles of forest policy which are mainly intended to: reactivate

the economy, consolidate participation by communities that live on land with forest potential in management and production activities, provide incentives for forestation for industry and firewood, establish long-term forest management contracts with the private sector and the municipalities, and restructure AFE to turn it into a public service that promotes private investment in the sector, administers national forests and watches over protected areas and wildlife.

- 1.40 The current AFE administration, which sits on the Production Cabinet established by the country's president, has the main purpose of laying the technical, legal, institutional, administrative and social groundwork and providing security of access to resources for all social and entrepreneurial sectors, with a long-term strategic planning vision, which is consistent with the horizon for the two phases of Pro-Bosque.

K. Complementary projects

- 1.41 The Bank is financing three operations that partly cover forest issues and will operate as significant forerunners for Pro-Bosque. (i) The program to manage natural resources in priority watersheds (1077/SF-HO) will support AFE in implementing policies and strategies for land tenure and management of forests and protected areas. It is complementary to Pro-Bosque in aspects of policies, cadastre, titling and regularization in forested areas, forest certification and marketing of products, although on a smaller scale and covering different geographic areas. (ii) Improvement of the competitiveness of small and medium-sized forest enterprises (ATN/ME-7953-RG) financed by the MIF and CATIE is a tri-national project (Honduras, Nicaragua and Guatemala) and is intended to improve the performance and competitiveness of forest SMEs through better business and environmental performance. The purpose is to strengthen the administrative and technical capacity of forest SMEs and improve the opportunities for selling forest products, taking a long-term view. (iii) Promotion of entrepreneurial competitiveness and strengthening of Honduran foreign trade management (1125/SF-HO), executed by the Foundation for Investment and Export Development (FIDE), promotes improvements in the business climate and associations in the agroindustrial and forest sectors. The Bank is also preparing a vocational and technical education program (HO-0202) which will improve technical education programs in four priority areas, including the forest sector. Pro-Bosque's technical education activities will be coordinated with it.
- 1.42 The World Bank is currently completing the preparation of two new operations as a continuation of the PAAR project. The first will support a national program to regularize land tenure (which will only cover forests in certain indigenous areas). The second, the rural productivity program, is intended to improve the use of forest resources through community silviculture, agroforestry and management of protected areas, which will complement Pro-Bosque activities. It has been agreed to

establish a coordination mechanism through AFE, which participates in both programs, to ensure there is no duplication of activities.

L. Triggers and content of phase two

- 1.43 **Multi-phase arrangement.** The success of the program depends on major institutional and policy changes. Therefore, agreement has been reached with the government to design a multiphase operation, which gives the country time to design and implement the new policies and institutional reforms during phase one and permits the government, in cooperation with the Bank, to adjust program interventions on the basis of the lessons learned. The triggers stress aspects of the program's political and institutional reforms.

Table I-3. Triggers for phase two

Component	Trigger
1	New guidelines for forest management plans approved and implemented.
1	A report by an ISO-accredited agency to the effect that AFE has progressed sufficiently to make it feasible to obtain ISO 9001 certification during phase two.
2	Participative plans to develop forest zones prepared and implemented satisfactorily in all the ZODEFS.
2	At least 50 percent of the hectares programmed for regularization have been deeded and registered in each ZODEF.

- 1.44 **Preliminary content of phase two (US\$33.3 million).** Phase two of the program will be designed to consolidate the regulations and monitoring of their application, and the availability of public forest services; extend forest land titling and registration and payment for environmental services in the rest of the country; and provide greater support for boosting productivity, based on the results of phase one. The structure of the program's components will be maintained, but the distribution of resources will be determined on the basis of the conclusions of the evaluation of phase one. Preliminarily, it is estimated that component 1 will shrink to 10 percent of the total, considering that the reforms should make good progress during phase one, so that the new resources will concentrate on components 2 and 3.

II. PROGRAM DESCRIPTION AND OBJECTIVES

A. Objectives

- 2.1 The general objective is to increase the economic, social and environmental benefits of the forest sector in Honduras through the sustainable development of forested land and improvements in the sector's competitiveness and business productivity.
- 2.2 The specific objectives are: (i) to continue to improve the regulatory and institutional framework to facilitate and promote the development and competitiveness of the forest sector; (ii) to improve the management and monitoring of forest lands (national, municipal and private) by regularizing land tenure and adopting competitive mechanisms for private sector participation; and (iii) to learn about opportunities to increase the productivity and efficiency of the sector all along the production chain.

B. Program design

- 2.3 Pro-Bosque is intended to strengthen the forest-industry-market value chain and horizontal and vertical integration among producers, which will not only improve competitiveness but will simultaneously increase the socioeconomic benefits for the rural population, particularly the very poor. Efforts and resources will focus on improving forest management and the competitiveness of the forest sector, impelled by a process where the public sector (local AFE office and organized municipalities) will provide support services and facilitate the development of forest businesses based on private sector investments in production (companies, communities, individual producers and producers' associations).

C. Characteristics of the program's priority zones

- 2.4 The first phase of the program will focus its activities on land in several priority geographic zones (known as sustainable forest economic development zones or ZODEFS). In the ZODEFS, the program will make use of existing coalitions of municipalities or other local or regional institutions to carry out its activities (see components 2 and 3), with a view to recouping or strengthening the productivity of the forest sector and developing the local economy based on forest management and a sustainable forest industry. The first four ZODEFS were selected on the basis of their institutional capacity and the capacity of the forest economy.
- 2.5 For the preparation and analysis of this loan operations, the four selected ZODEFS were studied in greater detail using the criteria mentioned. They include three pine forest regions (Francisco Morazán north, Olancho north and Teupasenti Danli) and a broadleaf forest region (Atlántida-Colón). Municipal groups are present in these

areas (coalitions or other types of associations) with experience in promoting forest development, and forest companies are quite active. During the first year of execution, the possibility of including one or two additional zones will be studied.

- 2.6 All the selected zones have human development indexes below the average for the Honduras (0.651), which ranks as the 116th country in the world. There are no statistics on the level of poverty in the zones to be covered, but the 64.5 percent of all Hondurans live below the poverty line, and the figure for rural areas is 73.8 percent (INE 2001). When the information is combined, it indicates that the program zones have a poverty level higher than the national average which is why the operation qualifies as a poverty-targeted investment on the basis of geographic criteria.

Table II-1. Characteristics of the four selected ZODEFS

Zone	Area (ha)	Forest (ha)	Type of forest	% national/municipal/private forest	Total population	Rural population (%)
Francisco Morazán Norte	383,488.37	236,612.56	Pine	25/1/74	92,700	65.6
Olancho Norte	320,147.30	204,282.04	Pine	93/6/1	52,400	68.6
Teupasenti Danli	314,770.65	133,818.90	Pine	49/26/25	178,400	70.8
Atlántida Colon	1,089,920.31	426,437.96	Broadleaf	93/2/5	590,800	58.4
Total	2,108,326.63	1,001,151.46		71/6/23	914,300	62.1

D. Program components

- 2.7 Pro-Bosque is a program that supports institutional change and investments by the private sector and municipal governments through three components, in addition to providing support for execution. The components are described below.

1. Policy and institutional framework component (US\$6.1 million)

- 2.8 This component will help to improve the investment climate and the efficiency of government action through: (i) adjusted policies and a modernized institutional framework; and (ii) a stronger monitoring and information system.

a. Policy and institutional restructuring subcomponent (US\$5 million)

(i) Policy changes

- 2.9 The changes in operating policies and regulations in the short and medium terms that will have a long-term impact include: (i) reformulating management plans; (ii) implementing long-term forest management contracts for forests belonging to the nation or the municipalities; (iii) simplifying or eliminating different technical regulations; and (iv) conducting more detailed studies on the policies to be developed in phase two.

- 2.10 The program will finance consulting services to develop the following guidelines and preparation forms that will be available over the Internet. (i) General forest management plan (one rotation cycle) with information on two levels: (a) *information to be submitted to AFE*: existing resources, forecast harvest by year, and environmental protection strategy; and (b) *information for own use* (part of the business plan): forest inventories, site index map, silviculture, genetic improvement, investments, financial analysis by product, monitoring, etc. (ii) Annual forest operating plan prepared under the framework of the general forest management plan, with detailed operations for the year (volume and areas to be logged, roads, environmental protection, monitoring, etc.). The annual plans will require approval from AFE only if they do not correspond to the information provided in the general forest management plan. (iii) Long-term forest management contracts for public forests will have a streamlined renewal mechanism through five-year audits. These contracts will follow the same technical guidelines as the general management plans and therefore the program's only additional financing will be for the design of mechanisms for awarding, supervising and renewing the contracts. (iv) Technical manual for forest producers which will be a voluntary tool to be used in producer training.
- 2.11 Promotion of the general and annual forest management plans will stress practical usefulness for forest producers, as part of their business plans. AFE will have three months after a general plan has been submitted to approve it and one month to approve the annual operating plans and updates to the general plans. After that deadline has expired, the plans will be considered automatically approved. AFE will accept forest certification with accreditation from the Forest Stewardship Council as valid for granting its approval and automatic renewal of the general and annual management plans and the long-term forest management contracts, as long as the certificates continue to be valid.
- 2.12 The program will also finance three studies to support the implementation of the new forest policies:
- a. Operation of the wood market in Honduras and the potential for seizing opportunities on the international market, including the identification of factors that impede the export of logs.
 - b. Incentives and mechanisms for establishing two types of forest plantations – for production and for protection.
 - c. System of payments for the environmental services offered by forests and mechanisms for financing and implementation opportunities in the ZODEFS.

(ii) Support for AFE in establishing its new organizational structure

- 2.13 To carry out the policy changes mentioned above and comply effectively with its new mandates, AFE's organizational and personnel structure must be readjusted. Given the structural problems in AFE linked to the many functions assigned to it and its chronic shortage of human and financial resources, it has already begun a restructuring process to be continued with support from the program to turn it into an entity that: (i) provides a public service with the mission of promoting sustainable forest development; (ii) is operationally decentralized and coordinated with municipalities, communities and the private sector; (iii) promotes sustainable forest development without the burden of police control over illegal logging; and (iv) generates income for the national treasury through long-term sustainable management contracts and logging contracts.
- 2.14 The program will support AFE in: (i) establishing a new operating policy; (ii) reengineering its current practices and procedures to establish a new organizational structure tailored to its role as a regulatory agency; (iii) strengthening its human resources through training and the incorporation of new professionals in areas in which it currently has no specialized staff; (iv) strengthening the regional offices so they can act as effective players in promoting the new national policies and regional and zonal strategies; and (v) providing appropriate technological resources to support its management activities.
- 2.15 The items to be financed include: (i) short-term consulting services to prepare regulations and procedures based on the new operating policy and organizational structure of AFE; (ii) workshops and seminars to train AFE staff and other sector agents in the new policies and procedures; (iii) a principal advisor to assist the management of AFE in implementing the new structure and advisors for AFE directors to help implement the new procedures; (iv) procurement of equipment to complement the training activities and a network for the new institutional structure; (v) adaptation of AFE's installations in the program zones; and (vi) costs of the process of obtaining ISO 9001 certification for AFE.

(iii) Support for technical education and training and applied research

- 2.16 The program will support technical education in forestry, with stress on forest management and use, forest economics, plantations, plant propagation, genetic improvement, prevention and control of forest fires and plant health protection. It will also finance applied research, the introduction, technological adaptation and validation of knowledge, systematically improving the practices used. These activities will be carried out in ESNACIFOR, under the existing technical cooperation arrangement between the school and AFE and involving international

cooperant academic institutions, to strengthen ESNACIFOR as a national forest research center.

- 2.17 It will also finance a program of 12 grants for technical forest education for personnel from the ZODEFS to study at ESNACIFOR, the country's only institution that grants a forest technician diploma.

b. Monitoring and information subcomponent (US\$1.1 million)

- 2.18 Within the framework established under subcomponent A, the forest sector information system currently operated by AFE will be expanded with two principal functions.

(i) Support for government compliance monitoring

- 2.19 The program plans for two activities to improve compliance monitoring of forest cover:
- a. *Preparation of a baseline to monitor changes in forest cover.* Preparation of a new national digital map on land use and plant cover (using the new FAO classification) as the basis for monitoring forest cover dynamics.⁴ This map will serve as the baseline for monitoring forest cover by processing and analyzing satellite images once a year for the ZODEFS. AFE will use this tool in its monitoring of all national forests, including surveillance of logging areas, forest fires and advances of massive insect attacks. It will be possible to detect the incidence of unauthorized logging and conversion to farmland (deforestation). The monitoring system will provide valuable georeferenced data to facilitate implementation of the compliance monitoring and control system and alert the authorities so they can take the necessary actions.
 - b. *Monitoring and control of illegal logging and trade in wood and nonwood forest products.* The program will support AFE, other national institutions (the Public Prosecutor, the Ministry of Natural Resources and the Environment, the Environmental Advocate, the Police) and local governments in establishing a decentralized and efficient interagency program to monitor, detect and prosecute violations of the law, to combat illegal logging and sale of wood.
- 2.20 The system and its mechanisms for inspection and control are mainly oriented to the control of events on the ground and not of the transportation of products already extracted, since the latter has not given good results. The system will be linked to awareness and education programs for residents of forests and their inclusion in

⁴ Under the national land use program (ATN/JF-7218-HO), a digital map of current land use has been prepared for the country. This effort should include the needs of AFE/COHDEFOR and the forest sector in terms of classification of the different categories of coverage.

rational management, protection and use activities and in community surveillance programs. This mechanism will also be linked to a series of instruments based strictly on seizures and fines, instead of lengthy and ineffective judicial processes.

(ii) Information of interest to the forest sector

- 2.21 The program will finance services to develop and operate an Internet portal with information of interest to the forest sector. It will include data on production, imports, exports, financing arrangements and support, an open space for business opportunities, legal regulations and instruments (model contracts and articles of incorporation), prices, quality, and a register of the suppliers of accredited services. The portal will also include standard instruments for forest inventories and forest management plans for production units, which will facilitate use and reduce the transaction costs of producers. As a byproduct, it will generate information to comply with the minimum requirements for public control. The site will also include the results of the program as obtained from the monitoring system (see paragraphs 3.30 and 3.34). The system will be partly self-financed through modest charges and company advertising. Its operation and maintenance will be outsourced through public bidding.

2. Local public management for forest development component (US\$ 11 million)

- 2.22 The purpose of this component is to establish a general and institutional framework that will promote regional forest development, focused within the ZODEFS.

a. Zone development subcomponent (US\$5 million)

- 2.23 This subcomponent will improve the effectiveness of activities in the ZODEFS to support the program's objectives, through strategic participative forest planning, promotion of interagency coordination, technical-cooperation activities and specific projects. The program will seek to support the consolidation of an institutional counterpart in each zone to coordinate the efforts of all the stakeholders and carry out and implement a participative planning process for the local forest sector. These entities will facilitate activities and investments in the zones financed by this subcomponent. They will interact with the local AFE offices and with the executing agency of the subcomponent on land ownership regularization (subcomponent 2B), establish a framework to develop productive projects (component 3), and propose candidates for the grants (component 1).
- 2.24 This subcomponent will finance some standard activities and other that are given priority on the local level to promote forest development in each ZODEF, based on the needs identified in the forest strategic planning processes. The standard activities are: (i) establishment of a structure for interagency coordination and the rules of the game for cooperation in forest development in the zone;

- (ii) development of conflict resolution mechanisms, including a social/economic matrix to identify the main local players; and (iii) development of a forest development plan for the zone, prepared with the participation of the municipal coalitions, communities, the private sector, the local AFE representatives, projects and other important players, based on the guidelines for participative strategic municipal planning recently approved by the Social Cabinet and existing land use and watershed management plans.
- 2.25 Depending on the content of the zone plans, the following activities will be financed: (i) institution-building for the municipal coalition or other unit selected to coordinate the ZODEFS; (ii) design and implementation of a system of prevention, monitoring and surveillance for diseases and forest fires; (iii) pilot projects involving payment for environmental services; and (iv) creation of a local forest information center to give SMEs and individual producers access to technological and market information over the Internet (see subcomponent 1B).
- 2.26 To promote the processes in question, the program will finance a specialized agency that will assign a zone promoter to each zone and provide a mobile team of four technical advisors to serve all the zones through AFE's local offices. The specialties of the technical advisors will include: (i) sustainable forest management and use; (ii) the forest industry and marketing of forest products; (iii) local planning and conflict resolution; and (iv) social and gender inclusion.
- 2.27 The nonreimbursable funds from the loan which will be used to cofinance priority projects in the zones will be allocated by the same entity that administers component 3, in accordance with the Operating Regulations.

b. Subcomponent for land ownership regularization (US\$6 million)

- 2.28 The program will support the national and municipal authorities in regularizing the tenure of land with forest potential in the ZODEFS. Of a total of over 1 million ha of forest in the four ZODEFS that have already been defined, the program will cover an estimated 625,000 ha in 44 municipalities in phase one.
- 2.29 This component will use a single methodology being formulated by the government as part of the national land regularization program, with support from the Rural Land Administration Project (PAAR). The following activities will be financed: (i) boundaries of jurisdictional and forested areas; (ii) establishment of a geodesic network; (iii) aerial photography, satellite images and basic mapping; (iv) social analysis and promotion; (v) systematic establishment of the cadastre; (vi) conflict resolution; (vii) automation of the registers; and (viii) legalization, deeding and registration of forest lands for owners and occupants with adverse possession rights. The National Agrarian Administration (INA), the Executive Directorate of the Cadastre (DEC), the Supreme Court and the municipalities will participate in the

work. The activities include the cadastre, surveying and deeding in Tolupan and Garífuna indigenous communities.

- 2.30 This process includes establishing regularization boards in which the municipalities will participate, training for municipal cadastre units and conflict resolution mechanisms. The work will be performed in close coordination with the second phase of the PAAR, which is known as the Program for Land Administration in Honduras (PATH). Apart from improving legal security regarding the tenure of forest land for a beneficiary population of 568,000 rural inhabitants, the modern and integrated cadastre systems installed in the municipalities will make it possible to identify and delimit private and public properties rapidly and cost-efficiently for legal, fiscal and land use planning purposes. The executing agency will sign institutional cooperation agreements with INA, DEC and the Supreme Court, respectively, prior to executing this subcomponent. **Approval of Nordic Development Fund financing will be a condition precedent to disbursement of resources for components 2 and 3.**

3. Productive projects component (US\$4.2 million)

- 2.31 This component will develop experience in opportunities for productive investments in the forest sector, which will vitalize the sector in the future once the main distortions and bottlenecks that currently affect forest production have been resolved. As a pilot project, the program will support investments in primary and secondary production in the ZODEFS and strategic partnerships on the local, national and international markets. It will establish a nonreimbursable financing mechanism with the beneficiaries based on the Operating Regulations, with criteria and parameters for cofinancing the different investment projects and studies submitted, together with the interested parties. These investments will serve to respond to the beneficiaries and, based on these experiences and the lessons learned, they will be developed in phase two of the program.
- 2.32 At least 30 percent of the resources for this component will be assigned to finance a basic menu of primary forest production projects in which it is essential to gain experience. This menu and its minimum requirements will be presented together with the program's Operating Regulations and priority will be given to proposals that: (i) require a lower percentage of cofinancing; and (ii) offer higher socioeconomic returns in projects presented with business plans.
- 2.33 In selecting the projects to be financed with the remaining resources, preference will be given to projects that: (i) propose investments in new forest varieties and apply modern and highly-productive techniques; (ii) require a lower percentage of cofinancing for their investments; and (iii) include vertical and/or horizontal integration in the chain.

- 2.34 The **eligibility criteria** for the project will be: (i) legal right to use the land and forest resources; (ii) a preinvestment study demonstrating the potential for economic and financial sustainability; and (iii) for primary production, have a general forest management plan that has been approved and is in effect for an area of at least 500 ha (individual or aggregate among neighbors).
- 2.35 The **eligible beneficiaries** will be: (i) organized producers and SME entrepreneurs in the ZODEFS; (ii) businessmen located outside the ZODEFS but who are associated with producers or companies in a ZODEF through projects involving vertical or horizontal integration; and (iii) individual entrepreneurs or producers forming part of an integration mechanism.
- 2.36 The **types of eligible investment projects** will be: (i) primary wood production and reforestation; (ii) production of nonwood forest products (resin, etc.); (iii) improvements in processing in sawmills; (iv) improvements in secondary processing (plywood, furniture, etc.); and (v) ecotourism projects in forests.
- 2.37 The program will cofinance the following items: (i) technical studies and plans; (ii) preinvestment studies; (iii) investment projects, including technical assistance; and (iv) training.
- 2.38 **Eligible investment for primary production** include: (i) business plans and forest management plans (general and annual operating plans); (ii) forest nurseries (infrastructure, inputs) for genetically improved plants; (iii) inputs for plantations; (iv) equipment and tools for silviculture; (v) light machinery; (vi) forest certification; and (vii) technical assistance for all of the above. For certification, the program will cofinance: (i) pre-certification to determine whether the unit is certifiable; and (ii) service contracts with certifiers accredited by the Forest Stewardship Council (FSC).
- 2.39 **Eligible investments for industrial processing** include: (i) business plans; (ii) light machinery for logging sparse forests; (iii) machinery and tools to improve and diversify production; (iv) kilns; (v) wood protection and preservation systems; (vi) certification of the custody chain with certifiers accredited by the FSC; and (vii) technical assistance for all of the above. The priority projects in this category will be determined through an analysis of the productive and operating situation of the forest industry, identifying technological bottlenecks that stand in the way of increased productivity and competitiveness.
- 2.40 **Eligible investments for ecotourism projects** include: (i) business plans and area management plans; (ii) fences and boundaries; (iii) access roads and forest paths; (iv) rest facilities and rustic lodging; (v) latrines; (vi) place names; (vii) information materials; and (viii) technical assistance for all of the above.

- 2.41 The labor for investment projects will be recognized as part of the counterpart financing to be provided by the beneficiary.

4. Program administration and auditing (US\$1.1 million)

- 2.42 Administration and coordination costs are represented by the salaries of three specialized professionals in the Administrative and Financial Directorate, who will take charge of program accounting and reporting. The category also includes project promotion costs, operating and travel costs for program coordination and supervision, annual operating and financial audits and the mid-term and final evaluations.

E. Scale, cost and financing

- 2.43 The scale of the components is based on an estimate of the cost of implementing the proposed institutional changes, the cost of the actions in the municipalities and the number of beneficiaries in the four ZODEFS studied, as well as the costs of the local forest projects and other activities to be financed by the program. The zones to be covered total 21,000 km² and in the first phase of the program financing will be provided for regularizing the ownership of 625,000 ha of forested land contained in them, 130 zone projects and 175 local investment projects, directly benefiting some 4,500 families, which will consolidate forest and agroforest production in those zones. The program will indirectly benefit a much larger population on account of the socioeconomic and environmental impacts.
- 2.44 In addition to FSO funds, the program will have resources from the Nordic Development Fund (NDF) in the amount of US\$6 million, which will be used to finance component 2B (land ownership regularization). That subcomponent will be 50 percent tied and will be tendered to specialized Nordic companies in consortium with regional firms.
- 2.45 The local contribution requires average annual allocations of US\$475,000 from AFE and local sources. However, the contribution of the beneficiaries of components 2 and 3 will be recognized as a loan counterpart contribution when it is made in cash.

Table II-2
Program costs (in US\$ thousands)

Category	BID	NDF	Local	Total	%
Components					
1. Policy and institutional framework	6,075			6,075	24.3
2. Local public management to support forest development	4,160	6,000	840	11,000	44.0
3. Development of productive projects	3,990		210	4,200	16.8
Administration, supervision and auditing	835		240	1,100	4.3
Subtotal	15,060	6,000	1,290	22,350	89.4
Unallocated	1,742		91	1,834	7.3
<i>Contingencies</i>	<i>1,295</i>		<i>91</i>	<i>1,387</i>	<i>5.5</i>
<i>Escalation</i>	<i>447</i>			<i>447</i>	<i>1.8</i>
Financial costs	698		119	816	3.3
<i>Interest</i>	<i>547</i>			<i>547</i>	<i>2.2</i>
<i>Credit fee</i>			<i>119</i>	<i>119</i>	<i>0.5</i>
<i>I&S. 1%</i>	<i>151</i>			<i>151</i>	<i>0.6</i>
Total	17,500	6,000	1,500	25,000	
Percentage	70%	24%	6%	100%	

III. BORROWER, EXECUTING AGENCY AND PROGRAM EXECUTION

A. Borrower and executing agency

- 3.1 The borrower will be the Republic of Honduras and the executing agency will be the Administración Forestal del Estado (AFE) [National Forest Administration].
- 3.2 AFE is a public technical institution, established by law, that reports to the Ministry of Agriculture and Livestock. The functions established in its legal framework are: (i) to administer nationally-owned forests; (ii) to regulate activities in municipal and private forests; (iii) to administer protected areas and wildlife; (iv) to oversee the protection of watersheds, in coordination with other government institutions and the municipalities; (v) to develop the forest social system; and (vi) to coordinate activities for protection against forest fires and pests. The institution is in the process of reorganizing, which will be supported by the program (see paragraphs 1.21 to 1.23). The execution strategy forms part of its new institutional framework.

B. Execution

1. Organization for execution

- 3.3 The general manager of AFE will be responsible for execution, under its new structure, with the assistance of specialized advisers.
- 3.4 Program execution includes two types of actions: (i) component 1 reinforces the process of reorganizing AFE that began when the operation was being prepared, which defined a proposed new strategy and procedures that will be implemented gradually as part of the existing legal framework; and (ii) components 2 and 3 correspond to investment activities that promote participative local processes and will benefit producers, associations, communities, companies, municipalities and coalitions of municipalities. Therefore, the execution plan will directly involve AFE in managing its reorganization process and in implementing the new procedures and rules for vitalizing the forest sector. AFE will also provide advisors to support the contracting of companies or organizations to execute components 2 and 3 and for monitoring and control of the program in general.
- 3.5 AFE's **board of directors** will act as the senior body responsible for coordinating and directing execution. The board will invite the executive director of FIDE and a representative of the municipalities or coalitions of municipalities in the ZODEFS to its meetings. The board will have the following functions: (i) to establish the guidelines and general policies for program execution; (ii) to approve the action plans and the annual forest operating plans, setting the goals and expected outputs; (iii) to resolve inter-sector and sector problems; and (iv) to follow up on execution,

goals and outcomes and take corrective action based on the reports of the operating committee.

- 3.6 The **program operating committee** will have the following functions: (i) to coordinate all operational aspects of execution; (ii) to resolve operating problems in the implementation of the new institutional policies; (iii) to evaluate the results of each component; and (iv) to coordinate interactions between the components, including cross-cutting aspects such as poverty reduction, social inclusion and gender equity. The committee will be chaired by the general manager of AFE and its members will be AFE's directors, who will be directly responsible for implementing the reorganization and the new institutional policies and processes. The committee will be supported by the manager's principal advisor. The decisions and minutes of the committee and the progress reports will be included in the agendas of the board of directors. The board may authorize the establishment of consultative committees, with the participation of other related agencies, to study or give opinions on specific matters.

2. Administration

- 3.7 The *general manager* of AFE will be responsible for overall program execution and will act as the principal interlocutor with the Bank. AFE will be restructured from the inside, with the general manager and the directors being directly responsible. They will also oversee the administration of the components, which will be executed under contracts with private sector entities. AFE's directors will be directly responsible for the restructuring and implementation, so that they see themselves as part of the process and can continue with the changes that will be needed in phase two.
- 3.8 The general manager will be supported by a *specialized advisory group* composed of five advisors who are specialists in the following areas: (i) organizational and operational reforms; (ii) information technology; (iii) forest issues; (iv) territorial aspects and ownership regularization; and (v) social inclusion and gender issues. The first of these advisors will be responsible for coordinating the group. The functions of the advisors will be to assist AFE's directors in: (i) preparation of the annual operating plans and adjustments to them depending on the results of execution and the decisions of the program operating committee; (ii) matters related to the responsibilities of the directorates; (iii) coordination of program activities between AFE's directors and other players, recommending adjustments to the committee; and (iv) preparation of progress reports on the components. **Contracting the principal advisor will be a condition precedent to the first disbursement.**
- 3.9 The different directorates will be responsible for executing the activities in the components. The activities include contracting consultants and services to support implementation and the organization of workshops and seminars. The terms of

reference for consultants and services will be prepared by the directorates in charge of each area and the contracting will be done by AFE's Administration Department (DA).

- 3.10 The DA will be responsible for the program's accounting and financial statements and for forwarding them to the Bank. The directorate will make payments once approval is received from the department that received the services. To that end, the DAF will be strengthened with three professionals specializing in contracting, administration and accounting.

C. Operational execution of the components

- 3.11 Operational execution will begin by promoting the program through at least four seminars that have a dual purpose. The first is to inform the private sector about the new AFE and the changes to its procedures and rules, which will reduce the time required for paperwork. The second is to promote interest in participating in the processes and mechanisms for financing under components 2A and 3. Activities to publicize the program in each of the ZODEFS will also be carried out to facilitate better cooperation among local actors in the forest sector.
- 3.12 Execution of component 1 includes the following activities: (i) specific consulting services; (ii) training and technical assistance; (iii) implementation of management systems; and (iv) rehabilitation of installations and computer equipment. The specific consulting services are related to the new processes and forest sector studies. Each of the TOR will be reviewed by the director with responsibility in AFE and the contracts will be awarded by the DA. The directors will be required to approve the results, with the assistance of the specialized advisors, before any payments are made.
- 3.13 Training for AFE employees will be designed on the basis of institutional requirements by a specialist to be contracted for that purpose. A package will be prepared covering those needs to be tendered to entities with the necessary experience and human resources. The candidates for this training will be chosen by each of the directors, with the general manager taking overall responsibility.
- 3.14 Implementation of the computer systems and interconnection with the regional offices will be put to tender under the direct responsibility of the chief of Administration. The grants for three years of technical forestry studies will be awarded to six students a year in the first two years, benefiting the first candidates presented by the ZODEFS who pass ESNACIFOR's entrance examination.
- 3.15 With regard to component 2A (zone development), support for planning and technical assistance in the ZODEFS will be provided by a specialized entity recruited through international competitive bidding, which will provide a team of specialists (see paragraph 2.26). The investments in the projects identified will be

- administered by the same entity that will be responsible for executing component 3, which will also be selected through international competitive bidding. This entity will follow a plan of operations and will be supervised by AFE's Directorate of Productive Development and the forestry and social advisors. **Having selected the entities to take charge of execution will be a condition precedent to disbursement of the funds for components 2A and 3.** Maximum financing per zone project will be 70 percent, nonreimbursable, with a minimum counterpart of 30 percent and a maximum cost chargeable to the project of US\$50,000.
- 3.16 Program funds for priority zone projects will be used to contract the services of private suppliers (companies, specialized agencies, NGOs and individual specialists) accredited by the program and paid directly to the suppliers (see the Operating Regulations).
- 3.17 For subcomponent 2B on land ownership regularization, a consultant will be hired to prepare the detailed terms of reference based on the methodology used by the PAAR project and considering national progress in the cadastre, register and deeding. The subcomponent will be executed by a consortium between a specialized Nordic firm and a local/regional firm or firms, since it will be financed by the Nordic Development Fund and 50 percent tied to Nordic companies. Primary responsibility for supervising this activity will be borne by the advisor specializing in land tenure.
- 3.18 Component 3 will be executed by a specialized entity contracted through international competitive bidding that complies with the following requisites: (i) experience and knowledge of forest issues; (ii) experience in Honduras and in the program zones; (iii) ability to analyze and evaluate the technical, institutional, financial and environmental feasibility of projects; (iv) experience in working with communities, municipalities and private companies; and (v) offering the best administrative conditions. The specialized entity will operate under a revolving fund of 5 percent, which will be replenished in accordance with progress in execution and evidence of disbursements. The entity will be paid a fix percentage of the disbursements. The component will be executed on the basis of the Operating Regulations, with all the criteria summarized in Chapter II, and the percentages of financing and budget caps described below.
- 3.19 In principle, the projects will be presented by interested beneficiaries on the basis of: (i) feasibility (cost-benefit, economic and financial sustainability, environmental and social impact, including gender equity, poverty reduction and social inclusion); (ii) vertical and/or horizontal integration; (iii) linkage with the development plan for the ZODEFS; and (iv) local contribution. The proposals received will be reviewed by the administrative entity to ensure they comply with the Operating Regulations and they will be presented to AFE's local office for pre-approval. Subsequently, the administrator will proceed to prepare the feasibility studies for the final evaluation and approval of the projects and will report to the program's operating committee

on the projects approved. Execution will be performed by the beneficiaries with technical assistance from private suppliers, as described and presented in each project.

- 3.20 It has been agreed with the government to group the types of investments with different percentages of nonreimbursable cofinancing (Table III-1). A project can consist of different types of investments and must always include technical assistance to ensure good execution (minimum of 10 percent of the budget). The maximum that the program will finance per project is US\$50,000, with the average estimated to be US\$20,000. For larger projects, the program will provide advice on mechanisms for obtaining domestic and international loans.
- 3.21 For the technical assistance, the program will cofinance contracts for services offered by private companies, specialized agencies, NGOs and individual consultants accredited by the program for: (i) a component in the productive projects financed by the program; and (ii) projects only involving technical assistance and training. The program will pay the suppliers of technical assistance and training directly for their services.

Table III-1. Percentages of financing by type of investment

Type of investment	% local contribution	% program contribution
Studies, technical assistance, training, certification	30	70
Reforestation (plants, inputs, tools)	30	70
Primary forest production (machinery, inputs, equipment)	50	50
Ecotourism in forested areas (infrastructure, inputs, equipment)	50	50
Forest industry (machinery, inputs, equipment)	70	30

- 3.22 Execution of the component and supervision of the local projects will be performed by the administrative entity, based on visits planned under an annual operating plan (AOP) prepared under the supervision of AFE's forestry advisor. The advisor and staff from AFE will accompany the administrator on some visits to review progress and gain experience for possible adjustments in the component. The administrator will prepare monthly reports on progress in the projects and after they are completed, it will perform annual evaluations to measure progress toward the goals. The evaluations will be used to adjust the component in order to increase its impact on the forest sector and target activities that bring the most benefits to producers.

D. Operating Regulations and annual operating plans

- 3.23 Implementation of the program will be regulated under specific criteria and procedures that form part of the Operating Regulations. **Entry into effect of the Operating Regulations for the program, agreed on in advance with the Bank, will be a condition precedent to the first disbursement.**

- 3.24 The program will be executed through annual operating plans (AOPs), to be agreed on with the Bank at the annual follow-up meetings. The first AOP will be presented as an integral part of the initial report to be presented to the Bank by the executing agency, in accordance with the general conditions governing loan contracts.

E. Financial statements and audits

- 3.25 AFE will maintain separate accounting and financial records for the program in such a way as to permit: (i) the identification of financial transactions conducted with program funds, independently from other resources; and (ii) preparation of the program's financial statements.
- 3.26 AFE will present the program's annual financial statements to the Bank audited by an independent firm of public accountants acceptable to the Bank, within 120 days after the close of each fiscal year. The cost of the audits will be paid for from the loan proceeds. To ensure transparency in the use of resources from the Fund, the program will publish a list of users of the Fund in the media and on the program's web site.

F. Procurement

- 3.27 Procurements of goods and related services and the contracting of consulting services will be carried out in accordance with Bank procedures and policies. International competitive bidding will be required for goods and related services worth US\$250,000 equivalent and over. Goods and related services below that amount will be procured under local legislation, provided it is compatible with Bank policies. International competitive bidding will be required for consulting services costing more than US\$200,000 equivalent. The program will contract works to rehabilitate AFE's offices. The procurement plan is given in Annex II.

G. Execution and disbursement schedule

- 3.28 The project will be executed in 48 months and disbursements will be made over 54 months. To ensure that the resources from the Fund are disbursed within the program period, the Operating Regulations will propose that approved projects should have deadlines compatible with the end of the program.

Table III-2. Disbursement schedule (US\$ thousands)

Funds	Year				Total
	1	2	3	4	
IDB (FSO)	2,537	5,267	6,080	3,616	17,500
NDF	1,200	1,400	1,700	1,700	6,000
Local	375	375	375	375	1,500
Total	4,112	7,042	8,155	5,691	25,000

H. Preparatory activities

- 3.29 To begin as soon as possible with program promotion activities, the contracting of key personnel, bid processes and training on the central and zone levels, the executing agency will use resources from the Project Preparation Facility's line of credit (11/LC-HO). The cost of the initial activities will total about US\$400,000. The amount actually used from the line of credit plus interest and other financial charges will be repaid from the first disbursement of the loan.

I. Monitoring and evaluation

- 3.30 The Bank's Country Office in Honduras, with support from the team at Headquarters, will be directly responsible for program supervision and monitoring.
- 3.31 The monitoring and evaluation system will measure the impact on: (i) changes in income and jobs created in the program's zones; (ii) increase in productivity; (iii) improvement in the management of forest resources; and (iv) improvement in the regulatory framework, as mentioned in the program's objectives. A *monitoring system* will be developed using the baseline to be established under component 1 and data on the program compiled directly, which will make it possible to measure the results. Control groups outside the ZODEFS will be included to obtain comparative information. The results and lessons learned will be described in reports that will be made available on AFE's web site.
- 3.32 *Program monitoring* will include an evaluation of the indicators established in the logical framework (Annex I) and indicators on contractual compliance by the operating entities and executors of the subcomponents. During the program, AFE, as the executing agency, will hold periodic consultations with participants in the ZODEFS, in order to measure their satisfaction with the services provided by the executing agency and by the suppliers of services contracted by it. This information will allow adjustments to be made in the program during execution.
- 3.33 Program funds will be used to contract external consultants to perform two *evaluations*, one mid-term and one final. The mid-term evaluation will be performed when 50 percent of the Bank's loan has been disbursed. The evaluation will recommend adjustments that need to be made to the program and the Operating Regulations and will examine progress in complying with the triggers for phase two. It will also verify whether the monitoring methodology and data compiled are appropriate for measuring the program's impact. The final evaluation will be performed when 90 percent of the loan has been disbursed. The evaluation will review the results and initial impacts of the program, the lessons learned (which will affect the design of the second phase) and compliance with the triggers for that phase.

- 3.34 The final evaluation will measure the results and initial impacts of the program in comparison with the data in the baseline study. (i) *Progress in restructuring AFE and its performance*: measure the results of the new regulations that were prepared and implemented, the reduction in average time to obtain permits for general forest management plans and annual forest operating plans and efficiency in the detection and control of illegal logging, and the use of the information system for the private sector. (ii) *Forest sustainability*: the annual percentage of deforestation and reforestation in the ZODEFS. (iii) *Economic impact*: the percentage increase in economic returns of a selection of the productive units that benefited from program financing, and which type of investments had the greatest positive impact. (iv) *Social impact*: the number of beneficiaries, broken down by socioeconomic level and gender, and the percentage impact on their income and employment. These points form part of the program's logical framework.

IV. FEASIBILITY AND RISKS

A. Technical and institutional feasibility

- 4.1 Since the program includes the restructuring and reorganization of AFE and an adjustment in its internal policies and procedures, the execution plan should not impose an executing unit from outside the institution. The reorganization should be done from the inside by the directors themselves and other AFE employees, led by the senior level, under the direct responsibility of AFE's general manager, assisted by the advisors financed by the program.
- 4.2 The use of a separate executing unit would run the risk of turning the unit itself into the focal point and power center of the program, rather than AFE, which would become a secondary element. To ensure that this execution plan is feasible, high-level advisors will be used to provide assistance and advisory and consulting services. The institution's staff will be strengthened by specialists in contracting and in accounting, needed for program monitoring.
- 4.3 Honduras is a country with a long tradition and experience in forest utilization (although not necessarily efficiently or sustainably) and therefore it is not embarking on the unknown. It has the capacity to adopt new forest technologies through applied research, education, training and technical assistance. Although it needs to be strengthened, there is also national technical capacity capable of implementing the program. International cooperation efforts in many forest projects (some successful, others not) have established a technical base that can be used for program implementation. The institutional failures or weaknesses identified are being addressed during execution, through training and institution building. AFE's institutional capacity has been analyzed and, with technical assistance from the Pro-Bosque advisors and in cooperation with the other stakeholders, it has the capacity to carry out the planned activities and sustain its actions after the program has ended.
- 4.4 There is confirmed interest among local communities and organized agroforestry groups in using forests sustainably as a tool for development and poverty alleviation. Accordingly, local players are expected to respond positively to the program. The operation focuses on the zones with the greatest forest potential, where local industries and private owners have expressed enthusiasm for the program, on the condition that they are given greater security regarding their rights to future benefits.
- 4.5 Civil society is bringing increasing pressure to bear for responsible management of forest resources, which is viewed as an expression of social control. Therefore, a project or program that points in the direction of sustainable management will be supported by civil society. International forest certification will play a key role by

convincingly demonstrating that forest operations are sustainable and beneficial for society.

B. Economic and financial feasibility

- 4.6 The present operation focuses on revising the policy framework and public institutions with an influence on the forest sector, regularizing the ownership of forest properties, strengthening zone development and gaining experience through investments in pilot projects with modern practices and high productivity. With these actions, the program proposes to eliminate the distortions that discourage the rational operation of the forest sector in Honduras.
- 4.7 The main benefits expected in the first phase of this program will come from growth in the country's forest production in the medium and long terms, once the actions included in the components have been able to establish a framework that is conducive to private investments in the sector. Although growth in forest production will bring substantial environmental benefits, the analysis shows that private financial benefits will be sufficient to spur private investment and ensure that the program brings economic returns.
- 4.8 To examine the expected returns from forest management and use and wood processing activities in Honduras, typical models were prepared for a range of productive activities, involving tree production on land apt for forestry and wood processing. The models illustrate the effects of the existing distortions on the behavior of the productive agents and project that behavior in scenarios where the distortions have been corrected and prices for standing timber are close to the equilibrium market price on truly competitive markets.

1. Private financial feasibility

a. Scenarios with existing prices and insecurity in land tenure

- 4.9 The results obtained using models for typical forest operations confirm that under current prices and forms of production of standing timber, the production of trees for wood offers unattractive returns. By introducing modern practices, species and more productive varieties, tree production can be increased by at least 300 percent and, in a few years, achieve an average of 9.5 m³/ha in growth in pine forests. If selected forest varieties are also genetically improved, these growth indexes could be multiplied. However, this productivity potential is not a sufficient investment incentive to compensate for the risks stemming from uncertainty in the tenure of forest land, whose greatest benefits take a 30-year horizon to obtain. In these conditions, the widespread practice of exploiting forests, paying little attention to regeneration and management, is rational.
- 4.10 The situation in wood processing industries is somewhat similar. At current prices for standing timber, the operation of an inefficient circular saw is profitable,

considering that the investment costs are fully amortized. Although the installation of a band saw is highly profitable, the prevailing uncertainty regarding the availability of logs, introduces a risk factor that discourages investments of this kind.

b. Scenarios with better prices and security in land tenure

- 4.11 If prices for standing timber rise by 100 percent, i.e. to US\$26/m³ and uncertainties in the tenure of forested land is resolved, the introduction of modern practices and more productive varieties becomes highly attractive, with returns of between 15 percent and 26 percent a year on forest land of inferior quality (sparse pine forest with poor and average soils).

2. Economic feasibility

- 4.12 To illustrate the global amount of private benefits (not counting the environmental benefits) expected from the first phase of the program, the expected net benefits from rational exploitation of one hectare of sparse pine forest with poor quality soil were calculated in a framework of security in land tenure, for a net present value of US\$400 at a 12 percent annual discount rate. It would be sufficient for the first phase of the program to make these results feasible on 62,500 ha of forest of this kind to obtain total net benefits of US\$25 million in present values, which would justify the total cost of this phase of the program. This is a very conservative projection, since the expected net benefits per hectare of pine forest of better quality and with better soil and per hectare of broadleaf forest are much higher and the country has a total of 6 million ha of acceptable forest to be used. The expectations for returns on forest plantations are much higher and were determined in a recent study by FIDE to have the highest economic potential in the sector.

C. Financial and institutional feasibility

- 4.13 The program will contribute to a financing framework for AFE that is tailored to the central government's financing rules. Breaking with its direct dependency on sales of wood to finance its operating costs will ease the pressure on national forests caused by logging auctions that have no technical justification.
- 4.14 The measures that will be supported by the program, such as the reduction in the size of AFE's structure and staff and the introduction of a new management model that will turn it into a highly cost-effective institution in carrying out its functions, are justification for the government, particularly the Department of Finance, for changing AFE's current system of financing.

D. Environmental and social considerations

- 4.15 The program will have large positive impacts for the environment and social groups from various strata in the ZODEFS, particularly for very poor families living in the

forests. The strategies for improving forest management practices will contribute to the objectives of improving the socioeconomic situation of residents and businesses in the ZODEFS and the rehabilitation and maintenance of ecological processes and environmental services in forests. The risks and potential negative impacts will be limited to logging activities, if they are carried out without respecting the applicable regulations and technical specifications, including measures for environmental and social protection and management.

- 4.16 When the project was being prepared, a broad process of consultation was carried out with interested groups from the private sector, coalitions of municipalities, individual municipalities and civil society, with stress on representatives from the regions that will form the ZODEFS. This process has resulted in a logical framework for the program and action proposals to develop the ZODEFS. The participate process will continue on various levels during the program, including institutional, environmental, social and operational aspects, with emphasis on interagency coordination and local cooperation to avoid or mitigate conflicts.

1. Positive impacts of the program

- 4.17 Under component 1, *policy and institutional framework*, the removal of barriers to the sustainable management of forests and the promulgation and dissemination of new technical and operating standards will make it possible to develop strategies and practices that are socially, economically and environmentally favorable in the ZODEFS. The improvement and expansion of the current information management system in AFE will include a new baseline for coverage and land use in the ZODEFS that will be used in monitoring the dynamics of forest resources, the detection of deforestation or the illegal logging. This will make it possible to organize subsequent actions for their control, involving different government institutions on the national and local levels. The same information system can be used to monitor and evaluate the environmental and social impact of the program. Also, the inclusion of the procedures required by the Ministry of Natural Resources and the Environment in the process of preparing sustainable forest management plans on all scales will facilitate the inclusion of the environmental and social dimension in sustainable forest management activities and de-bureaucratizing the process under the national environmental impact assessment system.
- 4.18 Component 2, *local public management for forest development*, takes a socially equitable approach that will facilitate participation by the most vulnerable groups. Those groups include rural families living in abject poverty (among the poorest in the country), indigenous groups (the Tolupan Indians in Francisco Morazán Norte and Garífuna in Atlántida) and women, many of whom are heads of families who have had no economic share in the sustainable development of forests.
- 4.19 The *zone development subcomponent* will strengthen coalitions of municipalities and municipal governments enabling them to become better managers of natural

resources, including forests, through the participative preparation of forest development plans for the ZODEFS. The policy to be promoted under Pro-Bosque of coordinating and cofinancing its activities with other projects, programs and institutions already operating in the ZODEFS is worth noting. This coordination will bring benefits in terms of efficiency and greater impact of investments per capita and synergy between efforts to integrate rural development strategies and actions.

- 4.20 The *land ownership regularization subcomponent* will facilitate better land use and management by AFE and other government institutions on the national and local levels, helping to increase land values and the property taxes collected by the municipalities. The actions proposed under this subcomponent will facilitate: (i) a reduction in conflicts over land among all parties; (ii) the surveying and deeding of forest properties for families with adverse rights and of indigenous land and the surveying and delimitation of protected areas and public forested land.
- 4.21 Under component 3, *development of productive projects*, the program will stimulate new sources of employment and higher family income, whether through the larger number of jobs in the ZODEFS created by forest companies of all sizes or by facilitating opportunities for family and community groups, associations and cooperatives to develop forest microenterprises and small businesses, in areas such as the management, use, processing and/or sale of wood and nonwood products.
- 4.22 The expected improvements in forest protection, particularly control of forest fires on the community level, will improve conditions in the watersheds and the many environmental benefits, which include capturing rainwater, recharging local and zone aquifers and reducing the incidence of flooding. The program's policy of promoting voluntary and independent forest certification by the FSC is, in itself, an inducement for better management practices that include the necessary measures for environmental and social management and compliance with the country's legislation, regulations and technical standards. Promotion of the reforestation program on plantations will offer economically attractive alternatives and will contribute in the medium and long terms (15 to 30 years) to a reduction in pressure on the natural forests.

2. Potential negative impacts and their management

- 4.23 The potential negative environmental and social impacts are chiefly limited to logging activities if they are carried out without respecting the applicable rules and technical specifications, including measures for environmental and social protection and management. Since logging will often require the opening up of roads and the construction of other works to facilitate the extraction of wood, there could be impacts related to interruptions in hydrological processes, accelerated erosion and sedimentation of the beds of nearby streams and rivers. The new roads could

encourage settlements on national and municipal land, resulting in the reconversion of forests to agricultural uses.

- 4.24 In the past, logging companies have sometimes come into areas without consulting the population. Situations of this kind could cause indignation and rejection of the companies and their activities in communities close to the logging areas, which has led communities to levy 'war taxes' on the companies.
- 4.25 The program proposes to prevent or at least limit these impacts by implementing new methods of operating in forests. The long-term sustainable forest management contracts will include a series of specifications and technical and operating rules to prevent and/or manage environmental and social impacts. These specifications will include instructions and guidelines to facilitate consultations with the local population and conflict resolution, thereby minimizing social conflicts from the outset.

3. Specific measures included in the program's environmental and social management plan

- 4.26 The program includes a series of actions and tools for environmental and social management. The main measures are:
 - a. Consulting services to develop guidelines for sustainable forest management plans (for both pine and broadleaf forests), which will include the necessary EIAs, to be negotiated and approved by SERNA, to ensure that the plans comply with the requirements of an environmental and social management plan and serve as the basis for obtaining the environmental license. They will take account of the environmental and social management specifications and rules to be included in AFE's manual of technical standards for monitoring and supervising long-term forest management contracts.
 - b. A proposal for policies, procedures and actions to control illegal logging, linked to monitoring by remote sensors and community and police surveillance on the ground.
 - c. Study for the analysis and proposal of appropriate mechanisms to facilitate payment for the environmental services of forests.
 - d. Proposed environmental and social eligibility criteria and rules and procedures for project to be considered under the project financing mechanism.
 - e. Proposed guidelines and procedures for monitoring the program's environmental and social impact on the local level through a survey to establish a baseline and longitudinal monitoring campaigns during the entire life of the program to measure the level of participation and equitable distribution of the benefits

among the local population and overall in the ZODEFS, using an analysis of changes in use patterns and plant cover and the condition of the forests.

- f. The inclusion of a specialist in social development, poverty reduction, social inclusion and gender equity in the specialized advisory group. The program will also have short-term consultancies on specific environmental topics.

E. Special considerations and program risks

4.27 The risks detected are:

- a. The operation will not deal directly with problems outside the sector (macroeconomics, credit conditions for external trade) that could affect interest in investing in the sector and limit the demand for program financing. This risk will be mitigated through advisory services and dialogue with the government. The risk of the lack of demand for investments has been reduced by restricting the scale of component 3 to small pilot projects during phase one.
- b. There is a risk that political will for reforms in the sector and financing for AFE will not be maintained, in view of the pressure from other sectors and that elections will be held in the middle of phase one. This risk is being mitigated by establishing broad partnerships for forest development in Honduras, political dialogue and dialogue with international aid organizations, the private sector, campesinos, municipalities and NGOs.
- c. Uncertainty regarding the government's policy to clarify tenure over what is classified as public land could significantly affect the indicative targets established for the regularization of land ownership and for activities associated with long-term contracts on public land and, consequently, the general climate for investments in the forest sector. In determining the scale, the team used its own judgment on the most probable scenario, leaving some flexibility for possible adjustments. The assumption is that most of the land appearing in official statistics as belonging to the nation will be deeded to its residents. The program will finance studies and activities to support the government in designing alternatives for the legal, social and political aspects associated with titling forest land. Independently of the situation that finally prevails and to mitigate the associated risks, the program will begin its activities in the ZODEFS where the highest percentages of land have already been recognized by the government as private.

SUSTAINABLE FOREST DEVELOPMENT PROGRAM (PRO-BOSQUE) (HO-0218)

LOGICAL FRAMEWORK

Objective: To help increase the economic, social and environmental benefits of the forest sector in Honduras.

Purpose (phases I and II): To develop forested land in a sustainable manner and boost the competitiveness and productivity of businesses in the sector.

LOGICAL FRAMEWORK FOR PHASE I

PROGRAM AND COMPONENTS	OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
PROGRAM:	Objective: To help increase the economic, social and environmental benefits of the forest sector in Honduras.	The income of families in the program areas has improved.	<ul style="list-style-type: none"> - Regional statistics - Follow-up reports - Impact studies 	- Macroeconomic and sector policies are favorable for forest development.
		Permanent jobs are created in the areas covered by the program.	<ul style="list-style-type: none"> - Regional statistics on employment - Follow-up reports - Impact studies 	- There is an adequate supply of complementary services (infrastructure, technology and financing).
		In the program areas, the reforestation rate is higher than the deforestation rate, and there are annual increases in forest cover.	<ul style="list-style-type: none"> - Follow-up reports - COHDEFOR's forest information system 	
	Purpose: To create a favorable climate for higher private investment and business participation, under competitive and sustainable conditions.	<p>By the end of phase 1 of the program, the following progress has been made in comparison with 2003:</p> <p>Rational policies to promote forest operations are applied and operating. This includes:</p> <ul style="list-style-type: none"> - AFE's operating policy - AFE's institutional structure - monitoring systems and GIS - system of payments for environmental services. <p>Production practices with high returns in forest operations are publicized by public forestry services.</p> <p>Development plans in 4 ZODEFS covering 2 million ha in execution.</p> <p>Prices for standing pine have increased by at least 50% in real terms.</p> <p>At least US\$10 million worth of pine logs are exported a year.</p>	<p>Baseline and final evaluation studies</p> <p>Progress reports and project completion report</p>	<p>No natural disasters or macroeconomic events occur that have a substantial negative impact on the zones or the national economy.</p> <p>There is public will to sustain the reforms needed in the sector.</p>

PROGRAM AND COMPONENTS	OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
		<p>The amount of wood sawn using circular saws is reduced by at least 50%.</p> <p>The average time for approving management plans is less than 5 working days.</p> <p>Illegal logging is less than 10% of total production in both coniferous and broadleaf forests.</p>		
COMPONENTS*				
<p>COMPONENT 1: A forest policy and public institutional structure that are favorable for the private sector and sustainable management of forest resources.</p>	<p>Subcomponent on policies and institutional structure: Forest policy is reformed and government action is redirected toward investments and competitiveness by the private sector.</p> <p>Subcomponent for monitoring and information: Information system on the sector for public oversight and information for the private sector strengthened.</p>	<p>The following has been achieved by the end of phase 1:</p> <ul style="list-style-type: none"> - Proposal on new rules and regulations for the sector completed. - Study on the wood market and export opportunities completed. - Study to promote the establishment of industrial forest plantations completed. - Policy framework and procedure for implementing the proposed environmental payment systems. - A new organizational structure for AFE, highly decentralized, with mechanisms for participation by the players in the forest sector on the national, zone and local levels proposed. - Agreements on research and training between AFE and ESNACIFOR signed and with research project results and 12 grant holders enrolled. - National digital map on land use and plant cover has established a baseline for that cover. - Program to control illegal logging proposed. - Internet portal with forest information operating. 	<p>Progress reports and project completion report</p>	<p>There is political will to carry out the necessary reforms in the sector and to restructure AFE institutionally, to boost private sector participation.</p> <p>Proposal to transfer responsibility for forest statistics to the INE is completed.</p>

PROGRAM AND COMPONENTS	OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
COMPONENT 2: A general and institutional framework for regional forest development is established.	Subcomponent on zone development: Organization of regional forest development institutions is strengthened.	<p>The following has been achieved by the end of phase 1:</p> <p>The interagency organizational structure in 4 ZODEFS is operating in accordance with the rules determined for each zone.</p> <p>Development plans for 4 ZODEFS covering 2 million ha are approved by the organization in each zone.</p> <p>130 projects to facilitate forest development in the ZODEFS are financed and executed.</p>	<p>Progress reports and project completion report</p>	<p>Political will is maintained and sufficient resources are available in the municipalities to support zone development.</p>
	Subcomponent on regularization of land ownership: Cadastre and forest land titling in the ZODEFS carried out as programmed.	<p>The cadastre and register of property deeds for 625,000 ha of forested land are completed.</p>	<p>National Land Information System (SINIT)</p>	<p>No substantial reductions occur in demand for the actions financed by the program owing to sector or extra-sector factors.</p>
COMPONENT 3: Pilot productive projects.	<p>Pilot projects in logging and wood processing are carried out.</p>	<p>The following has been achieved by the end of phase 1:</p> <p>About 175 logging or wood processing projects, with potential to provide experience and lessons learned for phase 2 of the project have been financed and carried out.</p>	<p>Progress reports and project completion report</p>	<p>No substantial reductions occur in demand for the actions financed by the program owing to sector or extra-sector factors.</p>

* Components according to profile 2 and this logical framework correspond to “Projects” under OVE’s logical framework matrix, since they include their own “purposes”.

PRO-BOSQUE PROJECT (HO-0218)
PROCUREMENT PLAN (US\$)

Procurement	Amount	Type of contract	Bid method	Period
Component I				
<i>Subcomponent I A</i>				
(i) Policy changes				
New forest management rules	150,000	International consulting services*	LCB	II/04-II/05
(ii) Studies to implement new policies				
Design of incentives for forest plantations	60,000	International consulting services*	LCB	I/04-III/04
Design of the system of payments for environmental services	60,000	International consulting services*	LCB	II/04-IV/04
Structural and policy analysis of forest markets	60,000	International consulting services*	LCB	I/04-III/04
(iii) Restructuring of AFE				
Training for AFE personnel	200,000	Training services	LCB	I/04-IV/07
Advisor for the manager of AFE on project implementation	240,000	International consulting services	ICB	I/04-II/04
Specialist in organizational and operational reforms	240,000	International consulting services	ICB	I/04-II/04
Specialist in information technology	240,000	International consulting services	ICB	I/04-II/04
Specialist in forest issues	240,000	International consulting services	ICB	I/04-II/04
Specialist in land issues and property ownership regularization	240,000	International consulting services	ICB	I/04-II/04
Specialist in social inclusion	240,000	International consulting services	ICB	I/04-II/04
Preparation of new regulations and procedures for AFE	100,000	Local consulting services	LCB	II/04-III/07
ISO 9001 certification	350,000	International consulting services	ICB	II/04-III/04
Implementation of the system of management by results	200,000	International consulting services/software	ICB	I/04-II/04
Computer equipment, software and Intranet for AFE	300,000	Equipment	ICB	III-04
Vehicles	375,000	Equipment	ICB	II-04
Motorcycles	40,000	Equipment	LCB	II-04

Procurement	Amount	Type of contract	Bid method	Period
Audiovisual equipment	100,000	Equipment	LCB	II-04
Office rehabilitation	400,000	Construction	LCB	II/04-III/05
(iv) Building technical capacity				
Technical training	340,000	Training	LCB	II/04-III/07
Technical training for human resources	360,000	ESNACIFOR agreement	Grants	II/04-III/05
Technology transfers and validation	440,000	ESNACIFOR agreement	Predefined	
Subcomponent I B				
Establishment and analysis of the baseline	300,000	International consulting services	LCB	I/04
Implementation of the forest Internet portal (turnkey)	770,000	International consulting services	ICB	II/04
Component II				
Subcomponent II A				
Advisory group on forest development zones	800,000	International consulting services	ICB	I/04-II/04
Subcomponent II B				
Regularization of ownership of forest land	6,000,000	Nordic/local consortium	Nordic	II/04
Component III				
Administration of the Forest Financing Fund	500,000	International consulting services	ICB	I/04
Program technical management and administration				
<i>(i) Administrative and financial support group</i>	-	-		
Procurement specialist	48,000	Professional services	LCB	I/04
Administrative assistant	96,000	Professional services	LCB	I/04
Accounting assistant	96,000	Professional services	LCB	I/04
Executive secretary	60,000	Professional services	LCB	I/04

Procurement	Amount	Type of contract	Bid method	Period
<i>(ii) Advisory services to promote the program</i>	80,000	Local consulting services	LCB	I/04
<i>(iii) Consulting services for evaluation</i>				
Mid-term evaluation	25,000	Local consulting services	LCB	II/05
Final evaluation	40,000	Local consulting services	LCB	I/07
<i>(iv) External auditing</i>				
Independent firm of public accountants	60,000	Local consulting services	LCB	I/04

* It will be necessary to contract international consultants to transfer highly specialized experiences