



The World Bank

Additional Financing for Forests for Prosperity (P181002)

Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 10-Jun-2024 | Report No: PIDA36330



BASIC INFORMATION

A. Basic Project Data

Country Nepal	Project ID P181002	Project Name Additional Financing for Forests for Prosperity	Parent Project ID (if any) P170798
Parent Project Name Forests for Prosperity Project	Region SOUTH ASIA	Estimated Appraisal Date 07-Jun-2024	Estimated Board Date 28-Jun-2024
Practice Area (Lead) Environment, Natural Resources & the Blue Economy	Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance	Implementing Agency Ministry of Forests and Environment

Proposed Development Objective(s) Parent

The Project Development Objective (PDO) is to improve sustainable forest management; increase benefits from forests and contribute to net Greenhouse Gas Emission (GHG) reductions in selected municipalities in Province 2 and Province 5 in Nepal.

Components

Policy & capacity building support for new government structures and processes for sustainable forest management
Community-based sustainable forest management and smallholder forest plantations
Forest enterprise improvement and development
Project management, monitoring and learning

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Project Cost	12.00
Total Financing	12.00
of which IBRD/IDA	0.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	12.00
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Global P'ship for Sust. and Resilient Landscapes - PROGREEN

12.00

Environmental and Social Risk Classification

Substantial

B. Introduction and Context

Country Context

1. **Over the past decade, Nepal's economy has demonstrated impressive growth and resilience despite a variety of economic shocks.** COVID-induced movement restrictions accompanied by a near shutdown of tourism resulted in Nepal's first economic contraction in almost 40 years in FY20 (-2.4 percent). Vaccine roll-out and border re-opening supported the economy's recovery. Growth reached 4.8 and 5.6 percent in FY21 and FY22 respectively.
2. **Nepal's economy slowed significantly in FY23 due in part to monetary tightening, sluggish capital expenditure, and import restriction measures.** A 150 basis points increase in the monetary policy rate, and import restriction measures to stem foreign exchange losses under the fixed exchange rate regime muted growth in the industrial and services sectors, which grew by 0.6 and 2.3 percent during the year, respectively. Manufacturing, construction, and the wholesale and retail trade sectors all contracted.
3. **Despite the economic slowdown, average consumer price inflation accelerated to a seven-year high of 7.8 percent.** Cereals, housing, and utility prices together account for over 30 percent of the consumer price index, and their prices rose. Inflation exceeded Nepal's Central Bank's policy ceiling of 7 percent despite tighter monetary policy, reflecting in part India's export ban on wheat and flour.
4. **The current account deficit narrowed from 12.6 percent to 1.3 percent of gross domestic product (GDP) between FY22 and FY23, reflecting a significant decline in goods imports and a strong rebound in remittances.** Exports and foreign direct investment are small relative to remittance inflows and imports. In the context of relatively low external debt repayments, foreign reserves rose to 10 months of import cover as of end-FY23, well above the policy floor of 7 months of import cover.
5. **The fiscal deficit almost doubled from 3.2 percent to 6.1 percent of GDP between FY22 and FY23.** Over half of all fiscal revenues are trade-related. As imports declined in FY23, fiscal revenue contracted in nominal terms for the first time since FY21, falling from 23.1 percent to 19.2 percent of GDP between FY22 and FY23. Expenditures also declined but by much less (1 percentage point of GDP), reflecting lower transfers to subnational governments. The deficit was financed through external concessional borrowing, domestic borrowing, and the prior year's cash balance. The May 2023 Joint World Bank-International Monetary Fund Debt Sustainability Analysis finds that the country's risk of debt distress remains low for both external and overall public debt.
6. **Economic growth is expected to rebound to 3.9 percent in FY24 and 5.0 percent in FY25 under the baseline forecast.** The baseline forecast assumes that (a) monetary policy will be gradually eased in FY24 and FY25 relative to FY23; (b) lumpy skin disease affecting livestock – which has infected 1.3 million animals since



April 2023 will be under control by mid-January 2024; (c) India's export ban on select cereals and vegetables will be lifted by FY25; and (d) electricity exports to India and Bangladesh will reach 1,000 megawatts annually by FY25. The lagged impact of lifting import restriction measures in January 2023 and gradual loosening of monetary policy are expected to support the industrial and services sectors. Agricultural growth is projected to slow down in FY24, in part due to livestock losses, then provide a boost in FY25 once the disease is under control.

7. Nepal's political system is democratic and is a coalition-based government. Nepal has had two successive coalition governments that took office since the federal and provincial elections held in November 2022. The first coalition lasted for only two months, which was followed by the current coalition comprising eight political parties. This has affected the provincial government set up as well. The Government's 16th periodic development plan (2024/25-2028/29) is expected to be finalized in April 2024. At the sub-national level, seven provinces and 753 local governments have governing oversight for which legislation, institutions, and administrative procedures have been constitutionally formalized, while the task of enacting new laws and amending existing ones in line with the 2015 constitution is still in progress.

Sectoral and Institutional Context

8. Nepal's total forest area (including shrubs) is 6.4 million ha, representing a forest cover of 45 percent of the land area. Nepal has made remarkable achievements in expanding its forest cover in the past three decades. Nepal's total forest area (including shrubs) is 6.4 million ha, representing a forest cover of 45 percent of the land area. Most forests are state-owned, with private forests occupying less than one percent. State-owned forests are further divided into protected areas and national forests, with the latter comprising government-managed forests, community forests, collaborative forests, leasehold forests, forest protection areas, and religious forests.

9. Successful Community-Based Forest Management (CBFM) model has, over the past 30 years been the key to reversing deforestation and forest degradation. The Government has gradually transferred the national forest user rights to communities for their management under various models. CBFM was originally envisioned to achieve forest conservation and meet household subsistence requirements. About 2.23 million hectares (34 percent) of Nepal's forests are now managed by over 22,500 community forest user groups (CFUG), representing 2.9 million households. Poorer households have been effectively supported through land allocation inside community forests for fodder and NTFP production. CBFM remains a mainstay of Nepal's Forest Sector Strategy (2016) and is a priority under Nepal's 15th National Development Plan, along with forest-based enterprise development and ecotourism. Nepal intends to hand over additional forest areas to communities for SFM.

10. The government of Nepal's 2016 Forest Sector Strategy and National Forest Policy 2019 have as their goal to increase forests' contribution to national prosperity and climate change mitigation. The 2022 Forest Regulation has prioritized Sustainable Forest Management (SFM) by building on the country's vaunted community forestry experience to help secure livelihoods, jobs, and climate action. The SFM will contribute to growth, jobs, and income throughout the forest value chain, including sustainable timber, non-timber, and tourism, transitioning from pure conservation toward a more modern, economically productive sector with strong social and environmental sustainability.

11. Although Nepal is richly endowed with forest resources, the forest sector productivity is low, with the country importing wood products. Officially reported harvests of round wood average about 60,000m³/yr. It is estimated that 1.2 million m³ of fuelwood and 900,000 m³ of timber could be sustainably harvested annually, generating employment opportunities for 4.8 million people. After decades of effective protection, a significant area of forest under community-based forest management (CBFM) now has the potential for the sustainable



production of timber and non-timber forest products (NTFPs) to help meet rural livelihood needs, sustain local forest-based enterprises and jobs, and substitute imports.

12. Small and medium-sized forest-based enterprise (SME) development is hampered by several constraints. Forest-based SMEs could generate more than US\$8.7 billion/year and 1.38 million workdays through 400,000 sustainable full-time green jobs. Yet, small entrepreneurs are poorly integrated and have no access to modern technology to reduce waste, increase the value and quality of their products, and reduce imports. Private sector investment in forest-based enterprises faces a highly constrained policy environment with high interest rates imposed on commercial lending. The development of SMEs is constrained by complex, lengthy, and incomplete regulatory requirements. Nepal ranks 110 out of 190 countries in the Ease-of-Doing-Business Report. Business development services are not available, including support for developing sustainable business management plans and producing and selling commercially viable products. Banks cite a lack of liquidity for extending credit to forest-based SMEs. Other impediments include a lack of market access, financial literacy of potential clients, and information services for SMEs in rural communities.

13. Women's involvement in commercial forest sector activities is limited. Traditionally, women have been involved in the collection and utilization of subsistence forest products, whilst timber harvesting for commercial sales and forest product utilization and processing involving skilled work and business activities have been male-dominated. The potential to generate paid employment and equal opportunities in skilled and entrepreneurial positions has yet to be realized. The creation of such opportunities is now relevant given the extent of rural, male out-migration and the enhanced education of women and girls.

C. Proposed Development Objective(s)

Original PDO

The Project Development Objective (PDO) is to improve sustainable forest management, increase benefits from forests, and contribute to net Greenhouse Gas Emission (GHG) reductions in selected municipalities in Province 2 and Province 5 in Nepal.

Current PDO

The same as the original

Key Results

The Results Framework has been revised to reflect the additional intermediate outcomes from the restructuring by adding sub-components and activities. The updated results framework also incorporates the relevant indicators from the World Bank's scorecard indicators.

D. Project Description

14. The proposed restructuring will scale up current project activities associated with the private sector mobilization. The additional activities under the Additional Financing (AF) are proposed to cover the financing gap for community forestry and plantation activities, improve the design of the project, and introduce new activities that are fundamental to achieving the adjusted project outcomes. The additional activities supported under the AF are software and equipment for early warning systems for controlling forest fires, small income generation matching grants for agroforestry (such as forage, mini water storage, drip irrigation, beekeeping, solar



energy, horticulture, etc.), development of provincial-level forest sector policies, strategies, regulations, and manual and guidelines, grant for implementation of CBFM plan, support to District Forest Offices (DFO) for establishing high tech nurseries for producing quality seedling which all will have positive impact on improving the E&S risk management.

Proposed New Activities by Components.

15. Component 1: Policy and capacity building support for new government structures and processes for sustainable forest management. (Additional activities): An additional finance of US\$0.9 million is added for sub-component 1.1 to continue the project support to operationalize federalism in Nepal at the three-tier government (federal, provincial, and local levels). The proposed additional financing will further strengthen the federal structure in Nepal and contribute to the implementation of activities under Components 2 and 3 by supporting the necessary reviews, assessments, services, and systems and the development of policies based on the specific needs identified during project execution.

16. An additional sub-component 1.2 is proposed, “Strengthening Forest Data and Carbon Monitoring,” in the amount of US\$0.7 million. This sub-component will support the Forest Research and Training Center (FRTC) to strengthen its technical and technological capacity to:

- (i) Generate emissions data, including the National Forest Inventory and Subnational inventories; produce activity data related to national forest cover, degradation, and deforestation mapping; analyze soil samples, including carbon data; and support the remote sensing and GIS lab in processing and analyzing remote sensing data.
- (ii) Continue generating data for the Measurement, Verification, and Reporting (MRV) system for the Emissions Reduction Program in the Terai Arc Landscape (WB-supported carbon operation, P165375, and building on the forest analytical work supported by the Global Program on Sustainability).
- (iii) Continue working on allometric equations to estimate above-ground biomass and below-ground biomass for 9 key species for the entire country. Since Nepal had no allometric equation developed for any species earlier over the last 60 years of forest management practice, this activity is a historical milestone in Nepal.

17. Component 2: Community-based sustainable forest management and smallholder forest plantations (Financing Gap): An additional US\$9.2 million is proposed to cover the financing gap to address GON’s Cabinet decision to reallocate the concessional loan from Component 2 to Component 3 (refer to paragraph 28). Notably, it will support ongoing activities under the parent project through:

18. Sub-component 2.1: Sustainable Forest Management through Community-Based Forest Management (CBFM) will continue supporting the implementation of forest management plans by Community Forest Users Groups (CFUGs), including provisions of seedlings, felling, timber grading, thinning operations, preparation, among other activities. This sub-component will upgrade existing nurseries and establish new nurseries (up to 6) to improve quality and increase the quantity of tree seedlings in the selected DFOs in Madhesh and Lumbini provinces. A high-tech forest nursery will produce high-quality seedlings for the restoration of the forest landscape.

19. Sub-component 2.2: Smallholder plantations on public and private land will continue supporting the establishment of and assistance of 275 public land management groups in the Terai region by local governments by providing technical assistance, physical inputs (i.e., seedlings, materials, etc.) to Public Land Management Groups (PLMG), and cover labor costs for tree planting, conservation, and management to the members of the PLMG (which are the poorest and most vulnerable). Farmers for smallholder plantations on private land will receive “asset for asset” grants for agroforestry activities.



20. **Component 3: Forest Enterprise Improvement and Development (Scaling Up):** Under the restructuring and AF, it is proposed to scale up this component and reallocate the parent project's concessional loan of US\$10.86 million to expand the number of beneficiaries that receive access to credit for improving and developing forest-based SMEs, where ADBL remains a key implementing agency for this component. An additional finance under sub-component 3.1 in the amount of US\$0.7 million is proposed to continue dedicated technical assistance for forest-based SMEs.

21. **Component 4: Project Governance, Monitoring and Learning (Incremental costs):** Additional finance of US\$0.5 million is proposed to cover the incremental costs to support the project's overall day-to-day management and administration, including regular monitoring and evaluation and knowledge management, particularly for the new proposed activities.

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

The environmental and social risks, anticipated to be minor in scale and reversible, are associated with impacts on hotspot areas or critical habitats, the homogenization of forest flora, waste management, health and safety issues, and the potential exclusion of disadvantaged or vulnerable groups from the project's benefits. The draft Environmental and Social Commitment Plan (ESCP) prepared for the parent project has been updated and disclosed prior to appraisal and will be finalized during Negotiation. The Environmental and Social Management Framework (ESMF) and LMP prepared for the parent project is adequate for managing and mitigating environmental and social risks. The Stakeholder Engagement Plan (SEP) has been updated and will be finalized after consultation with stakeholders. Similarly, SEA/SH action plan prepared for the parent project will be applicable for AF.

E. Implementation

Institutional and Implementation Arrangements

The restructuring will maintain the implementation arrangements of the parent project. REDD Implementation Centre (REDD IC), Ministry of Forests and Environment, will be the implementing agency and responsible for the overall management and coordination of the project.

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APPROVAL

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