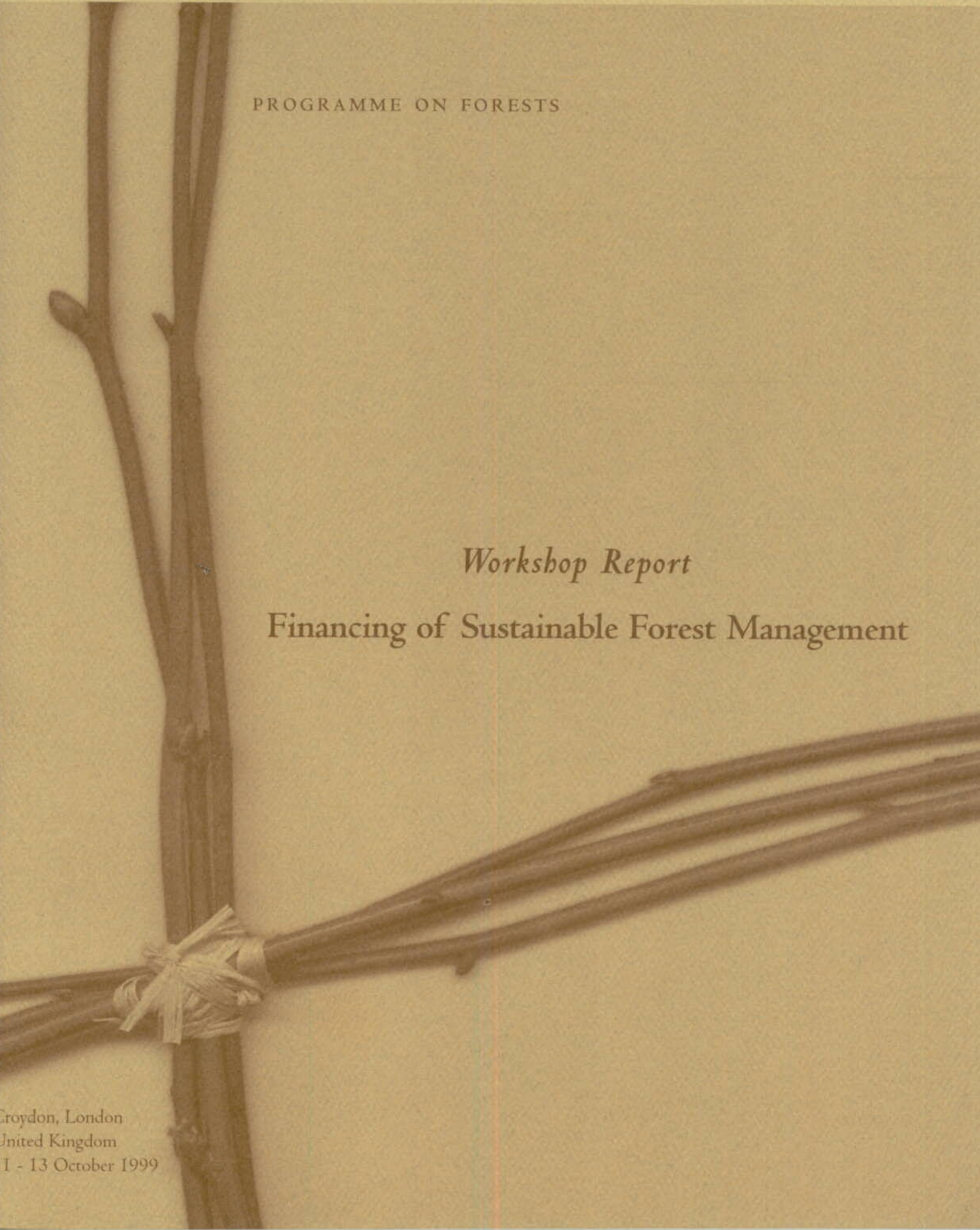

PROGRAMME ON FORESTS

Workshop Report

Financing of Sustainable Forest Management

Croydon, London
United Kingdom
1 - 13 October 1999

PROFOR

WORKSHOP REPORT

FINANCING OF SUSTAINABLE FOREST MANAGEMENT

Selsdon Park Hotel
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Ralph Schmidt
Director PROFOR

I. Contributions from the Croydon Meeting

1. Background

The UNDP is the Lead Agency for the IFF Programme Element II.a "Need for financial resources". In response to the IFF request for additional information, UNDP conducted three forest financing related studies[1] whose results were presented to the third session of the IFF in May 1999. Despite significant conceptual developments, the financing issues remain politically sensitive, and the operationalisation of financing mechanisms and strategies, technically complex. Although the third session of IFF allowed for a better understanding among the country representatives, these political concerns and technical difficulties prevented the Forum from reaching consensus on the financial issues.

To facilitate the negotiation and consensus building of this programme element of IFF, UNDP felt a need to make an effort to improve further a common understanding of issues concerning sustainable forest management and financial resources mobilisation. As a result, UNDP organised a workshop of experts to explore and discuss the IFF agenda on this programme element and other relevant developments on financing sustainable forest management. The United Kingdom Department for International Development (DFID) provided financial support.

This report presents a summary of the workshop on financing sustainable forest management (SFM), organised in Croydon, UK from 11-13 October 1999. It is divided into three sections: the rest of this section provides a brief summary of the findings of the workshop on the state of play of funding SFM, Section II describes the proceedings and Section III synthesises the emerging analysis.

The Croydon meeting was a good opportunity to recapitulate, reiterate and clarify where the international forest policy dialogue on financing for SFM stands, to move the debate further and to identify the next steps that the international community now needs to consider.

2. Where do we stand

The international community is committed to the goal of sustainable forest management and recognises its importance to the livelihoods of the poorest, particularly through the productive function of the forests.

In most instances forestry competes with many other potential land uses such as agriculture. Except in cases where sustainability is a concern to forest enterprises, conventional economic analysis and market forces promote the liquidation of forests and conversion into other land uses.

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[1] *Financial Mechanisms for Sustainable Forestry* by Moura Costa et al. (EcoSecurities and Indufor)
An Assessment of Data on ODA Financial Flows in the Forest Sector by A. Madhvani (ODI)
Financing Sustainable Forestry: Issues under International Deliberation by M. Joshi (UNDP)

Sustainable forest management can be self-financing, but under prevailing policy and market circumstances, it remains less profitable than unsustainable forest exploitation.

3. What has been clarified

Achieving SFM's policy goals requires increasing the profitability of sustainable practices while decreasing that of unsustainable exploitation. To this end, the financing frameworks that exist at the national and international levels must be changed and their interlinkages improved, while bearing in mind the different situations of the countries.

The required changes have to address policy and market imperfections, and include new roles and functions for the public and private sectors, at both national and international levels. The utilisation of improved or new financing mechanisms and instruments is also essential to this process of change towards SFM.

Through swift policy reforms, governments have to create enabling conditions that ensure investment in SFM. This includes the elimination of structural and operational barriers, setting appropriate incentives, the development and enforcement of guidelines and regulations, and elimination of corruption. In addition to regulation, governments must also arrange to pay for social and environmental goods and services.

Many developing countries will need assistance to do this. Developed countries should bear most of the costs of global benefits of forests they wish to sustain or these benefits will not endure. Current ODA flows may not give sufficient priority to SFM. Developing countries can address this shortfall through forest partnership arrangements where they set national priorities for development cooperation in agreement with the donor community.

From an investment perspective, SFM will only be achieved through a combination of public and private investments. The roles of the public and private sources of capital are distinctive but complementary. They should be considered jointly when designing financing strategies for SFM. The investment potential of the private sector has to be mobilised and re-directed towards SFM. A rapid response from the private sector is needed to accelerate the development of appropriate financing strategies at the national and international level. Public funding should be used to leverage private investment in SFM by addressing fundamental issues that inhibit private investment in SFM.

SFM cannot be achieved without considering the economic dimension of forest-related activities and capturing external costs and benefits. Market-based-instruments (MBIs) show significant potential to provide positive incentives for forest owners, managers and investors. They tend, however, to be politically and technically challenging to implement. Much work is needed on the practical design of financing mechanisms and instruments to lower transaction costs, reduce waste and eliminate inefficiency.

The effectiveness of national financing mechanisms would be reinforced if they were linked to and supported by appropriate international mechanisms. Whether existing or new, international mechanisms would (i) be open to all countries involving both beneficiaries and financing sources in decision making, (ii) respond to national needs and work through national forest programmes, (iii) contribute to internalising global externalities of forests in promoting SFM, (iv) link with national financing mechanisms, (v) be transparent and administratively efficient, (vi) co-ordinate with the financing mechanisms of multilateral environmental agreements (MEAs) in order to avoid duplication, and (vii) have secure and sustained funding sources.

An international forest fund and an investment promotion entity/agency (IPA) are complementary and mutually reinforcing options for international-level SFM financing mechanisms, but they can be implemented independently. While there was no consensus on the relative merit of an investment promotion entity/agency and a global forest fund, it was clear that the conceptual basis for the former is far better articulated and well understood.

4. What could be the next steps to consider

The following suggested actions are derived from the results of the Croydon meeting. They have to take place on two different but inter-related fronts, and require the collaboration and commitments of stakeholders at the national and international levels:

Conceptual development:

i. Develop appropriate valuation and accounting methods for investment in SFM;
ii. Assess how existing international financing mechanisms can be improved;
iii. Define further the constituting elements of new international financing mechanisms such as investment promotion entity and global forest fund; and
iv. Explore the concept and modalities of public-private partnership.

Policy development:

v. Develop national financing strategies which combine public and private investments;
vi. Develop appropriate policy guidelines and regulations, including ground rules for socially and environmentally responsible but financially profitable forestry operations;
vii. Eliminate perverse subsidies and barriers to private investments;
viii. Establish mechanisms to pay the owners and managers of the forests for social and environmental goods and services produced by their forests (watershed, natural beauty for tourism, social imperatives etc.);
ix. Create markets for currently un-traded forest goods and services;
x. Develop national capacities to use MBIs; and
xi. Streamline ODA flows into SFM, keeping in mind that developed countries should bear most of the costs of global benefits they wish to sustain or these benefits will not endure.

II. Workshop Description

1. Objectives

The objectives of the workshop were to:

- Develop a common understanding of strategies and mechanisms for financing sustainable forest management (SFM) at international, national and project levels; and
- Contribute to the work of the Intergovernmental Forum on Forests (IFF) in its Programme Element on financial resources

2. Participants

The workshop was attended by 45 participants[2] from governments (representing developing, developed and economies in transition), non-governmental and international organisations, private financing institutions, and research organisations.

3. Methodology, structure and agenda

The workshop addressed the following issues:

- Is financing for SFM different from conventional forestry financing?
- What are the potential approaches and mechanisms for SFM funding and the related constraints?
- What can be done to facilitate and leverage investment in SFM?

The workshop was structured in the following manner:

- Opening session
- Presentations of key issues and country cases in plenary
- General discussions in plenary following presentations
- In-depth discussions in working groups on selected key questions
- Reports from working groups to plenary and more focused discussions
- Consolidation of key points emerging from the process
- General agreement on these key points by the participants

While keeping the focus, the initial agenda[3] was kept flexible to allow for daily revision. It adapted to the progress and group dynamics of the workshop. The flexible agenda and use of an independent facilitator proved valuable for the smooth running of the workshop as indicated by the participants' evaluation at the end of the workshop.

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[2] List of participants in Annex 1

[3] Final agenda in Annex II

4. Documentation

The background documentation[4] provided to the participants included short, thought-provoking papers as well as concept papers and case studies prepared by the speakers.

5. Presentations

The opening session set the general background of the workshop. *Ralph Schmidt*, Director, UNDP Programme on Forests (PROFOR) welcomed the participants and stated the purpose and strategic relevance of the workshop. He urged the participants to be open-minded as the workshop was to be an informal but technical exploration of the issues related to SFM. He emphasised that the workshop is set in an informal atmosphere not targeted towards a negotiation, therefore, no country positions should be made. He also recalled the broad definition of sustainable forest management and the importance of economic factors in the deforestation process. *Andrew Bennett*, Chief Natural Resources Advisor, DFID opened the workshop with an address in which he stressed that not all goods and services can be captured by the market, thus, he called for careful decisions on where and how to capture the values and benefits from SFM. He was followed by Ambassador H.E. *Ilkka Ristimaki*, Co-chairman of IFF who placed the workshop in the broader context of the international policy dialogue on forests.

The first day presentations aimed at bringing the participants to a common level of understanding on the current situation in terms of economic theory, strategic approaches towards SFM, international financial flows, and national approaches to financing SFM. *David Pearce*, Professor at the Department of Economics, University College London introduced the economics of SFM. He noted that his research indicates that rapid exploitation of forests produces a higher initial rate of returns, in effect, higher short-term profits than SFM. In order to make SFM more attractive and profitable, he emphasised that the non-timber benefits of forests must be captured by the market through the commoditisation of non-timber values and services, the rectification of market failures, and the creation of an appropriate set of incentives.

Markku Simula, Indufor, presented the core components of financing strategies at the national and international levels. The transition towards SFM calls for the elimination of the structural and operational barriers to private investment, improved access to capital by the forest sector, redirecting private sector financing towards SFM, and leveraging private sector investment through public sector funding.

Mahendra Joshi, IFF Secretariat and UNDP/PROFOR, presented the results of the UNDP study on the financial flows at the international level. While confirming the decline in ODA flows, the study pointed to the need to improve the usefulness and policy relevance of existing databases, through better design and reporting, while keeping in mind the cost effectiveness of data collection, processing and retrieval.

The national financing strategies of Colombia and United Kingdom were presented by *Manuel Rodriguez*, Director, Andean Centre for Sustainable Development and *Tim*

[4] List of provided documents in Annex III.

Rollinson, Forestry Commission UK, respectively. Despite contrasted environmental and socio-economic situations, both countries exhibit similarities in terms of combining different funding sources and instruments and striving to achieve sustainability in funding.

The presentations during the second day were dedicated to potential sources of financing, market-based instruments, and international mechanisms for SFM funding.

Natasha Landell-Mills, IIED and *Michael Richards*, ODI reviewed market-based instruments (MBIs) which aim at changing market signals, and are increasingly recognised and used. Depending on the country context, the various MBIs exhibit different prospects and implementation constraints. Such constraints are political, institutional and technical. The choice of MBIs requires a systematic screening and assessment of their respective advantages and requirements on the part of the decision-makers.

Mark Campanale, Socially Responsible Investment Team, Henderson Investors, provided a critical overview of foreign portfolio investments in forestry. So far, high returns on investment have been possible because of close-to-zero forest concession costs. However, the situation is changing. With the increasing general public awareness and concern, financial analyses have integrated some sustainability and environmental economics considerations. Environmental accountability of investing institutions could be fostered and transparency increased by listing (or de-listing) companies which comply (or not) with their published forest management plans and reports.

Eric Oddleifson, Director, GMO, presented the Brazil Sustainable Forest Fund, a case of public-private partnership. Through SFM project, the private sector can contribute to the social and economic development of the population at local and regional levels. Barriers to private investment exist when public policy is unstable, land tenure is not clearly defined, and government procedures complex, unclear and time consuming. Other impediments include the existence of environmental activism, the lack of information on forest resources and traditional utilisation and limited infrastructure and accessibility. Public-private partnership is necessary to reduce investment risk and enhance chances for success in SFM projects.

Without appropriate international financing mechanisms, one may not be able to achieve SFM in most forests. *Pedro Moura-Costa,* EcoSecurities, presented a concept of the investment promotion entity and its different options as proposed in the study[5] commissioned by the UNDP. This entity would contribute to removing barriers to private investment in SFM through activities such as the provision of information on financial services and mechanisms, identification of investment opportunities, investment packaging, risk mitigation and structural development.

Lennart Ljungman, Director, Forest Policy and Planning Division, FAO presented the rationale behind the concept of another international financial mechanism, the Global Forest Fund (GFF). He outlined the components of a global forest fund that could serve

[5] Moura Costa, et al. "Financial Mechanisms for Sustainable Forestry"(EcoSecurities and Indufor).

to internalise the global externalities of forests. The argument for such a mechanism is based on the assumption that beneficiaries are willing to pay for the global service and existence value of forests; a mechanism is needed to channel payment for such services to the appropriate forest actors in the field. Possible functions and activities of a global forest fund as well as options for funding and type of governance were presented as options.

6. Group work

The meeting divided into four working groups each with a facilitator and rapporteur. Breakout groups featured a mix of sectors, backgrounds and perspectives, gender and nationality, including a balance of ‘North’ and ‘South’ representation.

Group work sessions focused on two essential aspects of financing strategies: the respective roles of financing sources, and the potential for new international financing mechanisms.

7. Plenary

Most presentations and all group work sessions were followed by plenary discussions. Strategic points progressively emerging from these discussions were gathered and discussed in a last session where a general agreement was obtained. The key points that emerged under general agreement appear in the following section in boxes.

III. Interpretation of Presentations and Summary of Discussions

This section gathers the issues explored and discussed in the short presentations, plenary discussions and group work. It also provides the participants' common understanding on the key points that emerged in the sessions. To clarify for those who did not attend the meeting, this section includes a few points from the background documentation that were not specifically mentioned or thoroughly discussed during the workshop.

1. Context and economics of SFM

Financing SFM is one of the key issues in the intergovernmental policy deliberations on forests.

SFM is a long-term policy goal that includes the conservation of forest resources and production of forest goods and services. It is intimately linked with sustainable development and sustainable livelihoods in many developing countries. The process towards SFM, including its financing, is incremental and entails new roles and responsibilities for the different stakeholders, including the global community. This process can only be defined in concrete terms and implemented on a national and local level.

Increased understanding of the environmental, economic, social, political, institutional issues at stake, emerging international and national consensus, and improved national policies tend to indicate that the process towards SFM is already underway in some countries. Given the continuing global deforestation, financing efforts must be intensified and streamlined, especially during the transition period after which SFM would be self-financing.

Forestry characteristics such as long-term rotation periods, uneven distribution of benefits and costs over time, provision of public goods and services at the local, national and global levels, imply longer term financing and investment strategies than conventional financing strategies in other sectors. The financing flows and investments are determined by the discount rates[6], the existence and conditions of markets, as well as the respective roles by the public and private sectors.

[6] Any profit-oriented business activity produces a stream of revenues (and expenses) over time. Goods and services received at present are worth more to most people than the same goods and services received sometime in the future. Such phenomenon of time preference and opportunity cost of capital are reflected by discount rates (or interest rates). Economists use such discount (or interest) rates on the future stream of revenues and expenses to calculate their equivalent present values. In general, the larger the discount rate the earlier the propensity to harvest the forests. Due to the fact that earlier revenues are considered more valuable than the later ones, a sustainably managed forest producing more absolute net revenues (or profits) over 50 or 100 years, could still be considered less profitable by investors than liquidating the forest much earlier.

At the national level, financing strategies for SFM depend on the general situation (society and cultures, ecological zones and land use, level of economic development, policy and macro-economic environment); the specific context of the national forestry sector (forest resource endowment and trends, institutional organisation, the forest-related policy and legal frameworks including national forest programmes and property regimes); and, the production and/or service functions performed by the forest resource. Depending upon the national context, different financing pathways toward SFM have to be followed, all of which should consider the needs of local, national and international communities.

Financial resource flows into forestry are substantial but inadequate, and they are not channelled into SFM. Sustainable forest management calls for new investment patterns, a radical departure from the current market situation and new roles for financing sources. Policy reforms and measures at the national and international levels are needed to create more conducive market conditions and allow the different financing sources to contribute more effectively and efficiently to SFM.

A framework has been proposed with the objective to mainstream investment strategies for SFM from both public and private sectors, at the national and international levels. The objectives of such a framework are to redirect existing financial resources, improve their efficiency and effectiveness, and mobilise additional resources into SFM rather than unsustainable practices.

Key Points

1. Investments in sustainable forest management (SFM) are different from most other sectors because of their significant externalities and long term horizons.

2. The ongoing transition to SFM, which requires bridging financing, is a time-consuming process that can be accelerated through swift policy reforms and rapid responses by the private sector. Specific financing solutions need to be developed for widely varying local situations with different forest types, including activities such as production, conservation, restoration of degraded lands, as well as meeting the needs of local communities.

3. The focus in measures supporting SFM should be on national and local levels where the goal of SFM is defined in operational terms and linked with sustainable development objectives. Due to the heterogeneity of country situations national financing strategies for SFM need to be tailored accordingly.

Studies indicate that financially, SFM is currently not as profitable as unsustainable forestry (such as conventional logging), nor is SFM competitive financially with other land uses.

Market signals to the different stakeholders are neither as conducive to SFM. Under the prevailing market circumstances and concerns of short-term needs and higher discount rates, deforestation will continue, led by unsustainable forestry and conversion of forestlands into other land uses.

The available evidence needs to be substantially augmented before one can conclude that SFM can eventually be, in certain circumstances, an economically better land use alternative. It is recognised that based on a more comprehensive economic analysis and under new market conditions, SFM can eventually be self-financing. The financial losses to the owners and managers of forests from SFM relative to conventional logging can only be offset if a market is created to capture forests' other values or compensation schemes and measures are created for those who lose revenues because they practice SFM.

Key Points

4. Deforestation and unsustainable forest practices appear more profitable in the short term as actors get wrong signals from the market. This needs to be rectified by reducing the opportunity costs of SFM and countering extra-sectoral problems in order to make forestry compete on equal terms with other land uses and non-sustainable practices less attractive.

2. Strategic elements of SFM financing

Commoditisation and internalisation of externalities

When considering the total economic value from different potential land uses, "improved" economic analysis comprises forest benefits and services for use and non-use. Provided these different non-timber values, including existence value, can be measured and expressed in monetary terms, the market can account for the social benefits accrued from SFM. Environmental and social benefits that are not currently marketed need to be regarded as new types of commodities.

The non-timber benefits that the market can account for include: carbon storage and sequestration, watershed protection and other environmental services, bio-prospecting, genetic material (agricultural germplasm), pharmaceutical value, recreation, ecotourism and existence value. Economic analysis points to the major role that forest carbon values could play through the Clean Development Mechanism (CDM) proposed in the Kyoto Protocol. However, through CDM, the prospect for carbon offset trade would be presently limited to afforestation, reforestation and avoided deforestation, and not consider carbon storage by natural forests. Political and technical complexities further temper this optimism. The modalities and practicalities of CDM implementation will take time to be developed and agreed upon.

It is not enough to place a money value on social and environmental benefits and services that are not currently marketed. New market conditions have to warrant that financial flows capture these values, allowing for a significant part of the revenues to be accrued to those practising SFM, and the sharing of the costs between the beneficiaries of SFM, at the local, national and global levels.

The internalisation of externalities is to be an essential strategic component to generate the financing needed for SFM. Non-extractive benefits of forests occur at different levels. The internalisation of these externalities and their costs is related to the willingness of the concerned communities (global, regional, national and local) to pay for such benefits so that their provision can be ensured. Relatively straightforward in the case of single ownership, the internalisation of externalities becomes a political and negotiation challenge when different vested interest are at stake locally, nationally or globally.

Key Points

5. SFM contributes to social goals and environmental conservation but the creation of public goods and services is not recognised by markets. Benefits from carbon sequestration, biodiversity, and water supply are examples of services, which occur at global, regional, national and local levels that have the potential to be internalised through market or other mechanisms. SFM would be self-financing were such externalities (including the existence value of forests) internalised. Appropriate valuation and accounting methods need to be developed to guide decision-making on policies and investments.

Incentives and market-based instruments

Incentives modify stakeholder attitude toward resource uses. They help determine the market conditions. Appropriate legislation, combined with a revised set of incentives, would help remove investment barriers to SFM.

Traditional regulatory approaches, though necessary, by themselves do not guarantee a change in economic behaviour conducive to SFM. They may build resentment among stakeholders. For these reasons, regulation alone may not be sufficient. In addition they are often expensive to implement. Public policy guidelines should be limited to stipulate what needs to be done rather than how to do it.

Enabling incentives would induce forest stakeholders to act in a more sustainable manner. Incentives such as land tenure and security of resource use rights encourage long-term planning and investment on forests, thus promoting sustainable forestry. Enabling incentives also comprise the provision, to the forest users and those eventually affected by forest utilisation, of better information on services and non-timber benefits of sustainably managed forests

Economic incentives act directly on the profitability of forest utilisation by stakeholders. They include levy of taxes on forest rents and undesirable management systems, removal of perverse subsidies, and payment for environment services. The latter is preferable to subsidies that often create market distortion and stakeholders dependency.

The removal of various structural and operational barriers to investment creates a favourable climate for SFM financing. An appropriate framework would provide conditions and fulfil requirements that are prerequisite, facilitatory or complementary to direct investment in SFM activities “on the ground”.

Structural requirements pertain to policy (e.g. favourable macro-level investment climate, existence of an investment framework such as a national forest programme, appropriate national accounting system), institutions (dynamic and efficient public/private sector interface, absorption capacity for concessionary funding, cross-sectoral co-ordination and co-operation) and, market infrastructures and mechanisms for risk-mitigation.

Operational requirements relate specifically to project identification, preparation, implementation, management and monitoring. They directly address forest operators and managers. Operational requirements include research and forest inventories, comprehensive management plans, technical assistance, training and extension, support to marketing and trade promotion, and monitoring, including certification.

Key Points

6. Enabling conditions are essential for investments in SFM. These require the elimination of various structural and operational barriers. Both policy guidelines and regulation, as well as incentives, are required. Incentives are generally more cost-effective than legislation although they need to be supported by an adequate level of regulation.

By altering market signals (i.e. modifying positive and negative incentives), market-based instruments (MBIs) make SFM more profitable than unsustainable activities. The various MBIs are increasingly used. They demonstrate a different potential to attract private finance for SFM while they face various political, institutional and technical constraints in implementation.

Fiscal measures such as linking charges to forest management costs or forest stumpage value can improve the forest revenue system. They may be constrained by forestry administration capacity and the difficulties of measurement.

Trade and market liberalisation removes state controls on domestic transport restrictions and price control, and domestic-foreign flows (e.g. export/import quotas, taxes and bans) that often distort the market. Liberalisation may have adverse social impacts as it may make the poorer segment of the population more vulnerable. Moreover, the knowledge and consensus are still limited on potential returns from liberalisation and the investment it would generate.

Commercialisation of public environmental goods and services aims at ensuring that the private sector captures a financial reward from the provision of non-timber benefits. The pricing of environmental services such as amenity values and biodiversity conservation is technically difficult. Finding an agreement between the stakeholders at the local, national and global levels on the values can be a major political obstacle.

Certification verifies that the quality of forest management meets specified SFM criteria and indicators (C&Is). It can serve to communicate to buyers and consumers groups that the purchased products originate from sustainably managed forests, increase the producers' access to markets, mitigate risks for investors, and generate price premiums for the producers in some cases. This latter potential is questioned by some economists who argue that sustainably produced forest products should be offered at lower prices to provide a positive incentive for consumers. Certification is not applicable to all conditions. It is often costly and requires institutional capacity or third-party intervention to implement. Moreover, despite considerable work on C&Is, there is yet to be a consensus on a unified system of certification.

In order to select the appropriate MBIs, policy-makers may assess them against criteria such as environmental and cost effectiveness, social impact, and political, institutional and legal feasibility. Obviously most MBIs cannot readily apply where the national market is not sufficiently mature or integrated into a global economy.

Key Points

7. Market-based instruments (MBIs), such as national level fiscal measures, trade liberalisation, commercialisation of public goods and services, certification and demand creation for SFM products and services, have a potential to provide positive incentives for forest owners and managers, as well as local communities and other users. They tend, however, to be politically complex and technically difficult to implement. MBIs may influence the competitiveness of individual producers or forest-based products and services vis-à-vis their substitutes. Their implementation should be compatible with international trade rules. Furthermore, political will to tackle vested interests and adequate institutional capacity are needed to make these instruments work, together with adequate environmental policies.

New roles of financing sources

Financing sources are those entities that provide financial resources for the implementation of forestry-related activities. They are traditionally classified as domestic and foreign, public and private. The distinctive roles of public and private sources of capital vary according to the national context and the type of activity.

Private sector investment grows in importance, and public resources for forest sector development stagnate and remain low in the agenda of government expenditures. Consequently, the potential roles of the different sources in funding SFM are evolving.

In order to accelerate and intensify the process towards SFM, national financing strategies need to strike a dynamic balance between the roles of the different funding sources. Complementarily and synergy must be sought and co-ordination improved.

Role of public sources

The primary purpose of the domestic public capital is to achieve public goals. The role of the public financing sources varies according to the level of economic development and forest resource endowment. Public sources must provide for such goods and services as social development, public education and training, generation of knowledge and information, support to traditional non-market economies and small/medium enterprises and development of infrastructure. Public sources have to bear the cost of goods and services that are not catered to by the market.

It is the responsibility of the domestic public sector to develop an effective policy framework for SFM, including regulatory aspects. The domestic public sector has to ensure re-investment of forestry incomes into SFM and establish the correct incentives. Such incentives are often necessary to encourage the private sector in adopting improved forest practices.

The main purpose of the ODA is to support national efforts by providing technical assistance, technology transfer and capacity building. The current stagnation and focus of ODA indicates that the financial flows from the foreign public capital does not reflect the priority to SFM, as expressed in the IPF/IFF objectives and Proposals for Action.

The role of ODA has to evolve. After having concentrated on operational requirements, foreign public capital now ought to emphasise structural requirements. The multilateral finance institutions need to support more substantially and effectively SFM and the related incremental funding requirements, by providing loans or grants for the public and private sectors of developing countries.

Role of private sources

The raison d'être of private capital is to realise profits and generate wealth. This assumes the existence of a market and entails taking risks. The importance of private sector capital involvement depends on the maturity of the market.

Domestic private capital is essential to meet local needs of rural communities, but it is often overlooked because it results from the input of many small farmers and landowners. Foreign private sources can provide access to capital (FDI, portfolio investments, commercial bank loans), management skills, foreign market, technology and in-country technology development capacity.

Timber companies usually raise funds through international bond markets or equity placings on stock markets. Until recently, foreign institutional investors have achieved high profit margins and return to investment often through access to forest resources at low or zero concession costs. Sustainability and the total economic value of the concession were not the primary concerns of the financial analysts of the international investing institutions. The unsustainable behaviour of timber companies could, to a certain extent, be traced back to their foreign institutional shareholders.

Encouraged by broadened financial analysis based on environmental economics and a longer time-horizon, and motivated by emerging market opportunities for non-timber benefits, the international capital markets have started to recognise the potential for investments in SFM. This evolution is also due to the pressure stemming from a growing awareness on the part of the general public and some governments in developed countries. While the generation of attractive returns remains essential, a new type of investor now combines it with forest resource conservation and development, and the social and economic development of the local population. Their stated goal constitutes a significant shift in the investment attitude of some segments of private capital.

Synergies and partnership between public and private sectors

With SFM, the roles of the public and private sources are bound to evolve. For different reasons, the public sector needs private capital and vice versa. The public sector does not have the financial capacities necessary to bear all the costs of SFM. The private sector cannot willingly take up all risks and up-front costs such as infrastructure, research and social expenditures. This calls for the establishment of public/private partnership mechanisms that foster synergy and partnership.

The domestic and foreign public sectors must act as catalysts that facilitate private sector participation in SFM. The creation of a mutually trusting and enabling environment for private sector investment requires increased transparency in decision-making as well as clear guidelines and regulations. It is also the role of the public sector to supply information on investment opportunities. Financially, the public sector can contribute to sharing the investment risks by, for example providing loan guarantees and bridging funds for up-front investment.

With greater involvement, power and influence of the private sector, it becomes the responsibility of the public sector to ensure that private capital is used in a socially and environmentally responsible manner.

In this new type of relationship, the private sources could influence governments to adopt or institute measures that would lead to SFM, and contribute to the development of enabling mechanisms.

There are obstacles to partnership on both sides. The public sector hesitates to mingle with a private sector with which it does not share approaches and motivations. The private sector is reluctant to work with public sector bureaucracy. The different forms and modalities of partnership have to be explored further until it becomes a reality on a leveled playing field.

Key Points

8. The roles of public and private sources of capital are distinct but complementary and they should be considered jointly in financing strategies for SFM. The purpose of public sector financing is to achieve public goals while private capital generates wealth and creates markets, while taking risks. In order to ensure financial flows for SFM, the roles of both sectors must be enlarged and their boundaries less distinct. Public funding should be targeted at leveraging private investment.

9. The current ODA flows do not necessarily reflect the priority to be given to SFM. There is no systematic link between the IPF/IFF objectives and Proposals for Action and the allocation of financial resources through the existing mechanisms.

10. Large amounts of private capital applying ethical criteria could be mobilised for financing SFM, provided that assurances can be obtained that investments will not be environmentally damaging or socially detrimental. On the other hand, the issues of risk mitigation and lack of liquidity related to forest investments need to be addressed.

11. It is the responsibility of the public sector to provide effective ground rules for private capital to be used in a socially and environmentally responsible manner if the private sector does not take on this responsibility.

12. Alignment of public and private interests is necessary to create effective partnerships that are playing an increasingly important role to raise financing for SFM. In the establishment of partnerships, stakeholder participation contributes to clarification of objectives, needs and expectations of the involved parties, which facilitates implementation.

3. International mechanisms for SFM funding

Each country will have to develop its own financing strategy in order to implement the national forest programme effectively. National strategies have to consider new market prospects and instruments, and the evolving investment capacities and interests of the public and private sectors. This may call for the establishment of national mechanisms specifically aimed at SFM financing and linked to international mechanisms.

In order to support financing strategies at the country level and better reflect the IPF/IFF objectives and Proposals for Action, the international policy framework needs to be strengthened. There is also a need to increase co-ordination and co-operation between financing actors. One possibility is to "re-visit" and re-enforce existing mechanisms such as the GEF. An alternative is to explore the prospects for new complementary, mechanisms, such as an Investment Promotion Agency or a Global Forest Fund, often discussed during IFF.

The options for the improvement of SFM financing must be further explored and articulated before decisions are made that are of a policy nature and certainly not to be made within the context of a technical level workshop.

Investment promotion entity/agency

The objectives of an investment promotion agency/entity (IPA) would be to identify and analyse opportunities for financing SFM, and to act as a broker between investors and projects. This would involve the development, provision and management of a range of financial services that facilitate private sector financial flows into SFM.

An investment promotion agency/entity could attain the character of a "clearing house mechanism" for information, capacity building, technology transfer between the private and public sectors.

The activities could include the identification and marketing of investment needs and opportunities, investment packaging and structuring, the promotion and development of innovative financing instruments, and streamlined access to risk mitigation services.

Although initially funded through an injection of seed capital the IPA would become self-sufficient in the long run through contributions such as management fees and interests on loans to commercial activities. All funds allocated to projects would be managed through a blind pool to comply with agreed investment guidelines.

Managed by a small central board and regional boards, the IPA could be governed through a central advisory group with a representation of donors, NGOs, recipient countries or regions, and the private sector.

Global forest fund

On the one hand, there is a significant gap in the coverage of existing facilities for compensation of global public goods and services as they relate to the management of forests. On the other hand, there are areas where the willingness-to-pay of the global community for global services provided by forest is quite high.

The objective of a global forest fund, which is not synonymous with a global forest financing institution, would be to finance the internalisation of global externalities of forests in promoting SFM. The fund could support the additional cost during the transition period towards SFM, through compensation and subsidies for not yet marketed goods and services (e.g. existence value and carbon sequestration where there is not yet agreement).

Whereas this is hardly a propitious moment to be proposing new international funds, it seems that without such an arrangement extensive SFM will not be achieved and eventually almost total forest destruction in poor countries will be the result. Open to all countries, transparent, democratic and administratively-efficient, the fund should dispose of secure and sustainable sources of funds. A global forest fund would neither substitute for ODA financing flows nor even capture them. Financing sources from the private sector could include taxes on global business (stock market and financial transfers), surcharge on forest products, membership fees, etc.

The fund should be responsive to country-specific needs and linked with national financing mechanisms as well as operate through national forest programmes. Co-ordination with the international policy dialogue on forests and financing mechanisms of multilateral environment agreements should be secured to ensure responsiveness and avoid duplication.

Key Points

13. There is a consensus on the need for ways and means that improve and increase investment in SFM. The choices are either to improve and build on existing mechanisms, or to develop new mechanisms. The decision on such improvements is of a political nature.

14. One way to address effectiveness concerns would be for countries to establish national mechanisms specifically aimed at financing SFM and implementing national forest programmes, which could be linked to respective international mechanisms.

15. Appropriate international mechanisms, whether existing or new, would (i) be open to all countries involving both beneficiaries and financing sources in decision making, (ii) respond to national needs and work through national forest programmes, (iii) contribute to internalising global externalities of forests in promoting SFM, (iv) link with national financing mechanisms, (v) be transparent and administratively efficient, (vi) co-ordinate with the financing mechanisms of multilateral environmental agreements (MEAs) in order to avoid duplication, and (vii) have secure and sustained funding sources.

16. An international forest fund and an investment promotion entity/agency (IPA) are complementary and mutually reinforcing options for international-level instruments for SFM financing, but they can be implemented independently from each other. The IPA could attain the character of a 'clearing house mechanism' for information, capacity building, technology transfer, finance, etc. between the public and private sectors to facilitate investment. It could facilitate alignment between public and private sectors in financing, and between public sectors in developed and developing countries in development activities. The options for an international forest fund have not yet been thoroughly studied.

17. Further work should be carried out on options to strengthen public-private partnerships and to improve the effectiveness of existing mechanisms and/or to create new mechanisms in order to raise financing for SFM. In this work, objectives, functions, activities, governance and funding of an international forest fund and an investment promotion entity/agency should be explored.

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Annex II - AGENDA

Day 1 : Setting the scene **Monday , 11 October 1999**

By the end of the first day, the participants are expected to have reached a common understanding of the current situation, in terms of the economic concepts and theory relevant to SFM; and the core components of a framework strategy toward SFM. Clarification on the financial flows at the international level and examples of national financing strategies will have been given.

08h00-08h45 Registration

09h00 **Opening ceremony**
Ralph Schmidt, Director, PROFOR, UNDP
Andrew Bennett, Chief Natural Resources Adviser, DFID
H.E Ilkka Ristimaki, Co-Chairman, IFF

09h30 **Overview of issues and opportunities in financing of SFM**
Ralph Schmidt, Director, PROFOR

09h45 **Workshop objectives, structure and schedule**
Richard Scothorne, facilitator

10h00 **Coffee break**

10h15 **Is financing for SFM different to traditional forest financing?**
Professor David Pearce, Department of Economics, University College London

11h00 **Plenary : SFM as a financing opportunity?**
During the plenary, the following questions will be addressed: Is there a -
- need for additional financial resources?
- How far can the market be used to reinforce sustainable forest financing?

12h00 **Transition towards SFM: Core components of financing strategy at the national and international levels**
Markku Simula, INDUFOR

12h30 **Lunch**

14h00 **Trends in financial flows at the international level**
Mahendra Joshi, PROFOR

14h30 **Financing SFM in Colombia**
Manuel Rodriguez, Director, Andean Centre for Sustainable Development

15h00 **Financing SFM in the United Kingdom**
Tim Rollinson, Forestry Commission, U.K

15h30 **Coffee break**

16h00 **Group work: Transition towards SFM**
Four work groups will explore the following questions:

- What could be the respective roles of the different financing sources in promoting SFM?
- What are the barriers which prevent the different sources from playing these roles?
- What are the risks inferred by the potential roles outlined in the answer to questions 1?

17h30 **Group work closes**

19h30 **Dinner**

Day 2 : Potential instruments, mechanisms and sources for SFM funding
Tuesday, 12 October 1999

By the end of the second day, the potential sources of financing and mechanisms (particularly the private sector and international forest fund), and market-based instruments (particularly an investment promotion entity) will be clarified for the participants. The participants will have explored and discussed the political, structural and operational barriers to the activation of additional financing sources, the utilisation of innovative instruments and the establishment of new mechanisms

08h30 **Introduction of the day by the facilitator**

08h35 **Reports by working groups**

09h45 **Market-based instruments to promote SFM**
Natasha Landell-Mills, Research Associate, IIED and Michael Richards,ODI

10h15 **Portfolio Investment: Forestry companies in the emerging market**
Mark Campanale, Senior Analyst, Socially responsible investment team Henderson Investors

10h45 **Coffee Break**

11h15 **Public-private partnership and a proposed investment promotion entity**
Pedro Moura Costa, Director, EcoSecurities

11h45 **Private-public partnership: Example of the Brazil Sustainable Forest Fund**
Eric Oddleifson, Director, GMO

12h15 **Plenary: Role and scope of Public-private partnerships and investment promotion for SFM?**

13h00 **Lunch**

14h15 **A Global forest fund: What are the options?**
Lennart Ljungman, Director, Forest Policy and Planning Division, FAO

14h45 **Plenary: What could a global forest fund add to existing financing mechanisms?**

15h30 **Coffee Break**

15h45 **Group work: assessment of international financing instruments**
(Group 1 and 4; Group 2 and 3):

Group 1 and 4 will explore the following questions:
- Given that investment in sustainable forestry is hindered by a variety of barriers, is there a need for new financing mechanisms to increase investment into SFM?
- In this context, is there a role for a global forest fund?
- If so, how could it be structured?

Group 2 and 3 will explore the following questions:
- Given that investment in sustainable forestry is hindered by a variety of barriers, could public-private partnerships have a role in increasing investment into SFM?
- In this context, is there a need for an investment promotion agency?
- If so, how could it be structured?

17h30 **Group work closes**

19h30 **Dinner**

Day 3: Strategy to facilitate and leverage financing for SFM
Wednesday, 13 October 1999

At the end of the session, the participants will have a better understanding of each other's perspective on the transition toward SFM. The key issues and themes which have emerged will be elaborated and discussed

08h30 **Introduction to the day by the facilitator**

08h35 **Reports by working groups and discussion**

10h00 **Coffee Break**

10h30 **Key points emerging**
Markku Simula

10h45 **Key points - commentary**
Everton Viera Vargas

10h55 **Plenary: Key points emerging**

11h55 **Closing comments introduced by Ralph Schmidt**
John Hudson
Ilkka Ristimaki
Ralph Schmidt

12h55 **Close**

Lunch

Annex III - LIST OF DOCUMENTS

Financial Mechanisms for Sustainable Forestry
Pedro Moura Costa, Jyrki Salmi, Markku Simula, Charlie Wilson, UNDP/PROFOR Publication

Financing Sustainable Forestry: Issues under International Deliberation
Mahendra Joshi, UNDP/PROFOR Publication

An Assessment of Data on ODA Financial Flows in the Forest Sector
Anand Madhvani, UNDP/PROFOR Publication

Can Tropical Forestry be made Profitable by 'Internalising the Externalities'?
Michael Richards, ODI and Pedro Moura Costa, EcoSecurities

Forestry-Based Carbon Trading: Pros and Cons of a New Market for Environmental Services
Michael Richards, ODI and Pedro Moura Costa, EcoSecurities

Is Financing for Sustainable Forest Management Different to Traditional Forest Financing?
David Pearce, University College, London

Innovative Financing Instruments in the Forestry and Nature Conservation Sector of Costa Rica
Thomas Heindrichs, GTZ, Eschborn, Germany

Diagram for Establishing Country Financial Profiles
Philippe Alirol

IPF Proposals for Action: International Cooperation in Financial Assistance and Technology Transfer

Why Finance Sustainable Forestry?
Robert Repetto and Niger Sizer, World Resources Institute, Washington D. C.

Presentations

Transitions Towards Sustainable Forest Management: Core Components of Financial Strategy at the National and International Levels
Markku Simula, Indufor, Finland

Innovative Financial Mechansims for Sustainable Forestry
Pedro Moura Costa, EcoSecurities, United Kingdom