



Enabling the legal framework for PES, Costa Rica

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Short title: Enabling the legal framework for PES, Costa Rica

Key Message: The new forestry law laid the groundwork for the introduction of a new national forest strategy transforming earlier reforestation incentive programs into a new policy framework called “pagos por servicios ambientales” (PSA, or “payments for environmental services”) (Zbiden & Lee 2005).

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What is the problem?

More than half of Costa Rica was covered by forest in 1950. This was drastically reduced to 29 percent by 1986. Costa Rica had one of the highest deforestation rates in the world in the 1980's. Some of the main reasons for rapid deforestation were: titling laws that rewarded deforestation in the 1930s and 1940s, the growing population (which increased from 860,000 people in 1950 to 1.73 million people in 1970) and the massive conversion of forest to pasture. Several government policies and economic interactions supporting this conversion took place from 1960–1970. These promoted agricultural development, cattle ranching and the conversion of forest to farmland. In the 1970s, there was an increase in demand for beef, which resulted in an increase of pastureland from 0.8 million to 2.2 million ha from 1950 to 1984.

In addition, cattle production had inherent comparative advantages over other land uses, including forestry: small starting capital, easy market access, a yearly income and the fact that cattle could be used as collateral for loans. Trees and forests could also not be used as collateral for loans. There were also factors that reduced the attractiveness of forest products and forestry: long gaps between harvests and no bank loans offered for forest projects. In Forest sector institutions had limited ability to provide technical assistance and the processing of forest harvesting permits was time consuming and difficult (Camino et al. 2000 & Subak 1999).

What was the response to this problem?

The Costa Rican government recognized that the aggregate value of the forests' environmental services constituted an enormous financial potential – beyond the mere commercial value of the wood in natural forests and plantations. The government introduced innovative mechanisms by which smallholder owners of natural forests and plantations could receive direct payments for the forests' environmental services to Costa Rican society and the world at large. These payments were not in the form of subsidies, but rather payment for the value of the services.

These services include mitigation of greenhouse gases (carbon sequestration); protection of water for rural, urban or hydro-electric purposes; protection of biodiversity for conservation, sustainable scientific and pharmaceutical purposes, research, genetic improvement and the protection of ecosystems and life forms; and preservation of natural scenic beauty, particularly for tourism. Although Costa Rica has a long history of conserving natural resources by developing incentive mechanisms for the rehabilitation of wooded lands, it took years of policy debate and consensus building to develop a national approach of paying for environmental services (Rodriguez Zunega 2003).

There are three laws that constitute the legal framework within which Costa Rica established the program. The 1995 Environment Law 7554 mandates a “balanced and ecologically driven environment” for all. The 1996 Forest Law 7575 mandates “rational use” of all natural resources and prohibits land cover change in forests. Finally, the 1998 Biodiversity Law promotes the conservation and “rational use” of biodiversity resources (Sanchez-Azofifa 2007).

The evolution of forest law in Costa Rica:

Forest Law No. 4475 (1969): This Law made the costs of reforestation tax-deductible, thereby providing a financial reward to those who invested in reforestation activities. This initial focus on tax rebates primarily benefited only the largest forest companies – in other words, those with considerable tax liability. *Forest Law No. 4475* also further protected the forest industry: concessions were allowed in forest reserves, tax exemptions were put into place, export of unprocessed timber was prohibited, and the import of forest products was restricted (Bennett & Henninger 2009).

Forest Law No. 6184 (1977): This law established reforestation as a legal imperative for Costa Rica. This law required no less than 2% of all agricultural loans of total commercial and state bank credits to be allocated for reforestation projects. Also, interest rates on these loans were capped at 8% for reforestation projects and trees were permitted to be used as collateral.

Forest Law No. 7032 (1986) & Forest Law No. 7174 (1990): These two laws allowed for significant forest authority intervention in the use of forest resources. They established further fiscal incentives through the creation of certificates, which rewarded landowners for their reforestation efforts. These certificates had nominative value and could be sold or used to pay taxes or government fees. One instrument, Forest Bond Certificates (or *Certificado de Abono Forestal - CAF*), broadened the benefits of tax-deductible reforestation costs beyond only large timber companies. The other instrument, Forest Bond Certificates for Forest Management (or *Certificado de Abono Forestal para e Manejo del Bosque – CAFMA*), which was introduced in 1992, made direct subsidies available for the first time. In addition, Forest Protection Certificates (*Certificado para le Proteccion del Bosque – CPB*) were also introduced – yet another groundbreaking legislative change that supported forest conservation over timber production. Land included in this program varied in size from 1 to 300 ha. Enrolled land could also not be exploited in any way except for ecotourism (Bennett & Henninger 2009).

Forest Law No. 7575 (1996): The Structural Adjustment Programs of the World Bank in the mid-1990s forced Costa Rica to terminate the subsidies being offered through *CAFMA* to property owners for reforestation. *Forest Law No. 7575*¹ was enacted in 1996 to legally

¹ Most of the details on how Forestry Law No. 7575 operates are described in a ministerial decree that followed the law. This decree makes official a manual and procedures that govern the PES: participants, eligibility, requirements, contract, disbursement, follow-up, etc.

establish a payment for ecosystem services program (or *Programa de Pago por Servicios Ambientales – PSA*). It explicitly recognizes four environmental services of forests: carbon fixation, hydrological services, biodiversity protection, and provision of scenic beauty. The law was an adaptation of the existing system of financial incentives for reforestation and provided the legal basis for landholders to be compensated for providing ecosystem services. A new Certificate for Forest Conservation (or *Certificado para la Conservación del Bosque – COB*) rewarded landholders for their ecosystem services. An institution, the National Forest Financing Fund (*Fondo Nacional de Financiamiento Forestal, FONAFIFO*) was set up through the law to manage the program in collaboration with other governmental and non-governmental organizations. The law broadened the source of financing for the program to various general funding streams at FONAFIFO's disposal: tax (dedicated fuel tax) revenues, grants and loans from national and international institutions, debt relief, agreements with the private sector, and market instruments (Bennett & Henninger 2009, Chomitz 1998).

Wider Implications of Forest Law No. 7575

Costa Rica has defined its national market for environmental services by creating demand through legislative measures and determining the value of services through policy debates. The concept of payment for environmental services has incredible potential and Costa Rica has succeeded in using payments to support sustainable forest management and increase forest resources while supporting both landowners and conservation.

International agreements such as the United Nations Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol and the emerging Clean Development Mechanism (CDM) have enabled Costa Rica to take a leading role in the prevention of global climate change through internationally financed projects in natural and plantation forest management and conservation – with a particular emphasis on the participation of smallholders. Costa Rica has linked its legal obligations to UNFCCC with the domestic potentials of fostering sustainable forest management in an innovative way (Rodriguez Zunega 2003).

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