$ 40 billion needed to reduce global deforestation

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Private financing for sustainable forest management is far greater than public financing, but still falls far short of what is needed to halve global deforestation by 2020. There is a serious information gap on financial flows and why some countries attract large private investments. International institutions are working to improve data and facilitate access to finance, while governments could increase international investment by improving their resource governance and investment environments.

The United Nations Forum on Forests (UNFF) and Collaborative Partnership on Forests Advisory Group on Finance (AGF) estimate that the annual funding need for sustainable forest management (SFM) is US$ 70–160 billion and the requirement to halve global deforestation by 2020 is US$ 20–40 billion a year. As deforestation largely takes place in developing countries, SFM financing really is a development issue. At present, official development assistance to forestry, about US$ 1 billion a year, covers about 1 % of the financing need, and other public financing barely doubles that. In addition, although REDD+ 1 financing is increasing – for 2010-2012 US$ 4.5 billion was pledged – much is yet to be disbursed. To scale up SFM and create added value, economic growth and employment while protecting forests and their ecosystem services, domestic and foreign private financing and investment need to be accelerated. Yet there is little data – we need, for example, to better understand why some countries attract large private investments and what drives the financial flows.

The World Bank 2 recognizes private sector participation as an essential condition for achieving its objectives of ending extreme poverty and promoting shared prosperity. Forestry, wood processing and non-timber forest products 3 could all help – forests contribute to the livelihoods of more than

1.6 billion people including more than 90 % of those in extreme poverty 4. But they will not be achieved by public or private action alone (Asen et al., 2012).

In 2012–13 the Program on Forests (PROFOR) and the Bank launched two studies on the role and dynamics of private forest-sector financing. One provides in-depth data, analyzes different sources and examines ways of improving them. The other looks at ways of analyzing the investment climate and attracting investment, with the aim of helping countries improve their business environment. Although not limited to SFM financing, the studies will provide a better understanding of it 5.

Mapping private forest investments

Although there have been studies on private investment flows to the forest sector, there has been no coordinated and systematic effort to provide a comprehensive, global picture. We know, for example, that the area of private commercial plantation in Latin America is 18.7 million ha. – 78 % of the region's total plantation area – and 5.1 million ha. in Asia and Oceania – 14 %. In Africa, a low percentage – 6 % or 0.3 million ha. – suggests that plantation establishment is still driven by the public sector.

Total annual private sector plantation investment was estimated at US$ 1 763 million for 2011, excluding investments in REDD and landscape restoration as well as by households, communities and most small and medium enterprises (SMEs). The majority, 83 %, was in Latin America, 16 % in Asia and Oceania and just 1 % in Africa.

Investors, concerned with new markets and maximizing risk-adjusted returns, prefer to invest in countries that combine good growing conditions with a stable investment environment, which includes political and economic stability and secure land tenure.

In many countries of sub-Saharan Africa, unclear land tenure, corruption and other aspects of weak governance, inadequate infrastructure and a scarcity of arable land and skilled workers constrain long-term private investment. However, some countries, including Mozambique, South Africa, and Tanzania, with good growing conditions, adequate infrastructure and stable policy and economic environments have attracted private investment. In Mozambique, large land areas are potentially available for development and both it and Tanzania have port infrastructure providing access to the Asian market.

Another consideration is a strong domestic market; Brazil and China, for example, have attracted notable investment. These are developing rapidly in many African states, driven by growing economies and populations. Large urban centers such as Kinshasa, Lagos, and Nairobi consume huge amounts of wood and wood products for energy and construction, forming the basis of large-scale informal trade.

While countries cannot change their location or growing conditions, national decision makers should be informed of changes that could reduce risks and make their countries more attractive to investors. and the private sector, public officials and communities all need more data on the forest sector, land use and markets.

Benefits and barriers

Different types and sizes of investors have different objectives – industrial investors are primarily concerned with profit in growth markets; small (household) investors' interests often cite contributing to subsistence needs and security; while commercial investment decisions are influenced by factors beyond forest-sector policy and measures that can influence the investment environment.

International timberland fund managers, financed primarily by institutional investors such as pension funds, are an increasingly important source. Although they focus heavily on a few countries in Latin America, total assets under their management have already reached an estimated US$ 80 billion.

Beyond wood sales or its use in an investor’s processing unit, timberland can help commercial investors diversify their portfolios and spread risk as, historically, timber has provided good protection against inflation. Additionally, although European and North American demand for fibre-based products is stagnating, demand Asia, Latin America and Africa is expected to grow, and in the longer term, new uses of wood-fibre could increase demand.

Even developing country smallholders can benefit from investing in forests. For a farmer, for example, trees can provide fuel and fodder, help regulate local ecosystem services and generate income and job opportunities beyond agricultural production cycles. Wood, after all, is non-perishable and often only increases in value if not harvested.
Nonetheless, forest investments have their own risks, including fire, pests and poor liquidity if an investor wants to pull out.

There are some significant barriers to private SFM finance that developing countries must be aware of, and address. Firstly, investors are sensitive to political, land tenure, currency, social, environmental and reputational risks, whether real and perceived, and countries that can demonstrate lower systematic risks are more likely to attract investment.

Weak availability of domestic and foreign equity, loan and debt financing, combined with limited understanding of forest investments within the financial institutions, are other barriers, while raising international finance for projects of less than US$ 25 million is particularly difficult. Moreover, even when domestic debt financing is available, local interest rates may be excessively high and pay-back periods short, typically 6–36 months.

Lastly, high upfront costs, due, for example, to a lack of information on forest resources 6, investment opportunities and risks, and higher transaction costs for small- and medium-sized projects act as further deterents.

Overcoming obstacles

As, to improve the investment climate, policy design and implementation need to be based on good financial statistical information, data collection needs to be improved, and international financial institutions (IFIs) can help.

Building an information base

Currently, information on domestic forestry financing and financing of natural forest management is inadequate, and there is no structure for systematically collecting and compiling data. Company surveys, media searches, ad hoc surveys and specialist databases could help, but require substantial improvements in the staff and financing of national statistical offices and central banks. Furthermore, national forest institutions need financial and capacity-building support for information generation and knowledge management.

Improving access to financing

Investors are mainly interested in maximizing risk-adjusted returns, and key to assessing these are growth potentials and access to growth markets; political, regulatory and economic stability; and a stable investment environment with good governance, which includes secure tenure; adequate physical and institutional infrastructure; and the rule of law.
Governments can influence policies, regulations and the investment environment, sometimes by simply deciding to act. But improving resource and land governance, reforming the business climate, supporting forest research and development and helping smallholders and communities organize themselves to take advantage of economies of scale are likely to need time and public investment.

Despite a data paucity, it is safe to say that private foreign and domestic financing for SFM are far greater than public financing, albeit distributed unevenly. Although there is a role for the public sector to deliver global public goods or as a source of frontier funding for high-risk investments, domestic and foreign private financing can be expected to play an increasingly important role

Ultimately improving the investment environment is a national responsibility, but international partners can support governments. The World Bank and IFIs could, for example, help in building analytical and risk-mitigation tools as well as by ensuring that adequate financing is available. Furthermore, IFIs could support building capacity to collect and disseminate data as they often have the capacity to provide support and expertise to not only the forest sector, essential when, for example, wider financial or public sector reforms are needed.

National governments can help by improving resource governance – including land tenure systems, developing enabling national policies and strategies, promoting national partnerships and SME development, developing smart subsidies and removing market inefficiencies.
National governments can also improve the availability of data, particularly forest inventories, land registries and land-use information, and invest in research and development, for which new technologies can be helpful and provide cost-efficient solutions.

Furthermore, issues related to forest finance must be looked at from different angles, and partners from outside the forest sector – people and institutions dealing with financial sector, banking development and regulation, infrastructure, agriculture and labour force development. And finally, international platforms such as UNFF should continue to develop best practices and improve access to finance.

Footnotes:

1 Reduced Emissions from Deforestation and forest Degradation; the objective of UN-REDD is to mitigate climate change through improved forest management.
2 World Bank Group issued a revised forest strategy in 2002. After that, in 2002–13 the total investment in forest is about $4.3 billion; over 60% has been invested by the World Bank and the remaining by International Finance Corporation (IFC), the World Bank Group's private sector arm. Annual volumes fluctuate greatly but have been $50–500 mill for the Bank and about $130 for IFC. However, two qualifications here; first, most of Bank financing goes to the public sector and secondly, despite the Bank being the largest financier of the sector, the sector is small for the Bank. In the past years the share of forest projects in the Bank's overall lending has been fluctuating around 0.5%. Investments to the private sector are mainly done by the International Finance Corporation (IFC), the World Bank Group's private sector arm.
3 These include various non-timber forest products often used by households; nuts, medicinal plants, honey, fuelwood etc.
4 World bank (2004) ; World Bank (2008)
5 Castrén, T.,et al. 2014 [forthcoming] and Castrén, T., Katila, M. and Lehtonen, P. 2014. Business Climate for Forest Investments: A Survey. Washington, DC: Program on Forests (PROFOR).
6 Based on information from Global Forest Resources Assessment 2010, only 45 countries have done a complete national forest inventory and only 22 have done it more than once. This means that for a vast majority of countries there is no current information on their forests and trees outside forests. However, recent advances in information technology and the lower cost of earth observation data should make at least basic inventories more affordable to many countries.

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