info brief

CIFOR *infobriefs* provide concise, accurate, peer-reviewed information on current topics in forest research

CIFOR

No. 29, November 2010 | www.cifor.cgiar.org

Financing sustainable small-scale forestry

Policy issues and lessons from developing national forest financing strategies in Latin America

Marco Boscolo[1], Kees van Dijk[2] and Herman Savenije[3]

Key points

- Increasing forest financing requires better communication and understanding between the forestry and finance sectors. This can take the form of joint development of financing strategies, instruments and business cases.
- Limited forest financing is often less about money availability than about poor access. In tapping into new sources of finance (including domestic ones) and realising the potential of new emerging instruments (capital market instruments, payments for environmental services, risk mitigation schemes, guarantees), governance and institutions in both sectors are often a more serious limitation and risk factor than the lack of money.
- Forest financing mechanisms for small-scale forestry need participatory diagnosis and flexible design in order to respond to diverse—formal and informal—local realities and build on existing livelihood strategies.

Introduction

One of the main challenges countries face in reducing deforestation and forest degradation—and in enhancing sustainable forest management (SFM)—is how to increase the competitiveness of SFM compared with other land uses. If forest users do not derive a sufficiently high return from SFM in comparison with unsustainable uses or land conversion, deforestation and forest degradation will continue. Improving the attractiveness of SFM requires broadening and diversifying financing as well as increasing the revenues that can be derived from forests. Financial resources are needed to solve cash flow problems, pay for operational capital or labour, invest in new technologies and manage risks and uncertainties. Soft investments are also often needed to build capacity and improve the overall policy and institutional environment in order to make forest financing more accessible and affordable.

This policy brief reviews some issues and shares some lessons from efforts to finance SFM, particularly when carried out by local communities, indigenous groups and small forest owners. In particular, we reflect on the findings from a regional knowledge-sharing initiative and from FAO and its partners' ongoing work in support of national forest financing strategies in various countries. These results are linked to the opportunities and challenges that arise from carbon-based forest financing (e.g. Clean Development Mechanism Afforestation/Reforestation (CDM A/R); reducing emissions from deforestation and forest degradation and enhancing forest carbon stocks (REDD+)).

The challenges and opportunities

The problems that hamper the financing of SFM are manifold and complex. Such problems include: undervaluation of the multifunctionality of forests; strong dependence and focus on timber as the main source of income; inequity in the division of costs and benefits in the wood chain; the long-term nature of forestry cycles;

1 FAO, Forest Department, Rome, Italy, marco.boscolo@fao.org
2 Tropenbos International, the Netherlands, kees.vandijk@tropenbos.org
3 Tropenbos International, the Netherlands, herman.savenije@tropenbos.org

Box 1. Initiatives on forest financing in Latin America

Between 2005 and 2007, FAO and the NFP Facility, in partnership with IUCN-ORMA, CCAD, OTCA/DGIS/GTZ-BMZ, and with support from the Ministry of Agriculture, Nature and Food Quality of the Netherlands and the German government, carried out the project Estrategias y mecanismos financieros para la conservación y el uso sostenible de los bosques en América Latina. This was a collaborative **knowledge-sharing and joint-learning** initiative between national forest programmes, subregional organisations and international organisations, focusing on what countries themselves can do at the country level. The initiative produced 19 country assessments, subregional and regional syntheses, numerous workshops and a capacity-building module for in-country strategy development. An overall synthesis and various publications are available at www.fao.org/forestry/finance/en/ and www.tropenbos.org. Since 2008, FAO, the NFP Facility and their partners have been supporting the development of national forest financing strategies in various countries, including Ecuador, El Salvador, Guatemala and Paraguay.

and the low profitability and high (perceived) risks of forestry investments. Furthermore, forestry practices in the tropics often exhibit low productivity and efficiency because they are conducted with outdated technologies and without sustainability considerations. Finally, insecure tenure, weak institutions, poor sector governance and adverse policies contribute to making investments and business development in sustainable forestry unattractive.

However, forestry is also facing unprecedented opportunities. The multiple functions and values of forests are increasingly recognised as key in resolving global issues such as climate change, green energy, poverty, environmental degradation, biodiversity loss and raw material supply. An array of new and promising financing sources, instruments and mechanisms is emerging at global and country levels. All these opportunities, if realised, can contribute to creating additional and diversified sources of investment and income for forests and enhancing livelihoods of forest-dependent people.

Forest finance, REDD+ and forest people

REDD+ and forest-based carbon markets may offer additional financing options for SFM. The final success of REDD+ will largely depend on how it is integrated into each country's policies and how it is practically shaped at the ground level. The national design issues, including the process through which finance is received and distributed amongst stakeholders at national, subnational and local levels, will be a significant determinant of whether REDD+ will deliver on its promise. There is a broad understanding that the REDD+ finance design must include specific safeguards to ensure that the mechanism not only targets deforestation and degradation, but also represents an opportunity to benefit poor, marginalised and vulnerable groups.

Diversity of financing instruments and access

Small-scale forestry depends on a range of financing instruments. They vary in origin (e.g. funding can come from international donors, public budgets or private resources), objectives (financing can be an instrument to create monetary value added or social or conservation benefits), distribution mechanisms and intended beneficiaries. Whilst there is some documentation on the extent and effectiveness of donor and public funding, less is known about private financing, whether formal or informal. Various financing alternatives are commonly encountered in Latin America (see box).

Key lessons

We have identified the following aspects that should be considered when supporting the development of forest financing instruments and strategies. All of these may be relevant to REDD+ financing at the national level. We have compiled these based on the experience of FAO, the NFP Facility, Tropenbos International and partners such as the countries' national forest programmes, International Tropical Timber Organization (ITTO), International Union for Conservation of Nature (IUCN), Amazon Cooperation Treaty Organization (OTCA), Central American Commission on Environment and Development (CCAD) and the Dutch and German governments.

Table 1. Forest financing alternatives across Latin America

Instruments	Examples
Informal credit	Advance payment for goods (products) and services (labour), which can be in cash or in kind
Credit lines and project financing	Loans from cooperatives, commercial and development banks (public and private), including micro-finance
Donations, bilateral and multilateral aid	Loans and grants from development and bilateral and multilateral agencies Debt-for-nature swaps
Philanthropic donations/grants	Conservation, research and development, social grants
Public incentive programmes	Subsidies and targeted grants issued and managed by public banks Investment tax credits/exonerations Subsidised interest Payments for environmental services Credit guarantee schemes
Private investment instruments	Own savings/investment capital Debt instruments (e.g. trusts, warrants, advanced purchase of products) Capital market instruments (securitisation, forward contracts) Guarantees
Funds	Forestry funds; national environmental funds; conservation trust funds (funded from public, private or mixed sources)
Partnerships	Community–private–public partnerships (which can serve to transfer know-how and technology, to facilitate market access, etc.) Public–private partnerships

1. Integrate REDD+ financing within broader national strategies for forest financing. The publication 'Realising REDD+: national strategy and policy options' makes a compelling case that effective implementation of REDD+ requires broad reforms and a comprehensive strategy:

> Agricultural policies can limit the demand for new agricultural land. Energy policies can limit the pressure on forest degradation caused by woodfuel harvesting, while reduced impact logging (RIL) practices can limit the harmful impacts of timber extraction. Setting up protected areas (PAs) has proved effective in conserving forest, and— although being far from perfect— support for PAs should be considered as part of any comprehensive national REDD+ strategy (p. xii).

We add here that policies and instruments will be even more effective if synergies are found with other financing options, with activities aimed at organising vulnerable forest stakeholders and with the strengthening of the policy and institutional environment. Such synergies can be identified and realised through national forest financing strategies which describe a country's vision for the future of forests and people, outline priorities and assess the requirements to achieve that vision. They are conceived as tools in support of national forest programmes. Experiences from Latin America suggest that financing strategies can support this when they:

- are based on negotiation and agreement between all major stakeholders, including representatives of the financial sector;
- promote diversification in and synergies across financing sources and mechanisms, responding to the various forest conditions and needs of the many different forest users;
- ensure that a supportive institutional, legal and socio-economic environment for investment and market development is in place, including improvements in the governance of both sectors; and
- include the multiple benefits of forests as management objectives taking into account the specificities of locations and circumstances.

2. Develop flexible mechanisms that respond to diverse local conditions. It will remain a challenge to devise financing mechanisms that can respond to the diversity and dynamics of local realities and forest users. We found that attributes such as pragmatism, flexibility and adaptability are necessary. Any mechanism can be enhanced by acknowledging and respecting the pace at which things can change and respecting stakeholders' internal ability to adjust. Thus, in our view, a key challenge is not only to identify what measures are needed to make countries 'REDD ready', but also *to design REDD+ finance mechanisms that are 'community ready'*. Such mechanisms are client-driven and embrace the view that local communities are the driving forces of their own social and economic development and best placed to consider their own realities, needs, aspirations and dynamics.

3. Consider existing livelihood strategies as the starting point. One concrete way to adapt financing to local realities is to design and implement financing schemes with a view that goes beyond forest financing needs to address the *livelihood strategies* of different groups. For a large portion of forest-dependent people, forests are not the most important source of livelihood. Compensation schemes that respond to community needs and that look beyond forests have proven promising, practical and sustainable.

4. Improve access to finance: Limited financing is less about money availability than about access. Our experience has revealed a wide range of formal financing instruments (credit, project financing, aid, philanthropy, public incentives, private investment, funds, partnerships), but their suitability and access are often limited. Many small producers experience limited access to formal financing for several reasons, including that: (1) forests are often not acceptable collateral for a loan (exceptions include Colombia and Uruguay); (2) land cannot be used as collateral without clear land tenure; (3) lending policies favour low-risk and short-term loans; and (4) interest rates are often higher than the rate of forest value growth when timber is the only marketed output. A facilitated conversation between forest and finance stakeholders can help bridge the gap that exists between those with funds who need attractive projects and those who need the financing for attractive projects. In the case of forest finance, access has a lot to do with building understanding, relationships and solutions that are based on solid socio-economic and environmental data and knowledge of the institutional frameworks.

5. Don't overlook informal financing: Despite its importance it is not well known. Selected research and anecdotal evidence suggests that a huge and largely undocumented amount of forestry activities takes place outside 'formal' financing schemes. This situation is more common where access to formal financing for small-scale forestry is limited. Indeed, in rural and remote regions, strengthening and expanding existing informal financing modalities may indeed work better than trying to attract urban financial institutions to rural areas. Unfortunately, information on informal financing of forest activities and its functioning is very limited. Consequently, additional systematisation and research are needed.

6. Harness the potential of new instruments (capital market instruments, payments for environmental services (PES), risk mitigation schemes, guarantees) and domestic capital. There is a large untapped potential to link forestry to domestic private capital through formal

Box 2. Bridging the communication gap: The Paraguay experience

In Paraguay, a facilitative process is underway where mutual learning is taking place between the forestry and financial sectors. This mutual learning is taking the form of joint goal and priority setting, multidisciplinary working groups and joint field trips where representatives of the financial sector (e.g. bankers, managers of pension funds, etc.) can visit interesting cases of sustainable forestry (plantations and natural forest management).

This work has produced a number of initial results. Fondo Ganadero, a bank that supports cattle ranching, has created a new credit line (initially worth US$1 million) for tree planting on pastureland and pasture improvements. The Agencia Financiera de Desarrollo (AFD), a public development bank, has expressed interest in developing a US$2 million credit line (PROFLORA) for planting activities. Forest stakeholders are also lobbying the Central Bank to modify a legal resolution that limits fiduciary agencies in the creation of investment trusts.

This collaborative work is helping to increase the visibility of the sector, thus promoting interest in forestry amongst farmers and cattle ranchers. It has also helped identify opportunities to create links between large and small producers through private–private partnerships (e.g. outgrower schemes). Where institutions and extension services are weak, such partnerships offer the opportunity for small producers to increase their access to markets, reduce their market risk and increase access to financing, seedlings, know-how and technical assistance.

financing instruments, especially for productive activities. Important potential for additional and new sources for investment exists through the creation of capital market instruments (institutional capital such as pension funds, private capital, business capital), the development of mechanisms for PES (local, national and global), the broader use of guarantee instruments and the bundling and/or packaging of multiple instruments. In the design and validation of REDD+ projects, the bundling of several small community forestry sites could also provide a viable and cost-effective option. Tapping into domestic private capital requires bridging the significant communication gap that exists between small forest producers and financing institutions and designing adequate risk mitigation mechanisms. Access to financing instruments also requires that forest operators organise themselves and their operations in business plans that are properly structured and financially solid.

7. Address poor governance and weak institutions: They are often a more serious constraint and risk factor than money. Our experience supports the view that the challenge of increasing financing goes hand in hand with the challenge of increasing the attractiveness of SFM and the credibility of forest institutions (public and private). It also suggests that institutions' success in attracting the attention of the financial sector and mobilising new and additional funding for SFM can be linked to their ability to:

- maintain or improve their level of technical competence and credibility vis-à-vis the ministry/ministries in charge of finance;
- acquire knowledge about financing language, instruments and processes;
- build alliances with other sectors, in particular the financial sector, and improve inclusiveness and local participation;
- manage for results and improve accountability;
- proactively take advantage of emerging markets and instruments for forest goods and services; and
- balance institutional capacity (human, financial and technical) with institutional mandate.

8. Build on existing structures but be mindful of their strengths and weaknesses. In supporting the development of national forest financing strategies, a common challenge we have encountered has been institutional weakness and isolation, which often manifest through a paralysing competition between forestry, environmental and other agencies, such as finance, planning, agriculture, public works, etc. Poor communication and cooperation between agencies and between central and decentralised governance structures are negatively affecting the development of credible and broadly accepted REDD+ strategies. An open question is thus whether, to improve governance, we should rely only on traditional forest institutions and established processes such as national forest programmes or strive for alternative participatory governance structures. The answer will partly depend on these agencies' ability to meet the accountability challenge and fill the gap in their capacity for achieving partnership and outreach.

9. Ensure that institutional arrangements are in place to enable local meaningful participation. Institutional arrangements are necessary not only to design site-based projects and programmes but also to achieve local engagement in political decision-making at multiple scales, and to improve transparency, monitoring and impact. Indigenous peoples are increasingly represented as recognised stakeholders at policy tables, including in REDD+ discussions. However, squatters and other forest-fringe people usually cannot yet refer to similar international agreements (such as the UN Declaration on the Rights of Indigenous Peoples) or are not organised in the same way. Additional policy measures, including empowerment and capacity-building activities, will be needed to develop effective institutional capability amongst these forest-dependent people to ensure their active engagement also.

10. Find creative solutions to enhance tenure security. The importance of secure forest tenure as a precondition for the effective local implementation of REDD+ and other financing instruments has received considerable emphasis throughout the years. Lack of land tenure is often profiled as a 'killer constraint' in the pathway towards SFM and its proper financing. However, although identified as one of the key areas requiring policy reform, land tenure clarity and security alone are not sufficient conditions to promote changes in land use in the absence of other incentives, investments in capacity and other conditions. When will the land tenure problem be resolved in practice? Whilst insistence on clear tenure is obvious and legitimate, there is also a need for creative solutions that will provide 'good enough tenure' for attracting investment. For example, some countries (e.g. Paraguay) are attempting to minimise the adverse effects of insecure tenure on forestry investments by passing legislation that separates ownership of the land from ownership of the trees. In Mexico, anticipating REDD+ financing and the need to resolve tenure uncertainties, a proposal to include a clause on carbon credit trading that reflects an agreed-upon protocol is being studied. Another option considered consists of the development of private contract schemes regulating rights and responsibilities of the parties related to carbon credits, based on simplified legal requirements.

11. Be strategic. When resources are limited, the discourse on supporting better governance, financing mechanisms design and implementation, public and private institutions, improved information management and market and enterprise development risks becomes a *wish list* with limited follow-through. In these cases, we have found it essential to resort to 'best practices' such as investments in stakeholders' capacity for partnership and outreach. In our experience, we have consistently found that cross-sectoral partnerships are better achieved if facilitated by agencies or individuals with undisputed credentials and strong connections outside the forestry sector. We have also found it important to be 'strategic'. For example, whether communities are better served through targeted interventions (e.g. direct support to the Alliance in Guatemala) or through broader support to the sector (e.g. by facilitating linkages between small producers and medium-sized and large producers, as in Paraguay) will depend on country circumstances and the relative strengths and weaknesses of the various forest stakeholders.

12. Bridge the gap: Promote innovation, knowledge sharing and information exchange beyond the forestry sector. Over and over again, we have been surprised by the limited knowledge the forestry and financial sectors have of each other. This knowledge gap is likely to adversely affect REDD+ projects and programmes in their design, development, validation and financing phases. On the other hand, we find that when this veil of mutual ignorance is lifted, (1) significant domestic financial resources become available to the forestry sector and (2) financial institutions can be formidable allies in devising innovative solutions to the problems of the forest-dependent poor. Forest stakeholders thus need to reach beyond their traditional networks and invest in better communication and collaboration with other sectors, public and private entities, civil society and political circles.

Box 3. An integrated approach to forest financing: Guatemala

Guatemala provides a good example of a country-driven effort to improve financing for small-scale forestry. Stakeholders are recognising that greater understanding and collaboration between the forestry and financial sectors have the potential to benefit both sectors and generate positive impacts in economic, social and environmental terms. They set in motion a set of initiatives in support of 4 key dimensions.

Governance. Small forest users, communities and indigenous groups have recognised that, as a group, they were disorganised, uninformed and poorly equipped to operate in the market for products and services. Their lack of coordination and a common vision also hindered their ability to influence forest policy decisions and the development of financing solutions appropriate to their needs. To address these weaknesses, the National Alliance of Community Forest Organisations of Guatemala (Alianza Nacional de Organizaciones Forestales Comunitarias de Guatemala) was created in 2009. It provides a forum for 11 second-level organisations and 400 grassroots organisations in Guatemala to find a common voice and influence decisions on the design of forest public funding programmes and the formulation of forest policy, and to engage with REDD+ readiness initiatives. It also provides them with an opportunity to identify key priorities for action and capacity-building needs with a broad basis of consensus. This level of coordination amongst indigenous groups and community forest organisations is unprecedented in Guatemala.

Financing mechanisms. Working together, forest and financing representatives have identified possible financing instruments with potential for development in the short to medium term: (1) microcredit; (2) 'factoring'; (3) repurchase agreements; and (4) securitisation of forest-based cash flows. Besides these private financing instruments, Guatemalan stakeholders are also evaluating public financing options.

Institutions. One of the critical bottlenecks in the development of financing instruments in Guatemala has been the availability of the economic-financial information needed to prepare 'bankable' projects, to properly estimate the value of forest assets and future forest earnings and to rigorously assess forestry investment risks and instruments to manage them. To address these bottlenecks, a Forest Finance Intelligence Unit (Unidad de Inteligencia Financiera Forestal) was appointed within the Forestry Agency (INAB). The unit is tasked with providing forest finance information and capacity-building opportunities for foresters and finance professionals and facilitating the development of pre-investment initiatives (business cases). The country is also evaluating options to operationalise a forest credit guarantee fund (Fondo de Garant'a Crediticia) that was created with the forestry law and capitalised with national funds but has not been used because of the lack of regulations.

Market chains and enterprise development. Ongoing initiatives include: characterisation of producer forest value chains with definition of financial profiles for small-, medium- and large-scale producers; and technical support of small-scale enterprises in terms of market and enterprise development.

References

Angelsen, A., Brockhaus, M., Kanninen, M., Sills, E., Sunderlin, W.D. and Wertz-Kanounnikoff, S. (eds.) 2009 Realising REDD+: national strategy and policy options. CIFOR, Bogor, Indonesia.

Food and Agriculture Organization of the United Nations (FAO). 2009 Financing sustainable forest management. Forestry Policy Brief. FAO, Rome. www.fao.org/forestry/16559-1-0.pdf (Accessed November 2010).

Van Dijk, K. and Savenije, H. 2009 Towards national financing strategies for sustainable forest management in Latin America: overview of the present situation and the experience in selected countries. Forestry Policy and Institutions Working Paper 21. Food and Agriculture Organization of the United Nations (FAO), Rome. http://www.tropenbos.org/images/Tropenbos/Topics/Forest-financing/sustainable_forest_management.pdf; ftp://ftp.fao.org/docrep/fao/011/k3276e/k3276e00.pdf (Accessed November 2010).

This summary was drawn from the following paper "Financing sustainable small-scale forestry issues and lessons from developing national forest financing strategies in Latin America", prepared for the Workshop on forest governance, decentralisation and REDD+ in Latin America and the Caribbean, Oaxaca, Mexico. 31 August – 3 Sept 2010. The workshop was a country-led initiative in support of the United Nations Forum on Forests (UNFF) (http://www.cifor.cgiar.org/Events/Oaxacalist/introduction.htm).
The full paper will be published in a special issue of Forests - an open access journal of forestry and forest ecology: http://www.mdpi.com/journal/forests.

TROPENBOS INTERNATIONAL

FIAT PANIS

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Swiss Confederation

Federal Office for the Environment FOEN

FORDFOUNDATION

www.cifor.cgiar.org www.ForestsClimateChange.org

Center for International Forestry Research
CIFOR advances human wellbeing, environmental conservation and equity by conducting research to inform policies and practices that affect forests in developing countries. CIFOR is one of 15 centres within the Consultative Group on International Agricultural Research (CGIAR). CIFOR's headquarters are in Bogor, Indonesia. It also has offices in Asia, Africa and South America.

CIFOR CGIAR