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Programme element II.a

Matters left pending and other issues arising from the programme elements of the Intergovernmental Panel on Forests process

The need for financial resources

Report of the Secretary-General

Summary

The forest sector in most developing countries has substantial needs of funding for sustainable forest management but is constrained by many factors. The present report briefly discusses some of the constraints and potential financial mechanisms to address them. It is recognized that the lack of reliable international database system on financial flows in the forest sector is an important constraint in guiding the international forest policy deliberation. Many developing countries with low forest cover need special consideration for funding, including mobilization of community resources and international mechanisms such as those of the Convention to Combat Desertification.

The Global Environment Facility is one major international source of public funding. However, although an important source, its scope to fund all aspects of sustainable forest management is limited. As regards an international forest fund, the existing highly decentralized and seemingly uncoordinated current system of financial cooperation contrasts with a single international fund system. There are many positive and negative aspects of

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both these systems that need to be weighed in assessing their relative merits. Given the importance of the private sector, an innovative investment promotion entity is proposed to draw upon public resources and leverage private support for all kinds of commercial and non-commercial sustainable forest management activities, including those in low forest cover countries.

Most of the conclusions and proposals for action of the Intergovernmental Panel on Forests are still valid and worth pursuing. In addition, countries and relevant organizations need to cooperate to maximize the effectiveness of existing resources, explore new sources and mechanisms (including those related to climate change and biodiversity), enhance institutional capacity of developing countries, improve financial flows databases and consider issues of international funds to support sustainable forest management. Section III provides detailed conclusions and proposals for action.

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I. Introduction

A. Mandate

1. Issues regarding financial resources lie at the heart of policy deliberations on the conservation, management and sustainable development of all types of forests. The Intergovernmental Panel on Forests (IPF) recognized that these issues are cross-sectoral and interlinked, and require a holistic approach at the national and international levels.

2. To build on the outcomes of IPF and make progress on outstanding issues of financial resources, the Intergovernmental Forum on Forests (IFF), at its first session, defined programme element II.a as follows:

> "Consider matters left pending on the need for financial resources. Consider urgently the following options for action, as contained in paragraph 68 of the report of IPF on its fourth session (E/CN.17/1997/12):
>
> (i) To urge the establishment of an international fund to support activities for sustainable forest management;
>
> (ii) To pursue action to enhance funding in other ways, *inter alia*, by inviting the United Nations Development Programme and the Bretton Woods institutions, together with other relevant international organizations, to explore innovative ways both to use existing financial mechanisms more effectively and to generate new and additional public and private financial resources at the domestic and international levels in order to support activities for the management, conservation and sustainable development of all types of forests" (see E/CN.17/IFF/1997/4, para. 7, category II (a)).

3. These issues received preliminary discussion at the second session of IFF (Geneva, 24 August–4 September 1998), where participants requested information on: (a) updated financial flow data related to forests; (b) a compilation of country experiences on new and innovative financial mechanisms; (c) a synthesis of evaluations of the effectiveness of existing international funds; (d) closer coordination and collaboration between the secretariats of IFF and the United Nations Framework Convention on Climate Change; and (e) identification of the special needs of developing countries with low forest cover. The present report aims to address these issues.

B. Overview of the Intergovernmental Panel on Forests process

4. Many of the conclusions and proposals for action of IPF at its fourth session remain valid and relevant. IPF called for more official development assistance (ODA) for forest programmes, and reaffirmed the need to fulfill the pledges of Agenda 21 on finance for sustainable development in general and sustainable forest management in particular. IPF also stressed the importance of policy reform, as outlined in the Forest Principles, as well as mobilization of domestic resources. Fully utilizing available forest rents to promote sustainable forest management, and providing incentives and regulation for the private sector to invest in sustainable forest management, were also emphasized by IPF.

5. The challenges ahead are twofold: first, fulfilling the commitments made at the United Nations Conference on Environment and Development (UNCED), and second, implementing the IPF proposals for action by all countries. In addition, there are still some very important finance issues on the IFF agenda, particularly concerning an international forest fund, and

they require serious analysis and deliberations. While focusing on new or unresolved issues on financial resources, it seems equally important to continue to focus attention on the implementation of the IPF conclusions and proposals of action.

C. Financing needs

6. IPF examined in considerable detail and agreed upon the substantial needs for finance for sustainable forest management. UNCED estimates for financing needs in all of its programme areas included about $31 billion annually for forests in developing countries for the period 1993–2000. Work during IPF placed this need to be closer to $70 billion, particularly to compensate losses of resource stocks from deforestation. It may be useful to compare this figure with that for international trade in forest products, which already exceeds $100 billion. By a wide margin, the use of most forest products is domestic. Activities that fall under sustainable forest management are highly variable, and reliable estimates can only be determined on a case-by-case basis. Recognizing that estimates are very imprecise and inherently difficult to verify, the present report does not assert any particular figure concerning financial needs. While it is widely recognized that such needs are substantial (measured in tens of billions of US dollars), debating the exact level may not necessarily lead to useful conclusions. However, the following overarching principles governing approaches to meet financial needs may be recalled:

(a) Meeting financial needs is by definition competitive;

(b) The private sector evaluates alternative investments;

(c) The public sector determines priorities for limited funding;

(d) Public and private financing are attracted and their levels are likely to increase when funds are used effectively and when the objectives of investment are achieved.

7. The above considerations have a profound influence on meeting financial needs for sustainable forest management.

II. Major issues of forest financing

A. General issues of forest financing

8. There are fundamental issues that restrain private investment in sustainable forest management, and they are related to characteristics of markets and policies that are special if not unique to forests and forestry. This discussion is closely related to and complements that on valuation of forest goods and services (see E/CN.17/IFF/1999/12) and economic instruments (see E/CN.17/IFF/1999/13) in other reports before the forum at its third session.

9. *Market failure* occurs due to absent, distorted or malfunctioning markets in which forest goods and services are undervalued or not valued at all and are treated as free goods. Major sources of market failure include: (a) externalities in which the effect of an action on another party is not taken into consideration by the perpetrator; (b) missing markets for environmental services and other open-access public goods; and (c) monopsonic (near-monopoly) competition. These factors often lead to a wide divergence between the interests of the forest owner and the overall interests of society, as well as to unsustainable practices.

10. *Policy failure* occurs both when the State fails to take action to correct market failures and when policies are implemented which further distort prices and cause disincentives for

sustainable forest management. These can either be sectoral policies or policies from other sectors, including macroeconomic policies. Policy failure particularly affects property rights; when property rights are weak or unclear, the incentives for forest users are distorted and tend to encourage resource degradation. Impacts of policies of sectors other than the forest sector are often unpredictable and frequently perverse. The impacts of macroeconomic policies increase the complexities involved in finding an optimum mix from the viewpoint of sustainable development.

11. Forestry has a number of other characteristics which make financing of investment more complex than in most other sectors, including: (a) long rotation periods (from six to more than 100 years), which represent a source of risk and uncertainties; (b) uneven distribution of benefits and costs over time since initial investment outlays can be large (typically in afforestation and reforestation), annual management costs relatively small, while most of the revenue (if not all) occurs at the end of the rotation period; and (c) the various rights to use the forest resources (customary and formal) may be poorly defined or in conflict with each other, which influences the rights of forest-dwelling people and also makes investment a complicated and risky exercise.

12. These characteristics make forestry quite different from other land uses, particularly agriculture, where similar problems of long-term financing are not encountered, and where the link between investor and beneficiary is direct and non-market benefits play a limited role.

13. Thus, problem of financing sustainable forest management is not so much a matter of flows or instruments per se, but:

(a) How current flows can be directed from unsustainable to sustainable forestry;

(b) How the necessary preconditions for investment can be met, reflecting the different time preferences of investors and society related to various forest-based benefits.

B. Issues identified within the Intergovernmental Panel on Forests process

1. Data and trends for financial flows

14. Concerning international cooperation on forest programmes, databases exist in virtually every bilateral and multilateral organization involved with forests. However, the available data are inconsistent, and there are often wide annual fluctuations which seem to reflect reporting anomalies rather than actual changes. As requested by IFF at its second session, the IFF secretariat and the United Nations Development Programme (UNDP) made a necessarily rapid attempt to gather and synthesize as much information on this topic as possible. Many organizations and Governments cooperated in this task. The results, which are contained in table 1, are discussed below.

15. The data in table 1 are the result of considerable effort and research, but they should be approached with caution. The margin of error on the totals might be as much as plus or minus 20 per cent due to a number of reasons. There are other concerns which need consideration. For example, countries often report on ODA commitments but not disbursements; data on total ODA give an incomplete picture without information on what kinds of financial assistance were extended, how and where; and it is not clear how ODA is being allocated between countries with low forest cover and forest-rich countries, or between conservation and development.

16. The data indicate that ODA to forest programmes increased substantially (more than doubled) from the late 1980s until UNCED. The overall level then appears to have declined to the current level of about $1.3 billion. Funding by multilateral development banks plays

an important role, both in the peak period around 1992 as well as in the current period of decline. The funding of United Nations programmes has remained almost at the same level throughout the period. Bilateral funding also peaked in about 1992 but has remained close to those levels, particularly that of European Union countries.

17. IPF and IFF have often stressed an integrated cross-sectoral approach to forest programmes and their funding. Virtually all organizations report funding of many forest-related activities within integrated programmes. Whereas this can be seen as a positive development, an appropriate methodology has yet to be developed for reporting on this type of integrated funding in a way that will also allow disaggregation. This development could possibly indicate a systematic underreporting of international cooperation related to forests. Country studies would seem the best avenue to explore these questions.

18. Concerning private-sector capital flows to forestry, there are no comprehensive figures for global flows or flows to developing countries. It is known that overall international private investment in developing countries has increased from less than $50 billion in 1990 to about $250 billion in 1997 and has since declined. While it is not unreasonable to assume that forest investment has followed a similar pattern, no concrete data or information is available. It is also not known how much private capital is invested in what an authoritative body would describe as sustainable forest management. On the other hand, there seem to be abundant examples of investment in unsustainable practices.

19. The data on budget allocations for the forest sector from domestic public sources are equally complex and difficult to collect and aggregate worldwide.

20. The IFF secretariat and its cooperators would propose the need to undertake country-level studies on financial flows to reveal more information; however, such studies could not be carried out before the third session of IFF.

21. IFF did not request information on financing flows through private non-profit organizations. Some recent publications indicate that these flows are substantial, which would also mean that there is underreporting of overall flows.

22. It is not useful to gather information that would merely be interesting. The challenge lies in gathering more complete and reliable data to guide the international policy dialogue, as well as to assess the situation realistically.

2. Global Environment Facility

23. As requested by IFF at its second session, evaluations of the Global Environment Facility (GEF) were reviewed in context of the proposal to establish an international forest fund. GEF is the financial mechanism serving the Convention on Biological Diversity and the United Nations Framework Convention on Climate Change. It funds the incremental costs of activities that benefit the global environment. Activities concerning land degradation, primarily desertification and deforestation, are eligible for funding provided that they contribute to the focal areas of GEF. GEF received $2 billion in its core-fund in 1994, and another $2.75 billion was pledged for replenishment in 1998 for the period 1998–2002.

24. “Forest ecosystems” has remained the largest operational programme of GEF; it had received $311 million by the end of June 1998, accounting for 16 per cent of total GEF allocations. The annual resource allocation for this programme is currently about $60 million. In addition to that programme, GEF is supporting forest-related projects or components under other operational programmes, such as the mountain or arid ecosystems programmes.

Key issues related to Global Environment Facility funding of sustainable forest management

25. The GEF projects are aimed to protect globally significant biodiversity in forest ecosystems. The current GEF strategy to achieve this objective focuses mainly on the creation and strengthening of protected areas. This focus, although important, does not address the issue of sustainable forest management in developing countries in a comprehensive way. The GEF strategy does not allow it to finance sustainable timber harvesting in forests. However, it can finance other sustainable uses of forests. An analysis of 50 forest-related projects concluded that less than 5 per cent of total GEF funding to date has supported productive sustainable forest management activities.

26. GEF forest project documents do not usually make a reference to existing national forest programmes, indicating a need to foster synergy between GEF and national forest programmes through effective coordination at the national level.

27. The incremental cost concept, which is central in assessing project eligibility, depends on disaggregating the costs of achieving global environmental objectives over and above the costs of national sustainable development. The application of this concept can be difficult within sustainable forest management, where multiple objectives, as well as costs and benefits, are integrated in a holistic approach.

28. Initially, GEF was conceived as a financing mechanism primarily for public sector projects, without much emphasis on the private sector. However, there are now, several GEF trust funds that can finance or are specifically targeted to support private-sector projects. One such $20 million fund, managed through the International Finance Corporation (IFC), promotes small and medium-sized enterprises involved in biodiversity and climate change mitigation by covering the increased risks of pursuing these innovative commercial ventures.

Potential for Global Environment Facility funding of sustainable forest management-related projects

29. Background studies for the present report concluded that in its current form, the GEF potential for financing productive sustainable forest management-related projects outside protected areas remains quite limited. If sustainable forest management were to be adequately addressed at the national and global levels, GEF would need to broaden its scope and increase the involvement of the private sector. This in turn might contradict some of the fundamental precepts of GEF. In any case, GEF is and will continue to be an important financing mechanism for forest conservation (which is an integral part of sustainable forest management). It is currently an important but not adequate mechanism for solving the complex problems of deforestation, forest degradation and the sustainable development of forest-dependent communities.

3. Using existing financial mechanisms more effectively

30. IPF recognized that utilizing available mechanisms and resources more effectively is just as important as creating new and additional resources for the forest sector to promote sustainable forest management. Efforts to improve efficiency and effectiveness apply to all financial sources and mechanisms.

31. The question of using existing mechanisms more effectively has two major aspects: increased resource mobilization through existing mechanisms, and more effective use of those resources. The assessment of effectiveness should be based on the progress made to achieve sustainable forest management at national level, which presumes that sustainable forest management has been adopted by the Government as a key policy goal. More effective use of all financial resources also depends strongly on conditions which extend far beyond the forest sector, such as a well trained and equitably remunerated civil service, a stable security

environment and intolerance of corruption. All countries have committed themselves to these goals, and they are essential for effective use of resources for sustainable forest management.

32. In terms of the mobilization of domestic resource, strategies should address both increasing public resources to forests and creating a more favourable investment climate for private sources, domestic as well as international. In the case of domestic public sources, the major goals are to increase revenues from forest products and services, and to ensure necessary reinvestment for sustainable forest management.

33. The prices of forest products from government-owned forests have tended to be lower than the market could pay in many countries; consequently, fiscal revenue has been and continue to be lost. Many services of forests are often not priced. Charging what the market can pay for forest products and services has two major benefits: it can increase public revenue, and it can induce less wasteful and profligate use of forest resources. However, the actual situations are often not so simple. While the above pertains to publicly owned forests, government decisions affect private-sector markets as well as pricing. Secure and well-defined land tenure emerges as a major concern regarding privately owned forests.

34. Governments can influence the level of private-sector investment in sustainable forest management through monetary, fiscal and debt-management policies. Government efforts need to specifically address inherent barriers to invest in sustainable forest management, such as: (a) reducing investment risks and uncertainties; (b) reducing cash-flow problems associated with the long-rotation forestry activities; and (c) improving the access of the private sector to credit and technical forestry support. There are many successful examples of such instruments. An overwhelming message from private investors interested in sustainable forest management is that they require stability and reliability of rules and conditions governing investment.

35. ODA received considerable scrutiny and analysis by IPF. ODA typically supports environmental conservation, social development, infrastructure, capacity-building and technical assistance. More recently, there is growing interest in supporting the internalization of global externalities. About 20 donor countries and 13 multilateral agencies are involved in ODA, and their priorities and strategies for cooperation may not always match those of recipient countries. This situation underscores the significance of formulating country-driven national forest programmes and using such programmes as the basis for international cooperation.

36. Within IPF and other forums, there seemed to be a fairly clear agreement, in principle, that international cooperation should support national forest programmes in developing countries through a programmatic approach. Currently, a somewhat scattered project approach still prevails in most situations, but new approaches are being pursued and developed in some countries. In summary, coordination and partnerships are still the key to improving the effectiveness of ODA. This is not a new concept, but its implementation can be greatly improved and expanded. International public resources can also be mobilized to address specific targets, as illustrated by the International Tropical Timber Organization (ITTO) Bali Partnership Fund (see box 1).

Box 1
ITTO Bali Partnership Fund

The Fund was established by ITTO in 1994 to fund activities that enhance the capacity of member countries to implement a strategy for achieving exports of timber and timber products from sustainably managed forests by the year 2000 (also known as the ITTO Year 2000 Objective). Activities include supporting special needs of member countries whose forest-sector contribution to national economies is adversely affected by the implementation of the ITTO Year 2000 Objective, necessary policy reforms and implementation, capacity-building, extension, research etc. The Fund, which depends on voluntary contributions and earmarked earnings of the ITTO Special Account, is expected to be functional in 1999.

4. Innovative ways to generate new and additional financial resources

37. Innovative financing mechanisms tend to fall into two categories: they are either designed to remove some barriers to investment in sustainable forest management, or they are financial vehicles used in other sectors and then adopted to sustainable forest management. Innovative financing mechanisms are often designed to address the problem of environmental externalities. Eighteen innovative mechanisms, with their typology, potential and purpose, are listed in table 2. This area is evidently too complex and detailed to be thoroughly reviewed in the present report. Some of the more important concepts summarized below are based on background studies on this topic undertaken to review these mechanisms thoroughly (see also box 2).

Box 2
An example of private sector forest finance from the United States of America: institutional ownership of timberland

Institutional investors, such as pension funds, insurance companies, banks, universities and other endowments, and foundations own more that 1 million hectares of timberlands in the United States, the market values of which exceeds $2.7 billion. These institutions have found investing in timberlands attractive because long-term returns were higher than average returns on stocks and bonds, their overall risk was diversified and business cycle fluctuations tended to be dampened. There may be a significant opportunity to interest large institutional investors in long-term sustainable returns and therefore sustainable forest management, not only in the United States but worldwide.

38. *National environmental funds* have been established in a number of developing countries. Such commercial environment-oriented capital could have significant potential for sustainable forest management financing, but mainly for conservation.

39. *Public-private partnerships in various forms* can play a useful role by combining private sector efficiency with public interests in sustainable forest management operations. Examples are numerous in other sectors and need to be further developed in forestry.

40. *Micro-credits and small targeted grants* promote the mobilization of households and community resources to establish agroforestry, community forests and small-to-medium-scale forest-based enterprises in many developing countries. The Grameen Bank of Bangladesh and the Project Reference Regional Forestry Programme for Central America are some examples of such mechanisms. GEF has piloted this concept for its objectives, and this could also be developed for sustainable forest mange.

41. *National forest funds* are special public funds set up to finance specific activities for forest development. Many funds are financed from a percentage of forest levies or taxes. NFFs are operational in most Latin American countries, as well as in Indonesia, British Columbia, Canada and many states in the United States. The attraction is that public expenditures on sustainable forest management could be largely auto-financing. The criticism is that earmarking tax receipts for sustainable forest management may constrain efficient public resource allocation.

42. *Environmental service charges* are paid by beneficiaries for the range of services provided by forests, particularly fees for water from forests. Many countries, including Japan, Costa Rica, Colombia and the United States (e.g., in New York City,) transfer part of the revenues generated from water supply and hydropower generation to finance forest management programmes in the watersheds. Costa Rica has also extended the concept to raising revenues from energy taxes and compensating private landowners for conserving and managing forests on their lands.

43. *Debt-for-nature swaps*, perhaps the oldest innovative financing mechanism in forestry operations, have retired $159 million in face value of debt so far. The United States recently enacted the Tropical Forestry Conservation Act, 1998 which allows qualifying developing countries to restructure their debts to the United States in exchange for actions to save their tropical forests.

44. *Forest-based carbon offsets.* The Kyoto Protocol of the United Nations Framework Convention on Climate Change has opened up two new venues for mobilizing new and additional resources which could have significant implications for forest finance. First, it created carbon-trading options among countries under the clean development mechanism, whereby industrialized countries can meet their emission reduction obligations through carbon-offset projects in developing countries. Second, industrialized countries may use forestry and land-use change activities as strategies to meet greenhouse gas reduction obligations. The global demand for carbon credits is likely to reach billions of dollars per year once the necessary trading mechanisms are in place. Many technical, legal and institutional issues remain to be resolved before this becomes an operational mechanism. The issue of whether forests and land use projects can be funded by clean development mechanism is still under discussion.

45. *Biodiversity patents or bioprospecting fees* involve creating an international legal basis for licensing biodiversity use and extracting a payment commensurate with its economic value. The Costa Rica-Merck Industry agreement was the first such example; Brazil is starting a programme for cooperative research on the biochemistry of tropical forests and for product licensing. Some of the critical issues associated with these mechanisms are related to intellectual property rights and enforcement, biodiversity valuation (i.e., society's willingness to pay), synthetic techniques to produce biochemical molecules, and benefit-sharing.

5. Needs of developing countries with low forest cover

46. A relatively small number of large countries contain most of the world's forests However, forest policies and programmes are equally if not more important for many of the

countries (at least 50) that have most of the remaining area of the world's forest cover. There are a few prosperous countries with low forest cover, but many of the poorest countries possess very limited forests. In these countries, forests and other wooded lands are an integral part of the society's fabric, and provide basic subsistence needs of people living in and around forests.

47. The general principles described in the present report in paragraph 5 above also apply to low forest cover countries. However, there are special situations and needs that should be recognized. In many countries, almost all of which are developing countries, forest cover is shrinking and forest resource stocks are declining. A number of countries (as many as 30) have lost almost all of their forests and more and more developing countries are being classified in the low forest cover group.

48. These low forest countries are in a special and often difficult situation because many of their poor people depend on forest resources for survival. Also, these countries do not have the option, enjoyed by some forest-rich countries, to utilize forest resources as an engine of sustainable development, nor do they have the funds to buy products from other countries.

49. In some countries where the supply of forest products has been sharply reduced, farmers have responded by investing in forest production for their own needs and for profit. Where trees have become scarce and demand for forest products is high (this latter is the case where populations of poor people are found), then community-based fuelwood production is often feasible and profitable.

50. There are three crucial aspects for consideration in national strategies. First, scientific and technical aspects could be considered that are aimed at tree plantations and regeneration in degraded ecosystems rehabilitation. Second, financial aspects, recognizing that it is very difficult to rely on mobilizing domestic financial resources in very poor and populous countries where natural resources are degraded, and international cooperation will need to play a very key role. Finally, community participation and integrated approaches are essential.

51. The Convention to Combat Desertification has worked in depth on issues of participatory natural resource management in arid and semi-arid ecosystems. This work is very closely related to programmes required in countries with low forest cover, and should be fully incorporated into integrated programmes. Future work of the Convention on finance should also be the basis for financial proposals for low forest cover countries.

6. Possible new financial mechanisms

52. An *international forest fund*, to create a new mechanism to generate resources was proposed by many delegates to the first and second sessions at IFF. The establishment of an international forest fund is mainly a policy question subject to intergovernmental deliberations in the context of the following considerations:

(a) IPF and IFF reaffirmed the need to fulfil the pledges of Agenda 21 and other UNCED agreements on finance for sustainable development in general and sustainable forest management in particular;

(b) IPF made considerable progress on many aspects of the complex issues related to finance, by suggesting national forest programmes as the frameworks to organize policy reform and improvement and to coordinate and generate comprehensive support from domestic and external sources;

(c) Overall, ODA has not increased in recent years, and it has become clear that increases are generally influenced by public opinion and political priorities in developed countries. The question may be posed whether an international forest fund would increase the overall flows. In the absence of any overall increase, it would seem that any new fund would tend to decrease allocations to other programmes, unless sources other than ODA support such a fund;

(d) Developing countries have found it difficult and cumbersome to manage ODA, which flows through about 30 different channels. However, this is not a situation which is confined to forestry programmes only. Furthermore, it could be argued that each new channel or organization increases the flows;

(e) While an international forest fund could provide more coherent governance and organization for available funding to achieve greater impact, current dispersed governance arrangements may actually be more effective mechanism;

(f) There are many issues concerning governance and management of a fund that require further study and careful consideration; funding mechanisms for the Convention on Biological Diversity, the United Nations Framework Convention on Climate Change and the Convention to Combat Desertification offer an example of established models. An arrangement such as the Inter-Agency Task Force on Forests seems to be unique to forestry cooperation; its effective role is now well known and could be taken into account in any governance or management situation.

53. Private-sector funding is discussed below. However, it should be recognized that the future funding challenge is not only related to private investments but also to investment required to ensure sustainable management of forests not used for wood production. This relates to the complex question of international and national transfers to internalize positive externalities by supporting forest-based sustainable livelihoods of the rural poor. Along with productive sustainable forest management, this is a key to slowing deforestation, and would require public-sector finance.

54. Whatever the outcome on public funding arrangements, the essential role of the private sector in the productive, entrepreneurial aspects of sustainable forest management needs to be recognized, reinforced and promoted. Mobilizing private-sector resources has thus been identified as a key component of a global sustainable forest management financing strategy. To accomplish such mobilization, many of the barriers to investment in sustainable forest management activities and operations must be removed or mitigated. Public-sector financing, both as bilateral and multilateral ODA and from domestic sources, can play an essential catalytic role in this process of barrier removal. A possible model for such a role is described here in the form of an *investment promotion entity*. Such an entity would be specifically charged with using public-sector resources to leverage private-sector financing for sustainable forest management investments. Its operations would be primarily at the global level.

55. The word entity is intentionally used as neutral term. It should not be interpreted as corresponding to any particular structure, size, scope etc. Also, the entity is explicitly designed not to play a major role in direct investments of its financial resources at the project level through grants, lending facilities, incremental cost support (e.g., GEF) or any other means. It should not, therefore, be regarded as a sustainable forest management fund in the traditional sense of the word.

56. The form and structure of this entity are less important than its functions, which are best considered on their own merits and in their own right, and where appropriate, integrated into existing institutional remits.

57. The defining objectives of the proposed entity would be to mobilize and facilitate financial flows to sustainable forest management activities in developing countries. This would be accomplished by capitalizing on existing and potential public and private-sector financial

resources, primarily at the global level, with a specific view to leveraging higher levels of private sector finance.

58. To this end, the entity would carry out activities akin to innovative investment banking, using a suite of existing and new innovative financial mechanisms designed to promote investment into sustainable forest management. In addition, the entity would aim to redirect private-sector resources currently flowing into non-sustainable forestry activities by facilitating access to information and technical assistance, and by promoting the development of necessary financial and regulatory structures.

59. Inherent to this private sector-oriented role is the need for the entity to be as slim, streamlined and efficient as possible, in order to deal with the pace and demands of private-sector investors and forest operators, and to avoid large overhead costs.

60. The entity's core activity would be centred on investment packaging and structuring of financial deals for sustainable forest management operators, primarily in the private sector. In support of this core activity, the entity would provide information related to a wide range of sustainable forest management investment parameters, and identify and promote sustainable forest management investment opportunities. The entity's other main activity would be in providing streamlined access to risk mitigation services and facilities.

61. In addition, there is potential scope for the entity to play a contributing role in ongoing structural reforms in the forestry sector at the international level, and at the national level through partner institutions such as Task Force members.

62. The entity would require its own initial funding to set up the necessary informational infrastructure and provide working capital to initiate operations. However, it should be self-financing in subsequent years by charging appropriate investment facilitation fees for the service it provides to its clients. The entity could be an independent body or attached to existing financial institution(s).

III. Preliminary conclusions and proposals for action

A. Conclusions

63. The need for financial resources to support sustainable forest management in developing countries is substantial, but the supply of resources is limited. Thus, the forest sector requires a multi-pronged approach to remain aggressively competitive in increasing financial resources from all sources, as well as in increasing efficiency and effectiveness of available resources and mechanisms. There are elements of sustainable forest management that clearly require financial arrangements related to the private sector, while others require increased public funding.

64. The private sector could and should play a significant role in filling the resource gap in forestry. Public sectors, both national and international, should make every effort to make private-sector investment in sustainable forestry that is secure and commercially viable. For this, a stable and transparent social, economic and political environment will remain an important precondition.

65. Recent developments under the United Nations Framework Convention on Climate Change offer new potential opportunities for forest financing, which call for collaborative research and policy dialogue between IFF and the Convention.

66. GEF has been instrumental in financing many forest-related projects, which have global benefits. However, in its current form, the potential for financing productive sustainable forest management-related projects outside protected areas remains limited.

67. The establishment of an international forest fund is a political question. If proved to be politically feasible, careful consideration should be given to its conceptual foundation, practical implications and legal framework, including such issues as the institutional structure, revenue sources and magnitude, as well as funding criteria. Evaluations of GEF have indicated that an international fund can be effective if based on a formal legal instrument.

68. Within their current frameworks, international arrangements and funds have limitations to address all the essential elements of sustainable forest management. Because it is apparent that public funds will not be available in the required magnitude, and because it is clear that private-sector funding has a very important role to play in sustainable forest management, an investment promotion entity is proposed for discussion. It is designed as a flexible, self-sustaining and market-based agency to facilitate investment in sustainable forest management. It could coordinate and capitalize existing sources and mechanisms to promote the mobilization of resources for sustainable forest management.

69. Lack of reliable data on financial flows is a serious limitation to understanding the nature of the issues and the achievements made by different countries towards sustainable forest management.

70. The financial needs of developing countries with low forest cover require special consideration, balancing their genuine need for forest products and services with ecological, technical, financial and social feasibility.

B. Proposals for action

71. To support enhanced financing in activities related to sustainable forest management, the IPF made several proposals for action which are still valid (see E/CN.17/1997/12). Therefore, the Forum may wish to reaffirm those proposals, and to urge all countries and relevant organizations to seriously engage in their implementation. The IPF proposals for actions to support developing countries included:

(a) More coordinated and collaborative actions among developed and developing countries, multilateral organizations and private sectors;

(b) Increased financial resources through all sources, including ODA;

(c) Enhancing the absorptive capacity of developing countries;

(d) Reforming economic, forest and financial policies to increase forest revenues, reduce perverse subsidies and promote private-sector investment in sustainable forest management;

(e) Increasing concessional lending;

(f) Resolving developing country debt problems;

(g) Encouraging private-sector investments, including local communities, in sustainable forest management activities, through various economic and financial incentives.

72. In addition to reaffirming the IPF proposals for action, the Forum may wish to:

(a) Urge developed countries and relevant organizations to review their international assistance in forestry to improve institutional capacities of developing countries, to base their assistance on the priorities identified in the national forest programmes of recipient countries, to increase effectiveness of available resources, and to increase their ODA contributions;

(b) Urge countries and relevant organizations to explore the role of forests in (i) mitigating of greenhouse gas emission and related possibilities for financing sustainable forest management, and (ii) providing biodiversity and other environmental services of forests as a means of financing sustainable forest management;

(c) Urge countries and relevant organizations to help developing countries identify and further develop innovative financial mechanisms, and share experiences and information on such mechanisms to increase financing for sustainable forest management;

(d) Urge countries to undertake programmes and projects aimed at the mobilization of resources from community and rural households for sustainable forestry as a means for income generation and rural development;

(e) Urge countries and relevant organizations to undertake activities for systematic collection and analysis of financial flows data in the forest sector in order to make reliable, updated information available;

(f) Urge countries and relevant organizations to improve the effectiveness of existing mechanisms (including GEF) for financing a wide range of sustainable forest management activities;

(g) Urge countries to consider different modalities of a global mechanism to generate and allocate sustained financial resources for the sustainable management of forest resources. This may also require concomitant discussion of a new international arrangement (or institution) dealing with the conservation, management and sustainable development of all types of forests. The proposed investment promotion entity concept is one possible element of such an arrangement. The Forum may wish to specify any preparatory studies it wishes the Inter-Agency Task Force on Forests to carry out in this context.

Table 1
Estimated official development assistance in the forest programmes: commitments in nominal United States dollars

(Millions of United States dollars)

	1986	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*[a]
Bilateral											
European Union[b]	247	320	394	446	514	557	566	466	491	520	469
Non-EU countries[c]	182	275	367	269	366	461	364	333	270	447	511
Total	**429**	**595**	**761**	**715**	**881**	**1 017**	**930**	**799**	**761**	**967**	**980**
Multilateral											
Multilateral development banks[d]	170	196	367	313	766	430	869	279	782	173	148
United Nations agencies[e]	186	187	194	201	204	212	209	197	241	230	220
Total	**356**	**383**	**561**	**514**	**971**	**642**	**1 077**	**476**	**1 023**	**403**	**368**
All donors (estimate)	784	978	1 322	1 229	1 851	1 659	2 007	1 275	1 783	1 370	1 349
FAO questionnaire data	765		1 115		1 425			1 545			

[a] The 1996 estimate is less reliable.

[b] Including the European Commission and the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden and the United Kingdom (no data available on Greece and Luxembourg).

[c] Australia, Canada, Japan, New Zealand, Norway, Switzerland and the United States of America.

[d] African Development Bank, Asian Development Bank, Inter-American Development Bank and World Bank.

[e] FAO, GEF, ILO, ITTO, UNDP, UNEP, UNESCO, UNIDO, UNSO and WFP.

Table 2
Applicability and funding potential of innovative financing mechanisms for sustainable forest management

		Categories of sustainable forest management activities			
Innovative mechanism	*Funding potential*	*Production*	*Conservation*	*Plantation*	*Product industries*
A. Direct commercial financing mechanisms					
Portfolio equity instruments	medium	yes	possibly	yes	yes
Public-private instruments	high	yes	yes	yes	yes
Private-sector forestry investment funds	medium	yes	unlikely	yes	yes
B. Direct concessionary financing mechanisms					
National environmental funds	high	possibly	yes	unlikely	possibly
Debt-for-nature swaps	high	unlikely	yes	possibly	no
Conservation trust funds	low	no	yes	no	unlikely
Biodiversity venture capital funds	medium	unlikely	yes	no	possibly
Small and medium-scale enterprise credit lines	high	yes	yes	unlikely	possibly
Micro-credit	medium	yes	possibly	yes	yes
Small targeted grants	low	possibly	yes	unlikely	possibly
C. Market development mechanisms					
Forestry-based carbon offsets	high	yes	yes	yes	unlikely
Bioprospecting fees	low	unlikely	yes	no	possibly
Water resource use charges	medium	yes	yes	yes	no
Tradable development rights	low	possibly	yes	unlikely	no
Marketable forest protection and management obligations	medium	yes	yes	no	no
D. Structural mechanisms					
Fiscal instruments	high	yes	yes	yes	yes
National forest funds	medium	yes	possibly	yes	unlikely
Environmental performance bonds	medium	yes	unlikely	yes	unlikely