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Financing for sustainable forest management: mobilizing financial resources to support the implementation of the non-legally binding instrument on all types of forests and to promote sustainable forest management

Note by the Secretariat

Summary

The present note has been prepared to facilitate the work of the open-ended Ad Hoc Expert Group to Develop Proposals for the Development of a Voluntary Global Financial Mechanism/Portfolio Approach/Forest Financing Framework to support the implementation of sustainable forest management, the achievement of the global objectives on forests and the implementation of the non-legally binding instrument on all types of forests (hereafter referred to as the instrument). The critical importance of finance within the instrument is evident from its integration as one of the four global objectives on forests.

Forests provide a multiplicity of benefits to society. Alarming rates of deforestation and forest degradation are cause for serious concern and challenge in the global effort to make progress towards sustainable forest management. In the current market and policy environment, sustainable forest management is often still less profitable than adopting unsustainable practices. The United Nations Forum on Forests has recognized that substantial financial resources are needed to address these challenges. Current financial flows in the forest sector from domestic and external, public and private sources are significant, but not sufficient. Sources of funding to support sustainable forest management are fragmented and rarely cover the full breadth of sustainable forest management activities.

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The note intends to provide a brief overview of the main driving forces working for and against sustainable forest management and to map out the main financial sources available for forests and forestry.

Section VI contains a brief discussion of the three financing concepts referred to in Economic and Social Council resolution 2007/40, the voluntary global financial mechanism, the portfolio approach and forest financing framework.

In section VII, the note provides some components and issues for consideration by the Expert Group in developing proposals, to be submitted to the United Nations Forum on Forests at its eighth session, to be held from 20 April to 1 May 2009.

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I. Introduction

1. The seventh session of the United Nations Forum on Forests, held in April 2007, agreed on a non-legally binding instrument on all types of forests (hereafter referred to as the instrument) and adopted the Forum's new multi-year programme of work. The Economic and Social Council, in its resolution 2007/40 transmitting the instrument to the General Assembly for approval, also decided to develop and consider, with a view to adopting at the eighth session of the Forum, a voluntary global financial mechanism/portfolio approach/forest financing framework for all types of forests, aiming at mobilizing significantly increased, new and additional resources from all sources, based on existing and emerging innovative approaches, also taking into account assessments and reviews of current financial mechanisms, to support the implementation of sustainable forest management, the achievement of the global objectives on forests and the implementation of the non-legally binding instrument on all types of forests; and that the Forum should, within existing resources, convene before its eighth session an open-ended ad hoc expert group meeting to develop proposals for the development of a voluntary global financial mechanism/portfolio approach/forest financing framework, and invited the Collaborative Partnership on Forests to assist in the development of those proposals.

2. In the instrument, adopted by the General Assembly in December 2007, Member States reaffirmed four shared global objectives on forests and their commitment to work globally, regionally and nationally to make progress towards their achievement by 2015. The global objectives are:

1. Reverse the loss of forest cover worldwide through sustainable forest management, including protection, restoration, afforestation and reforestation, and increase efforts to prevent forest degradation;

2. Enhance forest-based economic, social and environmental benefits, including by improving the livelihoods of forest dependent people;

3. Increase significantly the area of protected forests worldwide and other areas of sustainably managed forests, as well as the proportion of forest products from sustainably managed forests;

4. Reverse the decline in official development assistance for sustainable forest management and mobilize significantly increased new and additional financial resources from all sources for the implementation of sustainable forest management.

3. The fourth objective specifically addresses the issue of financial resources. In this context, according to the multi-year programme of work, the eighth session of the Forum (20 April-1 May 2009) will consider means of implementation as a separate agenda item, under which it will consider a decision on a voluntary global funding mechanism/portfolio approach/forest financing framework for sustainable forest management. It is clear from previous negotiations that the finance issue is central to the effective implementation of the instrument and follow-up to the past decisions of the Intergovernmental Panel on Forests, Intergovernmental Forum on Forests and of the Forum itself.

4. Forests provide a multiplicity of benefits that will only continue if forests are managed sustainably and deforestation trends are reversed. Previous Forum deliberations have rightly noted how some forest benefits accrue principally to local

communities, some to a nation or a region as a whole, and some to the entire planet. The global forest situation has now become more serious than at any other time in history, because biological diversity, climate stability and a host of other forest values are threatened by forest destruction and other human activities.

5. The present note has been prepared to facilitate the discussions at the Ad Hoc Expert Group meeting in order to develop proposals for the development of a voluntary global financial mechanism/portfolio approach/forest financing framework, for consideration by the eighth session of the Forum. It is organized in the following manner: section II provides an overview of the instrument and major forest and finance issues; section III briefly considers the role of the private sector; section IV reviews existing and recent international financial cooperation; section V describes some emerging programmes; section VI discusses the terms "global financial mechanism/portfolio approach/forest financing framework"; and section VII concludes with issues for consideration.

II. Background

A. The non-legally binding instrument on all types of forests

6. The instrument provides for a broad set of actions by Member States to achieve the global objectives on forests and sustainable forest management. They comprise 25 national policies and measures and 19 international cooperation measures. The critical importance placed by the instrument on finance is evident from the fact that it forms one of the four global objectives on forests; in addition, the instrument calls upon countries and the international community to undertake the following actions in the finance arena to achieve the instrument's objectives:

(a) Create enabling environments to encourage investment by multiple stakeholders, including the private sector and local and indigenous communities;

(b) Develop strategies to outline short, medium and long-term financial planning for achieving sustainable forest management;

(c) Establish and strengthen partnerships and joint programmes for implementing sustainable forest management;

(d) Mobilize and provide significantly increased new and additional financial resources from all sources;

(e) Reverse the decline in official development assistance for sustainable forest management;

(f) Develop and establish positive incentives to reduce the loss of forests, to promote reforestation, afforestation, and rehabilitation, to implement sustainable forest management and to increase the area of protected forests and other areas of sustainably managed forests;

(g) Support countries to develop and implement economically, socially and environmentally sound measures that act as incentives for sustainable forest management.

7. In response to the invitation in Economic and Social Council resolution 2007/40, the Collaborative Partnership on Forests has formed an Advisory Group on

Finance to support the Expert Group meeting. The Advisory Group is conducting an analysis of the funding sources, potential newly evolving sources and gaps in relation to the measures of the instrument. At the time of submission of the present note for official processing, the analytical work was still ongoing. While some of the preliminary findings are used in this note, the full analysis will be presented during the Expert Group meeting.

B. Forests and finance

8. Sustainable management of all types of forests has long been the goal of the global community, but the current situation is neither satisfactory nor a cause for complacency. Out of 3.95 billion hectares of forest worldwide in 2005,[1] more than half, 2.1 billion hectares, are in developing countries, and 0.9 billion are in countries with economies in transition. Total deforestation[2] during 2000-2005 was 13 million hectares per year. At the same time, there have been significant increases in planted forests and natural expansion of forests, which have significantly reduced the net loss of forest area to about 7.3 million hectares for the 2000-2005 period. Virtually all deforestation occurs in tropical forests in developing countries.

9. It is not known exactly how much forest is sustainably managed. According to a 2006 study by the International Tropical Timber Organization (ITTO),[3] an estimated 36 million hectares were sustainably managed within the 900 million hectares of forest in its 33 producer member countries. This indicates a significant improvement over the estimate, in 1988, of one million hectares, but is still less than 5 per cent of the forest in those countries. This percentage may be indicative for some of the other developing countries as well, although there is little data available.[4] It should be noted that a number of forests owned by communities, smallholders or industrial groups are well managed and many inaccessible forests largely undisturbed, but those forests often remain unrecorded in official statistics on sustainable management. Nevertheless, today, virtually every forest ecosystem sustains some degree of human impact, and without adequate financial support, it is difficult to achieve sustainable forest management in many parts of the world. The necessary investment ranges from minor, for example, when protecting an inaccessible forest, to major, if high opportunity costs are involved.

10. In discussing finance and forest management in developing countries, it is paramount to recognize the direct link between the livelihoods of the poor and forests, and that rural populations invest a substantial amount of labour to harvest fuelwood and many other forest products that are essential for their survival. Some 1.8 billion cubic metres of wood[2] are harvested annually for this basic purpose (about half of all the wood harvested), and most of this gathering is done by women. More than one billion people depend largely on forests for their subsistence.[5] This kind of foraging, with minimal technology, produces billions of dollars' worth of

[1] Food and Agriculture Organization of the United Nations, Rome. *State of the World's Forests, 2007* (http://www.fao.org/docrep/009/a0773e/a0773e00.htm).
[2] Ibid., *Global Forest Resources Assessment*, 2007.
[3] International Tropical Timber Organization, *Status of Tropical Forest Management 2005*.
[4] Food and Agriculture Organization of the United Nations, Rome. *State of the World's Forests, 2007* (see part I for a more detailed review of progress towards sustainable forest management).
[5] Chomitz, K. W. et al. 2007. "At Loggerheads? Agricultural Expansion, Poverty Reduction, and Environment in the Tropical Forests", *World Bank policy research report*.

benefit for poor rural people, through a vast array of products for food, shelter and medicine. Although this benefit or value from the forest is not normally recorded in official economic statistics, it is real and directly impacts the livelihood of millions of poor people. There is no guarantee that this kind of forest use will result in sustainable forest management, and, in many instances, products or services may be depleted or disappear. Nevertheless, the concept of sustainable forest management incorporates the reduction of rural poverty and sustaining benefits for forest dwellers. However, it is important to ensure that these activities are carried out in a sustainable manner.

11. More organized or industrialized forms of sustainable forest management require substantial amounts of finance. Sustainable forest management, on any scale beyond household activities, has multiple technical requirements, and often also requires involvement of stakeholders with different interests in the forests. Economic sustainability, indispensable for social and environmental sustainability, requires financial information, including information on markets and opportunity costs, and knowledge related to accessing funding sources. Larger operations require proportionally more complex financial analysis, as well as technological knowledge.

12. All of the above activities require finance from some source. The general observation is that sustainable management is less profitable than unsustainable practices, as it requires higher investment and operation costs. Therefore, a greater revenue stream or external financing is necessary for sustainable forest management. This is so despite the apparent contradiction that sustainable forest management, by definition, should be self-financing. It can be self-financing when all those benefiting are also paying the appropriate price (or compensation) for the benefits they receive. In the absence of societal regulations or compensation for public benefits, there are strong incentives for unsustainable use leading to degradation and deforestation. Moreover, where land tenure is weak, unclear or contested, there are added pressures for rapid and unsustainable harvesting of forest products, be they fuelwood, wildlife or timber.

13. The pressures for unsustainable practices arise from various sources and are often associated with short-term maximization of net income by immediately extracting the valuable products without concern for the future productive capacity of the forest. Regeneration investments usually have very long-term horizons, which may go well beyond the time preference of many private forest owners. Slow growing trees can easily take 50, 60 or even many more years to mature for harvesting. Private investment in such cases is constrained by the length of the gestation period of the investment.[6]

14. It is often more profitable to establish faster-growing plantations than to wait for natural regeneration to mature. Plantations provide many benefits, and attract significant private investment, but they generally do not provide the same mix of benefits as natural forests. The continuing destruction of natural forests cannot be offset by substitution with plantations. However, the rehabilitation of natural forests through planting is an important issue which will also require substantial investment.

[6] Indufor, Finnish Foreign Ministry, 2006. Study on financing mechanisms for sustainable forest management.

The area of planted forests is growing rapidly to meet demand (about 50 million hectares over the past 15 years), and reached 220 million hectares in 2005.

15. There are many land-use alternatives to forests, which often provide greater short-term profits than the forested use. These are cases in which the opportunity costs of maintaining forest cover are higher. Conversion to agriculture is a common cause of deforestation and the recent food crisis and policies promoting biofuel production augment the pressure. These various economic forces can work in concert, and their effects can be cumulative.

16. The main conclusion is that the free play of market forces alone does not produce sustainable forest management. Simply mobilizing or facilitating private investment and providing an enabling environment for such investment will not constitute an adequate financing system for sustainable forest management, unless other structural deficiencies and fundamental issues, such as proper valuation of the entire range of forest goods and services, are also addressed at the same time.

17. Globally, 84 per cent of all forests are State-owned.[7] This policy may be prompted by the good intention of ensuring the sustainability of public benefits of forests. However, evidence has indicated that, where government capacity is not sufficient to cope with the demanding task of forest protection, management and law enforcement, there is a strong tendency and/or incentive for unsustainable actions by private operators. Thus, State ownership alone, without adequate institutional capacity and a cross-sectoral comprehensive policy framework, would not deliver those sustainable benefits.

18. If finance, including compensation for all the benefits, is necessary for sustainable forest management and for a continuation of those benefits, then it would seem a reasonable and equitable principle that those who benefit from the different products and services of forests would provide the needed financing. This reflects the well-accepted United Nations Conference on Environment and Development principle of common but differentiated responsibilities, and indicates that cooperation and partnerships are essential to progress towards sustainable forest management.

19. This is happening to some degree, because there are local, national and international funding sources available for sustainable forest management in many situations. However, finance is normally allocated where preferential returns are expected, and there are many forest areas in many countries where very little or no national or international finance is present or available on that basis. In those areas, sustainable forest management rarely occurs, as documented by the above-mentioned estimates and thus it is clear that the current flow of finance for sustainable forest management is not adequate.

20. Lower-income countries have less financial resources available, and this is where the problems are most acute. Moreover, as described above, it is not just indiscriminate financing that is needed. Private financing may be available, but this alone, without proper safeguards, will not achieve sustainable forest management in all places or even where it is most needed. An effective and efficient finance system would therefore need to draw upon private and public sources, at the local, national and international level. The public sector needs to design ways to finance the public

[7] FAO, *Global Forest Resources Assessment 2005.*

benefits that are not valued in the current private marketplace through a number of means, including by strengthening and creating markets for the many goods and environmental services that forests provide. This is not a simple solution, but it seems to be the only viable one.

III. International private sector investment

21. In considering financial mechanisms for sustainable forest management, it is useful to appreciate the large financial flows associated with forests. In 2004, trade in global forest products reached a total value of $327 billion, with industrialized countries accounting for about three quarters of this.[2]

22. There is no systematic information available on domestic or foreign direct private investment in the forest sector in developing countries. There is, however, a common view that the bulk of the investment in forestry is from local sources, while in the processing industries, particularly in pulp and paper, foreign financing is significant, in many countries. Foreign financing takes different forms through direct investments, portfolio investments and credits. Domestic investments in forest management, plantations and wood industries are made by the formal private sector and by communities, landowners and farmers who may often be operating in the informal (and unrecorded) sector.

23. According to the United Nations Conference on Trade and Development,[8] private foreign direct investment flows[9] to forest industries in developing countries have grown rapidly (more than doubled in 1990-2005), amounting to about $0.5 billion per year in 2003-2005. Foreign direct investment stocks[10] in the wood and paper industries in developing countries have increased, reaching $17.8 billion in 2005. Another important trend observed is that foreign direct investment is being made by developing-country investors in other developing countries. Based on available data, the annual total investment in forest industries in developing countries could be in the range of $2 billion per year.

24. A key issue in private sector financing is to ensure that investments are not made in illegal and unsustainable operations. With regard to the instrument, industry can directly contribute to production, processing and trade, and thereby to the achievement of the first three global objectives on forests. The indirect economic, social and environmental impact of the industry is broad and cross-cutting, and therefore both enhancement of positive effects and mitigation of negative consequences are needed.

25. In a few countries, direct investment in timberlands, which in the past was mainly made by forest industry corporations, has been shifting to indirect

[8] United Nations Conference on Trade and Development (UNCTAD), *The World Investment Report 2007*.

[9] Foreign direct investment flows are new investments by foreign enterprises made during a period of time — either by calendar or tax year. While much inward investment is included in foreign direct investment flow statistics, not all of it will be. For example, if an inward investor decides to expand its facilities in a country, but uses local finance, this would not appear in foreign direct investment flow statistics, as it involves no inflow of money to the country.

[10] Foreign direct investment stocks measure the level of cumulative foreign direct investment stock of capital investment by foreign enterprises at a single point of time that takes account of both new investment and disinvestment.

investment by institutional investors, such as Timberland Investment Management Organizations. Such timberland investments can make a contribution to the instrument's national measures in enhancing production of forest goods and services and associated trade. The impact is, however, likely to be limited to a relatively few countries which can offer attractive timber-growing conditions, suitable land availability and an adequate investment climate. To maximize mutual benefits, safeguards are needed to mitigate possible negative impacts and to integrate these new actors into the national and local socio-economic framework.

26. There is a significant potential for community-based sustainable forest management in the tropics. Communities will face many of the same comparative advantages and constraints outlined above. Community-based sustainable forest management justifiably is attracting the priority interest of Governments and international cooperation, because of the direct links to rural poverty reduction and environmental sustainability. Of course, community forestry requires adequate organization and technical skills to be able to compete in the marketplace. That will take finance and capacity-building at the beginning, but has the potential to deliver important future returns.

IV. International financial cooperation

A. Official development assistance

27. This note cannot present a detailed overview of all official development assistance related to forests, but it is useful to review a few major elements that are important to the design of any new financial system. The official development assistance to forests has evolved along with international thinking on the issue since the United Nations Conference on Environment and Development. While forest-sector focused programmes are still important, the priority of official development assistance has shifted to wider rural development and environmental conservation programmes, where forests may play an important role.

28. Accurate, disaggregated and comprehensive data on official development assistance for forest programmes is not readily available. However, since the 1992 United Nations Conference on Environment and Development, there have been many estimates. Recent estimates of total forest-related official development assistance vary from about $1 billion to $1.9 billion per year. If the higher number is taken, World Bank forest-related loans accounted for an annual average of about $580 million over the past three years, and about 20 bilateral programmes accounted for about $1 billion per year.[11] To put this into perspective, it is estimated that China's public sector finance for forestry was $4.2 billion in 2003.

29. To programme official development assistance, recipient countries generally meet with the international partners who may finance programmes in their countries, and a consensus programme is developed that reflects priorities of the country and the donors. This approach reflects the consensus expressed, notably, by the 2005

[11] World Bank, Global Forest Partnership (unofficial interim document), 2007.

Paris Declaration on Aid Effectiveness,[12] and the Monterrey Consensus on Financing for Development. In national level documents and meetings on the comprehensive assistance programme, forest-related programmes have often not been included as priorities, with the result that forest-related official development assistance has not increased proportionately to the challenges of sustainable forest management. This seems understandable in a context in which countries are struggling to provide basic health and education services, as well as economic growth and food for their people.

30. In countries with relatively large forest areas, forest programmes often do become prominent within cooperation programmes. In those cases, there have often been many forest-related projects that are supported by different donors, both public and private. It then becomes the country's task to effectively coordinate multiple projects into a coherent programme and to effectively combine public funding with private investment and actions. This, of course, relates to the portfolio approach referred to earlier and discussed below. More effective use of the portfolio is facilitated where there are meaningful resources available somewhere within it.

31. These circumstances go to the heart of the issues surrounding the fourth global objective on forests, namely: "reverse the decline in official development assistance for sustainable forest management …". It can be argued that developing countries are the leaders for their own development policies, and that forest programmes do not receive priority compared to other needs. However, it is also the case that the global community is faced with the reality of inadequate official development assistance for sustainable forest management, and little prospect of this changing under current arrangements. To further illuminate the situation, other international cooperation efforts specifically focused on forests are considered below.

B. World Bank Group

32. The World Bank's forest strategy, approved in 2002, was targeted at an increased role for forest-specific financial assistance, and, as a result, an upward trend can be observed since then. The forest strategy relies on three pillars (poverty reduction, integration of forests in sustainable development and enhancement of global environmental services). In 2007, the lending volume reached $512 million.

33. In general, the Bank's investments include stand-alone forest projects, and projects which contain significant forest components.[13] The latter accounted for 39 per cent of the total forest lending in 2000-2005. These projects are mainly related to biodiversity (68% of the number of projects), poverty reduction (12%), rural development (8%), energy (8%) and natural resource management (4%). Stand-alone forest projects cover a broad range of thematic areas, including sector

[12] Commitments from the Paris Declaration on Aid Effectiveness include: (a) ownership — partner countries exercise effective leadership over their development policies, and strategies and coordinate development actions; (b) alignment — donors base their overall support on partner countries' national development strategies, institutions and procedures; (c) harmonization — donors' actions are more harmonized, transparent and collectively effective; (d) managing for results — managing resources and improving decision-making for results; and (e) mutual accountability — donors and partners are accountable for development results (http://www.oecd.org/dataoecd/11/41/34428351.pdf).

[13] These projects are not classified as forest investments.

reforms, community forestry, plantation development and payments for forest environmental services. In addition to sector loans and investment project lending, development policy loans have become increasingly important. By 2006, the Bank had approved 11 such loans, with forestry components totalling some $94 million.

34. The International Finance Corporation, the private sector arm of the Bank, promotes sustainable private sector investment to foster economic development and reduce poverty. It has helped to finance a number of forest sector projects, particularly in the pulp and paper industry, averaging funding of about $250 million per year and leveraging about five times that amount.

35. The Multilateral Investment Guarantee Agency promotes foreign direct investment by offering political risk insurance to investors and lenders. In the forest sector, the Agency's political risk guarantees have only been applied in two projects during the late 1990s. A more extensive use of this instrument could be explored, as the long-term horizon in forestry investments is compatible with the political risk guarantees.

36. The Bank has launched several initiatives in the area of carbon and forests; these will be considered in section V below, on emerging opportunities and programmes.

37. The Bank has four partnership programmes or funds to enhance the implementation of the 2002 forest strategy, as follows: (a) World Bank/WWF Alliance for Forest Conservation and Sustainable Use, (b) the Programme on Forests, (c) the Forest Law Enforcement and Governance and (d) the Critical Ecosystem Partnership Fund. The Bank considers that these partnerships have been helpful in implementing its forest strategy; the financing mobilized has been relatively modest, but effective.

38. The Bank's financing covers a broad range of the instrument's elements for national measures, as its scope is generally fairly comprehensive and projects are usually sizeable.

39. The Bank is actively involved in mobilizing new funds for forestry, as are all the intergovernmental organizations discussed in this section.

40. In addition to the World Bank, the regional development banks in Africa, Asia and Latin America have been supporting a variety of forest-related projects for many years, and at least a dozen bilateral programmes are important contributors to forest-related projects. These programmes make up the bulk of the $1 billion of official development assistance referred to above.

C. National Forest Programme Facility

41. The National Forest Programme Facility is a multi-partner funding mechanism, hosted by the Food and Agriculture Organization of the United Nations (FAO), that supports active stakeholder participation at the country level in the development and implementation of national forest programmes. The Facility provides grants directly to stakeholders in partner countries to assist them in developing and implementing national forest programmes that effectively address local needs and national priorities, and reflect internationally agreed principles.

42. Since its creation in 2002, the Facility has developed partnerships with 57 countries and four subregional organizations; it has allocated $7.7 million in grants to stakeholders, about 70 per cent of which are non-governmental. Facility grants have supported the participation of stakeholders in formulating policies and strategies, broadening national forest programmes and developing new legal, fiscal and institutional instruments. It should be noted, however, that the demand for assistance from the Facility far exceeds its current financial endowment.

D. Global Environment Facility

43. The Global Environment Facility (GEF) finances new and additional grant and concessional funding to meet the incremental costs of measures to achieve agreed global environmental benefits. It is the only multi-convention financing facility in existence and is now the major source of funding specifically supporting the Convention on Biological Diversity and the United Nations Framework Convention on Climate Change. The GEF is also a source of funding supporting the United Nations Convention to Combat Desertification.

44. Since 1991, the scope of GEF forest-related activities has gradually expanded from the focus on biodiversity to include integrated ecosystem management, land degradation, sustainable land management and, more recently (since 2007), sustainable forest management. The accumulated funding to forest-related projects by 2005 (236) was $1,192 million.[14] Earlier projects focused on protected areas as the main tool for biodiversity conservation, but there is a trend towards more support to sustainable forest management outside of protected areas.

45. In 2007, the GEF Council approved a sustainable forest management programme to address this area of intervention in a more comprehensive and coordinated way than in the past. The areas that can be supported by the programme include: (a) sustainable financing of protected area systems at the national level; (b) strengthening terrestrial protected area networks; (c) strengthening the policy and regulatory framework for mainstreaming biodiversity; (d) fostering markets for biodiversity goods and services; (e) support of sustainable forest management in the wider landscapes; (f) promotion of sustainable biomass production; (g) prevention, control and management of invasive alien species; and (h) management of land use, land use change and forestry as a means of protecting carbon stocks and reducing greenhouse gas emissions. During the first six months of its implementation, GEF programme has committed about $70 million and leveraged about $223 million in co-financing. GEF investments in sustainable forest management during the fourth replenishment period may exceed $250 million. The sustainable forest management programme opens up new opportunities for GEF funding, with the major emphasis continuing to lie with biodiversity conservation and forests as part of sustainable land use for production of global public goods.

E. International Tropical Timber Organization

46. The International Tropical Timber Agreement is a legally binding instrument which provides for financing mechanisms for the sustainable management of

[14] Global Environment Facility, GEF Activities Related to Forests, GEF/C.27/14, 2005.

tropical forests. The present agreement, adopted in 1994, provides for (a) an administrative account for assessed contributions by all members, to meet the administrative expenses, and (b) a special account for project and pre-project financing from voluntary contributions. In addition, the Bali Partnership Fund has been set up to assist producer members in making the investments necessary to achieve article 1 (d) of the 1994 agreement (to enhance the capacity of members to implement a strategy for achieving exports of tropical timber and timber products from sustainably managed sources by 2000).

47. Since 1987, the International Tropical Timber Organization (ITTO) has mobilized about $314 million to finance some 800 projects and activities, and since 2000, the yearly allocations are in the region of $14 to 18 million. The Bali Partnership Fund mobilized about $42 million of the above-mentioned amount. The funding volume has remained at roughly the same level during the last 10 years, but in recent years, significant donor contributions have been made. Sources of finance to the special account include voluntary contributions from consumer members, the Common Fund for Commodities,[15] regional and international financing institutions, and other sources.

48. The new International Tropical Timber Agreement (of 2006) has been devised to widen and strengthen the financing base for ITTO operational activities and attract increased predictable funding. However, the 2006 agreement has not yet entered into force.

F. Global Mechanism

49. The Global Mechanism was established under the United Nations Convention to Combat Desertification to increase the effectiveness and efficiency of existing financial mechanisms and to promote actions leading to the mobilization and channelling of substantial financial resources to affected developing country Parties. The Mechanism increasingly specializes in providing a range of financial advisory services to countries in the context of combating desertification and promoting sustainable land management. Due to the link between those issues and forests and forestry, the Global Mechanism offers an important case for learning lessons.

G. Non-profit and philanthropic contributions

50. There is an increasingly important role for philanthropic contributions and the work of the non-profit organizations that they support. The number of philanthropic foundations and wealthy philanthropists are rising, mostly in the developed and fast-developing parts of the world. As an indication of the magnitude of philanthropic giving, the estimated international contribution by all United States foundations for all causes was $3.8 billion in 2004, which was about 18 per cent of their total donations.[16] While the bulk of such international giving was for health causes, about $665 million was for international development and environment programmes.

[15] The International Tropical Timber Agreement (ITTA) is a commodity agreement negotiated under UNCTAD.

[16] Renz, L. and Atienza, J., International Grant Making Update, Foundation Center, 2006.

51. An important sum of money is contributed through philanthropy to sustainable forest management, especially for the conservation component. Increasing this contribution would require a very effective fund-raising programme, the success of which would not be assured. Philanthropy can be an important complement, but certainly not a substitute, for public funding. Furthermore, sustainable forest management is not, fundamentally, a charitable endeavour; it is a question of different elements of society equitably compensating for the benefits they receive. The Collaborative Partnership on Forests Sourcebook (see below) provides valuable information on such philanthropic foundations, among others, that can be tapped for funding.

H. Sourcebook on funding for sustainable forest management

52. The sourcebook on funding for sustainable forest management, created by the Collaborative Partnership on Forests, lists a number of donors, philanthropic and other sources of funding for forestry projects and programmes. The sourcebook is currently being updated and correlated with the instrument's provisions by FAO. The preliminary findings of the updating are that:

- Sources of funding to support sustainable forest management are fragmented, and no single fund covers the full set of the instrument's measures.
- Funding across the various measures varies greatly. Some attract much more interest than others.
- Funds identified in the sourcebook are strongly weighted towards capacity-building and conservation, and less towards production and technical activities.
- Funds listed in the sourcebook usually have specific objectives and are competitively awarded.
- Implementation of innovative financing arrangements varies greatly between countries.
- An assessment done in Latin America suggests that funding to support sustainable forest management is difficult to locate. This is particularly so for sustainable forest management activities such as natural forest management, and supporting small and community forest producers. Furthermore, the process for seeking funding is arduous and lengthy.

V. Emerging opportunities and programmes

53. Several of the environmental services that forests provide, such as biodiversity conservation, carbon sequestration, water regulation and recreation and tourism, can generate income for sustainable forest management. These opportunities have been capitalized upon in many instances, but there is still tremendous potential for expansion. While all these services have great promise, carbon sequestration has emerged as an extremely important one, owing to climate change. Forests play a very important role in global climate and in the global carbon cycle. FAO estimates that global total carbon content of forest ecosystems was 638 billion tonnes, roughly half in wood and half in the soil. From 1995 to 2005, the carbon in biomass in

developing countries was reduced by 20 billion tonnes. In 2004, total annual global anthropogenic greenhouse gas emissions reached 49 billion tonnes of carbon dioxide equivalents, with the forest sector contributing 17.4 per cent, or 8.5 billion tonnes of this, mostly due to deforestation and degradation.[17]

54. Decisions on financing mechanisms for sustainable forest management are obviously closely related to whatever decisions may be taken in the next few years regarding forests within the United Nations Framework Convention on Climate Change discussions. In its decision 2/CP.13,[18] the Thirteenth Conference of the Parties of the United Nations Framework Convention on Climate Change in 2007, encouraged Parties to explore a range of actions, identify options and undertake efforts, including demonstration activities, to address the drivers of deforestation relevant to their national circumstances, with a view to reducing emissions, deforestation and forest degradation and thus enhancing forest carbon stocks due to sustainable management of forests; decided that demonstration activities should be consistent with sustainable forest management, noting, inter alia, the relevant provisions of the United Nations Forum on Forests, United Nations Convention to Combat Desertification, and the Convention on Biological Diversity; and invited Parties, in particular Parties included in annex II to the Convention, to mobilize resources to support efforts in relation to the actions referred to above. This "reducing emissions from deforestation and degradation in developing countries" (REDD) initiative has generated much interest in the role of forests in climate change negotiations and in generating substantial financial resources for the forest sector.

55. This presents an opportunity, in that carbon storage, biodiversity conservation and sustainable forest management, which contribute to the reduction of poverty and to economic growth, can be compatible. Conversely, deforestation and forest degradation, the absence of sustainable forest management, produce carbon dioxide emissions. The potential is that a market demand for forest carbon storage could counterbalance the formidable economic forces working against sustainable forest management in many instances. One challenge is that when any single good or service, among the many produced simultaneously by sustainable forest management, attracts significant finance, this can reorient the goals of forest management to the detriment of other goods and services. This would indicate that forest management for carbon storage should integrate the lessons on sustainable forest management which have been discussed in depth in the United Nations Forum on Forests and its predecessors. The United Nations Framework Convention on Climate Change emphasizes the need to have comprehensive policies and measures to address issues related to the sources, sinks, and reservoirs of greenhouse gases, taking into account the different socio-economic contexts (art. 4, para. 3, of the Convention).

56. It would appear that there will soon be important forest activities within the ambit of the Convention. If this occurs, and if there is a funding mechanism associated in some way with the United Nations Forum on Forests, it will be

[17] Intergovernmental Panel on Climate Change, Climate Change 2007; synthesis report of the Intergovernmental Panel on Climate Change fourth assessment report (http://www.ipcc.ch/ipccreports/ar4-syr.htm).

[18] FCCC/CP/2007/6/Add.1.

appropriate for the Forum and the Conference of the Parties of the Convention to define their respective responsibilities and means of coordination.

57. Building on the positive experience of the BioCarbon Fund, the World Bank has established the Forest Carbon Partnership Facility, which will test incentive payments in pilot developing countries, operating through a Readiness Fund which will build capacity, and a Carbon Fund which will support performance-based payments for REDD policies and measures. The target capitalization is $300 million, and by May 2008, the World Bank had received $150 million from nine countries. The World Bank is also in the process of establishing a “forest investment programme”, which would address the gaps of sustainable forest management financing in the existing and emerging instruments, such as REDD schemes.

58. In this context, it may be noted that the Collaborative Partnership on Forests is developing a strategic framework for coordinated forest sector response to the climate change agenda, to be presented at the fourteenth session of the Conference of the Parties of the United Nations Framework Convention on Climate Change and the eighth session of the United Nations Forum on Forests.

VI. Global financial mechanism/portfolio approach/forest financing framework

59. Economic and Social Council resolution 2007/40 included the phrase, “a voluntary global financial mechanism/portfolio approach/forest financing framework for all types of forests … to support the implementation of sustainable forest management, the achievement of the global objectives on forests and the implementation of the non-legally binding instrument.” These different terms appeared to reflect different approaches to providing new and additional financial resources for sustainable forest management. However, there was no comprehensive explanation of the conceptual models or practical arrangements for finance to which these terms might refer. The present note makes an effort to analyse the concepts in this section, so as to contribute to a focused discussion by the Expert Group and develop a clearer understanding of the terms and their implications.

60. On the basis of related discussions, “voluntary global financial mechanism” could refer to a global forest fund, a concept introduced by a number of delegations in the previous United Nations Forum on Forests sessions, or it could refer to, for example, a mechanism to mobilize financial resources that would have no dedicated “fund” of its own to disperse. Many developing country delegations supported the idea of a global forest fund, but no consensus has been reached on this concept thus far, reflecting a lack of support from potential donors. A global financial mechanism could interact with and utilize existing funding sources, and also generate new sources of funding.

61. The fourth session of the Intergovernmental Forum on Forests in 2000 discussed the issue of a global fund without reaching consensus. It did, however, conclude that in order to support, inter alia, the additional costs during the transition period towards sustainable forest management, such an international financial arrangement or mechanism should preferably: (a) involve participating donors and beneficiaries in relevant decision-making; (b) respond to national needs and support national forest programmes; (c) facilitate internalizing externalities of forests in

promoting sustainable forest management; (d) build on or link with national financing mechanisms; (e) be transparent and administratively efficient; (f) complement the financing mechanisms of relevant multilateral agreements; and (g) have secure and sustained funding sources.[19]

62. The term "portfolio approach" was introduced to the seventh session of the Forum deliberations in an informal paper.[20] The word "portfolio" has several meanings; in financial terms it refers to risk management through diversification of investment, denoting an appropriate mix or collection of investments. The proposed "portfolio approach" for forest financing frames this concept in a complementary manner, noting that various aspects of sustainable forest management may be financed from a variety of sources. A portfolio of funding for sustainable forest management already exists at different levels, in the sense that there are many sources and types of funding that Governments, projects, communities and companies are tapping. The Forum has affirmed many times that all these types of funding — public and private, national and international, philanthropic and for profit, and others — are necessary and useful.

63. It is encouraging that many new types of funding are emerging. However, it is also clear that sustainable forest management has not yet been achieved in many countries, indicating that the "portfolio" of existing funding mechanisms is inadequate either in availability, accessibility or overall quantity. The portfolio of these mechanisms needs to be complemented by new financing sources and mechanisms for sustainable forest management.

64. Since a portfolio of types of funding sources exists at the national and international level, it follows that there should be a "forest financing framework" to increase the coherence of financial support for projects and actions at all levels in a programmatic approach. The issue of creating a coherent programme from many types of projects funded from different sources is a long-standing one within international development assistance that has received attention for some years. The substantial analytical work on national forest programmes addresses this issue with regard to forest-related financing at the national level. International discussions have urged that national governments take the lead in managing integrated programmes within their country. A framework could define the roles of various different sources (national, bilateral, multilateral, non-profit, etc.) in any new mechanism. It could also determine the governance and modus operandi of any new mechanism. Any new framework should, of course, build on existing partnerships, and create maximum synergy and effective cooperation between existing and emerging programmes.

[19] Report of the Intergovernmental Forum on Forests on its fourth session (E/CN.17/2000/14).

[20] El-Lakany, H., M. Jenkins and M. Richards, Background paper on means of implementation (contribution by PROFOR to discussions at the seventh session of the United Nations Forum on Forests, April 2007). The paper states that it does not reflect any official position of the World Bank or PROFOR.

VII. Conclusion and issues for consideration by the Ad Hoc Expert Group

65. **Member States have made a strong commitment to sustainable forest management by adopting the instrument, with clear global objectives on forests and a comprehensive set of measures. The above review makes it clear that countries and the international community, in its support to countries, still face many challenges to significantly expand sustainable forest management, due to inadequate financial resources. Nevertheless, a multitude of excellent programmes over many years have generated many lessons and principles that should be incorporated into the development of any new proposals for a financial system focused on the implementation of the instrument, achieving the four global objectives on forests, and achievement of sustainable forest management. Thus, such a financial system should be designed to support the numerous actions specified in the instrument. It is important that the development of proposals would need to clarify the concepts referred to in the Economic and Social Council resolution and discussed in the previous section, and also consider purpose, scope and operational modalities.**

66. **It is clear that the proposal(s) would also need to address fundamental policy and market failures concerning forests, so that correct valuation of forest goods and services and appropriate payment mechanisms can be generated.**

67. **Most often, national-level decisions that affect forests are not confined to the forest sector, so that national leadership is required across sectors. An effective financial arrangement or system for sustainable forest management should integrate a strategy for influencing national-level decision-making across sectors, as it affects forests. This is where new and emerging instruments based on carbon and other payments for environmental services are expected to provide large contributions to forests. This is also where concerted strong action and significant upfront investment would be required to make them work, in practice.**

68. **Financial support programmes also need to address the local or field level, as well as capacity-building. The local level is where sustainable forest management actually occurs. An effective financial arrangement or system for sustainable forest management should include mechanisms to provide incentives, support and/or effective regulation at the local level to communities, companies (whether owners or lease holders) and individual landowners. In addition, a financial support system for sustainable forest management should support capacity-building for effective institutions, including law enforcement. Many international cooperation programmes are already carrying out many activities in this area, and these valuable programmes should be continued and expanded.**

69. **As discussed in the present note, there are a number of existing sources of funding that have direct or indirect windows for supporting sustainable forest management. Others have potential that can be tapped with some adjustments. New opportunities, such as those from the climate change process, and a range of payments for environmental services, are evolving. The private sector, both domestic and international, shows new potential. In this context, any new proposal for a financial mechanism, approach, or framework needs to be based**

on coordination, cooperation and collaboration with existing and evolving sources of funding.

70. **The Ad Hoc Expert Group may wish to consider some strategic components and approaches in the development of any proposal(s) for any financial arrangement or systems (be it a mechanism, approach or framework). A non-exhaustive list of such components is presented below.**

1. Strategic components

A financial arrangement or system should:

- **Respond to national needs and support national forest programmes, and build on or link with national financing mechanisms. In general, countries and other actors should determine priorities for funding within the framework of instrument implementation and sustainable forest management**
- **Allocate funds on a results-driven and performance-based manner**
- **Give priority to projects and programmes that directly contribute to achieving one or more of the global objectives on forests**
- **Facilitate internalizing externalities of forests in promoting sustainable forest management**
- **Consider a sustained and predictable funding base: Multiplicity of funding sources from a number of public and private sources**
- **Leverage additional resources from other sources**
- **Collaborate closely with existing funding mechanisms for synergy**
- **Develop synergy and collaboration with any future funding sources that are related to United Nations Framework Convention on Climate Change REDD**
- **Explore ways to develop and mainstream other payment for environmental services-based funding mechanisms (e.g., water, biodiversity, recreation, etc.).**

2. Operational approaches

A financial arrangement or system should:

- **Seek minimum new structures and transaction costs, with high standards of performance and accountability**
- **Involve participating donors and beneficiaries in relevant decision-making**
- **Increase close involvement of the private sector and civil society organizations**
- **Seek transparent and efficient administration, including an effective monitoring and evaluation system.**

Issues for consideration by the Ad Hoc Expert Group:

1. **Given the fact that sustainable forest management requires additional financial resources, and the implementation of the instrument will hardly be effective without additional resources to developing countries, what measures should be taken to mobilize new and additional financial resources for the explicit purpose of the implementation of the instrument?**

2. **How can international cooperation be enhanced to support national measures of the Instrument?**

3. **Forests provide many local, national and global benefits. How can development and implementation of payment/compensation mechanisms for these benefits be accelerated?**

4. **How can the discussion on forest-related financing mechanisms in other forums, in particular, those related to climate change, be coordinated and/or influenced in order to ensure achievement of the global objectives on forests?**

5. **What measures are needed to attract the private sector investment in sustainable forest management (and avoid unsustainable forest management practices), and to implement necessary safeguards?**

6. **What other additional elements are required in the forest financing mechanism, approach or framework?**

7. **What aspects need to be considered in the governance of a possible new forest financing mechanism, approach or framework?**

8. **How can the effectiveness of the existing public forest financing mechanisms and instruments be enhanced?**