Theme 2

Investing in landscapes for green returns

Background and context

Over the last decade, the challenge of how to increase and diversify financial resources in support of sustainable land and resource use, especially in developing countries has dominated both national and international policy agendas (EFTRN 2008). Many countries in Southeast Asia have tried a wide range of mechanisms to mobilize resources from different sources to improve the productivity, profitability and sustainability of smallholder production systems as part of continuing efforts to promote green economies, and establish genuine measures of global progress (FAO 2011; UNEP 2011; Kubiszewski et al. 2013). These developments have led to a search for institutions at national and subnational levels with the capacity to absorb, manage, utilize and build upon international investments. Local governance conditions, which do not provide an enabling environment for private investments, are a key part of the problem as they contribute to heightened risk. A financing gap has emerged because of poor disbursement of public funds to support, for example, REDD+ activities, and an extremely limited forest carbon market.

Global financial markets find themselves at an inflection point distinguished by a 60% decline in cross-border capital flows since the 2007 peak, a 32% share of
global capital flows to emerging economies in 2012 (compared to 5% in 2000), and US$ 1.9 trillion in “South-South” foreign investments between emerging economies. These trends may result in greater dependence by lending institutions on domestic markets, the emergence of a more sustainable approach to financial-market development and global integration and perhaps, even the establishment of a BRICS bank.

It has been estimated that the required funding for sustainable forest management (SFM) alone is in the order of US$ 70-160 billion per year globally (Tuukka et al. 2013). At present, official development assistance disbursements to the forest sector cover about 1% of the estimated total financing needs for SFM, and other available public sector financing sources are barely double that amount. To scale-up investments, to create value-added, economic growth and employment and protect forests from competing land-uses, domestic and foreign private financing and investments must increase significantly. Despite the importance of the private sector, information on private forest financing is scarce and inadequate. Studies related to finance flows in the private sector have begun to emerge in recent years, and data—especially on international private investments in wood processing—have become available in selected public statistics. However, there is no coordinated and systematic effort to collect information on private investment flows in the forest sector. Surprisingly, little is known about why this potential has not been fully realized and what the main impediments are (Tuukka et al. 2013).

A robust and predictable system for mobilizing financial resources from various sources is still needed to stimulate investments in smallholders and landscapes for green returns. Opportunities exist to catalyze both public and private investment to finance sustainable land-use and actions addressing the drivers of deforestation (ETFRN 2008; Buchner et al. 2011; AGF-CPF 2012; GOI/GGGI 2013; The Munden Project 2013; IFFP 2014).

The Cha-am Hua Hin Declaration on the Roadmap for an ASEAN Community 2009-2015 was adopted by member states of the Association of Southeast Asian Nations (ASEAN) in March 2009. This encompasses the ASEAN Economic Community Blueprint, which aims to transform ASEAN into a region with free movement of goods, services, investment, skilled labor, and freer flow of capital fully integrated into the global economy. The AEC specifically aims to facilitate the integration of ASEAN into a single market for goods, services and investments and the ultimate creation of a single window based on simplified, harmonized and standardized trade and customs processes. The AEC is predicated on free and open investment regimes to enhance ASEAN’s competitiveness in attracting foreign direct investment (FDI) as well as intra-ASEAN investment. Under the Framework Agreement on the ASEAN Investment Area (AIA) all industries (in the manufacturing, agriculture, fishery, forestry, and mining and quarrying sectors; and services incidental to these five sectors) shall be open and national treatment granted to investors both at the pre-establishment and post-establishment stages.1 (ASEAN 2009, 21-40).

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Globalized trade and investment and increasing market and financial integration are changing the ways in which economic growth and development planning in Southeast Asia is implemented. Global financial markets are in flux, albeit with growing interest in a broad portfolio of emerging markets (Anon 2014). The disappearance of trade barriers and easier access to international finance creates opportunities for countries or regions that have been economically peripheral in the past to quickly become part of the global economy.

1 Some exceptions are listed in member countries’ Temporary Exclusion Lists and Sensitive Lists.
In Southeast Asia, this process has led to the formation of special economic zones, free trade areas, economic development corridors, and accelerated development master plans (e.g. MP3EI in Indonesia, GMS Economic corridors and ASEAN-China FTA). Adopting a landscape approach (Frost et al. 2006) to guide investment decisions will require that stakeholders consider multiple objectives for their geographic area of interest to determine the best ways to invest (Holmgren 2012). Nevertheless, sectorial approaches to policies and decision-making continue to constrain investment decisions by considering only limited sets of stakeholders and objectives, despite the UN Secretary-General’s High-Level Panel report (UN 2013) emphasizing the need for crosscutting approaches and transformational change (Holmgren 2013). Failure to promote cross-sectoral and/or land use planning at national and subnational scales in many Southeast Asian countries hinders the implementation of sustainable land-use practices. A landscape framework can and must integrate investments across land-based sectors (forestry, agriculture, livestock, mining, urban land-use, etc.) in support of all sustainable development goals (SDGs) for our common future.

The efforts by ASEAN member states to move towards the single window vary both across the region, and within countries. Significant FDI and intra-ASEAN land-based investments, and official development assistance have continued in recent years, including the Letter of Intent between the Governments of Indonesia and Norway to support Reducing Emissions from Deforestation and Forest Degradation (REDD+) with a US$ 1 billion pledge. Nevertheless, a financing gap has emerged as public funds for REDD+ are not being disbursed while the private sector continues to be unwilling to invest in REDD+, given the multiple risks and continued uncertainty associated with it. This is compounded by the high opportunity, transaction and implementation costs of REDD+ in the continued absence of a fully-functional compliance market.

The most important investments in the region continue to be in pulp and paper, mining, rubber, and oil palm even though the Norwegian Sovereign Wealth Fund sold its US$ 314 million stakes in 23 of the world’s largest oil palm companies (Gnych 2013). Many private sector actors have already demonstrated their commitment to sustainable business practices (APP 2013; HSBC 2014; Zulfahmi 2014) whilst civil society organizations and social media continue to play a critical role in improving access to information to increase consumer awareness and meet the growing demands for accountability by governments and corporations alike.
To improve access to private financing, a number of factors are critical, including a country’s political, regulatory and economic stability, secure and risk-free land tenure; the transaction costs of doing business; terms for financing; and access to markets. Access to informal credit is preferred by many smallholders as it is more accessible, has lower transaction costs, requires little or no collateral, and offers responsive and flexible loan repayments (but often at high rates of interest of up to 60% per annum) (Nwaru et al. 2011). Currently local financiers, including rural financial cooperatives, commercial banks, or microfinance institutions find it hard to diversify risk, meaning they are usually forced to offer interest rates that are too high, resulting in unnecessarily high default rates. Meanwhile national and regional financiers, including larger commercial banks and agricultural development banks, have a greater capacity to mitigate their risk exposure, but they often lack insight into locally appropriate conditions.

This Summit theme will explore ways to attract investments at scale in support of sustainable land- and resource-use by smallholders focusing on three subthemes:

1. Promoting sustainable timber production – This panel will present and contrast the experiences of government, international investors and producer associations representing small and medium enterprises (SMEs), accreditation/certification bodies and research on furniture value chains to promote sustainable timber production in the landscape, and how each actor group can contribute to inclusive green growth.

2. Improving private sector performance in the oil palm sector – This panel will help to improve our understanding of the motivations and activities of the private sector; and emerging corporate governance mechanisms and their impact on forests and people.

3. Innovative approaches to financing for inclusive green returns – This panel will present examples of innovative approaches to financing which is being developed in Southeast Asia to promote green prosperity and the transition to a low-carbon and more inclusive and equitable development.

Promoting sustainable timber production

Timber production can contribute to green growth in Southeast Asia through the sustainable use of natural and planted forests. The future expansion of planted forests in the region is likely to happen for at least two reasons; their capacity to produce timber is much higher than natural forests per hectare, and they are valued for their abilities to deliver a number of ecosystem services, such as carbon sequestration and water regulation. To scale-up sustainable forest management and create value-added economic growth and employment, domestic and foreign private financing and investments need to increase significantly. Currently, most large-scale investments are in industrial pulpwod production, with investors mainly interested in maximizing risk-adjusted returns. Institutional reforms at national, subnational and forest or landscape management unit levels must also be carried out to promote sustainability of timber production.

A conducive regulatory framework is needed to reduce timber import dependence, develop rural economies, and mitigate climate change. International and domestic investments in planted forests, natural forests and wood-based industries can be the primary driver for forest sustainability (UNEP 2011; Glauner et al. 2012). Weak regulatory frameworks exist in several Southeast Asian countries and so balancing power among government, commercial actors and civil society is as important at the local level as the national level to encourage investment.

Another significant trend for financing and promoting sustainable timber production is the use of market-based instruments. Several reasons explain this trend, among others the funding gap between needs and available (public) resources (Barsk et al. 2012); and the assumed strengths of markets to help deliver with appropriate incentives to those responsible for undertaking sustainable production (Pirard 2012). These market-based instruments can take many different
forms. A prominent example is the certification of timber production, whose key principle is for producers to send signals to consumers with the guarantee of a more sustainable timber production process than average. However, progress has been slow in Southeast Asia, with only 4.1% of the world’s certified areas as of 2013 (FSC 2013). Overall, the myriad of market-based instruments that were designed in recent years to boost sustainable timber production did not live up to expectations. Biodiversity offsets have been promoted in a number of countries and benefited from the active support of the Business and Biodiversity Offsets Program (BBOP 2013) but the number of cases that have been implemented to date remains small. Payments for ecosystem services have also generated a wealth of experiments but the concept has progressively weakened from straightforward conditional contracts between service beneficiaries (e.g. water users) and providers (e.g. forest managers) to very broad and inclusive schemes that have little to do with markets (Lapeyre and Pirard 2013).

The sustainability of timber production can only be explored by understanding timber value chains, as they are mostly buyer-driven value chains. The power to negotiate prices, for example, rests with buyers and not timber, woodchip or furniture producers. Most wood value-added products benefit those actors who are close to the end-buyers. Evidence from research on teak furniture value chains in Indonesia tells us that incentives to grow trees will increase if the producers get greater value-added. Therefore, producer associations, marketing skills and improved access to credit are necessary to increase their bargaining powers with timber brokers and wood product retailers. Good governance of timber value chains will also increase value-added enjoyed by small-scale enterprises and tree growers (Purnomo et al. 2014). The local timber economy has improved livelihoods and dominates local economies in, for example, Jepara District in Indonesia and Binh Dinh and Dong Ky in Vietnam.

In the timber plantation sector, a number of governance challenges must be addressed to make sure that investments will be made to scale in the region to meet increasingly stringent sustainability requirements. Large-scale forest restoration programs based on timber plantations in Asia-Pacific have faced governance challenges, such as the control of state agencies and the political connections of the main corporate actors, corrupt practices and ultimately the risk that reforestation activities can prioritize land with natural forest cover (Barr and Sayer 2012). The Asian Development Bank was unable to prevent failure associated with the abuse of loans with low interest rates, inflated plantation rates and the lack of sound management practices in the case of Lao PDR (ADB 2005). In other cases, public subsidy programs aimed at stimulating investments in timber plantations proved to be badly designed (Bull et al. 2006). Unfortunately, the hopes that more market-oriented approaches such as payments for environmental services would help to improve the governance of plantation efforts on private lands are still to be satisfied (Pirard et al. In Press). Governance challenges are related to at least two other crucial issues: issuance of concession licenses on unsuitable land (see Paoli et al. 2013 for the case of palm oil in Indonesia), and capacity to deal with conflicts related to land tenure, with consequences for both people and investors (Leon et al. 2013).

Improving private sector performance in the oil palm sector

The private sector is increasingly aware of critical social and environmental issues along commodity supply chains, in particular when sourcing from developing countries. Internalizing such costs has driven the emergence of private standards and time-bound commitments, use of certification schemes, and corporate social responsibility (CSR) projects. In the palm oil industry many of the actors involved in pursuing more sustainable practices are firms with a public profile and vested interest in their branding, who rely on external capital to finance expansion, or who market sustainable products and understand the long-term benefits of a sustainable business model. These large companies often have the resources, knowledge and financing to implement the changes required.
However SMEs and smallholders are being left behind. This has been attributed to the costs of certification and achieving ‘sustainability’: a proliferation of standards and mechanisms creating confusion and complexity for companies; price sensitive consumer markets; limited evidence of the business case for sustainability; and the high up-front costs of preparing investments due to a lack of basic information.

Voluntary standards such as the Roundtable on Sustainable Palm Oil (RSPO) demonstrate increasing membership, mainly from downstream manufacturers and retailers, and governments are increasingly adopting similar mechanisms of third party certification to demonstrate environmental and social compliance. Although many larger producers are pushing the bar higher and higher, and industry spokespersons suggest a “trickle-down effect” to SMEs; with rapid deforestation in ASEAN member states, can we rely on this wait-and-see approach?

Despite the challenges, there is great scope within the field of corporate governance for leveraging change. Traditional corporate governance mechanisms focus on how company owners and suppliers of finance, govern or “control” managers, to ensure a return on their investment. However, there is increasing pressure for companies to be accountable to other stakeholders (beyond owners and traditional regulators) by ensuring fairness, transparency and accountability towards its shareholders and the wider society.

The role of investors, the financial services industry, suppliers, traders, managers and employees, in developing systems that govern the actions of companies so that they are consistent with the interests of all stakeholders, are invaluable. However, currently very little is known or understood about these relationships, in the context of sustainable development.

There are a number of mechanisms, policies and projects being trialed within ASEAN member states that adopt a landscape-level approach and incorporate the private sector, as well as broader community participation. For example the Global Green Growth Institute (GGGI) is working in collaboration with the public and private sectors in Indonesia and the Philippines to explore the multiple green growth benefits that can be realized by investing in sustainable activities on degraded land (GOI/GGGI 2013).

The palm oil sector is a perfect example of an industry where there is great potential for inclusive rural development and poverty alleviation, as well as growth, but which presents serious challenges in terms of environmental impacts. Using the palm oil sector as an example of a globalized value chain for a tropically produced commodity, panelists will explore key questions, identify challenges and discuss potential solutions.
Despite important differences between primary commodities, such as soy, beef and timber, lessons emerging from the palm oil industry can provide valuable insight into the role of corporate governance. This panel will help to improve understanding of challenges faced by different stakeholders within the private sector and the solutions currently being proposed to further engage companies in the sustainability discourse and green growth strategy. The session will focus on the

- importance of extended cost-benefit analysis;
- new financing models and regulations for investments in smallholders and SMEs;
- tackling of policy inflation - meeting the multiplying and changing social and environmental standards;
- continuing debate over land sharing vs. land sparing (Phalan et al. 2011)

We know that achieving more sustainable private sector practices will require the commitment of a complex mix of actors, even more so in developing countries which are striving to rapidly raise standards of living for their people. This session will explore some of the factors contributing to more sustainable business models and will use the knowledge and experience of stakeholders from different stages within the palm oil supply chain.

Innovative approaches to financing for inclusive green returns

A recent report tracked 513 forest and land-use carbon projects involved in offsets from agriculture, forestry and other land-uses across the globe. In terms of global GHG emissions in 2012 which were 58% higher than global emissions in 1990 (35.6 billion tons CO2), and total carbon sales through the Emissions Trading Scheme (ETS) (ca. € 60 billion), these voluntary carbon market contributions figures still represent ‘drops in the ocean’ i.e. less than 1% of global emissions and global trade in carbon (Peters-Stanley et al. 2013).

In the absence of any significant REDD+ financing, one major obstacle toward achieving sustainability objectives at the landscape level is access to credit. Rural loans are often primarily characterized by formal and informal offers of short-term credit, where informal systems require borrowers to pay onerous rates of interest (Ramachandran and Swaminathan 2010). Sustainable land-use practices in agriculture, agroforestry and forestry tend to produce cash flows anywhere from 2 to 10 years after the initial investment, and as such they require loans with longer maturities and more flexible repayment schedules, such as an agroforestry system with multistory timber and fruit trees in the Philippines (Ranola et al. 2007). Loans made in developing countries often have lower rates of interest than those offered in informal credit markets. Using three case studies of innovative approaches to financing, panelists will explore key questions, identify challenges, and discuss potential solutions in relation to the experiences of:

The role of sustainable purchasing as a driver of sustainable forestry

Investments in sustainable forestry are often considered the domain of governments, NGOs or multi-stakeholder institutions such as the World Bank. However, purchasing policies and practices of major private or public sector buyers of forest products can play a very powerful role in influencing outcomes on the ground. Buyers send signals up the supply chain, and by carefully crafting policy language, buyers can directly incentivize improved sustainability performance by forest product suppliers, and encourage better forest governance among regional and national governments.

Using lessons from Office Depot – one of the world’s largest paper buyers, with a well-regarded paper policy [https://us.fsc.org/newsroom.239.777.htm] and history of market intervention in Asia – as well as from other major Western buyers of forest products, the panel will explore:

- How can major buyers use their purchasing power to incentivize sustainability performance?
- What assurances do major western buyers need from Asian governments and suppliers before signing contracts for large volumes of wood and paper products?
- What are some best practices in terms of supplementing commercial contracts with on-the-ground investments to advance sustainable forestry?

The Gold Standard Foundation

For the past ten years, The Gold Standard Foundation (GSF) has pioneered its ‘results based finance’ approach. Individuals, corporations and governments buy carbon credits against verified emission reductions and sustainable development outcomes. This has channeled billions of Euros into more than 1,000 low-carbon development projects worldwide. GSF was established in 2003 by WWF and has more than 80 NGO partners worldwide. The Gold Standard Land Use and Forests guidelines were published in 2012. The Affo/
Reforestation requirements were released in 2013, while the Climate Smart Agriculture (CSA) guidelines are now being developed with FAO and 50 other organizations. A partnership with FSC International and Fairtrade International has been established, to provide certification schemes that values better carbon reductions on a landscape level. Gold Standard Requirements are designed to encompass the various activities within a sustainable landscape to not only enhance carbon stocks, but also to improve the sustainable use of resources, people’s livelihoods and the conservation of biodiversity.

The Landscape Fund

The Landscape Fund (TLF) is a new multi-partner initiative, led by the Center for International Forestry Research (CIFOR). It seeks to research, develop, test and assess a new approach to promote financing for sustainable land-use as an integral component of sustainable development.

Credit needs to be extended to support activities that produce saleable products (e.g. crops, timber, etc.) and not simply carbon credits. If a market for forest carbon credits were to become functional, TLF’s financial models would simply consider this as an additional source of cash flow for smallholders. This represents a “no regrets” strategy to either be integrated or detached from REDD+ as required (or more optimistically, lend credibility to REDD+ by showing financial viability). Investors interested in supporting sustainability practices would not need to wait for the development of a large-scale fully functional international compliance market. TLF aims to assess the scientific approach and methods needed to generate the evidence-base needed for the design, pilot and potential scaling-up of TLF. TLF research will encompass:

- **Analysis of key stakeholders involved in land-use practices and potential investors** – This activity will assess the roles and practices of smallholders and potential investors, together with the market environments in which they operate, including access to: markets; technologies and extension services; capital; land tenure and farm holdings/sizes; and risk assessments.
- **Review of funding mechanisms to maximize learning for eventual rollout of TLF** – TLF will benefit from past and recent experiences of other funds and/or funding mechanisms in developing countries, particularly those specifically designed to reduce risks in land-based investments.
- **Assessment of governance structures, options for the financial entity and insurance** – This activity will review existing governance structures and entities that are eligible for issuing loans in target countries. It will assess options for how the financial entity (FE) could eventually be set up, examining profit and non-profit making structures, and cost-benefit analyses for managing the securitization system; and issuing securities for TLF to be operational.

- **Research and development of a verification system for sustainability outcomes** – TLF will develop sustainability criteria to enable prospective investments to be quantified, monitored, reported and verified – all at reasonable cost and with sufficient accuracy and precision. It will provide evidence to investors, public institutions and other stakeholders that TLF mechanism and the individual aggregators meet these sustainability outcomes.
- **Assessment of best sustainable land-use practices** – This activity will review existing and potential best sustainable land-use practices that will help to develop a portfolio of sustainable land-use investment opportunities for piloting in target countries. Sustainable land-use practices should be carefully selected to maximize learning and investments across pilot sites.
- **Selection of potential aggregators in target countries** – TLF aims to identify and secure interest and commitment from aggregators. This activity will identify three types of aggregators: innovators (research-oriented), expanders (ability to scale-up), and financial institutions in target countries. The aggregators holding separate pools of loans are primarily responsible for monitoring and evaluating individual producer achievement of the sustainability outcomes and other performance indicators as adapted to local realities.

**Looking forward**

Policymakers have several options to stimulate investments in landscapes for green returns. These include the need to ensure synergies, complementarities, coherence and more effective coordination between multilateral environmental agreements and public financing organizations. A coherent shared vision is required of the roles, functions and modus operandi of international landscape financing with the aim of minimizing transaction costs. The private sector will continue to be the preeminent source of financing. Public funding whether from ODA, PES, REDD+ or domestic sources should be targeted to create the enabling conditions at national and international levels for private sector investments. This may include investments to address crosscutting policies that are directed at specific environmental goods (climate, biodiversity, soil, water); crosscutting
policies comprising several sectors, (land tenure, spatial and land use planning); policies within a specific policy field with an impact on different land use sectors (energy, trade, development, investment, corruption) and crosscutting issues with a (current) lack of (effective) policies (e.g. internalizing externalities including trade-based emissions and gender). These mechanisms should enable donors to use relatively small amounts of public finance to leverage large private sector investments into sustainable landscapes.

New business models need to be designed through, for example, credible and affordable international certification standards to create favorable market conditions for sustainably produced agricultural and forest products and services. Additionally, new risk insurance mechanisms need to be developed and tested for diversified sources of investments, in collaboration with donors (Sida n.d.) and investment banks, and integrated into national financial services such as loans and mortgages.

The following issues also need to be addressed at the country level to promote sustainable investments in landscapes in Southeast Asia:

1. Countries need cogent financing strategies for sustainable landscapes, which bring together different opportunities, instruments and sources in a coherent framework that responds to the financing needs of the various types of land use managers.
2. Robust and equitable sectorial policies, strategies, laws and regulations implemented and enforced by competent institutions must underpin such financing strategies.
3. Good governance based on the principles of enhanced law enforcement, transparency, accountability and integrity must be ensured.
4. Well-defined and secure land tenure, and clarity and stability in legal and regulatory frameworks are often preconditions for private sector investments.
5. Improved land-use planning is required to obviate the risks of unplanned and uncoordinated changes influenced by short-term politics and vested interest groups.

Additional research is also needed to better understand the conditions (i) shaping the interaction between large-scale investments and agricultural and forested land-uses to target degraded and genuinely available land; (ii) under which large-scale investments and government interventions can contribute to equitable smallholder participation; and (iii) to ensure that environmental costs associated with transnational production and trade and changing consumption patterns are internalized in economic models.
References


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