

**Inter-American Development Bank
Technical Cooperation Program (Trust Fund Financing)**

TC/FUNDS BRIEF

RG-T1572

I. GENERAL INFORMATION:

Name of the T.C. Project:	Support for Forest Business Competitiveness.
Project Number:	RG-T1572
Name of the Trust Fund:	Finnish Technical Assistance Program.
IDB Team	Jose Rente Nascimento (RND/INE), Team Leader; Diego Buchara (LEG); and Elizabeth Chavez (RND/INE).
Executing agency	IDB.
Beneficiaries:	Regional. Public and private sectors organizations in LAC countries.
Estimated Total Amount to be financed:	USD100,000
• Financed by trust fund:	USD100,000
Execution and Disbursement Deadlines:	Execution: 6 months from the date of approval of the TC/Brief. Disbursement: 8 months.

II. BACKGROUND

- 2.1 Forests and forest land uses provide important goods, services, income, and business based development opportunities that improve the welfare of local, national, and global beneficiaries. It is increasingly clear, however, that these benefits can only be realized if these land uses are adopted or kept by landowners. For that, landowners need a business climate that supports profitable forest-based investments.
- 2.2 The less favorable that the business climate conditions are, the less land owners, society, or humanity will be able to benefit from forests and the more likely they will suffer the adverse consequences of their losses. It is, therefore, necessary that countries be motivated, know and understand the business climate that affects forest-based investments as well as how to progressively improve it. For that, it is necessary to measure the business climate frequently, independently, and transparently.
- 2.3 Recognizing that need, IDB supported¹ in 2005 the creation of the Forest Investment Attractiveness Index (IAIF, from its Spanish name). The IAIF is planned to be calculated biannually to measure the business climate for investments in the forest sector on a countrywide basis and expressed results as a single number per nation. It allows the systematic, periodic, quantitative and more rigorous analyses of countrywide factors that affect the success of forest direct investments and business decision-making. The IAIF is based on a model² that measures the attractiveness of forest-based business investments to

1 ATN/NP-8323-RS - *Direct Investment in Sustainable Forest-based Business* was financed by the IDB-Netherlands Partnership Program in the Environment. The TC was completed in May 2005 and its results were published in the Internet site <http://www.iadb.org/homeid/>.

2 The methodology uses 20 indicators (some were specifically designed for the IAIF) and involves more than 80 variables or factors. The supranational indicators are GDP growth rate, interest rate, exchange rate; political risk; and international trade freedom. The indicators from other

domestic or foreign investors. IDB funds have financed the calculation of the Index for the years 2004 and 2006.

- 2.4 A companion methodology to the Index, the Process to Improve the Business Climate for Forest Investment (PROMECIF, from its Spanish name), helps governments and stakeholders to design, implement, and monitor legal, policy or institutional reforms, as well as other actions or investments. These actions are strategically defined as needed to improve the forest business climate. PROMECIF's Action Plans help IDB government borrowing member governments and other stakeholders to identify investments that the IDB Group or other funding sources may support to improve the climate for forest-based businesses. The Process is already being applied in Paraguay, Panama, and Ecuador, where the Bank may eventually finance some of the projects identified by their respective action plans. Haiti has funding to undertake the exercise, while private sector representatives from Bolivia and Peru have also shown interest in the application of the methodology.
- 2.5 Domestic as well as international investors or entrepreneurs also find the Index useful for an initial screening for future investments or to explain their current hardships. Additional users of the IAIF are national or international NGOs; bilateral or multilateral donors, and other stakeholders. The frequent calculation of IAIF assists these stakeholders in their decision making and is critical for the follow-up of PROMECIF's action plans effectiveness.
- 2.6 As any metric, the relevance and usefulness of the information service provided by the IAIF depends also on its timely availability to stakeholders. That means that the Index has to be calculated as often as possible so that it can be a relevant input to investors seeking business opportunities, governments interested in increasing the attractive of their territories to investors, as well as other stakeholders that recognize that the success of forests as a land use depends on the business climate that landowners face.
- 2.7 However, the demonstrated usefulness and success of the IAIF and PROMECIF as tools to increase the role of forests and forest-based businesses to development is not sufficient to assure the periodic calculation and dissemination of the IAIF as a public good because IDB cannot be expected to support them indefinitely.
- 2.8 As part of the operation that financed the calculation of the IAIF for 2006³, IDB established mechanisms that sought that the IAIF to be calculated on a continuous basis every two years by the Getulio Vargas Foundation for South American countries and INCAE Business School for Central America, the Caribbean countries and Mexico. These two prestigious organizations have concluded, however, that the IAIF has sufficient importance and appeal to become a financially sustainable enterprise on its own. They have, therefore, recommended the creation of an independent non-governmental and not-profit organization to calculate the IAIF, to perfect its methodology, to promote and disseminate the Index and its measurements, and to provide associated private goods and services to interested stakeholders. They believe this institution can be financed by stakeholders' donations as well as fees for goods and services that it can produce for sale. This autonomous organization would also be much more flexible which would allow it to adjust quickly to the evolving demands of its potential clients.

sectors found to affect investments in forest-based businesses are general norms and regulations; human development index; economic infrastructure; agricultural policies; environmental policies; labor factors; foreign investment flows; and property rights. The forest sector factors found to best explain the levels of direct investments in the sector are forest resources base (stocks and net flows), forest vocation lands available; domestic forest products markets; adverse forest policies; and forest business supportive policies.

³ ATN/FT-9297-RG- *Implementation of the Forest Investment Attractiveness Index (IAIF)*, financed by the Finnish Technical Assistance Program, The 2006 edition of the IAIF is being published in mid 2008.

This operation is designed to support the design, formal creation, and initial operation of an institution that will be responsible for the tasks of calculating the IAIF, perfecting its methodology, promoting and disseminating the Index and its measurements, as well as providing associated goods and services to interested stakeholders.

III. OBJECTIVES

- 3.1 Considering the usefulness of IDB developed Forest Investment Attractiveness Index (IAIF) and the Process to Improve the Business Climate for Forest Investment (PROMECIF), the general objective of this operation is to support the improvement of the competitiveness of forest-based businesses and land uses by assuring the periodic calculation and availability of the IAIF on a sustained basis. The operation will finance the analysis of alternatives, design, formal creation, and initial operation of a non-governmental and not-for profit international institution. The technical assistance covers also the design of systems and procedures, identification of staffing needs, and promotion and marketing activities.

IV. DESCRIPTION

- 4.1 In order to accomplish its objectives, the operation will support the hiring of a consulting firm to undertake the work. The study will generate two sequential sets of products: those related with the creation of the institution and those involved in its initial operation. Further details are provided below.
1. **Consulting Services Required:** A consulting firm will be hired with at least the following professionals to undertake the work under this Technical Cooperation (TC): **business lawyer** (to coordinate the team); **forest investment expert** with experience in investment analysis and forest business development; **institutional development expert**; **forest economist (promotion and marketing)**; and a professional **website designer**. An individual consultant will also be hired to support the supervision of the operation.
 2. **Outputs required:** The products of the operation will be generated in 2 phases: Phase I - Creation, includes: I.1- Identification of criteria for the selection of and analysis of alternative institutional models, statutes, locations for the creation, and financial sustainability; I.2- Design of organizational (structure, policies, operational norms, guidelines) and legal documents necessary and sufficient for the creation of the institution; I.3- Assistance for the registration and formal creation of the spin-off; and I.4- Site of Internet to disseminate the institution and facilitate fund raising. Phase II - Initial Operation includes (to start immediately after formal creation): II.1- Assistance for the establishment of the institution's board; II.2- Marketing among potential donors and partners; II.3- Development short terms work plan; II.4- Promotion, events' participation, Internet site, and road show; and II.5- Development of business plan and 2-year work program (includes calculation of IAIF 2008).
 3. **Duration:** The objectives of the TC are expected to be achieved in 6 months. After this period, the institution it supports is expected to operate indefinitely to calculate and disseminate the IAIF results at least biannually and provide associated goods and services.

V. JUSTIFICATION

- 5.1 Sustainable management of forest resources in any country depends on the success of forest-based businesses. To be sustainable, forest businesses need to maximize financial return at the same time that they satisfy criteria of environmental and social feasibility. If it is not a good business for the landowners and associated entrepreneurs, however, forests will not be managed and will likely be converted to other uses. Likewise, areas that should have tree cover so as to avoid soil and water related negative externalities, the forest vocation lands, are unlikely to sustain forest land uses. Therefore, the social, economic and environmental benefits to society that forests can provide are substantially undermined if forest-based businesses are not successful.
- 5.2 For CO₂ emissions from deforestation or forest degradation to be reduced, forest land uses have to be more competitive against alternative land uses at local level, and, increasingly, at international level. The same requirement is true for the capturing of carbon by afforestation, reforestation, or natural forest management. If these land uses do not generate attractive financial returns superior to the best results other competing land uses can provide to the producer, their opportunity costs, it is unlikely that landowners will keep natural forest CO₂ stocks thereby reducing emissions due to deforestation, or contribute to capturing CO₂ by managing these stocks, planting trees, or managing natural regeneration.
- 5.3 It is important to know how attractive a given country is to direct investments because, as direct investments increase in forest-based businesses, so do the contributions of the sector to sustainable development in terms of job opportunities, foreign exchange, income, goods and environmental services, especially in rural areas.
- 5.4 The IAIF has demonstrated the importance of a series of supranational, intersectorial and intrasectorial factors in establishing the climate that investors have to face if they are interested in pursuing successful forest-based business opportunities in a given country.
- 5.5 The IAIF, as an instrument for measuring and comparing performance at the country level, has stimulated individual countries to improve governance, to increase their forest-based sector competitiveness in attracting direct investments, and to increase the sector's contribution to the countries' social-economic development, including the increased provision of associated positive externalities. The IAIF-SN can also be an important input for the Bank's country environmental analysis; the design of country strategies; and the identification of new operations.
- 5.6 The IAIF and the PROMECIF have been found to be useful for stakeholders who want to undertake an initial screening of countries with the best business climate for investment in the forest-based sector; identify issues where local performance is above or below expectations or aspirations; use a framework for a more precise and constructive dialogue about forest business climate issues; set priorities among policy areas; assess quantitatively the success of interventions on specific indicators; track indicators performance trends; monitor indicators of interest; perform more sophisticated disaggregation and analysis; serve as a working framework to encourage research, debate, dialogue, and learning; clarify policy and investment tradeoffs; design intervention strategies and better define goals, programs, and policies; and benchmark factor performance.
- 5.7 The Index and the PROMECIF have been found to be particularly useful to small or low income countries interested in improving their attractiveness to forest domestic and foreign investors. PROMECIF, as mentioned above, is already being undertaken in 4 small counties, while private sector representatives from two others have also shown interest in applying the methodology. As new reading

of the Index become available and the performance of countries implementing Action Plans improve, it is likely that countries such as GU, BL, CR, DR, GY, HO and NI will find it to be to their advantage also to apply the Process.

- 5.8 For countries with substantial regional differences, a nationwide measurement of business climate was found to be insufficient to orient the actions of investors and other stakeholders already interested in sustainable forest businesses in the country. In 2008, IDB responded to a request by the Brazilian Government to be the pilot of an operation⁴ that seeks to implement mechanisms that can allow countries to understand the sub-national (provinces, states) level factors that affect the local business climate for the success of investments in the forest-based sector and how to improve them so as to attract more private sector investments.
- 5.9 The frequent calculation of the IAIF by a non governmental and non-profit organization is expected to provide consistent and independent stimuli that motivate governments as well as investors and civil society to discuss the influential factors and facilitate the design of strategic action plans. When successfully implemented, these Plans can improve a country's business climate for forest direct investment and, hence, the Index performance
- 5.10 The present technical cooperation contributes substantially to the achievement of the IDB's new strategies by (i) expanding income and job opportunities for the majorities, especially in depressed rural areas where most forest-based investments take place; (ii) improving borrowing country members' governance and state modernization; (iii) supporting production and productivity gains; and (iv) promoting and facilitating the establishment of better conditions for private sector development and investments in sustainable forest businesses.
- 5.11 The IAIF and PROMECIF can also be important inputs for the Bank's country environmental analysis and the design of country strategies. The innovative inter and intra sectoral indicators designed for the IAIF, for example, have been found useful for monitoring of other government interventions like investment projects or policy adjustments.
- 5.12 The collaboration of the Finnish Technical Assistance Program is especially welcomed because Finnish and other Nordic countries' forest companies are world leaders and also among the most important international investors in the Latin America forest sector. Therefore, this support is mutually beneficial since their involvement in the design of these tools give an extra edge in the understanding of the forest investment opportunities in LAC.

VI. ENVIRONMENTAL AND SOCIAL ASPECTS

- 6.1 The TC will have no direct environment or social impacts. However, it is expected to generate substantial indirect positive environmental and social benefits because: the frequent IAIF calculations and results dissemination motivate stakeholders to adopt actions that can make their forests and forest vocation lands to be more sustainably managed in environmental, social and economic terms. The methodologies to be developed foment local business climates that will be more favorable to investments in sustainable forestry that benefit the rural poor. Therefore, this operation is proposed to be classified as category C.

4 ATN/SC-10409-RS. *Improving forest investment attractiveness at sub-national level*. Financed by the Swedish Trust Fund for Consulting Services.

VII. BUDGET

The following costs are envisioned:

Categories	IDB (Finnish Technical Assistance Program)
Honorarium	82,000
Lawyer and Coordinator (5 months x 8,000)	40,000
Forest investment analyst (1 months x 7,000)	7,000
Institutional Development Specialist (1 months x 7,000)	7,000
Promoter and Marketing Specialist (3 months x 8,000)	24,000
Support (1 months x 4,000)	4,000
Per diem	7,500
International: 10 days x USD250	2,500
In US: 20 days x USD250	5,000
Travel Costs	9,000
International: 6 tickets x US\$ 1,000 + 6 Tickets x US\$ 500 (US).	9,000
Contingency Costs	1,500
GRAND TOTAL	USD 100,000

VIII. RESPONSIBILITY IN THE BANK

- 8.1 **Technical Responsibility:** Technical Responsibility: Mr. José Rente Nascimento from the Environment, Rural Development, Disaster Risk Management Division - Infrastructure and Environment Sector (INE/RND), tel. (202) 623-3752, Fax (202) 312-4025, email renten@iadb.org, is the Bank officer assigned to the operation and has technical responsibility.
- 8.2 **Responsibility for Disbursements:** INE/RND is responsible for disbursements.

IX. RECOMMENDATION

- 9.1 José Rente Nascimento, designated team leader for the project of the reference, recommends the approval of this operation and the use of resources from the Finnish Technical Assistance Program totaling up to USD100,000 in order to finance the corresponding project.

X. CERTIFICATION

- 10.1 I hereby certify that this operation was approved for financing under the Finnish Technical Assistance Program (FTA) through delegation of approval authority to the IDB as per Article 6.2.4 of the Cooperation Framework Agreement signed on December 10, 2003. Also, I certify that resources from the Finnish Trust Fund (FTA) are available for up to US\$100,000 in order to finance the activities described and budgeted in this document. This certification reserves resources for the referenced project for a period of twelve (12) calendar months counted from the date of signature below. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in US\$. The same currency shall be used to stipulate the remuneration

and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of that country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this TC Brief. Amounts greater than the certified amount may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, for which the Fund is not at risk.

ORIGINAL FIRMADO

6/11/08

Margerite S. Berger
Chief
Unit Grants and Cofinancing Management Unit

Date

XI. APPROVAL:

ORIGINAL FIRMADO

06/12/08

Hector Malarin
Chief
Environment, Rural Development, Disaster Risk Management
Division

Date