

CORPORATE VIEW ON FOREST SECTOR INVESTMENTS AND SFM

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1. Summary

The new EU countries provide a major stimulus for the EU forest industries in terms of driving the demand for forest products and providing access to expanded forest resources.

The corporate sector will evaluate the Central and Eastern European investment opportunity in the global context. Significant investments will also be made in the developing countries where the focus is on the pulp and paper industries based on plantations. New investment flows in all parts of the world will be increasingly influenced by social responsibility and environmental considerations.

The Central and Eastern European Countries could also potentially play a role in changing the landscape for financing of forest investments. Significant amounts of private sector financing could be attracted by the new prospects in the Central and Eastern European forest sectors, enhancing the role of timberland as an investment asset in Europe.

2. Growing demand for forest products in the new EU region will provide stimulus for the EU forest sector

Demand for forest products is expected to continue its growth in the new EU at an average rate of 1.3%/a during the next ten years. Paper consumption follows closely the pace of GDP growth, and the expansion in the new EU countries will be faster than in Western Europe. As a result, the current consumption gap of some

120 kg paper per capita will gradually close. The demand for wood products in Central and Eastern Europe is expected to increase at around 4-5%/a, which is significantly faster than the growth of about 1%/yr in Western Europe. Although the growth in Central and Eastern Europe is starting from a relatively small consumption base, the new markets will accumulate volume significance over time and they will gradually become a stronger driving force in the new EU region. Hence, the dynamic role of the new EU countries will be increasingly felt in the enlarged EU over the next five to seven years.

3. Investments will first focus on the wood industry opportunities

The corporate sector will evaluate the Central and Eastern European investment opportunity in the global context. Significant investments will also be made in the developing countries where the focus is on the pulp and paper industries based on plantations. New investment flows will be increasingly influenced by social responsibility and environmental considerations.

The sustainable development of forestry and wood processing industries in the Central and Eastern Europe will require political and economic stability with a long term perspective. Long-term, well-established priorities can be developed within the framework of national forest programmes. For instance, in Finland it has proved to be a useful instrument for establishing a fundamental framework for policy and action for a sufficiently long time span. Ideally, such strategic programming covers all the policy issues including clearly defined forest policy goals expressed e.g. through volume of forest resources and growth, protected areas and factors affecting ecological and social sustainability, wood supply potential for forest industry investments, economic benefits to be derived from forestry and the forest industries, and the know-how base and human resources related to the development of the sector.

The fact that the consumption of paper and wood products per capita in the new EU countries is less than half of the consumption level in the current EU will be a major factor attracting investments in Central and Eastern Europe. The investment patterns appear quite different for the wood and paper products industries. For wood products, the consumption gap and the availability of forest resources is already beginning to translate into local production through an on-going wave of investment. In contrast, the development of local production of paper and paper products is still limited, and substitution of imports from Western and Nordic Europe has started quite slowly.

In addition to the abundance of forest resources, a major attraction for industrial investments is the stumpage prices in Central and Eastern Europe, which are typically lower than those paid in Western Europe. Although the prices have in some cases started to converge towards EU levels, the price advantage is likely to remain in the medium term. With gradually increasing stumpage prices, the chal-

lenge will largely lie in increasing the efficiency of logging and harvesting operations ensuring competitiveness at the mill gate.

Another important challenge is related to the pattern of forest ownership in Central and Eastern European countries. Whilst in most cases only some fifth, or less, of the forests are owned by non-industrial private forest owners, the private ownership is extremely fragmented with a typical woodlot size of a few hectares. This underscores the role of state-owned forests in the development of wood processing industries. Simultaneously, new approaches and alternatives to involve private sector in forestry development should be actively searched. In particular, financial contribution or support from the public or private sectors to such purposes as forest roads construction, silviculture etc would be welcome as these investments are difficult to justify by small private forest owners who can not themselves reap the full benefits from such investments.

4. Private financing for timberland development?

There are untapped opportunities to raise private sector financing for forests in Europe. Arrangements enabling collaboration between (private and public-private) forest owners can be used to facilitate private sector financing and alleviate the constraints related to fragmented ownership. For instance, in the United States, the so-called Timberland Management Organizations (TIMOs) have emerged as vehicles for joint action in forest investment, ownership and management. TIMOs function as syndicated funds and have attracted some USD 15 bn capital, mainly from pension funds and other institutional investors. These organizations are flexible in structure, and they can be designed also as public-private-partnerships to reflect e.g. the shared ownership, the origin of capital and the respective goals of SFM (financial, ecological, social).

Stimulation of private sector will be necessary to improve the market dynamics, as well as for reasons related to financial leverage, which should be considered as an opportunity in the world of scarce resources. However, public forest ownership is likely to maintain its key role in many countries, particularly in Eastern Europe in ensuring a stable supply of wood and ecological benefits as well as an appropriate contribution to regional development.

Several million hectares of marginal agricultural land will be available for other land uses. Bringing them under managed forestry calls for very large volumes of financing. Environmental and social benefits of these investments often justify public sector support but, in view of the huge amounts involved, public financing should be targeted as a lever for private investment.

5. Sustainability through conservation incentives and social responsibility models

The steadily increasing role of the private sector in forestry calls for innovative measures to optimally balance the social, ecological and economic dimensions of sustainability. The greater role of the private sector could be coupled with expanded use of specifically designed incentive structures aimed to harmonize different management goals. Potential models for public-private-partnerships include conservation easements (voluntary legal restriction on land use for conservation purposes against compensation), conservation agreements and conservation concessions. International experience provides increasing evidence that incentives encouraging conservation efforts by a private forest owner tend to become more applicable instruments as market efficiency develops.

The societal demands on the forest industry have traditionally focused on the environment, e.g. reducing effluent flows to water in the late 1960s and 1970s, substituting chlorine bleaching in the 1980s, and forest certification since the mid-1990s. Environmental legislation as well as increased public awareness and NGO pressure have been driving these developments to a large extent. As a result, the forest industry worldwide has become more active in this area. Corporate social responsibility (CSR) was discussed and implemented in the corporate world even before the Johannesburg summit that emphasized the role of private companies in promoting sustainable development. At present CSR is part of all major serious forest industry operations, and it is something potential investors, shareholders, buyers and consumers are expecting for. The main drivers for CSR in the forest industry are:

- tightening environmental legislation within EU
- NGO pressure, including criticism of corporate globalisation
- CSR, including appropriate environmental management systems, are seen to improve competitiveness
- product markets and even accessing capital
- corporate image building (and maintenance)
- companies increasingly see social and environmental issues as something that is part of their own long-term strategy of staying in the business and meeting the expectations of various stakeholders related to sustainable development.

Voluntary environmental management systems such as ISO 14001/EMAS (Eco-Management and Audit Scheme) and forest certification (PEFC, FSC, etc) are already a standard in the forest industry. Especially larger international forest industry companies apply CSR measures and reporting globally wherever they operate.

In view of the above, it is interesting to note the results of a recent survey in Finland, where the respondents (corporate managers) were asked to list the most important motivations for social responsibility. The main factors in a descending

order were: “company owner considers responsibility important”, “the image and reputation are dependent on responsibility”, “financial profitability in the long term is dependent on responsible action”, “customers require responsible action”, and “responsible action creates an advantage when competing for key personnel”. In other words, the market forces are gradually proving to become an important driver for social responsibility in the corporate sector. This trend does not contradict the possible need to guide the social responsibility process by the public sector, e.g. through appropriate regulations and standards.

6. The Finnish forest cluster is characterized by evolving linkages with high-growth-high-tech sectors – a model to be copied, a lesson to be learnt?

The Finnish forest cluster has continued to flourish and grow. With Finland, Sweden and Austria joining the EU in 1995, the paper production capacity in EU expanded by some 50%. Whilst prior to 1995 the EU produced only three quarters of its paper consumption, the EU-15 became virtually self-sufficient in most products and a net exporter for almost ten per cent of its production, gaining a position in the world trade which is comparable to that of North America. Since entering EU, the Finnish forest industry has executed a series of cross-border mergers and acquisitions, resulting in a more competitive base for industrial production than ever before.

A remarkable trend to note has been the continuing expansion and development of the forest cluster, including such forest-related industries as machinery and equipment, automation, energy, printing and publishing, logistics and services. The forest cluster’s total contribution to GDP is estimated at about twice the direct GDP percentage of the wood and pulp and paper industries, i.e. around 10%.

An important feature in the development of the forest cluster is the pronounced trend to establish linkages to such fast-growing sectors as biotech and ICT. Driven by the search for new sources of competitive advantage, life sciences applications and ICT have during the recent years emerged as an increasingly important manufacturing technology in the pulp and paper industries. ICT applications focusing on forest management and inventory technologies, wood supply logistics and process automation have in many cases appeared as the key elements for competitiveness in the global context. Rapidly advancing gene technology is expected to soon produce breakthroughs in tree breeding. The strive for environmentally and ecologically sustainable silviculture has paved the way for biological pesticides and insecticides in forestry. Unfortunately, these new promising technologies are often not adequately aided by regulations or policy instruments in spite of general political will to promote sustainable development through such means.

Simultaneously, the forest cluster has gradually become a raw material source for several new products in such fast growing sectors as functional foods (e.g. stanol ester) and biodegradable materials industries (e.g. tall oil distillation derivatives). There is a reason to believe that these development trends will continue and

strengthen in the future. The interlinkages between the forest cluster and ICT and the life sciences sector opens up a new development avenue and an opportunity for continuous cost-competitive evolution of the economy based on sustainable use of natural resources.