



INTERNATIONAL TROPICAL TIMBER ORGANIZATION / FLEGT INDEPENDENT MARKET MONITOR (IMM)

The impact of FLEGT VPAs on forest sector investment risk in Indonesia and Viet Nam

DECEMBER 2020



Report author:
Christian Held,
UNIQUE forestry
and land use



This report has been produced with the financial assistance of the European Union

Viet Nam's VPA is expected to mitigate timber sector investment risk.
Photo: Nam Nguyễn

The views expressed herein are those of the consultants and the IMM and do not necessarily reflect the official opinion of the European Union

List of Acronyms

| | |
|-----------------|---|
| CoViD-19 | Corona Virus Disease 2019 |
| FLEGT | Forest Law Enforcement, Governance and Trade |
| IDR | Indonesian Ringgit (local currency) |
| IMM | Independent Market Monitor |
| ITTO | International Tropical Timber Organization |
| ISIC | International Standard Industrial Classification |
| LAS | Legality Assurance System |
| SFM | Sustainable Forest Management |
| SFE | State Forest Enterprise |
| SME | Small and Medium Enterprises |
| SNA | System of National Accounts |
| SVLK | National Timber Legality Assurance System (Indonesia) |
| TLAS | Timber Legality Assurance System |
| USD/US\$ | U.S. Dollar |
| VND | Vietnamese Dong (local currency) |
| VPA | Voluntary Partnership Agreement |

About the IMM

Co-funded by the European Union and managed by the International Tropical Timber Organization (ITTO), the role of the Independent Market Monitor (IMM) is to use trade flow analysis and market research to independently assess trade and market impacts of FLEGT Voluntary Partnership Agreements (VPAs) in the EU and partner countries.

About the ITTO

The ITTO is an intergovernmental organization promoting the conservation and sustainable management, use and trade of tropical forest resources. Its members represent the bulk of the world's tropical forests and of the global tropical timber trade. ITTO develops internationally agreed policy documents to promote sustainable forest management and forest conservation and assists tropical member countries to adapt such policies to local circumstances and to implement them in the field through projects. In addition, ITTO collects, analyses and disseminates data on the production and trade of tropical timber and funds projects and other actions aimed at developing sustainable forest industries at both community and industrial scales.

© ITTO 2020. This work is copyright. Except for the ITTO logo, graphical and textual information in this publication may be reproduced in whole or in part, provided that it is not sold or put to commercial use and its source is acknowledged.

Disclaimer

The designation employed and the presentation of material herein do not imply the expression of any opinion whatsoever concerning the legal status of any country, territory, city or area, or of its authorities or concerning the delimitation of its frontiers and boundaries.

The contents of this report are the sole responsibility of ITTO and its IMM project and under no circumstances can be regarded as reflecting the position of the European Union.

| | | |
|------------|---|-----------|
| 1 | Executive Summary | 4 |
| 2 | Introduction | 6 |
| 2.1 | FLEGT | 6 |
| 2.2 | Previous work on FLEGT VPAs and forest sector investments | 6 |
| 3 | Approach | 7 |
| 3.1 | Rationale and scope of the study | 7 |
| 3.2 | Forest sector data | 8 |
| 3.3 | Enterprise and stakeholder interviews | 8 |
| 4 | The impact of the VPA on Forest sector investment in Viet Nam | 9 |
| 4.1 | Review of investments in the Vietnamese forest sector | 9 |
| 4.2 | Enterprise perspectives on the impact of the VPA on forest sector investment in Viet Nam | 10 |
| 4.2.1 | FLEGT VPA potential to mitigate forest sector investment risk in Viet Nam | 10 |
| 4.2.2 | Impact of FLEGT VPA on enterprise crisis resilience in Viet Nam | 12 |
| 5 | The impacts of the VPA on Forest sector investment in Indonesia | 13 |
| 5.1 | Review of investments in the Indonesian forest sector | 13 |
| 5.2 | Enterprise perspectives on the impact of the VPA on forest sector investment in Indonesia | 14 |
| 5.2.1 | FLEGT VPA potential to mitigate forest sector investment risk in Indonesia | 15 |
| 5.2.2 | Impact of FLEGT VPA on enterprises' crisis resilience in Indonesia | 16 |
| 6 | Conclusions | 18 |
| 7 | Reference list | 18 |
| 8 | Annex | 19 |
| 8.1 | Annex 1: Enterprise questionnaire | 19 |
| 8.2 | Annex 2: Description of interviewed enterprises and actors | 21 |
| 8.3 | Annex 3: Wood products trade and consumption Viet Nam and Indonesia | 22 |
| | List of tables | |
| Table 1: | Perception of enterprises on VPA impact on investment criteria in Viet Nam | 12 |
| Table 2: | Support requirements of Vietnamese enterprises to manage CoViD impacts | 13 |
| Table 3: | Perception of enterprises on VPA impact on investment criteria in Indonesia | 16 |
| Table 4: | Support requirements of Indonesian enterprises to manage CoViD impacts | 17 |
| Table 5: | Enterprise sample Viet Nam | 21 |
| Table 6: | Enterprise sample Indonesia | 21 |
| Table 7: | Institutional actors interviewed for Viet Nam and Indonesia | 21 |
| | List of figures | |
| Figure 1: | Annual increase in fixed assets in Viet Nam's forest sub-sectors and VPA timeline (2000 to 2018) | 4 |
| Figure 2: | Annual increase in fixed assets for medium and large scale enterprises within Indonesian forest sub-sectors and VPA timeline (1998 to 2017) | 5 |
| Figure 3: | Negotiation of a VPA process | 6 |
| Figure 4: | Annual increase in fixed assets in Viet Nam's forest sub-sectors (2000 to 2018) | 9 |
| Figure 5: | Development of forest sector investment in Viet Nam (2000 to 2018) | 9 |
| Figure 6: | Development of the number of forest sector enterprises, Viet Nam (2004 to 2018) | 10 |
| Figure 7: | Annual increase in fixed assets for medium and large-scale enterprises within Indonesian forest sub-sectors (1998 to 2017) | 13 |
| Figure 8: | Development of forest sub-sector investment in Indonesia (1998 to 2018) | 14 |
| Figure 9: | Number of forest sub-sector enterprises in Indonesia (1998 to 2018) | 15 |
| Figure 10: | Consumption and trade of wood products in Viet Nam and Indonesia | 22 |

Executive Summary

Background

In 2018, the Independent Market Monitor (IMM) commissioned a scoping study on forest sector investment in FLEGT VPA partner countries. The study provided a baseline for monitoring the potential impact of FLEGT VPA implementation and FLEGT-licensing on investment in the forest sector.

The 2018 study had concluded that further monitoring of correlations between the FLEGT VPA process and forest sector investment should be limited to countries issuing FLEGT Licences, as in other countries the scope of reforms was considered insufficient to have any identifiable impact on forest sector investment.

Acting on this recommendation, IMM commissioned a follow-up study of FLEGT impact on forest sector investment, the investment enabling environment and forest sector resilience to economic crisis in Indonesia. Viet Nam was also included in the study as well for the following reasons:

- Viet Nam is a regional competitor to Indonesia in the wood and forest products sector and a key processing hub.
- Availability and quality of investment data allows for monitoring of investment activity in Viet Nam over a relevant period of time.

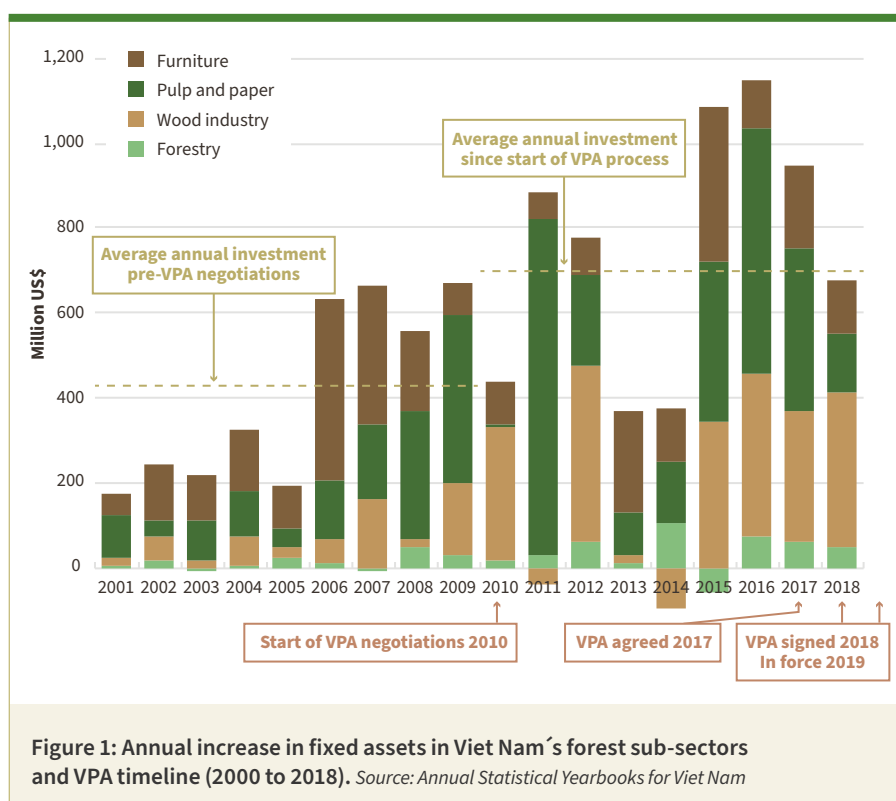
For both countries, most recent time series of forest sector investment data was retrieved from the Systems of National Accounts. The historical fluctuations of forest sector investments were contrasted against the VPA negotiation and implementation process in each country.

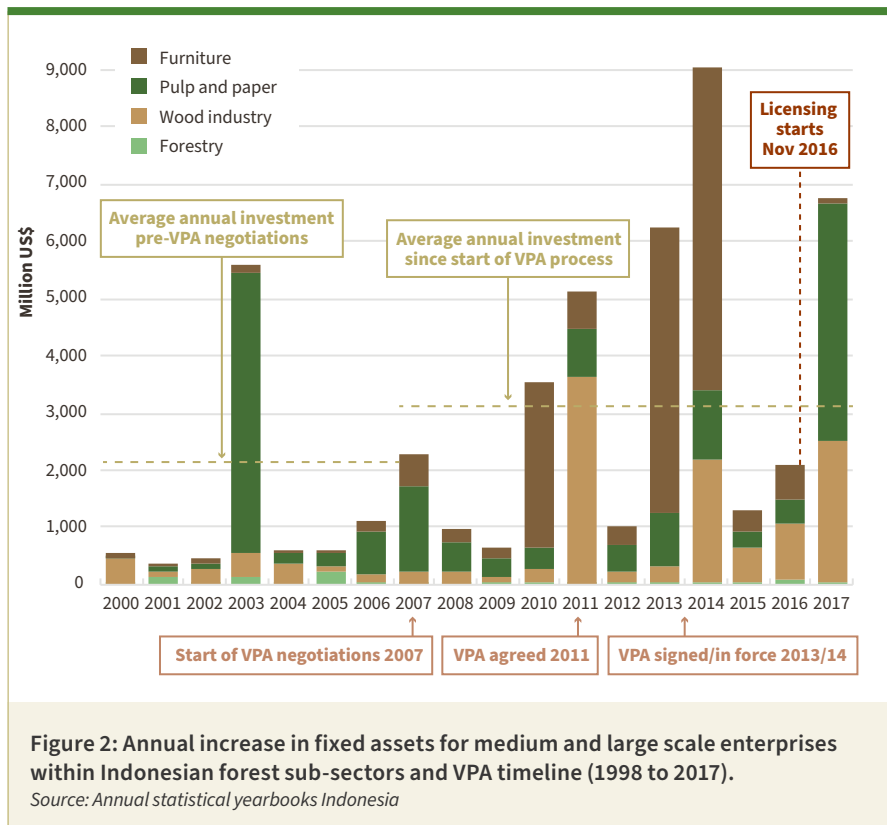
To contextualize and add qualitative aspects to the statistical investment data, interviews with medium and large sized enterprises were conducted in July and August 2020 in each country. In addition, a set of interviews with institutional actors from sector associations, civil society and relevant ministries was conducted.

Due to the limited number of interviews, the results of this study cannot necessarily be considered representative of the entire forest sector in the two countries. However, the information presented has been validated and approved by forest sector experts from Indonesia and Viet Nam.

Key outcomes Viet Nam

- Comparison of the time periods before and after the start of VPA negotiations in 2010 shows a significant increase in average investment volumes per year after 2010. The average annual investment volume in the forest sector increased from US\$415 million pre-2010 to US\$690 million after VPA negotiations started.
- However, survey respondents did not mention that the VPA negotiations had influenced their investment decisions. They attributed the increase in forest sector investment in the period after 2010 to important reforms of the economic system in Viet Nam, especially the WTO membership (2007) and subsequent government resolutions to reforming the investment enabling environment in 2010 and in 2011.
- For the VPA implementation period post-2019, survey respondents expect that the Timber Legality Assurance System (TLAS) will substantially improve transparency in timber trade, including imports, exports and domestic trade flows.
- The enterprises primarily perceived the VPA as an instrument to provide proof of the legal and sustainable origin of wood products and thus secure improved access to regulated markets.
- Further, Vietnamese enterprises saw potential for the operational VPA in the post-2020 period in terms of market risk mitigation and capital mobilization.
- The enterprises emphasized that accelerating the implementation of the TLAS to cover the entire forest





products covered by the VPA in the EU market and felt that more needed to be done in the EU to comply with Article 13 of the VPA, which addresses this topic.

Conclusions

The 2019 baseline study demonstrated that a FLEGT VPA alone cannot compensate for the lack of market drivers, such as an investment friendly environment, efficient production systems and favourable cost situation, among many other factors. However, the 2020 study indicates that in countries where all or some of the above criteria are met, as is the case in Viet Nam and Indonesia, VPAs can improve the investment enabling environment in the forest sector by:

- Creating improved access to regulated markets;

sector is crucial to ensure international credibility and reputation of Vietnamese wood products exports in the EU and other regulated markets.

- In light of the CoViD-19 pandemic, the VPA is expected to have a stabilizing effect on Vietnamese export market shares in regulated markets.

Key outcomes Indonesia

- Average annual forest sector investment almost doubled in the decade after the beginning of VPA negotiations (2007 to 2017) to reach US\$3.1bn per annum. Between 1998 and 2006 forest sector investment was US\$1.7 billion per annum.
- After 2010, the year when the VPA was agreed, the focus of investment has shifted from pulp and paper towards wood processing and furniture manufacturing.
- Survey respondents partly attributed the increase in investment in the wood and furniture sectors to improvements related to the FLEGT VPA process. These included improved Indonesian market access to regulated markets and substantial improvements in forest sector governance.
- Companies perceived positive impacts of the VPA on mitigating the economic effects of the CoViD-19 crisis by avoiding illegal logging and maintaining access to regulated markets for the post-crisis phase.
- With a view to post-crisis recovery, a key message from respondents was the need to boost export sales and intensify marketing efforts for Indonesian wood products. A number of respondents voiced dissatisfaction with EU efforts to “promote a favorable position” of

- Improving access to capital and investors through the formalization of forest sector enterprises;
- Eliminating market distortions through illegal competition;
- Establishing good forest governance, addressing social and environmental risk factors;
- Ensuring long term viability of operations by enhancing sustainable forest management practices.

To further strengthen the positive impacts of VPAs on forest sector investment, the following aspects should be considered:

- Expanding demand from regulated markets (i.e. support the development of timber legislation in additional countries, for example China or India);
- Strengthening the market position of FLEGT licensed products through improved marketing efforts and preferential treatment (e.g. in public procurement);
- Promoting FLEGT licensing as a factor to improve the credit rating of forest sector enterprises in VPA countries;
- Ensuring formalization of all market participants once a VPA is signed and implemented;
- Minimising additional costs for producers, for example by developing digital solutions for documentation and monitoring;
- Ensuring that no shortages of regulated timber occur due to limitations for implementing the Timber Legality Assurance Systems (i.e. technical and personal resources to operate the system).

2 Introduction

2.1 FLEGT Action Plan

Illegal logging can have drastic impacts on natural forests. Environmental impacts include deforestation, loss of biodiversity and emission of greenhouse gases. Social impacts include conflict with indigenous populations, human rights abuses, corruption and worsening of poverty.

The EU FLEGT Action Plan¹ is an initiative to combat illegal logging and related trade that was established in 2003 and aims to address the above issues by providing various kinds of private and public sector support as well as economic incentives via legislative measures.

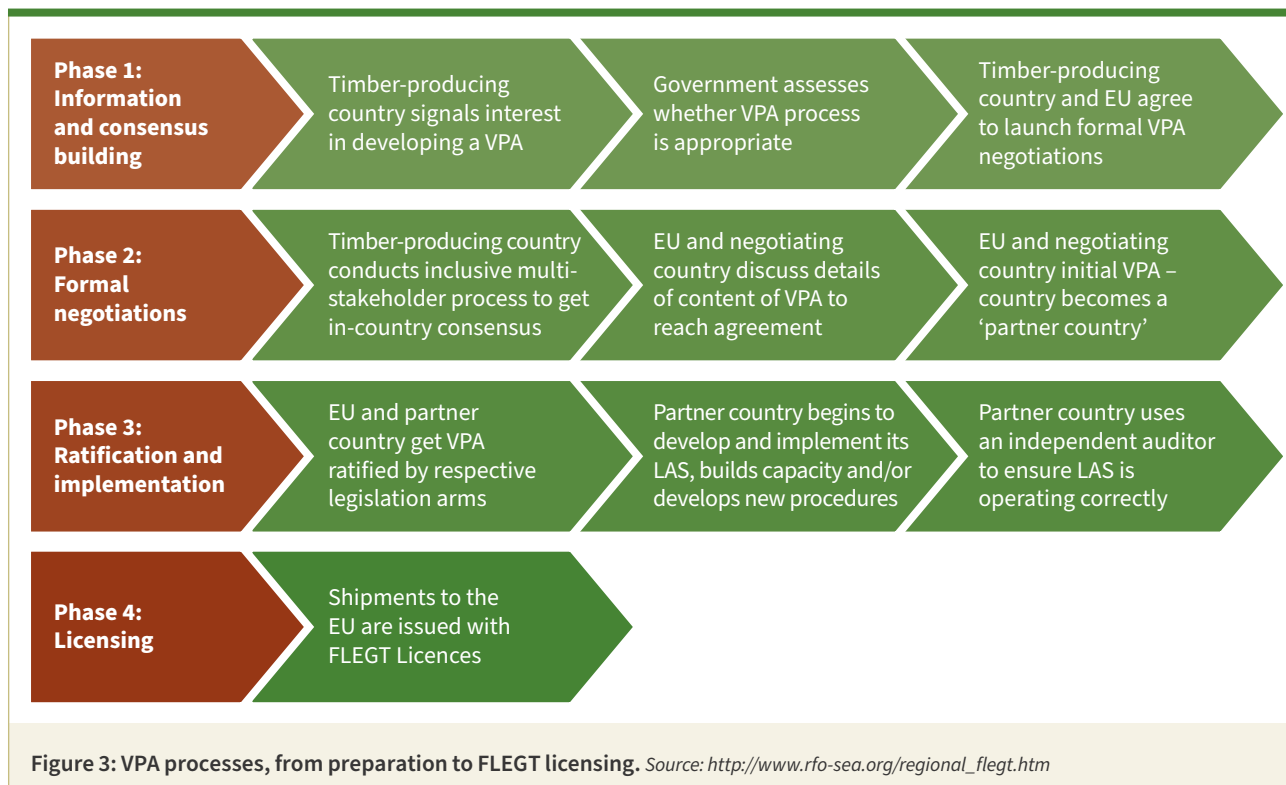
The plan involves activities and measures to combat illegal logging including regulation to prevent EU businesses from importing or trading illegal timber. In 2005, the EU adopted Regulation (EC) No 2173/2005² of 20 December 2005 *on the establishment of a FLEGT licensing scheme for imports of timber into the European Community* (FLEGT Regulation), as part of the implementation of the FLEGT Action Plan. The FLEGT Regulation lays down rules for the implementation of the FLEGT licensing scheme through the conclusion of Voluntary Partnership Agreements (VPAs; see *Figure 3*) with timber producing countries, including a requirement for imports into the EU of timber products originating in FLEGT partner countries to be covered by a FLEGT Licence.

By the end of 2020, seven countries had signed and ratified a VPA with the EU, with only one of them, Indonesia, having started FLEGT licensing in November 2016. This means that currently only Indonesian timber is recognised as legal without requiring further due diligence under the EU Timber Regulation. The remaining six countries are currently in different stages of the VPA implementation. Another eight countries are negotiating or have initiated a VPA with the EU. These 15 countries are known as VPA partner countries.

2.2 Previous work on FLEGT VPAs and forest sector investments

In late 2018, IMM commissioned a study on the potential of FLEGT VPAs to mitigate typical forest sector investment risks (IMM, 2019). The underlying assumption for this study was that implementation of FLEGT VPAs attracts legal and sustainable forest sector investments. The study surveyed domestic and international investors in eight VPA countries³ to analyze this relationship in detail. The study concluded that:

- International forest sector investors are increasingly interested in FLEGT VPA partner countries. This interest mainly focuses on Asia and Latin America, while Africa is still maturing as an investment destination. International investments mainly target industrial plantations and large wood industries.



1. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52003DC0251>

2. OJ L 347, 30.12.2005, p.1.

3. Indonesia, Viet Nam, Ghana, Cameroon, Republic of the Congo, Liberia, Central African Republic, Honduras

- Besides international investors, there are a large number of domestic enterprises in VPA countries, which invest in a wide spectrum of forest sub-sectors and value chains (both natural forests and plantation based);
- Especially investors who target international markets and are invested in natural forest-based value chains perceived VPAs as important for mitigating investment risks;
- Large-scale investors in plantation-based operations did not perceive VPAs as being of major relevance. Thus, the potential of VPAs to attract major plantation investment and influence investment strategies in this market were concluded to be limited at present;
- Nonetheless, large scale plantation investors also felt they might benefit from other impacts of VPAs, such as the overall improvement of forest governance and coherent forest sector policies;
- SMEs articulated that VPAs could positively influence their investment decisions if the process improved access to capital, raw materials and market opportunities. On the other hand, investors said that SMEs might also divest or exit the sector if VPAs restricted such access;
- Activities related to VPA implementation that directly affect the enabling environment for investment are not (yet) widely recognized in the investor landscape. This is partly because these actions have not yet been implemented in most VPA partner countries, and partly because these actions are not visible or well-communicated;
- Investors acknowledged the positive impacts the VPA process may have on sector reform in the VPA countries, though there were several complaints regarding the lengthiness of the process, with only one country having reached the FLEGT licensing stage;
- There was a general perception that FLEGT VPAs' positive impact on international timber trade remains limited until China and India implement timber import regulations, which also give preferential treatment to FLEGT-licensed timber⁴.
- The implementation of VPAs promotes the formalization of enterprises in VPA partner countries. This broadens the scope of bankable projects for international investors and also enhances the technical and managerial capacities of these enterprises.

The 2019 study concluded that an operational VPA, i.e. a VPA that enables a country to issue FLEGT Licences, was seen as a positive factor when considering potential investments. Drawing on this conclusion, IMM commissioned this follow-up study looking at the forest sectors of Indonesia and Viet Nam. At the time of writing, Indonesia was the only FLEGT-licensing partner country, while Viet Nam is progressing through the VPA implementation process and plays a key role as a processing hub for timber products. The aim of this study was to obtain more detailed information on VPA related investment criteria and draw lessons for future implementation of VPAs with a more inclusive focus on private sector investment risk mitigating opportunities.

Approach

3.1 Rationale and scope of the study

The IMM study on the potential of FLEGT VPAs to mitigate typical forest sector investment risks (IMM, 2019) concluded that an operational VPA was seen as a positive factor when considering potential investments. Thus, the aim of this study was to assess the current and potential impact of FLEGT licensing and VPA implementation on reducing risk and improving the investment-enabling environment in the Vietnamese and Indonesian forest sectors.

Investment in forestry depends on a set of factors. Each of these factors is assessed by investors for opportunities and risks before an investment decision is made. From the perspective of an investor in the forest sector, risks are typically grouped into three categories⁵:

- **Project risk** – these risks are directly related to the technical operation of an asset in the forest sector. Among other factors, these include: site conditions, productivity, production costs, financing requirements, cash flow profile, overall complexity, presence of off-takers, product prices, as well as natural hazards;
- **Forest sector risk** – these risk factors include sector specific policies, taxes and incentives, competition, level of differentiation, level of formalization and legality, access to land/forests and tenure security, environmental and social safeguards and requirements, among others;
- **Country risk** – this includes all other factors surrounding project and sector risk, including for

4. This perception indicates that the role of China, while significant, tends to be overrated. IMM analysis demonstrates that in 2019 66.5% of global tropical timber and timber product exports were destined for countries with regulatory measures to eliminate illegal trade. The proportion of wood product exports destined for regulated countries was even higher for VPA partner countries. In 2019, 79% of all wood products exports by FLEGT licensing and VPA implementing countries was destined for regulated markets. <https://www.flegtimm.eu/index.php?view=article&id=264:goal-of-closing-world-markets-to-illegal-wood-products-well-advanced&catid=20:project-news>.

5. NOTE: There are various approaches to structure forest investment risks in literature (see PROFOR 2014 for a comprehensive review of forest investment risk). However, they all comprise the same risk elements, though grouping them under different headings. For the purpose of this study, we applied a modified risk categorization to better match the key questions on the causal nexus of VPA and investment risks.

example the maturity of the market, economic stability and growth, terms of trade, incentives for investment, taxes, ease of doing business, regulatory frameworks and national security.

The FLEGT VPA initiative includes an array of activities and tools that enhance forest sector attractiveness for investments by reducing typical risks. Investors see the presence of a VPA as a positive criterion when evaluating investment opportunities. However, most of the risk-mitigating aspects only materialize when a VPA becomes fully operational and all required market participants in a partner country comply with the requirements.

The **CoViD-19** pandemic has led to global economic turmoil and shutdown of economic activities. The pandemic has triggered recognizable impacts such as market distortions, changed production costs, reduced access to raw materials and an increase in illegal sector activity (ILO, 2020).

The present study also investigated whether a FLEGT VPA may have a positive influence on the resilience and risk management of forest sector enterprises during the CoViD-19 pandemic⁶.

The study's objectives were to:

- Provide a historical review of forest sector investment and enterprise data and, where possible, correlate this with milestones of the FLEGT VPA process;
- Investigate the influence of VPAs on investment decisions pre-2020;
- Assess the potential of VPAs to strengthen resilience and manage risk during the CoViD-19 pandemic.

3.2 Forest sector data

The review of national forest sector investment data aimed to identify changes in investment and capital spending in the forest sub-sectors in Indonesia and Viet Nam. Forestry sub-sectors are identifiable within national statistics according to the International Standard Industry Classification (ISIC). For the purpose of this study the following forest subsectors were assessed according to the 2-digit ISIC classification:

- ISIC 02 Forestry and logging
- ISIC 16 Wood industry
- ISIC 17 Pulp and paper (includes non-wood fiber-based pulp and paper)
- ISIC 31 Furniture (includes non-wood furniture).

Time series data was available for the following parameters relevant to forest sector investment:

Viet Nam

- Year 2000 to 2017: number of enterprises for forest sub-sectors
- Year 2004 to 2017: number of enterprises disaggregated for size classes and forest sub-sectors
- Year 2000 to 2017: number of employees, disaggregated for all forest sub-sectors

- Year 2000 to 2017: increase in fixed assets and long-term investment, disaggregated for all forest sub-sectors.

Indonesia

- Year 1999 to 2018: number of medium-large enterprises, disaggregated for wood industry, pulp and paper, furniture, but not for forestry and logging
- Year 2004 to 2017 (excl. 2009 and 2016): number of small and micro enterprises, disaggregated for wood industry, pulp and paper, furniture, but not for forestry and logging
- Year 1999 to 2017: net increase fixed assets of medium-large enterprises, disaggregated for wood industry, pulp and paper, furniture, but not for forestry and logging
- Year 1999 to 2018: volume of domestic investment in forestry and logging and number of investment projects
- Year 1999 to 2018: volume of foreign direct investment in forestry and logging and number of investment projects.

3.3 Enterprise and stakeholder interviews

The enterprise interviews aimed to add value to the analysis of statistical information on forest sector investments by providing background on investors' decision-making processes and priorities. To that end, 20 enterprises were interviewed across all sub-sectors (Forestry and logging, Wood industry, Pulp and paper, and Furniture): 10 in Viet Nam and 10 in Indonesia.

In order to complement and contextualize the enterprise interviews and to obtain additional stakeholder perspectives, the study also included interviews with timber-sector associations representing a large number of companies in both countries as well as a number of institutional actors from the Vietnamese and Indonesian forest sectors. The interviews with institutional actors covered representatives from relevant ministries and civil society.

The interviews with enterprises, associations and institutional actors focused on two topics:

- Major investment risks in the forest sector and the influence of FLEGT VPAs on these risks and associated investment decisions pre-2020;
- Perceptions of the potential for FLEGT VPAs to strengthen resilience during the CoViD induced crisis - in particular in the post-crisis reconstruction phase.

The interview partners from enterprises were selected according to the following criteria:

- In business since the year 2005 or longer
- Have made regular investments in expansion or modernization
- Minimum of 50 employees
- Comply with national TLAS.

The questionnaire and description of interviewed enterprises and institutions are available in Annex 2.

6. From beginning of 2020 to August/September 2020.

The impact of the VPA on Forest sector investment in Viet Nam

VPA negotiations between the EU and Viet Nam started in 2010. The VPA entered into force in June 2019 and Viet Nam has since been working on implementing it.

4.1 Review of investments in the Vietnamese forest sector

Comparison of the decades before and after start of VPA negotiations in 2010 shows a significant increase in average investment volumes per year. However, the implementation of the VPA started in 2019 and the Timber Legality Assurance System (TLAS) has yet to be rolled out at large scale. Hence, it is not yet possible to assess the impact of an operational VPA and FLEGT licensing on forest sector investment in Viet Nam.

In the year 2000, Viet Nam enacted the enterprise law, which was an important step opening up the economy for private investment. Since then, investment in the forest sector has steadily increased, supported by bilateral trade agreements with the US. and a general liberalization of trade regulations in 2001. Major positive impact on investment activities in Viet Nam materialized after the country's WTO membership (2007). Subsequently, in 2010 and in 2011, the government enforced a series of resolutions to stabilize the Vietnamese Dong, inflation and reforms to the investment enabling environment.

At start of the VPA negotiations in 2010, the Vietnamese economy was in a phase of expansion and attracted investments across all industries, including the forest sector. The average annual investment volume in the forest sector increased from US\$415 million pre-2010 to US\$690 million after VPA

negotiations started (Figure 4). However, the beginning of VPA negotiations coincided with substantial reforms of the economic system, which were identified as the driver of investment growth by respondents.

Investment in forestry and logging was driven by the growing timber demand for domestic industries and raw material exports. Around 4 million hectares of

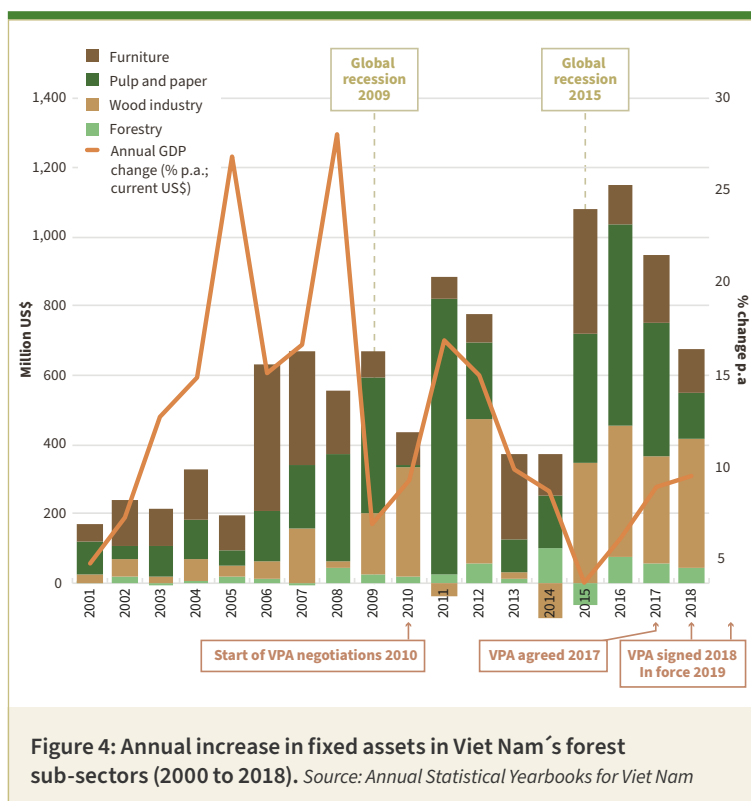


Figure 4: Annual increase in fixed assets in Viet Nam's forest sub-sectors (2000 to 2018). Source: Annual Statistical Yearbooks for Viet Nam

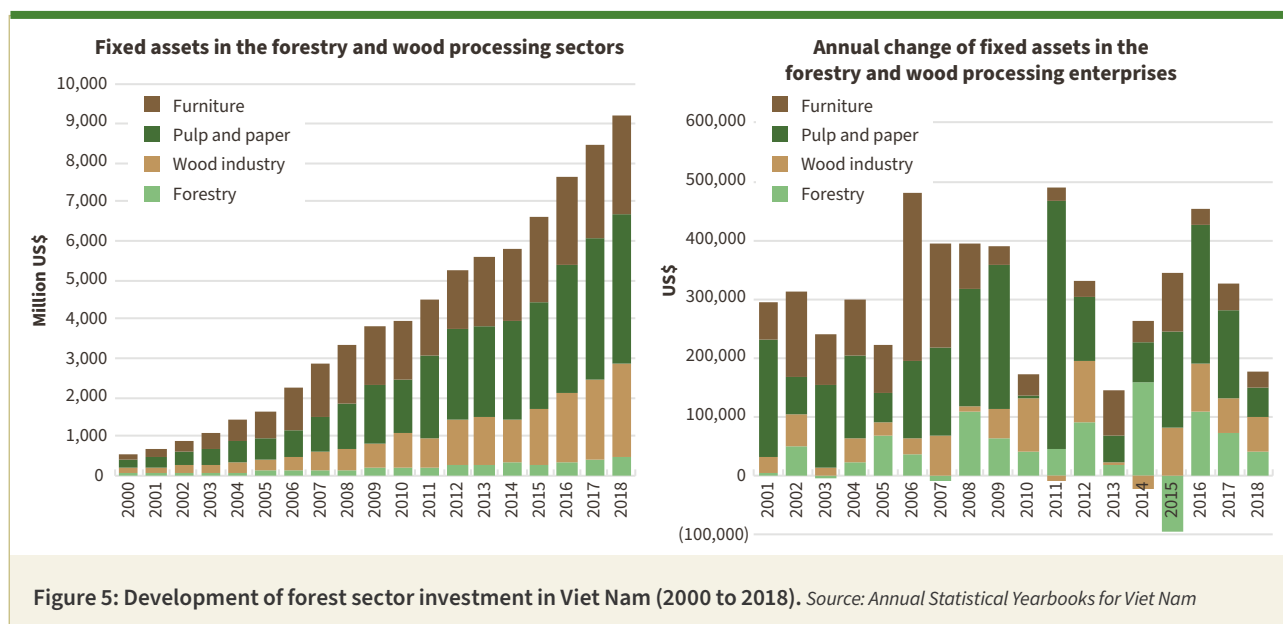


Figure 5: Development of forest sector investment in Viet Nam (2000 to 2018). Source: Annual Statistical Yearbooks for Viet Nam

plantations (mainly smallholders) have been established since the year 2000, enabled by improvements of land use right certification systems for private households. Hence, the number of micro enterprises in the forestry and logging sub-sector has increased over the last decade (Figure 6). At the same time, most of the formerly state-owned State Forest Enterprises (SFEs) have

completed a privatization process. These SFEs have been capitalized, re-organized and are now working as for-profit entities. Increasing investments and divestments in the forestry and logging sub-sector since 2010 can be attributed to these developments (Figure 5).

A major investment surge in the wood processing industry started in 2006 and has significantly increased since 2011 (with a short depression 2013/14; Figure 5). Investments in the Vietnamese wood processing and furniture sectors were driven by favorable factor costs and government support stressing the sector's strategic importance for national development⁷. Huge flagship investments were made by global lead companies (e.g. IKEA) in order to enhance their supply chains.

In spite of the increases in total volume of investment, the number of large enterprises has not significantly changed over the past decade. On the other hand, the number of SMEs and micro enterprises has developed dynamically. The most significant industry wide change has been the shift from wood industry to furniture enterprises. The effects of the 2008/09 financial crisis were keenly felt by larger furniture enterprises and SMEs. The recovery for large furniture enterprises has been slow, with the number of large furniture enterprises only reaching the pre-2008 figure in 2018.

To meet rising demand for quality raw materials by Vietnamese wood processing industries, log, sawnwood and panel imports have increased considerably since 2010. This increase coincides with the growth of furniture exports during the same period (Annex 3). Domestic roundwood production and primary wood processing industries can neither produce the quantities nor the qualities required by the export oriented secondary processing enterprises. Due to Viet Nam's reliance on imported raw materials, there is increased demand from importers for proof that wood products have been legally and sustainably sourced.

4.2 Enterprise perspectives on the impact of the VPA on forest sector investment in Viet Nam

The implementation of the VPA in Viet Nam is ongoing and FLEGT licensing has yet to come into force. As such, the results of the Vietnamese enterprise and stakeholders interviews cannot draw on enterprise experiences with FLEGT licensing. The results of the interviews reflect the expectations of respondents regarding the impact of the VPA on the investment enabling environment in the Vietnamese forest sector.

4.2.1 FLEGT VPA potential to mitigate forest sector investment risk in Viet Nam

Respondents did not see an influence of the VPA negotiations in the period 2010–2018 on forest sector investment decisions. Market forces, favorable factor costs and economic reforms were identified as the major investment drivers. However, respondents expect that the operational VPA will mitigate market risks, mobilize capital and improve forest sector governance in the future.

7. Viet Nam Forestry Development Strategy (2006-2020)

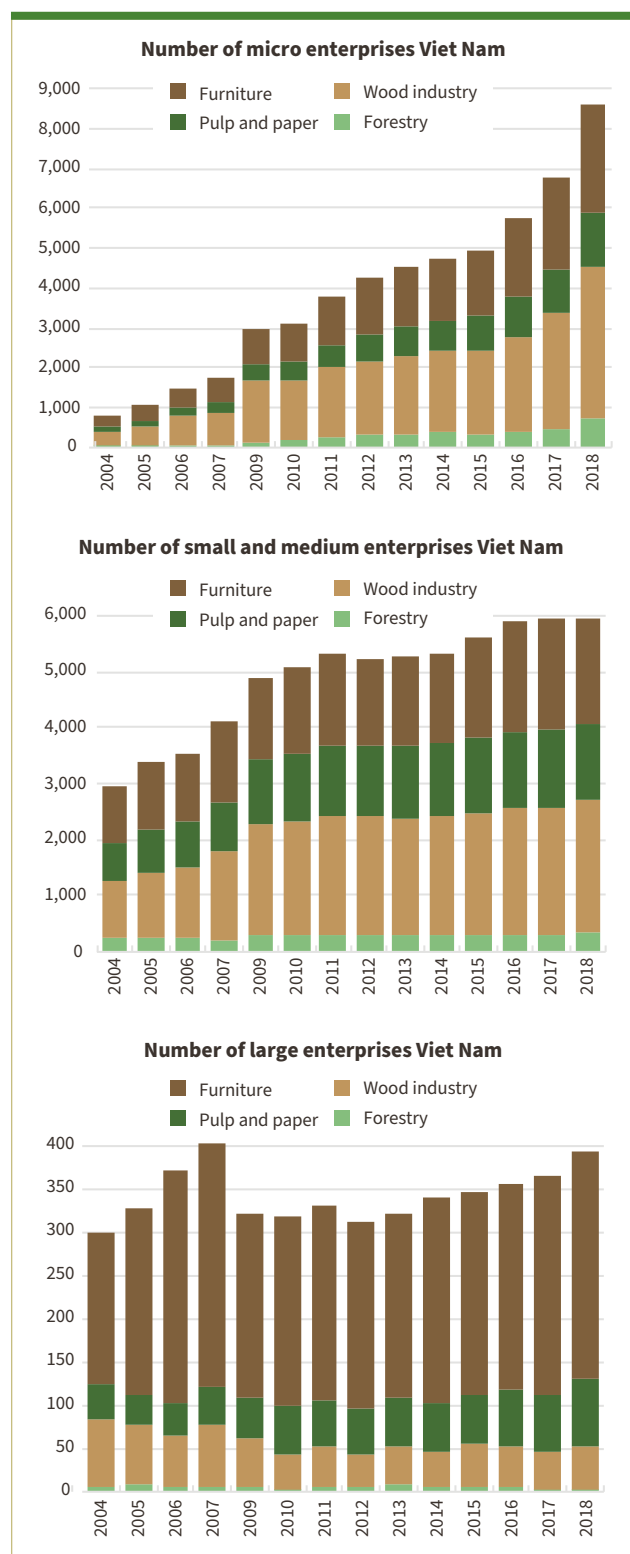


Figure 6: Development of the number of forest sector enterprises, Viet Nam (2004 to 2018).

Source: Annual Statistical Yearbooks for Viet Nam.

NOTE: Micro enterprises < 10 employees; small and medium enterprises 10-299 employees; large enterprises > 300 employees

Common forest sector investment risks

The surveyed enterprises reported the following as the most relevant risks when assessing investment/expansion opportunities:

| Most frequent investment risks | Less frequent investment risks |
|--|---|
| <ul style="list-style-type: none"> • Catastrophic events (storms, fires, diseases, pandemics) • Volatility of market prices • Restricted market access and lack of market information • Unfair competition from enterprises using illegally imported materials • Restricted access to capital | <ul style="list-style-type: none"> • Legal insecurity (land tenure, law enforcement) • Financial risk (exchange rates, inflation) • Increase of production costs • Lack of skilled work force |

VPA potential to mitigate investment risks

While it is not expected that the VPA will be able to mitigate catastrophic events, financial risk or production cost risks, respondents expect that the VPA will have a positive influence on several of the other investment risks⁸.

Market risks

The most commonly reported sources of risk was market risks. Especially exporting enterprises were optimistic about the potential of the VPA to reduce market risks.

Interviewees' highlighted the potential of the VPA to:

- Improve market access in the EU and other regulated markets;
- Stabilize market share and turnover in export markets;
- Diversify the range of export markets and potential clients;
- Negotiate price premiums for FLEGT-licensed timber;
- Establish long term business relationships on the basis of FLEGT licensing;
- Reduce unfair competition from enterprises using illegally imported materials.

Catastrophic events

Although most enterprises answered that the VPA's potential to mitigate the risk of catastrophic events is limited, respondents noted that the VNTLAS regulation requires forest owners to apply good forest management in line with the forest law. This includes practices with respect to managing fire risk and appropriate silvicultural practices to mitigate other natural hazards (e.g. diseases)⁹.

Access to capital

Restricted access to capital in the form of investment and working capital was frequently cited as a potential risk to forest sector enterprises. Respondents expect that the implementation of the TLAS will help to mitigate risks in terms of access to capital.

- Respondents perceived a direct correlation between the VPA and positive market prospects, increased turnover and improved credit ratings with commercial banks.
- Complying with TLAS requirements would improve credibility with clients resulting in more willingness to pre-finance production.
- Some interviewees expect increased interest from private equity investors as a result of improved reputation and transparency.

Forest land tenure

Respondents reported encroachment, timber theft and use of non-designated forests as risks with respect to land tenure. However, they perceived that the VNTLAS significantly contributes to reducing these risks as follows:

- The TLAS requires legal clarity on land tenure and thus stimulates the process of issuing land-use certificates;
- Implementation of the TLAS comes with enhanced law enforcement. It improves monitoring and reduces land encroachment and illegal logging;
- The TLAS has clarified legal and institutional procedures for domestic forest production and the regulation of timber flows from non-forest resources (i.e. rubber and trees outside forests).

Other risks

Two other investment risks were only mentioned by a few respondents:

- Lack of skilled work force: VPA implementation may enhance the qualification of staff, however, this would not resolve the challenge of the forest sector to compete for talents with other industrial sectors;
- Production cost: VPA implementation is seen as an additional cost and could potentially increase the cost of raw material.

The following table summarizes the answers of the Vietnamese enterprises, when asked to agree or disagree with a set of statements about the impact of the VPA/SVLK on investment relevant decision making criteria. The overall trends support the results of the open interview questions described in the sections before.

The majority of enterprises felt that the VPA partly or fully supports market development, access to capital and reduces unfair competition in the sector.

Respondents had mixed opinions regarding the impact of the VPA on the availability of raw materials. Some enterprises expected improving availability of raw material. Others expect that the availability of imported raw materials, especially from tropical regions, will decrease as a result of the introduction of the import

8. It is worthwhile to note that forest governance in Viet Nam also benefits from VPA negotiations and implementation. For example, through improved participatory approaches towards forest management (EFI, 2020a).

9. NOTE: In fact, the Vietnamese TLAS does not cover silviculture and forest management practices. These regulations are provided by the new Vietnamese forest law, which was enacted in 2019. The interviewees' perception on the TLAS influencing forest management guidelines may result from the close correlation during the elaboration period of the new forest law and the preparations during the VPA pre-implementation phase (2017-2019).

| Statement | Fully agree | Partly agree | Disagree |
|---|-------------|--------------|----------|
| The VPA process in Viet Nam is improving the business support environment for my enterprise (e.g. capacity building, market information). | ● | ● | |
| The VPA process in Viet Nam is positively affecting market prospects for my enterprise. | ● | ● | |
| The VPA process in Viet Nam is positively affecting forest sector formality and reducing unfair competition from the informal sector. | ● | ● | |
| The VPA process in Viet Nam is positively affecting my enterprise's access to capital or investors. | ● | ● | |
| The VPA process in Viet Nam is improving the availability of raw material for my enterprise. | ● | ● | ● |
| The VPA process in Viet Nam is reducing corruption in the forest sector. | | ● | ● |
| The VPA process in Viet Nam has a positive impact on recruiting qualified staff. | | ● | ● |
| The VPA process in Viet Nam is reducing production/factor costs of my enterprise. | | ● | ● |

Table 1: Perception of enterprises on VPA impact on investment criteria in Viet Nam. Source: Interviews with 10 enterprises
 Explanatory note: Fully agree = the respondent expects or experienced positive impacts of the VPA; Partly agree = the respondent expects or experienced only minor positive impacts of the VPA; Disagree = the respondent does not expect or did not experience positive impacts of the VPA

regulation under the VPA, as some suppliers won't be able to produce the necessary documentation.

The interviewees were pessimistic about the potential of the VPA to reduce corruption in the sector. Although positive expectations were articulated, the respondents felt that the problem of corruption goes beyond the possibilities of the VPA.

The interviewees did not expect that the VPA will positively impact production costs or facilitate the recruitment of qualified staff.

4.2.2 Impact of FLEGT VPA on enterprise crisis resilience in Viet Nam

Respondents reported numerous negative impacts of the CoViD pandemic that have affected their businesses. These were mainly market distortions, which the enterprises try to address by reducing costs and becoming more agile and flexible in production and sales. In general, the interviewed enterprises have not postponed investments.

As the VPA implementation is still in its initial phase, surveyed enterprises have yet to see any immediate crisis-mitigating effects. However, enterprise plans for the post-crisis recovery show clear overlaps with the expected benefits from FLEGT licensing, in particular with respect to improved market access.

Forest sector enterprises during recent crises

All enterprises stated that the 2008 financial and economic crisis affected their business. Exporting enterprises were more affected than enterprises supplying the domestic market.

The economic crisis from 2008 to 2010 particularly affected production costs. Oil and transport costs increased, as did interest rates and other factor costs/inflation. On the demand side, product prices could not keep pace with these cost increases. Turnover decreased as market opportunities became limited.

Competition broadly increased during the crisis. Many enterprises produced below cost efficiency (dumping), leading to a vicious circle of falling prices and economic

losses. Enterprises with poor liquidity were forced out of the market – in particular those that faced problems accessing short-term working capital from banks.

A common reaction of the enterprises was to lay off workers, in particular part-time employees. Alternatively, salaries were temporarily reduced and/or working time was reduced. Some enterprises used a combination of these measures. Other cost saving measures include reduced energy consumption and increased production efficiency.

On the other hand, a few enterprises kept their workforce (and thus incurred economic losses) with a view to; social responsibility, retain well-trained staff and be able to kick start production after the crisis.

Some enterprises tried to coordinate supply and sales with other enterprises with the aim to optimize supply costs and to better negotiate sales prices.

Some enterprises continued production of stock while other enterprises accepted small orders to maintain production. Others accepted orders despite making losses on production, with the goal to keep the clients for post-crisis business.

All companies pursued a strategy to identify new clients and markets, but few succeeded. Further, many enterprises diversified their product portfolio in order to access alternative market segments. This was only partly successful.

According to respondents, the level of illegal activity in the sector did not increase significantly during the 2008/09 economic crisis. Respondents attributed this to rigid law enforcement in the forest sector. Further, due to the prevailing market conditions there were low expected returns to illegal activities.

Forest sector enterprises during the CoViD-19 crisis

All Vietnamese enterprises stated that the CoViD crisis has resulted in reduced sales. However, fixed costs have remained stable. In general, market opportunities narrowed for all enterprises.

Aside from forestry enterprises, which were allowed to continue basic operations (planting, weeding, tendering, etc.), all enterprises had to temporarily stop production during the lockdown period. After lockdown measures were eased, enterprises re-started production, but sales volumes had been low and product prices also remained lower than the pre-CoViD period. Some enterprises continued to accept orders, despite making losses on them. Other enterprises reported increasing pressure from dumping by competitors.

In response to the pandemic, all interviewed enterprises reduced working hours for their staff, but only a few laid off workers. The enterprises intended to keep their workforce to be prepared for increasing orders and sales¹⁰.

Only few enterprises stated that they were postponing investments planned for 2020, while most continued investing as scheduled.

By the end of 2020 none of the interviewed enterprises had received support from government programs. Only one enterprise was able to extend the due date for tax payments.

In general, enterprises did not feel that the VPA helped to mitigate the CoViD crisis' negative impacts since the TLAS had not been fully implemented.

To overcome the impacts of the crisis and prepare for the post-crisis period, many enterprises stated that they plan to invest in product diversification and product quality improvement (also in roundwood production). Likewise, many enterprises reported that they were planning to expand capacity in preparation for the post-CoViD period. Respondents plan to target more diverse marketplaces and aim to reduce dependency on a limited number of buyers and destinations. Some mentioned that they would like to be better prepared for the next crisis and plan to develop crisis management strategies.

| Financial support | Business support |
|---|--|
| <ul style="list-style-type: none"> Simplified commercial banks' lending policy Reduced interest rate Reduced land-use tax and other taxes Increased investment support Delayed tax repayment Extensions for the repayment of bank loans | <ul style="list-style-type: none"> Support during market expansion and good market intelligence Upgrading technology; improving product quality and quantity Capacity building of management and staff (business administration, production, standards and certification) |

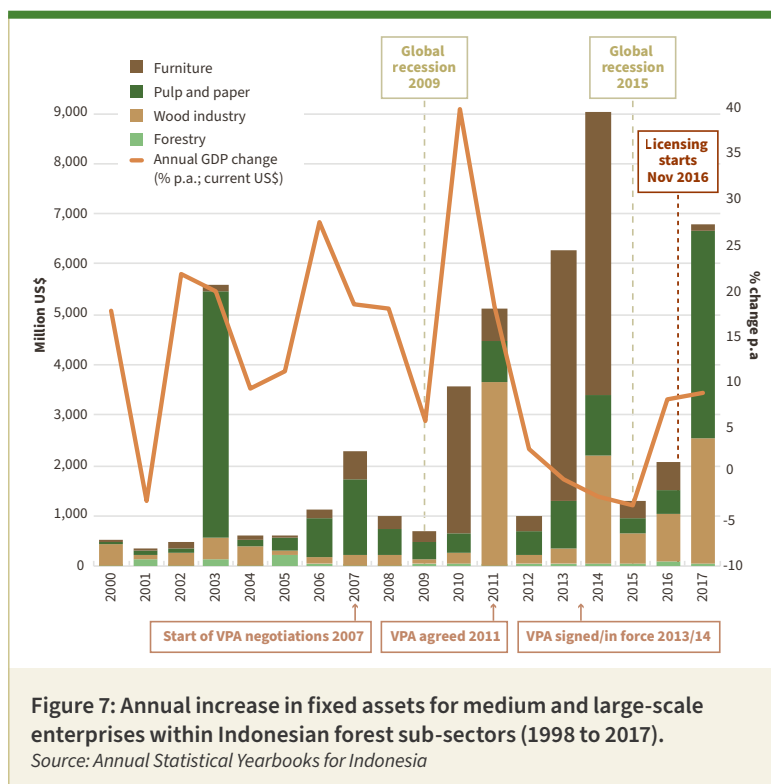
Table 2: Support requirements of Vietnamese enterprises to manage CoViD impacts.

The impacts of the VPA on forest sector investment in Indonesia

In 2003, Indonesia launched a process to design a timber legality assurance system. The National Timber Legality Assurance System (SVLK), was adopted in 2009 and became the basis for the timber legality assurance system under Indonesia's VPA with the EU. In November 2016, Indonesia began issuing FLEGT Licences to verified legal timber products exported to the EU.

5.1 Review of investments in the Indonesian forest sector

Average annual forest sector investment almost doubled after start of the VPA process in 2007. The focus of investment has shifted from pulp and paper towards wood processing and furniture manufacturing. The year 2011, when the VPA was agreed, was identified as turning point in forest sector investment. Survey respondents attributed this to the substantial improvements in forest sector governance, which led to increased interest in formal sector investment.



10. NOTE: The interview results contradict an ITTO review in the second quarter of 2020 on the impact of CoViD on the Vietnamese forest sector, which showed that about 45% of the labor force employed in the wood-processing industries has lost jobs due to the pandemic (ITTO, 2020).

During the early 2000s, the Indonesian forest sector was just recovering from the post-Suharto crises and turmoil that had led to widespread mismanagement and high levels of illegality in the forest sector (Hapsari, 2011). This troubled period was followed by a booming national economy that was fueled by intensive use of forest resources, conversion of natural forests to other land uses (i.e. palm oil, pulp plantations, infrastructure projects) and growing integration into the global timber economy. Due to large-scale conversion of forest areas, wood was widely available at low cost, leading to an increase in wood processing and furniture enterprises (Figure 9). However, investment volumes in wood industry and furniture remained low until start of the VPA negotiation process in 2007.

The average annual forest sector investment in the pre-VPA negotiation period (1998 to 2006) was US\$1.7 billion. This almost doubled since the start of the VPA process in 2007 to US\$3.1bn/year. Over the same period the focus of investment shifted from pulp and paper towards wood processing and furniture manufacturing.

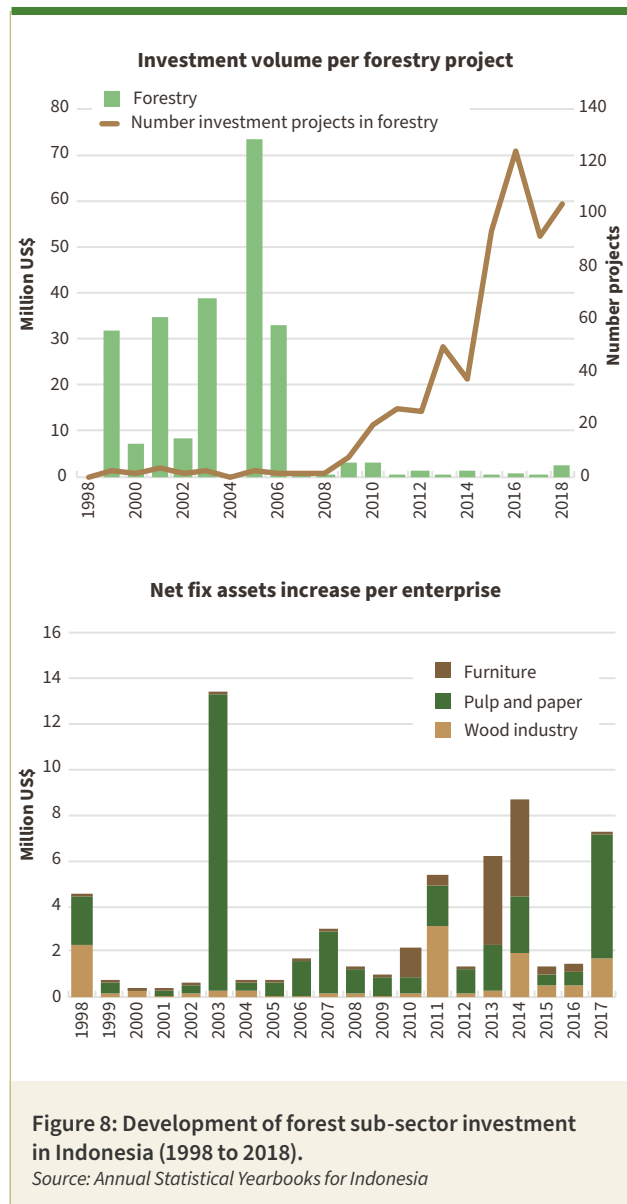
On the other hand, investment volumes in the forestry and logging sub-sector declined after 2006/07 (Figure 7 and Figure 8), as large-scale plantation investments by the pulp and paper sector were restricted. Since then, investment in the forestry sub-sector has become much more diversified and small scale. In 2018, more than 100 projects were implemented at an average investment volume of US\$2.5 million.

Survey respondents identified the year 2011, when the VPA was agreed a, as a milestone in forest sector investment. The VPA process influenced implementation of the forest moratorium, enforced in 2010, which led to more restrictive regulations on forest conversion and timber exports. In the aftermath, the number of enterprises that capitalized on illegal raw materials was significantly reduced.¹¹

While the number of enterprises decreased, investment volumes increased, i.e. in the wood and furniture industries (Figure 8). Survey respondents partly attributed this increase in investment volumes to the FLEGT VPA process and the related improvements in forest sector governance, as well as improved Indonesian access to the regulated markets in EU, the US, Australia and Asia.

Defining and quantifying the impact of the SVLK and the FLEGT VPA process on forest sector investment in Indonesia remains difficult, primarily because the Indonesian forest sector has experienced numerous disruptive changes and shocks over the past decades.

The global financial crisis of 2008 severely affected the Indonesian forest sector, in particular exporting enterprises (Annex 3). The crisis accelerated the ongoing process of wood industry concentration. After a short recovery in 2010 the national economy experienced years of low GDP growth and recession, which also affected the forest sector.



When FLEGT licensing started in 2016/2017, the Indonesian economy was in good shape again with GDP growth rates of around 10%. The number of medium and large enterprises and investment in the forest sector increased again (Figure 7 and Figure 9).

5.2 Enterprise perspectives on the impact of the VPA on forest sector investment in Indonesia

According to survey participants, the effects of the VPA process on forest sector investments in Indonesia increased in importance in 2010, when the Indonesian government addressed deforestation and illegality in the sector by enforcing a forest moratorium. The VPA process and forest policy reforms worked hand in hand to change the playing field for forest sector investment in the country.

In the pre-2010 period, many enterprises in the wood and furniture industry capitalized on easily accessible, low-cost raw material, without giving adequate

11. NOTE: Official statistical data does not provide time series for number of enterprises in forestry and logging; only number of foreign and domestic investment projects. For the other forest sub-sectors, detailed numbers for enterprises and employees is available, disaggregated for medium-large, small and micro enterprises.

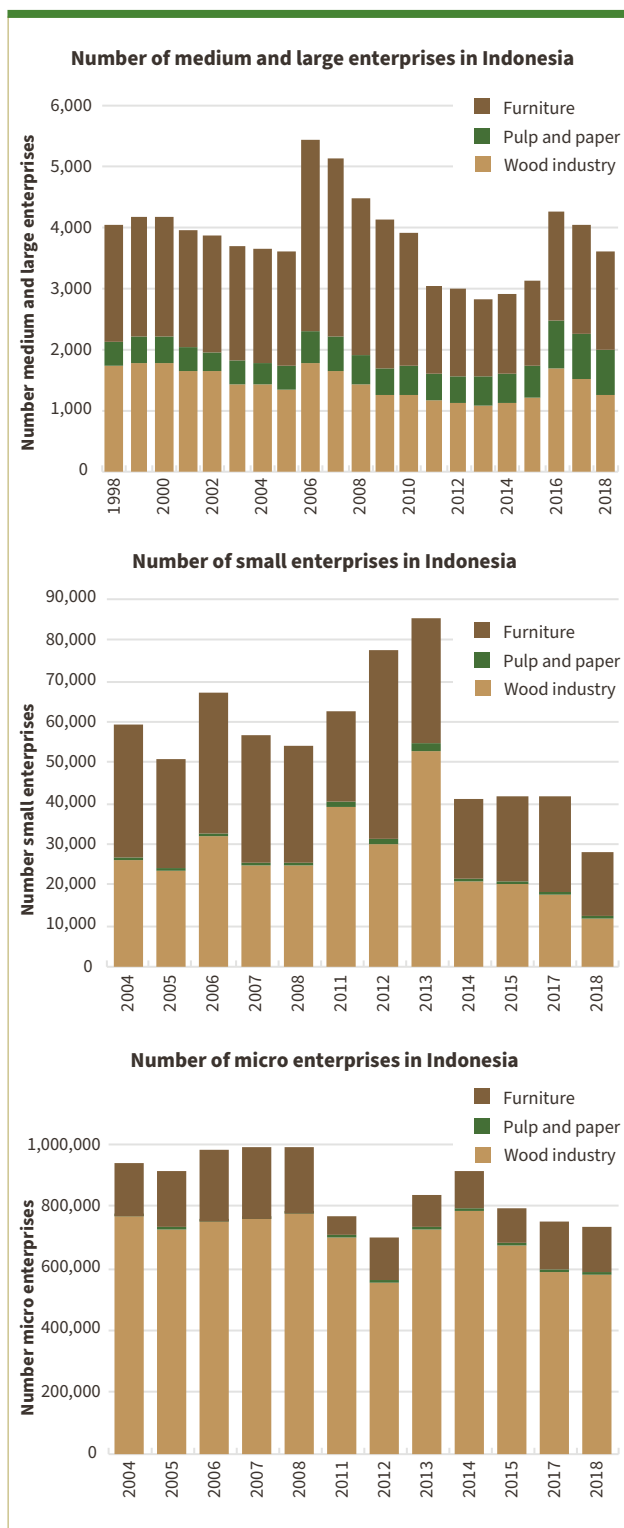


Figure 9: Number of forest sub-sector enterprises in Indonesia (1998 to 2018).

Source: Annual Statistical Yearbooks for Indonesia. NOTE: Micro enterprises < 5 employees; small enterprises 5-19 employees; medium enterprises 20-99 employees; large enterprises > 100 employees. The decreasing number of small enterprises from 2013 to 2014 remains unclear.

consideration to sustainability issues. Many of these enterprises went out of business post-2010, when their supply chain vanished due to the more restrictive regulations. Other factors that contributed to this decline were the struggling domestic economy, and the effects of the financial crisis of 2008/09.

5.2.1 FLEGT VPA potential to mitigate forest sector investment risk in Indonesia

Survey respondents partly attributed increasing investment volumes in wood industry and furniture operations to the VPA process. Agreement of the VPA in 2010 and enforcement of the national forest moratorium led to increased formal sector investment in forest industries. The VPA contributed to mitigating investment risk in the forest sector by improving sector formality, legal security and enhancing Indonesian producers' competitiveness in regulated markets of the EU, the US, Australia and regulated Asian markets.

Common forest sector investment risks

The surveyed enterprises reported the following as the most relevant risks when assessing investment/expansion opportunities:

| Most frequent investment risks | Less frequent investment risks |
|--|---|
| <ul style="list-style-type: none"> • Legal security • Land tenure • Market related risks (fluctuations, price volatility) • Illegal logging and resulting unfair competition | <ul style="list-style-type: none"> • Raw material shortage • Increasing cost • Catastrophic events (storm, fire, diseases, pandemic) |

VPA potential to mitigate investment risks

Respondents see limited possibilities for the VPA to reduce risks related to legal security and land tenure. However, they emphasize the role of the VPA for mitigating certain market risks and improving legality in the forest sector.

Legal security

Legal security and reliability was among the most prominent risks identified by the enterprises. According to the interviewees, Indonesian laws and regulations in the forest sector are constantly changing and lack transparent communication and implementation. New regulations are sometimes flawed and require corrections. On top of this, there would not be sufficient coordination between local and national level law making and enforcing units. Investment decisions are highly vulnerable to these risks.

Although the Indonesian VPA specifically addresses legislative clarity and reform in the forest sector, respondents were pessimistic about the potential for the VPA to substantially mitigate these risks.

Forest land tenure

Respondents highlighted the risks associated with land tenure conflicts and forest use rights. This risk includes land claims from local communities, overlapping user rights, and lengthy processes of land demarcation. This risk was especially highlighted by concession holders, but was also noted by buyers of roundwood: unresolved forest land tenure disputes would restrict reliability of supply, since logging operations are temporarily stopped.

Respondents stated that the VPA has a positive influence on mitigating land tenure risk, e.g. through stakeholder consultation process, or by providing conflict resolution mechanisms. Further, the VPA includes explicit acknowledgement of community forestry production.

| Statement | Fully agree | Partly agree | Disagree |
|--|-------------|--------------|----------|
| The VPA process in Indonesia is positively affecting market prospects for my enterprise. | ● | ● | |
| The VPA process in Indonesia is reducing corruption in the forest sector. | ● | ● | |
| The VPA process in Indonesia is positively affecting forest sector formality and has reduce unfair competition by the informal sector. | ● | ● | |
| The VPA process in Indonesia is improving the business support environment for my enterprise (e.g. capacity building, market information). | ● | ● | ● |
| The VPA process in Indonesia has a positive impact on recruiting qualified staff. | ● | ● | ● |
| The VPA process in Indonesia is improving availability of raw material for my enterprise. | | ● | ● |
| The VPA process in Indonesia is positively affecting my enterprise`s access to capital or investors. | | ● | ● |
| The VPA process in Indonesia is reducing the production/factor costs of my enterprise. | | ● | ● |

Table 3: Perception of enterprises on VPA impact on investment criteria in Indonesia. Source: Interviews with 10 enterprises
 Explanatory note: Fully agree = the respondent expects or experienced positive impacts of the VPA; Partly agree = the respondent expects or experienced only minor positive impacts of the VPA; Disagree = the respondent does not expect or did not experience positive impacts of the VPA

However, the underlying causes of land tenure related risks remain widespread. These include inequality in land distribution, unclear land titles, overlapping user rights, and structural social injustice.

Market risks

While interviewees acknowledged the positive impact of the VPA on market access and market expansion, they clearly stated that it would require substantial additional marketing efforts in order to compete against timber and timber products from other countries in international markets, some of which are uncertified and unlicensed and thus cheaper in production, while others have the reputational benefit of being FSC or PEFC-certified. The current price level for FLEGT-licensed timber does not reflect the additional effort it requires adequately and puts economic pressure on enterprises.

Illegal logging

Respondents stated that the VPA has introduced tracing and monitoring of timber flows. With implementation of the VPA, the number of market participants using illegally sourced raw materials has substantially declined.

Other risks

A number of other investment risks were mentioned by only a small number of respondents:

- Raw material shortage – Implementation of the VPA has led to temporary reduction of raw material availability since certification of forest production had to catch up with demand. Although there are still occasional shortages in raw materials, most enterprises said that overall situation had significantly improved. However, a few enterprises are still experiencing shortages of raw material, which is a risk to the long-term viability of their business;
- Increased production cost – Higher factor costs in Indonesia are threatening the nation’s international competitiveness. The VPA does not contribute to cost reduction;
- Catastrophic events – Forest fire occur regularly; according to the interviewees the VPA does not mitigate this risk.

The above table summarizes the answers of the Indonesian enterprises, when asked to agree or disagree with a set of statements about the impact of the VPA/ SVLK on investment relevant decision-making criteria.

The majority of enterprises felt that the VPA partly or fully supports market development, and has contributed to a reduction in corruption in the forest sector and has improved sector formality.

On the other hand, opinions were mixed with respect to the impact of the VPA on the overall business environment and the qualification of the forest sector work force.

The respondents’ experience with the VPA’s influence on raw material availability and production costs were also mixed. In general, they have experienced only a minor positive or no positive influence of the VPA’s on these factors. Also, no major positive impact of the VPA on access to capital was mentioned by the interviewed enterprises.

5.2.2 Impact of FLEGT VPA on enterprises’ crisis resilience in Indonesia

According to respondents, enterprises in the Indonesian forest sector have increasingly postponed investment due to the effects of the 2020 CoViD pandemic. They reported only a minor positive influence of the VPA for mitigating the CoViD crisis impacts. They stated that the VPA effectively controls illegality and ensures continuing access to regulated markets.

Forest sector enterprises during recent crises

The financial crisis of 2009/10 affected some, but not all of the interviewed enterprises. Its primary impacts included decreased sales volumes and reduced export opportunities. Many of the respondents were forced to reduce the number of employees during the 2008 crisis. Other measures included improving on operational costs, changing the source of raw materials (e.g. using rubberwood) and reducing wood raw material stocks. Also, investments were postponed due to capital shortages. Many enterprises sold production that had been destined for export, in the domestic market at lower prices.

Due to reduced demand, many enterprises observed an oversupply in international and domestic markets, accompanied by declining price levels. This led to the economic collapse of several enterprises in the forest sector. However, the crisis seemed to enhance ongoing trends in the wood industry (i.e. plywood) and had a catalytic effect on the number of enterprises by eliminating non-competitive actors.

Forest sector enterprises during CoViD-19 crisis

Enterprises stated that on average, the Covid-19 pandemic has resulted in a substantial fall in timber production and product sales.

Further, working capital shortage and the ongoing burden of fixed costs were common problems mentioned by the enterprises. The vast majority of interviewed enterprises postponed investments scheduled for 2020.

To mitigate the crisis impacts, some enterprises laid off large numbers of employees (i.e. part-time workers) and/or reduced staff working hours. Other coping strategies included reduced energy use and reduced use of raw materials. Many enterprises also introduced improved real-time monitoring and financial controlling of the production process.

On the other hand, some enterprises were trying to keep their workforce for social reasons, or to maintain the ability to meet also larger orders, when and if they come in. The order situation was described by respondents as more erratic than before the crisis.

Enterprises offered products that were previously destined for export markets to the domestic market at low prices. In spite of these measures, stocks continued to increase and the fixed cost burden remained high.

While wood processing industries were also looking for alternative international markets and diversifying their portfolio of products, the forestry sub-sector was bound to the domestic market due to roundwood export regulations. This left it with fewer crisis mitigation options and increases dependency on reduced prices in downstream value chains.

Some enterprises mentioned restricted availability of essential supplies to maintain production (e.g. spare parts, equipment) because of lockdowns imposed in countries producing these goods.

The Indonesian government has issued economic stimulus and support programs in the form of lowered interest rates and tax breaks¹². Other measures are under

| Financial support | Business support |
|---|---|
| <ul style="list-style-type: none"> • Simplify commercial banks' lending policy • Reduce interest rates • Reduce tax rates • Provide investment support for processing and reforestation • Extend the tax payment period • Re-financing loan cost / health insurance | <ul style="list-style-type: none"> • Public stimulus program for domestic timber demand • Support during market expansion and market intelligence • Upgrade technology; improved product quality and quantity • Capacity building for management and staff (business administration, production, standards and certification) |
| <p>Table 4: Support requirements of Indonesian enterprises to manage CoViD impacts.</p> | |

development (e.g. reducing VAT on logs). However, many enterprises stated that it was too early to judge whether these efforts can really mitigate the economic challenges at the time the interviews were undertaken.

Interviewees mentioned that the current crisis did not have much effect on the level of illegal logging operations. They assumed that the TLAS was able to efficiently control illegal activities.¹³

With regard to improving market opportunities in the post-pandemic phase, interviewees stated that FLEGT Licenses do not have the same level of market recognition as private voluntary certification, for example, and that additional marketing efforts would be required to create market advantages and recognition of the added value of FLEGT licensing. A number of respondents expressed dissatisfaction with EU efforts to “promote a favorable position” of products covered by the VPA in the EU market and felt that more needed to be done to comply with Article 13 of the VPA on this issue.

In order to overcome the impacts of the crisis, and to prepare for the post-crisis period, several respondents stated the need for support via improved access to working and investment capital and favorable interest rates. The need to expand export markets and intensify marketing efforts for Indonesian products was very prominent throughout most interviews. Further, respondents requested that domestic demand for timber should be stimulated through public reconstruction programs (public procurement, infrastructure programs). The above table lists the support requirements most frequently mentioned by Indonesian interview partners.

12. East Asia Forum Quarterly, 'Immunising Asia', Vol. 12 No. 2.

13. NOTE: Findings of a recent WWF report, which showed that tropical tree cover loss has increased during the pandemic. This was particularly true for Indonesian tree cover loss levels, with more than 1,300 km² lost to March 2020. The study by the University of Maryland analyzed satellite data of 18 tropical countries (WWF, 2020). However, whether this increase is directly linked to the impact of the pandemic or whether it is caused by other factors cannot be identified.

6 Conclusions

The main drivers for investment in the forest sector include market potential, fuelled by population growth, increasing incomes and exports opportunities. Also important are an investment friendly environment, efficient production systems and favourable cost situation, among many other factors. The 2019 baseline study demonstrated that a FLEGT VPA alone cannot compensate for the lack of such market drivers. However, in countries where all or some of the above criteria are met, as is the case in Viet Nam and Indonesia, VPAs can improve the investment-enabling environment in the forest sector by:

- Creating improved access to regulated markets;
 - Improving access to capital and investors through the formalization of forest sector enterprises;
 - Eliminating market distortions through illegal competition;
 - Establishing good forest governance, addressing social and environmental risk factors;
 - Ensuring long term viability of operations by enhancing sustainable forest management practices.
- To further strengthen the positive impacts of VPAs on forest sector investment, the study recommends that the following aspects might be considered:
- Expand demand from regulated markets (i.e. support the development of timber legislation in additional countries, for example China or India);
 - Strengthen the market position of FLEGT licensed products through improved marketing efforts and preferential treatment (e.g. in public procurement);
 - Promote FLEGT licensing as a factor to improve the credit rating of forest sector enterprises in VPA countries;
 - Ensure formalization of all market participants once a VPA is signed and implemented;
 - Minimize additional costs for producers, for example by developing digital solutions for documentation and monitoring;
 - Ensure that no shortages of regulated timber occur due to limitations for implementing the Timber Legality Assurance Systems (i.e. technical and personal resources to operate the system).

7 Reference list

| |
|--|
| EFI (2020a). The Indonesia-EU Voluntary Partnership Agreement. http://www.euflegt.efi.int/background-indonesia |
| EFI (2020b). The Viet Nam-EU Voluntary Partnership Agreement. http://www.euflegt.efi.int/background-vietnam |
| Hapsari, M. (2011). The Political Economy of Forest Governance in Post-Suharto Indonesia. Gadjah Mada University Press. |
| ILO (2020). Impact of COVID-19 on the forest sector. ILO Sectoral Brief, June 2020. https://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---sector/documents/briefingnote/wcms_749497.pdf |
| IMM (2019). Forest Sector Investments in FLEGT VPA countries. Scoping Study on investor perspectives and investment monitoring. International tropical timber organization / FLEGT Independent Market Monitor (IMM). https://www.flegtimm.eu/images/IMM_Investment_Study/IMM_Forest_Sector_Investments_Study_Final_Version.pdf |
| ITTO (2020). Impact of COVID-19 pandemic on tropical timber producers. International Tropical Timber Organization. MIS survey 1-2020. https://www.itto.int/news/2020/05/08/survey_shines_light_on_covid_19_impacts_on_tropical_timber_sector/ |
| STTC (2020). European Sustainable Tropical Timber Coalition. Potential and provisos for China's 'anti-illegal timber' forest law. http://www.europeansttc.com/potential-and-provisos-for-chinas-anti-illegal-timber-forest-law/ |
| WWF (2020). Waldverlust in Zeiten der Corona-Pandemie. Holzschlag in den Tropen. https://www.wwf.de/fileadmin/fm-wwf/Publikationen-PDF/WWF-Analyse-Waldverlust-in-Zeiten-der-Corona-Pandemie.pdf |

Annex

8.1 Annex 1: Enterprise questionnaire

Background information

1. Name of company:

2. Year starting business:

3. Name of interviewee:

4. Contact:

5. Position in company:

6. Sub-sector (tick box)

| forestry | wood industry | pulp/paper | furniture |
|----------|---------------|------------|-----------|
| | | | |

7. Type of capitalization (tick box)

| State owned | National private | Foreign invested | Other (explain) |
|-------------|------------------|------------------|-----------------|
| | | | |

8. Employees 2019 (Full time / part time)

| | Full time | Part time |
|-------------|-----------|-----------|
| N employees | | |

9. Turn-over 2019:

10. Main products (list three main products)

| | |
|---|--|
| 1 | |
| 2 | |
| 3 | |

11. Main markets

| Market | % share of sales | Destination |
|----------|------------------|----------------------------|
| Export | | Countries: |
| Domestic | | Consuming sectors/clients: |

12. How well do you know the FLEGT VPA (tick box)?

| Very well | Ok, but not in detail | A bit, but not enough | Not at all |
|-----------|-----------------------|-----------------------|------------|
| | | | |

VPA and investment decisions

13. Major investments since start of business

| | Investment (e.g. machinery, land,..) | Size of investment (in local currency) | Type of investment (e.g. starting business, modernization,...) | Year of investment |
|---|--------------------------------------|--|--|--------------------|
| 1 | | | | |
| 2 | | | | |
| 3 | | | | |
| 4 | | | | |

14. When investing in Indonesia's forest sector, what do you perceive as major investment risks?

| | Major forest sector investment risk in Indonesia | Is the FLEGT/SVLK mitigating this risk (yes/no)? Explain. |
|-----|--|---|
| 1 | | |
| 2 | | |
| 3 | | |
| ... | | |
| ... | | |

15. Has the FLEGT VPA influenced the investment environment of your enterprise (tick box and explain)?

| Statement | Fully agree | Partly agree | Disagree | Don't know | Explain |
|--|-------------|--------------|----------|------------|---------|
| The VPA has positively affected market prospects for my enterprise. | | | | | |
| The VPA has positively affected my enterprise's access to capital or investors. | | | | | |
| The VPA has positively affected forest sector formality and reduced unfair competition by informal sector. | | | | | |
| The VPA has reduced corruption. | | | | | |
| The VPA has improved availability of raw material for my enterprise. | | | | | |
| The VPA has reduced production/factor costs of my enterprise. | | | | | |
| The VPA has had positive impact on recruiting qualified staff. | | | | | |
| The VPA has improved the business support environment for my enterprise (e.g. capacity building, market intelligence). | | | | | |
| The VPA has triggered public and international incentives for the forest sector. | | | | | |

Crisis resilience: Your business during recent crises and lessons learnt

16. Which economic downturns over the past decades did impact your business?

17. Describe impacts (turnover, profit, employees, supply, exports, markets, costs,...); no need to quantify in detail, but explain.

18. How has your company overcome the crises' impacts?

19. Have there been policies in place supporting your enterprise during the crisis or/and reconstruction phase (e.g. stimulus programs, capital access, ...)?

20. Has informality and illegality in the forest sector increased during or shortly after the crisis? If yes, describe how it affected your enterprise.

Crisis resilience: Your business during current crisis and post-crisis expectations

21. How is the current CoViD crisis impacting your business?

22. Describe impacts (turnover, profit, employees, supply, exports, markets, costs,...); no need to quantify in detail, but explain.

23. Have you postponed investments due to the current crisis?

24. Are there policies in place supporting your enterprise during the crisis or/and reconstruction phase (e.g. stimulus programs, capital access, ...)?

25. What type of support is required most by your enterprise to overcome crisis' impacts?

26. Is informality and illegality in the forest sector increasing in this crisis – describe?

27. In your opinion, will the FLEGT VPA process in Indonesia help to mitigate negative crisis impacts?

28. To enhance post-crisis forest sector investments, what should be further improved?

8.2 Annex 2: Description of interviewed enterprises and actors

| Sub-sector | Ownership | Employees (full and part time) | Export sales | Domestic sales |
|-------------------------------------|-----------------------------|--------------------------------|--------------|----------------|
| Forestry, wood industry, pulp/paper | State owned | 143 | 0% | 100% |
| Wood industry , furniture | Other (Joint stock company) | 60 | 0% | 100% |
| Forestry | State owned | 297 | 0% | 100% |
| Wood industry | National private | 405 | 40% | 60% |
| Forestry | State owned | 237 | 0% | 100% |
| Pulp/paper | National private | 86 | 100% | 0% |
| Furniture | National private | 170 | 100% | 0% |
| Forestry, pulp/paper, furniture | National private | 329 | 93% | 7% |
| Forestry, wood industry, pulp/paper | State owned | 230 | 95% | 5% |
| Forestry | State owned | 54 | 0% | 100% |

Table 5: Enterprise sample Viet Nam.

| Sub-sector | Ownership | Employees (full and part time) | Export sales | Domestic sales |
|-------------------------|--------------------------------------|--------------------------------|--------------|----------------|
| Wood industry | National private | 3,000 | 90% | 10% |
| Furniture | National private | 200 | 100% | 0% |
| Furniture | National private | 1,200 | 100% | 0% |
| Forestry | Joint Venture | 144 | 0% | 100% |
| Wood industry | National private | 1,300 | 100% | 0% |
| Forestry | National private | 148 | 0% | 100% |
| Forestry, Wood industry | National private | 3,376 | 90% | 10% |
| Wood industry | National private | 900 | 95% | 5% |
| Pulp and paper | National private (publically listed) | 12,000 | 50% | 50% |
| Pulp and paper | Foreign invested | 900 | 65% | 35% |

Table 6: Enterprise sample Indonesia.

| Country | Institutions |
|-----------|--|
| Viet Nam | University of Hué German Technical Cooperation (GIZ) Swiss Import Promotion Program (SIPPO) |
| Indonesia | Ministry of Environment and Forests Indonesian Forest Entrepreneurs Association/Asosiasi Pengusaha Hutan Indonesia (APHI) Kaoem Telapak (Indonesian NGO) |

Table 7: Institutional actors interviewed for Viet Nam and Indonesia.

8.3 Annex 3: Wood products trade and consumption Viet Nam and Indonesia

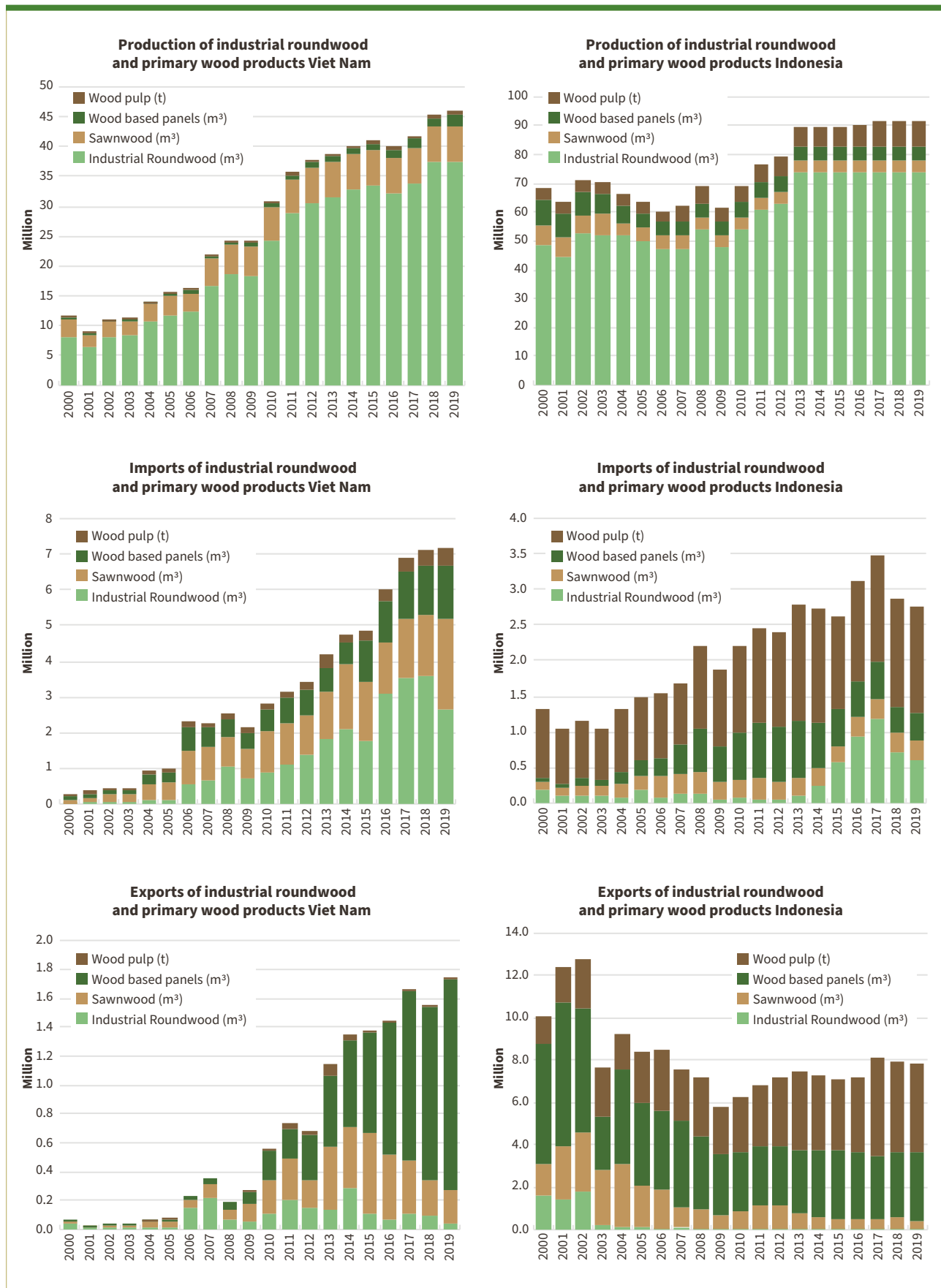


Figure 10: Consumption and trade of wood products in Viet Nam and Indonesia. Source: FAO ForestryStat, UN Comtrade database

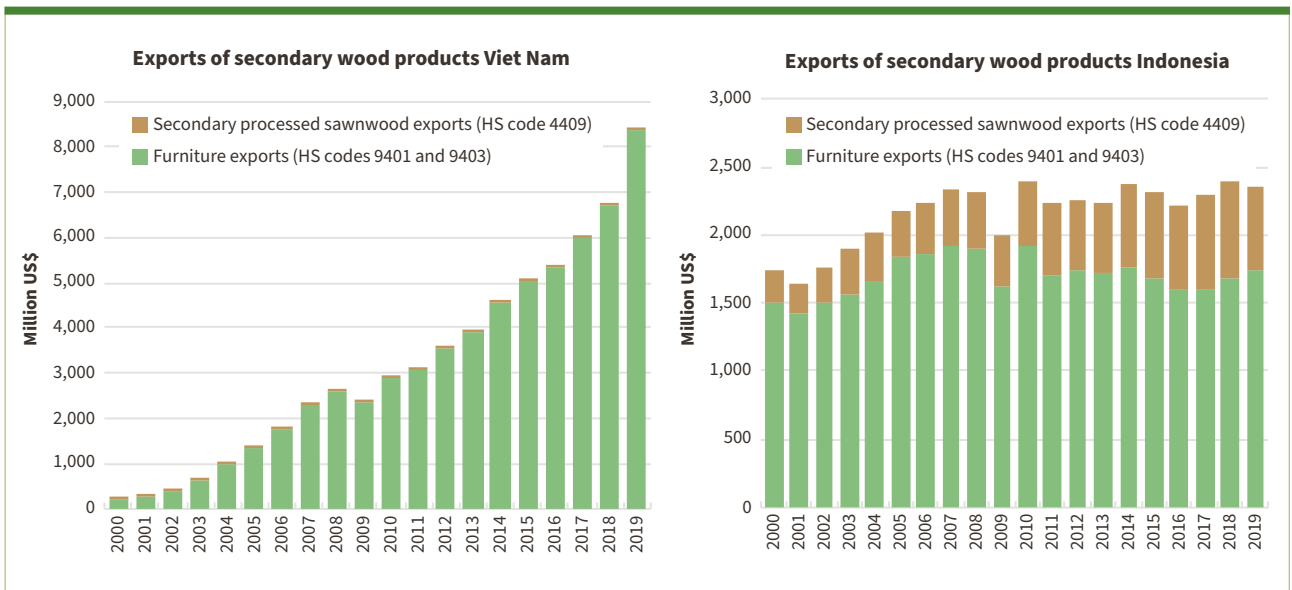


Figure 10: Consumption and trade of wood products in Viet Nam and Indonesia. Source: FAO ForestryStat, UN Comtrade database



IMM

Independent Market Monitoring of FLEGT-Licensed Timber

International Tropical Timber Organization (ITTO)

International Organizations Center
5th Floor, Pacifico Yokohama, 1-1-1 Minato-Mirai
Nishi-ku, Yokohama, 220-0012 Japan

FLEGT Independent Market Monitor

IMM Lead Consultant, Sarah Storck, lead@flegtimm.eu
