

Attracting capital -

Key challenge for Asia's forest sector

By John Halkett

Attracting international capital to assist in further developing forest industries is a challenge confronting Asian economies emerging from the setbacks of the late 90's.

Unfortunately, perceptions about political instability, institutional weakness and technical competence remain. And higher risks, whether perceived or real, mean that investment return expectations rise. Additional worries about resource depletion, slow progress in implementing sustainable forest management practices and a need to quicken the rate of plantation expansion, also pose concerns for international investors.

A climate conducive to attractive investment is critical for Asia's forest industries. Creating such a climate will instil confidence in the industry and provide the necessary momentum for research and development. Such research and development is essential as the industry changes and becomes more sophisticated - from the logging and rudimentary processing of timber from primary forest to value adding of smaller, lower quality logs and the establishment of plantations.

The Asian financial crisis of the late 90's had far-reaching effects on the regional economy and Asia's trading partners. These effects threatened to erode the region's significant social and economic advances achieved during the preceding years of sustained growth. The crisis also revealed many regional problems and challenges in relation to macroeconomic management, banking and capital market management,



Eucalypt plantations - part of the future of Asia's forest industry.

institutional capacity and governance of the financial systems. However, there were also some examples of outstanding economic performance by Asian companies.

Translating this to the forest industry, some concerns about instability, corruption and managerial competence remain. These are exacerbated by the long-term nature of forestry investments and the technical sophistication now required in forest products manufacturing.

Real pluses for investors

Beneath the somewhat pessimistic view, Asia's forest industry offers global investors some real pluses - cheap labour, substantial forest resources and proximity to large markets. Also, an increasing awareness that Asia's industry will continue to be a dominant global influence has focused attention on the potential financial returns that research and development investment could offer.

Increasingly, investment and research

are being recognised as essential partners in the future of Asia's forest industry. Research on a wide range of plantation establishment and management matters, on more sophisticated processing of logs and adding value to the timber produced is required.

In an example of increasing investment interest, Indonesia's Pulp and Paper Association Chairman Muhammad Mansur reports that foreign strategic investors are showing renewed interest in Indonesia's pulp industry. "They say the future in Indonesia is very bright. You have a big forest area, you have skilled labour with low wages, big domestic consumption and geographically you're in the centre of Asia."

Although Indonesian politics are now much less volatile, there remain caveats for investors. Environmental issues have become significant after years of forest fires and the Indonesian Government is prescribing replanting following logging.

Despite a brighter outlook, the global pulp and paper industry is still haunted by past over capacity and needs to further consolidate. But rising product prices and a stronger financial performance by the sector have breathed fresh optimism into the industry. Demand for pulp and paper products is now increasing and production capacity has actually fallen over the past year or so.

Accommodating political risk

In an initiative to improve the international investor climate in Asia, the Asian Development Bank (ADB) has

revamped its political risk guarantee policy. This move expands the scope of coverage to private sector investors.

“This represents a major shift in focus in ADB’s marketing of our political risk guarantee instrument,” says the Bank’s Christine Wallich. “ADB generally offers direct loan assistance to projects. In the future, we will also offer the political risk guarantee to attract commercial lenders. This will enable us to focus on assessing and mitigating country and political risks, areas in which we have a comparative advantage, leaving commercial risks to private sector lenders”.

“The ADB thinks that the improved political risk guarantee program will help catalyse long-term investment, thereby promoting growth and supporting ADB’s overarching goal of poverty reduction. Promoting capital flows and long-term foreign investment contributes to technology transfer, economic development and growth in the industry and service sectors. This creates jobs and contributes to the improvement of social and living conditions,” says Wallich.

The enhanced policy also includes a new co-guarantee program where the ADB will issue a contract of guarantee for the entire amount of coverage requested, but will retain only a portion of exposure under the contract, with the remainder being underwritten by private political risk insurers.

Adverse findings

Meanwhile, adverse reporting by some international organisations, critical of past investment decisions, is damaging future investment prospects. Organisations like the World Wildlife Fund (WWF) accuse some Asian timber companies of failing to manage forest following logging, violating indigenous peoples’ rights and practicing large-scale corruption.

In a report compiled by the WWF and the World Resource Institute, the role of

multinational logging companies is criticised. The report suggests that investment, formerly led by companies from Japan, Europe and North America, has shifted to Asian companies, mainly from Malaysia, Indonesia, Korea and Hong Kong. According to the WWF, this trend has resulted in an expansion of destructive logging operations.

“Most of the new investment focuses on short term activities, and the economic benefits to the exporting country are usually very low,” says the head of WWF Forests for Life Program, Jean-Paul Jeanrenaud. “In addition, the forests are often mined rather than managed, resulting in high levels of damage and increased access to previously untouched areas.”

The report calls for governments to freeze new foreign investment for the expansion of logging operations until land use planning has been completed and the traditional rights of local people have been defined. It also urges the World Bank and the European Commission to only support activities related to the achievement of sustainable forest management.

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Sawmill automation and optimising equipment, a focus for Asian investment.

Research activities

Research activity relevant to Asia's forest industry is gathering pace. For example, Australia's CSIRO Forestry and Forest Products is now conducting research to compare different methods of measuring growth stress and strain in fast grown eucalypt trees in Australia and China.

"Growth stress can be a major factor in the quality of sawlogs and sawn timber," said CSIRO's Jun Li Yang. "If we can assess this growth stress appropriately then we will know whether a tree will saw up well or should be sent straight to the wood chipper."

This research is central to future plantation and wood supply aspirations in

Asia, as pressure will be placed on eucalypt plantations to produce more wood in a shorter length of time. It follows that trees will be forced to grow at the maximum rate possible. Improved fertiliser regimes will provide the nutrients required and new weed control systems reduce competition for water. This will result in greatly improved site productivity but greater stress in young trees.

Yang and her colleagues will shortly be testing technologies developed in Japan, France and Australia to determine the best methodology for assessing growth stress. These results will be linked to another CSIRO study where fast grown eucalypts will be sawn to produce high value products.

"With the price of sawlogs approximately three times that of pulp logs, I would be amazed if tree growers would not look at the higher value product options," says CSIRO researcher Gary Waugh.

"However, with the more uniform fast grown plantation eucalypts, I doubt we will have that luxury. We will need to push the logs through the mill faster, which means that growth stress will have to be managed. And the more we know about this stress, the better we will be able to manage it," he says.

The results from this stress study will also be used to link wood quality to product output and allow future production of high value products from eucalypt plantations in Australia and Asia. ☆



Wood processing investment, a key to a more sophisticated, value adding forest industry in Asia.