

*Little and Legal: Micro-, Small-, and Medium-Sized Enterprises
(MSMEs) within the Emerging Timber Legality Paradigm*

Brief 3: Knowledge Gaps: Priorities for Future Research on Forest Product MSMEs

Andrea Johnson

CATIE-Finnfor and Forest Trends

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Forest Trends
1203 19th Street, NW
4th floor
Washington, DC 20036
www.forest-trends.org

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About the Series

The European Union Timber Regulation (EUTR), US Lacey Act Amendments, and Australia's Illegal Logging Prohibition Act (ILPA) were established not only to combat illegal logging and associated trade, but also to facilitate a thriving legal forest product sector that enhances rural livelihoods for forest-dependent communities. Is this happening – or are the processes of formalization and legalization, together with stricter enforcement of existing laws, creating unintended consequences for the most vulnerable actors they were meant to support?

A clearer understanding of both the opportunities and the impacts that emergent legality policy frameworks create for rural forest-dependent people, community forestry initiatives, and other small-scale enterprises (collectively referred to as micro-, small-, and medium-sized enterprises, or MSMEs) has increasingly become a priority for international policy dialogues. We take as a starting point that a strong relationship exists between successful MSME activity and improved rural livelihoods, poverty alleviation, and/or economic productivity. Attributing precise figures to this correlation is not easy, but the link between a robust MSME sector and a healthy economy – and the virtues of locally-based forest management for both people and ecosystems – has been demonstrated repeatedly in peer-reviewed literature.¹

This series of briefs attempts to contribute greater clarity to the debate by disaggregating the diversity of MSMEs and providing a conceptual starting point for more coherent dialogues and targeted, impactful policy and research design. It encompasses the diversity of MSMEs because the globalized reach of many wood product supply chains, and the rapid increase of South-South trade flows, obscure the lines between local and international trade. Further, all but one Voluntary Partnership Agreement (VPA) signed to date in Africa and Asia include the aspirational goal of achieving legality in domestic trade as well, making national markets a necessary part of the discussion.²

- **Brief 1** outlines the breadth of MSMEs and suggests a typology for differentiating among them with greater precision. This more nuanced picture helps us to recognize certain invisibilities – blind spots that impede or bias the way in which MSMEs are discussed by decision-makers – and identify new points of entry for MSMEs in legal supply chains and better policy-making in the context of national VPA processes.
- **Brief 2** examines the full range of interconnected barriers faced by MSMEs: barriers to achieving and maintaining legality, barriers to demonstrating legality, and barriers to competitiveness. We look more closely at whether and to what extent legality measures present new barriers and opportunities, and briefly discuss best practices for supporting MSMEs within this context.
- **Brief 3** presents priority directions for applied research that will contribute to finding concrete, specific answers to the pressing question of how to better support MSMEs as part of thriving, legal wood product sectors that generate economic, social, and ecological benefits.

¹See e.g. Kozak 2006; Gibson and van der Vaart 2008; SEAF 2007; Scherr, White, and Kaimowitz 2003; Macqueen 2008; and AgriCord and FAO 2013.

²The information contained in these briefs comes from literature on MSMEs both within and outside the forest sector; project reports and diagnostics from Africa, Asia, and Latin America; and as-yet unpublished experiences within CATIE's Finnfor Project, a Finnish-funded effort to improve rural livelihoods through strengthening wood product value chains in four Central American countries (Guatemala, Honduras, Nicaragua, and Costa Rica).

Acronyms

CFED	Corporation for Economic Development
CIFOR	Center for International Forestry Research
FLEGT	Forest Law Enforcement, Governance, and Trade
ICRAF	World Agroforestry Centre
IIED	International Institute for Environment and Development
MSME	micro-, small-, and medium-sized enterprise
MTK	Central Union of Agricultural Producers and Forest Owners, Finland
NGO	non-governmental organization
NTFP	non-timber forest product
PEFC	Programme for the Endorsement of Forest Certification
RIA	Regulatory Impact Assessment
RRI	Rights and Resources Initiative
VPA	Voluntary Partnership Agreement
WOCAN	Women Organizing for Change in Agriculture and Natural Resource Management

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1. Introduction

There is a great deal that could and should be done to better support forest product MSMEs in achieving legality, demonstrating legality, and contributing to sustainable forest resource management and poverty alleviation through competitive supply chains. The previous briefs in this series have provided a disaggregated typology of the breadth of MSMEs in the forest sector, described best practices for reducing barriers, and offered recommendations for addressing risks and capitalizing on opportunities presented by demand-side legality policies such as the Forest Law Enforcement, Governance, and Trade (FLEGT) Voluntary Partnership Agreements (VPAs). Generating and sharing good information is another necessary element of the picture, both for policymakers, donors, or non-governmental organizations (NGOs) thinking about how to design good interventions as well as for MSMEs trying to adapt to market trends, new laws, climate change, or new technologies and innovations. It is now crucial to invest in more targeted research and concerted attention into analyzing the critical knowledge gaps that still exist, in order to fully understand potential and actual impacts of demand-side policy initiatives.

The following sections describe four priority research areas that would advance our understanding of the barriers faced by MSMEs and how best to address them. Much of this work needs to occur on a country-specific level in order to achieve maximum impact. Use of gender-sensitive conceptual frameworks and study design is a necessary and transversal element to this research agenda.¹

Key Findings

More applied research is needed to better support legal and competitive MSMEs in global wood trade under the emergent legality paradigm. Research-for-development organizations, academics, and donors should put concerted analytical attention and funding to address the following knowledge gaps:

1. **Legal, regulatory, and institutional reform priorities:** Regulatory burden is a constant complaint of MSMEs, yet regulatory and legal reform in the forest sector often seems not to produce the results desired due to complex and endemic structural, political, and cultural factors. Further, there is general acknowledgement of the economic viability of the MSME model, but the correlation between a robust MSME sector and local livelihoods is rarely quantified. There is a need to understand under what conditions wood product MSMEs are able to be legal and competitive, and to identify and qualify cases where regulatory simplification has succeeded.
2. **Demand-side policy effects, costs, and benefits:** Most information about the effect of demand-side policies and producer country responses on MSMEs remains anecdotal or hypothetical; more systematic research should be conducted on transaction costs and market benefits in the new legality-specific framework.
3. **Strategies to strengthen MSMEs:** Participatory action research is a promising approach for testing and comparing ways to strengthen MSMEs all along the supply chain and for generating lessons that both practitioners and policy makers can use. For example, a “Legal Value Chain” analytical framework as proposed in this briefing incorporates careful review of legal and institutional requirements into a gender-differentiated value chain.
4. **The informal sector:** Identifying, quantifying, and researching the causes and factors underlying pervasive and persistent informality in timber product MSMEs (as opposed to those operating illegally) is essential to support robust VPA processes and address perverse impacts of legality policies. Case studies on the costs of remaining informal (as opposed to achieving legality) would shed considerable light on this topic.

¹ Colfer and Minarchek (2012) provide an excellent review of approaches, resources and methods for integrating gender into forest-related research.

Gender must be taken into consideration in study design and recommendations for all of these research priorities. Women are chronically under-recognized within supply chains, experience different impacts from formalization, and are disproportionately excluded from policy processes despite evidence that their involvement in forest management decision-making improves ecological outcomes. Additional research should investigate the link between women's participation and household incomes.

2. Legal, Regulatory, and Institutional Reform Priorities

Economic Viability of the MSME Model

Academic and gray literature is fairly clear regarding the positive correlation between robust local economies and a healthy MSME sector in general, though it stops short of attributing causation.² Nonetheless, there have been few studies to date explicitly quantifying whether small wood product businesses can be profitable in the global trade arena and within an economic model favoring large-scale, industrial market actors. Small enterprises within the context of a highly regulated product that requires long-term investments in unpredictable markets are clearly at a disadvantage, yet MSMEs exist and thrive in all corners of local and global wood product trade, in many contexts generating environmental, social, or local-level economic benefits that large firms simply could not. The question is less “whether” than “when” or “how”: under what legal, social, economic, and political conditions are wood product MSMEs viable? Existing research on enabling environments highlights the importance of macro-economic stability, transparency and sound law enforcement, entrepreneur-friendly policies, reduced corruption, and access to market information, communication, and transportation (Macqueen 2008). Further analysis must also be conducted specifically focused on MSMEs that have historically received substantial donor funding, to validate whether they will be able to compete when this support is removed.

Impacts of Regulatory Barriers and Simplification

Poorly designed laws and regulations may inadvertently create barriers that in practice put legal and competitive forestry operations out of reach, particularly for individuals and communities without secure tenure rights. These barriers may be structural, procedural, or technical, or a combination of all three, and identifying their underlying causes and indirect effects is a critical first step toward removing them. Are high registration and stumpage fees resulting in small producers' decisions to remain informal? Does a lack of local forestry offices/personnel impede timely permit processing, resulting in late shipments? Or is a country's entire concession system set up to fail by its very design? What interests – legitimate or not – and safeguards that currently exist would be affected by attempts to reduce transaction costs? Research should be conducted at the national or sub-national (jurisdictional) level, or through use of comparative analytical frameworks, to determine impacts of regulatory simplification both on MSMEs and the broader economy.

Existing country-level diagnostics have provided an invaluable entrance point to this research,³ but this work typically stops short of detailed analysis of the transaction costs and barriers created by legislative, regulatory, and institutional factors. Notable exceptions include Navarro's work describing steps and quantifying costs for timber harvest and trade in Central America⁴ and the Center for International Forestry Research (CIFOR)'s analysis of sawmillers operating in

² See e.g. CFED 2005 and Ayyagari et al. 2005.

³ The members of Forest Connect (a supra-network for locally-controlled forestry enterprises) have published a number of such studies. See e.g. Forest Connect's document page at <https://delicious.com/forestconnect>, and IIED's publications on small scale forest enterprises at <http://pubs.iied.org/search.php?k=&t=&a=&w=&s=SMFE>.

⁴ See e.g. Navarro Monge and Thiel 2007 and Navarro Monge et al. 2014.

Cameroon and Gabon, which found small actors are contributing more to local economies than the industrial forest sector.⁵

To provide optimal input to policy debates, assessments of forest sector reform needs should ideally quantify the economic implications of current legal regimes versus simplified or modified regimes, helping to pinpoint the most expensive and/or “burdensome” regulations, and evaluate the effect of possible changes. Regulatory Impact Assessment (RIA) is a relatively well-established tool “for assessing the positive and negative impacts (benefits and costs) and risks of existing or potential regulatory measures” and looking at whether a regulation is necessary, targeted correctly, and proportional to the problem being addressed (Center on Regulation and Competition 2004). Long used or even required in some countries as part of the law-making process, in the early 2000s the approach was adapted to integrate explicit poverty reduction objectives in developing country contexts. Broad consultation is a basic element of the methodology, and at least some forest sector-specific application exists (ibid; MacQueen 2008). Specific inclusion of female stakeholders is recommended to ensure that policy and regulatory changes do not have unanticipated perverse impacts (Shackleton et al. 2011).

It would be naïve to suppose that simply pointing out policy inconsistencies, bottlenecks, or unnecessary transaction costs were enough to generate reforms; to assume that fair regulatory systems are always implemented correctly; or to ignore past lessons in which regulatory simplification opens loopholes for true illegal activity. Any RIA-style assessment thus needs to be combined with analysis of the underlying political economy in order to determine whether legal reform has the enabling conditions to succeed, or if there are larger barriers of political will and strong economic interests that require different strategies, in order to understand effects on smallholders. Studies such as Hobley (2007) that examine the factors contributing to the success or failure of forest tenure and policy reform processes are a valuable contribution; more are needed that document success stories, even if partial.⁶

Regulatory reform and simplification is an arena in which lessons from beyond the forest may prove useful, turning to other natural resource sectors with large number of MSMEs such as artisanal mining or small-scale fisheries. Agricultural products and even manufactured goods like textiles are also promising sectors for analysis. In the US, whose laws mandate paperwork reduction and elimination where possible, agencies are required to assess likely costs to enterprises before introducing new regulations in any sector. Government guidelines on disclosure and simplification offer principles for increasing transparency and reducing regulatory burden that include consideration of default automatic enrollment systems, elimination of excessive or redundant questions in forms, electronic filing, and information-sharing across official entities (Office of Management and Budget 2010).

In a similar vein, comparative research could productively look at ways in which different countries actively *support* MSMEs through affirmative policies, government programs, financial services, trade or export promotion. To what extent do timber product MSMEs take advantage of such programs, and if not, what underlying obstacles exist that are particular to the forest sector? In any given country the tax structures, business registration procedures, transport and export processes can be barriers over which the forest authority proper has little or no control. On the other hand, government agencies tasked with economic policy, trade, or export promotion may have existing programs and services for MSMEs. Are there opportunities that are not being taken into consideration due to a lack of inter-institutional coordination within “forest sector” policy processes or project design?

Transactional Costs of Compliance with Demand-side Legality Policies

In the context of VPA processes, this kind of research will soon be necessary to assess actual progress against governments’ stated commitments to legal reform in countries which have signed agreements over the past 10 years, and to offer recommendations for how present and future VPAs can establish processes for periodic review and if necessary revision of legality definition matrixes. The RIA framework will again be useful here to determine any

⁵ See e.g. Cerutti and Lescuyer 2011.

⁶ Forest Connect’s Facilitators Toolkit offers a useful module on designing and presenting research for policy change. See Macqueen (ed.) et al. 2012.

transactional costs of compliance in new regulatory frameworks for MSMEs; for example, increased licensing fees under national Timber Legality Assurance Systems (TLAS). With the current evaluation of the EU FLEGT Action Plan underway, such data will be crucial, particularly in countries with signed VPAs that are addressing a second set of measures to be incorporated into TLAS.

Gender as a Transversal Theme

In most countries, women face additional legal and regulatory barriers due to inequitable policies, institutional sexism and practical barriers of mobility, legal literacy or tenure rights (El-Fattal 2012). Lack of female representation in governing bodies, accountability institutions and political processes at all scales, from local councils to national ministries to legal systems, has contributed to reforms and decisions that do not take gender issues into account.⁷ Research that documents these differentiated impacts and generates proposals for change is also broadly needed.

3. Demand-side Policy Effects, Costs, and Benefits

Too much of what can be said about barriers, opportunities, and impacts related to legality policies remains broad-brush, theoretical, or anecdotal. Policy-makers need more systematic data regarding the different types of emerging effects that the EUTR, Lacey Act, ILPA, and VPA processes are truly having on different types of MSMEs. A recent academic analysis of trade flows found strong evidence that the US Lacey Act had reduced the import of illegal timber into the United States, but had no conclusions specific to MSMEs in either in the US or producer countries (Prestemon 2015). Two recent comprehensive reviews of VPA processes found clear evidence that they have achieved positive governance impacts (Duffield and Richards 2013; Bollen and Ozinga 2013); stakeholders generally agree with that consensus and suggest that FLEGT is influencing governance even *beyond* VPA countries in a positive way (FLEGT Week 2015), but the VPAs' economic impacts are far less clear.

Perhaps the most pressing immediate need is quantification of (i) new transaction costs and (ii) any perceived market benefits from compliance with regulatory frameworks set in place by VPA processes. For example, the Indonesian Furniture and Handicraft Association recently asserted that the approximately \$7,000 cost of obtaining a license under Indonesia's national legality assurance system (SVLK) is prohibitive for small furniture producers competing with Vietnam and China, and has already put some out of business (ITTO 2015). On the other hand, the Indonesian government projects furniture exports to grow 50 percent through 2016 and reported an uptick in sales in 2014 (*Tempo.Co* 2014). Are impacts there or in other countries being disproportionately felt by MSMEs?

The past few years have also seen various countries begin to put into place new regulations, national initiatives, or measures of varying comprehensiveness, in direct or presumed response to the trend toward increased demand-side scrutiny of timber flows, but no systematic information seems to exist on these country-level responses to legality policies, much less on the way that they do or do not take into account MSME concerns. Tracking and measuring their effects is an emergent research priority, as is potential costs for industry and government stakeholders in demand-side countries facing new due diligence requirements under the EUTR, Lacey Act, or ILPA.

Gender as a Transversal Theme

Gender also has an intriguing relevance for legality. Several peer reviewed studies suggest that women's involvement in forest user groups, and particularly in their decision-making bodies, leads to better knowledge of rules, better regulation of illicit activities, and consequent improvements in forest condition (Agarwal 2009; Mwangi et al. 2011).

⁷ See e.g. Bandiaky-Badjji 2011.

4. Strategies to Strengthen MSMEs

This series of briefs has emphasized the integrated nature of barriers related to achieving legality, demonstrating legality, and being competitive. What are the best ways to remove these obstacles? A valuable body of case study documentation and synthesis has been generated on facilitating MSME competitiveness. The International Institute for Environment and Development (IIED), for example, advocates a three-pronged “market systems development” framework that combines strengthening of producer associations, facilitating provision of financial and business development services, and improving the business environment (including the political enabling environment discussed above) (Macqueen 2008; Macqueen et al. 2012), while Rainforest Alliance⁸ and TFT emphasize the role of non-state voluntary market mechanisms such as forest certification as a framework to build the capacity of MSMEs and link them with responsible buyers in global supply chains (Barr et al. 2012).

Countries with historically strong and formalized forest product MSME sectors offer analytical opportunities and the possibility to establish linkages for learning and strengthening. Finland and Sweden in particular boast proud histories of small-scale forest management and transformation, and are facilitating shared learning and stronger linkages between MSMEs in importer and exporter countries. Forest management associations in both countries play a vital role in supporting families to maintain productive forests, enabling a thriving sector that has not disappeared with the advent of a larger, industrial forest model, defying conventional wisdom:

- More than half of Sweden’s forest is owned and managed by smallholders. The Sweden-based International Family Forest Alliance has members in 23 countries and partnerships with many community forestry and Indigenous Peoples’ alliances in tropical forested countries.⁹
- In Finland, families own 62 percent of forests and 95 percent are certified under a Programme for the Endorsement of Forest Certification (PEFC)-recognized sustainable forestry system. Forest management associations in these countries play a vital role in providing support services to help families maintain working forests (Agricord and FAO 2013). The Finnish Central Union of Agricultural Producers and Forest Owners (MTK) has helped facilitate “twinning” partnerships between local forest management associations in Finland and countries including Tanzania, Nepal, and Nicaragua (Agricord and FAO 2013).

Value Chain Development

Research-for-development organizations that have long histories of working with rural producers are increasingly using Value Chain Analysis, which has been adapted for use in this sector with the explicit incorporation of goals like poverty alleviation and greater equity (e.g., economic, social, gender, and cultural) among actors along a supply chain (Donovan and Stoian 2012). Various definitions exist, but all begin with an analytical mapping process to characterize the actors, processes, and relationships within a given supply chain. Applied as an intervention, the value chain approach emphasizes working backwards from existing markets to identify opportunities for “upgrading” processes, functions (supply chain position), products, or relationships in order to add value and increase competitiveness, rather than inventing new supply chains (Dunn et al. 2006). Also critical to the concept is the importance of strengthening or formalizing relationships of mutual benefit between the different links of a supply chain. A somewhat dizzying array of methodologies for Value Chain Analysis and development has been produced.¹⁰ The majority of documented experiences thus far, however, have been related to agricultural sector supply chains; application to timber or broader forest product supply chains is still relatively limited.

⁸ See <http://www.rainforest-alliance.org/work/forestry/community-forestry>

⁹ See www.familyforestry.net

¹⁰ ICRAF has published two helpful reviews that compile and compare these different manuals and guidelines. See Nang’ole et al. 2011; Donovan et al. 2013.

While there is thus a fair body of work describing best practice strategies for strengthening MSME *competitiveness*, much less has been done to integrate or systematize lessons regarding resolution of *legality* bottlenecks. Moreover, the vast majority of research has been focused on forest producers. In the legality context it is critical to also look at MSMEs in other positions along the supply chain such as transformation, distribution, commercialization, and service provision. We suggest a modified “legal value chain” conceptual approach that includes as part of the analysis more careful attention to the laws, regulations, fees, and taxes to which various actors in a given supply chain are subject; their degree of compliance; the costs of compliance; and any bottlenecks linked to achieving and demonstrating it.

Such diagnostic research lays the groundwork for comparing the effectiveness of strategies for strengthening MSME competitiveness in the legality context. Publishing and sharing the results of such research-in-action will be uniquely valuable in re-shaping existing policies and advocating for ones that “work” in VPAs under negotiation. CIFOR’s participatory action research on the Jepara, Indonesia furniture value chain worked with stakeholders to evaluate challenges and impacts of four scenarios for small workshops producing and selling furniture in the context of Indonesia’s VPA and TLAS. The four scenarios examined were “moving up”, or focusing on development of new markets; “collaborating down”, or improving raw material supply and linkages between timber and furniture producers; “green furniture”, or facilitating chain of custody certification under the SVLK; and finally “association” by establishing a new industry association with a political voice and collective marketing portal (Purnomo 2013). (See *Briefs 1* and *2* for further reflection on this research.) And in Central America, CATIE’s Finnfor project is currently working to develop ten value chains of wood products among a rich diversity of actors, institutional contexts, types of forest resource, and supply chain structures, thus generating important information on the interconnectedness of legality and competitiveness, women’s roles in value chains, and both successes and failures in overcoming bottlenecks.¹¹

Assuring the Resource Base

A core issue for both legality and competitiveness – one that often goes undiscussed in policy circles but is a critical concern to MSMEs – is the ever-growing need to ensure long-term availability of legal raw materials as populations, consumer economies, and housing stock. Policies, incentives, and technical capacity must therefore ensure that this demand can be met by legal sources. While a number of countries have reforestation requirements for logging operations, these are seldom well-enforced; others have active reforestation incentive programs, which may be poorly integrated with technical assistance for best practices in silviculture or with market development, a concern as thousands of hectares of forests come into thinning or harvestable age with few buyers.¹²

With the growing scarcity of natural forest timber, MSMEs need technical extension skills to be successful, and the extent to which plantations actually substitute natural forest material on a large scale remains unclear. Research is therefore urgently needed to consider whether and how planted trees – in agro-industrial plantations, smallholder plantations, or various agroforestry systems – can serve to reduce pressure on natural forests (and under what constraints), and how best to create the conditions to realize their commercial benefits as well as potential co-benefits in terms of poverty alleviation, ecosystem services, and even biodiversity. Designing incentive programs and policies so that they effectively reach smallholders, micro-entrepreneurs, and communities, rather than benefiting only larger landholders or even contributing to social conflict and deforestation as has occurred in some Asian countries, is another priority.¹³ This research should be focused in countries that have identified raw material shortages as a concern (e.g., Ghana, China, and El Salvador), and/or countries with reforestation incentive programs (e.g., Costa Rica, Guatemala, Mexico, Uganda, India, and Thailand).

¹¹ Project Finnfor. See www.catie.ac.cr/finfor for more information.

¹² In Central America, this is the case for Guatemala (PINPEP and PINFOR) and Costa Rica (FONAFIFO). (Gutiérrez 2016).

¹³ See e.g. Enters et al. 2003.

Gender as a Transversal Theme

Understanding women's roles throughout the supply chain, and how involvement in MSMEs increases women's incomes (or women-led household incomes), is an under-researched space that should be an integral part of an overall agenda to strengthen MSMEs. A 2014 literature review of women in forest product value chains (primarily non-timber forest products (NTFPs)) found the majority of work focused on harvesting and primary processing in developing countries, particularly African ones, with far less data on male and female activities further along the chain and little data overall from Latin America (Haverhals et al. 2014).

In technical forestry and commercial forest product value chains, however, women often continue to be seen as minor players in a traditionally male sector, and as a result studies and projects related to forest management and trade are not usually designed to look specifically at women's roles or differential impacts from interventions (Purnomo et al. 2011; Gurung 2012). Gender-differentiated Value Chain Analysis is thus an important tool for describing and quantifying women's roles all along the supply chain (such as tenure, resource management, business administration, transformation, transport, trade, and commercialization), including gendered division of labor and interactions between men and women (Shackleton et al. 2011). Such participatory analyses help both to increase the visibility of existing female labor and to pinpoint gender-specific interventions that would increase enterprise success as well as the distribution of benefits from the forest resource.¹⁴

5. Describing and Understanding Informality (v. Illegality)

Taking into account micro-entrepreneurs, the majority of forest product enterprises around the world operate largely or entirely in informal markets. This has enormous implications for the question of how demand-side or national legality policies affect MSMEs, and equal relevance for research directions.

Seeing and Differentiating Informal Actors

First, diagnostic work on MSMEs sectors in producer countries should pay attention to size classes. The official definitions of "SMEs" used by almost all governments and lending institutions include firms of considerable size, with revenues into the millions of dollars, while a microenterprise might well be one family operating a near-subsistence operation from its house or collective lands. Informality has attendant consequences in terms of ability to access credit or markets, to interact with government agencies, to be represented in official processes, and to make longer-term planning decisions (see *Briefs 1* and *2*). Decision-makers in VPA policy processes, in particular, must be careful to understand the scope and nature of these different sub-sectors.

Qualifying Informality

Bribery and corruption are a good example of the costs of informality, which also include lower prices due to limited market access or the need to work through intermediaries; constant risk of confiscation during transport, with financial and sometimes legal consequences; lack of access to formal credit sources that would enable upgrading; and the health effects of poor working conditions. CIFOR's EU-funded Pro-Formal project, which supports work in Cameroon, Gabon, the Democratic Republic of the Congo, Indonesia, and Ecuador, has produced definitive data on the size of informal micro- and small business sector in these five countries in terms of trade and employment generated, as well as their operating costs – including bribery. It also put forth policy and regulatory options for integration and formalization in each country and as a synthesis.¹⁵ Underscoring the importance of more quality research on this topic, project evaluators noted specifically that the rigor of Pro-Formal's data "was accepted as incontestable by all the other actors working on forest policy [in countries]. This scientific legitimacy has been of crucial importance, not only in terms of its

¹⁴ A consortium of research-for-development organizations in Latin America has produced a toolkit for Value Chain Analysis with gender focus, available at <http://ruta.org/toolbox/>

¹⁵ See <http://www1.cifor.org/pro-formal/publications.html>

direct impacts on understanding of the sector, but also because of the way in which – despite the often uncomfortable and sensitive nature of its findings (especially in quantifying the scale of corruption) – the project has been insulated from any risk of political retribution.” Additional case studies on the costs of informality will provide valuable data.

Understanding the Underlying Causes

We must recognize that rural producers are eminently logical in their short-term economic decision making, and many remain informal. Reasons range from struggles over land tenure insecurity, to the costs of registering a business, to poor information access, to the absence of any real enforcement incentive. Both the impacts of informality and the structural, financial, administrative, and social reasons for remaining informal must be diagnosed and understood through careful analytical work in order to produce relevant and feasible recommendations for policies and programs to resolve these bottlenecks.

Quantitative and analytical work on forest sector informality is needed in all three tropical forest regions, both to contribute to FLEGT processes but also to instigate national policy dialogues about the difference between “informality” and “illegality;” why certain MSMEs are informal and how to make them formal. There is a yawning disconnect between legal regimes and rural realities, where travel to the nearest forest office to obtain a harvesting permit takes a full day or more, at a cost that subsistence farmers can ill afford. In many countries, almost the entire rural population is technically living outside the law given such regulations. And yet, these infractions are easier enforcement targets for local officials than larger illegal flows associated with commercial trade, resulting in a criminalization of rural livelihood activities (Cerutti et al. 2014).

Gender as a Transversal Theme

Women play a disproportionate role in informal forest activity oriented towards highly local or domestic markets, thus leaving them potentially more vulnerable to arbitrary law enforcement and depressed prices. However, while they may have much to gain from legalization and formalization, it is vital that decision-makers use a gender lens before implementing policy and project interventions, because formalization projects have sometimes had unanticipated perverse effects on women producers in the absence of a clear understanding of the underlying factors at work.¹⁶

6. Conclusion and Recommendations

Donors and research organizations should prioritize the knowledge gaps outlined above, particularly in light of the 2015 FLEGT Action Plan and EUTR evaluations and VPAs in the negotiation process. Sources and actors outside the traditional forest sector space should be part of this process in order to obtain a holistic picture of forest sector value chain activity. Engaging MSMEs, as well as decision-makers whenever possible, will maximize both the accuracy of findings and the potential for subsequent policy impacts.

¹⁶ See e.g. Purnomo 2011.

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