MAIN CONCLUSIONS AND POLICY RECOMMENDATIONS FROM THE 2004 INTERNATIONAL WORKSHOP ON FINANCING AND INVESTMENT IN CHINA'S FORESTRY SECTOR

September 22-23, 2004

Co-Organized by the Forest Economics and Development Research Center (FEDRC), Forest Trends, and the Center for International Forestry Research (CIFOR)

Co-Sponsored by the UK Department for International Development, the World Bank and the International Tropical Timber Organization

Summarized and Delivered by Ms. Zhang Lei

Director General

Forest Economics and Development Research Center

State Forest Administration

(English Translation of Chinese Original)

Ladies and gentlemen,

Good afternoon!

Thanks to the joint efforts and fruitful cooperation of the three hosting agencies and all the participants, the two-day 2004 International Workshop on Financing and Investment in China's Forestry Sector will soon successfully conclude. The context of this workshop is the "Resolution on Accelerating Forestry Development" (hereafter referred to as the Resolution) issued by the Central Committee and the State Council. This Resolution established the government's forestry development strategy giving priority to ecological construction and the forestry is developing with vitality. Focusing on the theme of "Guided by scientific outlook of development, further defining the investment orientation and priorities and accelerating the step of forestry development", experts and scholars from the financial, banking and forestry sectors have conducted extensive and in-depth discussions. According to the speeches of experts and discussions of all the participants, in consideration of the Resolution on the Financing and Investment Reform by the State Council, the workshop has reached consensus in many aspects.

Entrusted by the Organizing Committee, I am responsible for summarizing the workshop and reporting to all the participants on the main conclusions and policy recommendations of the workshop, which aim to draw attention from the Chinese government and academic circles after this workshop.

In general, the conference demonstrated the value of open communication between decision makers from the forestry and financial sectors. In addition, the conference demonstrated the value of sharing experiences and lessons between Chinese and international experts.

A key finding from the conference was that all sectors, government, private and community, have critical roles to play in ensuring adequate investment in forest conservation and production. The most important role of the government is to first provide a secure policy environment – including respect for private and collective property rights, reasonable regulations and taxes – and then to only subsidize activities that the private and collective forest sectors cannot or will not do themselves – such as ecosystem restoration and poverty alleviation. By creating a sound policy environment, the government leverages and encourages investment by the private and collective actors in their forests, and reduces the need for their own, public, investment. Very limited investment by the government also reduces the chances for distorting markets and encouraging inefficient projects – as well as reduces the risk of building overcapacity in the market.

The Resolution calls for two types of government investment: the first is in ecosystem restoration, and the second is for increasing the production of industrial wood. Because of the notable economic externality of the ecological benefits of forest, it is one area where market forces alone often do not generate adequate levels of investment. According to the theory of public finance, eco-forestry -- with ecological benefits as its leading function, -- naturally is one area that public finance tries to ensure and specifically supports. Therefore, the government should be the main source of investment for eco-forestry development.

Public investment in private forest production and processing is different, and these types of investments should be based on market principles. The issue of subsidies to productive activities has become increasingly complicated and controversial around the world – and is the topic of great debate at the WTO. China faces the challenge of modernizing its' public investments in the forestry sector to come in line with international standards, thereby reducing the distortion of markets and inefficient use of government funds.

Conclusion I: There is a need to improve and strengthen public investments in forest restoration

China now leads the world in public investment in ecological restoration – including the planting of shelterbelts, planting trees and grass on sloping lands and anti-desertification campaigns. These programs are relatively new and have been operating on a short-term, programmatic basis. There is a need to both fully establish these programs as long-term, legal mechanisms, and to improve the targeting effectiveness and efficiency of implementation.

Hereby, the policy recommendations are as follows:

First, the Government should formalize the legal and administrative framework for government investment to forestry. As the government seeks to improve China's public financing and investment system, legal and administrative measures should be adopted to ensure the long-term benefits, standardization and stability of public investment to the forestry sector.

Second, the Government should take steps to define more clearly the roles of central, provincial and local government and relative institutions. It is necessary to better define the financing and administrative programs of the central, provincial and local governments and to integrate investment in the development and management of public-benefit forests and large infrastructure construction into the financing budgets of governments at all levels. The central government should particularly respect the rights of private and collective forest owners and guarantee the development of key ecological programs closely related to the sustainable development of the national economy and society. Regional ecological programs developed by the local government should be included into local public investment. The counterpart ecological programs developed by the forestry sector should be included into the general budget of programs concerned. At the same time, financial transfers to forestry programs in key forest regions and poor areas should be expanded.

Third, the government should improve the Forest Ecosystem Compensation Fund. It is necessary to further clarify and define the scope, rationalize the procedures, and gradually increase the amount of the ecological compensation conducted by the government according to law.

Fourth, the system of the government purchase of non-state-owned public-benefit forests should be established gradually. The purchase of non-state-owned public-benefit forests established by various actors as well as coordination of the relationship of manager's benefits and state ecological safety not only reflects the state's respect to the property rights of non-public owners, but also takes into consideration of the needs of social development and strategy of giving priority to eco-development. This is of great significance in encouraging, guiding and supporting the development of non-public forestry, as the experience of many developed countries has shown. According to the requirements of the Resolution, governments at all levels should attend to developing the scheme of the government's purchase of non-state-owned public-benefits forest and organizing its implementation.

Fifth, there is a need to continuously improve the policy of discounted government loans for desertification control in the forestry sector. The government's use of discounted loans will both increase the benefits of government investments in forestry and promote private capital investment in forestry. The government should reinforce and perfect the discount orientation and strengthen its management.

Sixth, extensively raise social funds for investment. The stable social financing channels shall be established through collection of ecological tax and issuing of ecological lottery. At the same time, the social endowment channels shall be broadened by such ways as awarding entitling rights, leaving names on tree steles and pavilions, planting memory tree, adopting grassland or wild fauna and flora.

Conclusion II: There is a need to better target public investments in industrial plantation development and plantation-based wood processing industries.

China's imports of wood products have increased dramatically in recent years – making the country dependent upon external sources for wood and costing the Chinese government a substantial amount of money in foreign currency every year. In addition, the strategy of importing wood limits the extent to which China's forestry sector can contribute to rural development in China. For these reasons, the government has embarked on an important campaign to increase domestic supply of wood from plantations and to increase the domestic processing of wood products. Given the long history of government ownership of forests and enterprises, and the more recent subsidies to plantations, the government is now confronted with the problem of excessive reliance on public financing sources and the general expectation that government investment is necessary. The selective and careful use of government funds has become necessary.

Capital subsides to wood processing industries have become increasingly controversial. A number of presenters reported that government subsidies are leading to overcapacity in the paper and paperboard sector and possibly in other sectors as well. This overcapacity drives down prices, distorting markets, and is an inefficient use of limited government funds. Some participants recommended that government subsidies to wood-based industries be suspended altogether, arguing that they are not necessary Moreover, subsidies to large industry are often inequitable, creating unfair competition for small firms and collective forest owners. It would be better to aim for subsidy policies that advance China's dual goals of forestry development and poverty alleviation, such as helping collective forest owners produce more wood and improve small-scale forest industries.

Hereby, the policy recommendations are as follows:

First, there is a need to reevaluate the rationale and use of subsidies to industrial plantations and the processing industry, including assessing the effectiveness, efficiency and equity dimensions of the subsidies. It should be recognized that subsidies can encourage investments in high-risk projects, distort markets for forest products and exacerbate social inequalities.

Second, the government should prioritize plantation and industry subsidies to projects that directly support planting and processing by collective forest owners and other small holders.

Third, collateral loan of forest resources, particularly of collectively owned forests, should be actively promoted. The State Forestry Administration of China has recently issued the Regulation on Mortgage Registration of Forest Resources that has clearly defined the object, principle of forest resources mortgage. It is an urgent task to conduct the pilot work, summarize and extend current experience in this regard.

Fourth, the involvement of low-cost insurance funds should be encouraged. Currently, the deposit period of large amount of pension insurance funds tallies perfectly with the loan period of cultivating large-diameter rare tree species. The pension insurance fund has a low deposit interest and is looking for investment fields to increase its efficiency. Meanwhile, high-quality large-diameter timber is and will be in short supply in the market and can secure stable profit. Complementing and promoting with each other, the systematic integration of the two things will not only solve the shortage of forestry investment, but also find investment and value-added out-lets for the pension insurance fund.

Fifth, it should strengthen the credit support to farmers. First of all, requirements forgetting forestry loans should be eased and repayment period should be prolonged. Secondly, small credit and united deposit loans to farmers and forest workers should be increased. More compensation supports to the main investors of plantation, such as discount loans and afforestation subsidies to such ecological development activities as afforestation, sand control, should also be provided.

Conclusion III: Policy reforms that encourage greater investment by private sector and collective forest owners should be adopted

The vast majority of forest in China is neither industrial plantations nor protected areas. It is important to encourage investment in this majority portion of the Chinese forest. Maintaining the route of nationwide participation and social forestry, China should encourage and guide various financing factors to forestry. According to the principle of "who invest, who benefit", the legal rights and benefits of investors should be guaranteed. The social environment of fair competition should be created and investment from various social channels should be attracted to the forestry development. Given the need to develop domestic timber supply, the government should encourage more investment by private and collective forest owners in both plantation and natural forests.

Hereby, the policy recommendations are as follows:

First, favorable policies on forestry management by both private and collective forest owners should be developed, in both plantation and natural forests. In accordance with the Rural Land Contracting Law, the forestland contracting term should be prolonged and the legal rights and benefits of farmers and other forest managing bodies, including rights in plantation, tendering and management, logging and upgrading of forest, sales and benefits of timber and forest products, landscape benefiting, legal transfer and inherit of forest and forest land, should be practically protected.

Second, national forestry tax and fee reforms policies should be carried out and taxes and fees paid by forest producers should be reduced dramatically. According to the Resolution, Taxes on special agricultural products should be removed gradually with an emphasis on further clearing various illegal charging of fees in the process of timber sales and processing. Private and collective forest investments should be attracted to commercial plantation and the active management of natural forests through policies on tax reduction and exemption.

Third, Management of forest cultivation fund should be reformed. According to the Resolution, in line with the principle of “from the forest and to the forest”, forest cultivation fund should be returned to the forest managing bodies gradually.

Fourth, the logging quota (annual allowable cut regulation) should be relaxed on plantations. The state has strict limitations in logging public-benefit and natural forests. At the same time, the owners of mature commercial plantation forests should be allowed to conduct logging and production of timber according to the market demand and forest management plans. The government should consider loosening harvest control (the logging ban) gradually after natural forest resources are recovered.

Fifth, markets for forest, timber and forestland should be established and perfected. The government should consider issuing regulations on the management of transfer, sales, mortgage, lease and joint venture of forest, timber and forestland, to regulate transferring activities, promote transfer of forestland and timber management rights, vitalize forestry assets and practically protect the enthusiasm of the pubic in protecting and establishing forest.

Conclusion IV: There is a need to establish markets for forest ecological services.

The fact that government provides public goods doesn’t mean that government produces or manages all the public goods. Supply and management of public goods by the government alone may result in low efficiency. As public goods, forestry ecological service should introduce competition mechanism and increase investment benefits through markets. The government has already established extensive public payment schemes for ecosystem services, and these can be strengthened. The government can do much more by establishing the legal and regulatory framework for private actors to invest and trade in ecosystem services – as is happening in many other parts of the world. New private markets for carbon sequestration, watershed protection and biodiversity conservation are providing new, private, investment into forestry – compensating natural forest owners for the many public benefits of their private forests. China should actively promote these markets.

Hereby, the policy recommendations are as follows:

First, greater experiments and pilot projects in market for ecosystem services should be encouraged – designing them to advance both ecological restoration and poverty alleviation goals.

Second, all government, community and private sector actors should be encouraged to learn more from each other from these experiments, and to learn more from the many experiments and programs from around the world.

Third, new and more rigorous research on the existing experiments in China should be conducted – assessing the efficiency, effectiveness and equity of these markets.

Fourth, direct compensation mechanism of social ecological benefits should be established. A certain percentage of income of sectors and agencies benefited from forest, such as water conservancy, water and electricity and tourism sectors, should be charged for direct compensation to main forest managing bodies.

Fifth, central and provincial governments should establish clear laws and regulations – clarifying the rights and responsibilities of all parties – in particular, making sure that the rights of the poor and the collective forest owners are respected.

Conclusion V: There is a need to encourage private and public banks and investors to adopt new, and more stringent investment policies and due diligence procedures for all forestry and wood processing investments.

The conference discussed many issues related with public and private investment. On the one hand, government banks are carrying a large number of non-performing loans – a major constraint in advancing financial sector reforms. And on the other hand, the risks associated with investments in forestry and wood processing industries are often poorly evaluated by financial institutions, leading to inappropriate investments and potentially high rates of loan default. Several speakers recommended that financial institutions adopt stronger standards for assessing the social and environmental impacts of forestry and wood processing investments. Many international banks have recently adopted new principles to guide all investments and specific policies when considering investments in forestry which may provide useful models for China to adopt or build upon.

The policy recommendations are:

First, private and state banks involved in the forestry sector should prepare new standards for reviewing all potential investments, becoming consistent with international banking standards. These standards should include new and more rigorous financial due diligence and risk analysis. The standards should also be made publicly available to promote transparency and facilitate monitoring by government and civil society actors.

Second, private and state banks should also adopt more rigorous standards for social and environmental impact analyses prior to funding forestry and wood processing projects. These standards should be made publicly available to promote transparency and accountability. The new standards should enable the government and civil society to monitor performance of the loan recipients as well as the banks making the loans.

Third, state banks should develop new systems of independent monitoring of investment performance, assessing compliance with these new financial due diligence standards and policies to require social and environmental impact assessments.