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Reforming Forest Fiscal Systems

A Workshop Summary

Forest fiscal systems – specifically concession and revenue systems – provide the tools for mobilizing forest revenues, motivating private industry operations, and meeting broader policy objectives, including sustainable forest management (SFM), poverty reduction, and conservation of environmental values. Several countries, encompassing a diverse range of forest types and associated industries, are implementing or considering new approaches to designing and implementing effective fiscal systems.

In this context, the International Workshop on Reform of Forest Fiscal Systems convened in Washington DC from October 19 - 21, 2003, to provide a forum for frank discussion on the political economy of forest fiscal reforms. Participants from seven countries - Brazil, Cambodia, Cameroon, Ghana, Honduras, Indonesia, and Nicaragua – shared their experiences in the reform process. Discussions were particularly rich and diverse as participants representing ministries of forestry and finance as well as the private sector were at the table.

While the participants' specific situations varied, in all cases the goal for the forest fiscal system is to identify practical ways to ensure that forests can be utilized sustainably and make a more positive contribution to national poverty reduction objectives by stimulating growth and providing regular and enhanced revenue flows to governments.

The scope of discussion encompassed components of a forest fiscal system - timber royalties, concession fees (both industrial and community), forest-related taxes and fees, export duties, exemptions, and other incentives such as grants or preferential interest rates.

Beyond considering forest fiscal systems for efficient revenue collection and maximization, the Workshop looked at forest fiscal instruments as tools to promote SFM and broader societal goals including poverty reduction, gender equality, and good governance.

Editors note: This briefing note is based on views and opinions expressed at the Workshop. It does not necessarily represent consensus on issues discussed.

What is the Right Mix of Fiscal Instruments?

The right mix of instruments varies according to the specific country context, as what is effective in one country is often very different from what works in the next. Ideally, the package of fiscal instruments meets the criteria of

FISCAL REFORMS IN CONTEXT

Brazil: At present there are no government fees on timber extraction, nor is there a concession management system for public lands.

Cambodia: In 1995, prior to the logging ban, forest exports yielded US$33 million. Forests meet 90% of rural energy needs.

Cameroon: Fiscal reforms have yielded a three-fold increase in revenues in current prices from 2000 to 2003.

Ghana: Stumpage value distribution is highly skewed: in 1999, government and landowners received an estimated 13%, loggers 5%, and processors 82%.

Honduras: In 1992, commercial activities were privatized, and the Forest Development Corporation (COHDEFOR) began selling timber through public auction.

Indonesia: Central government taxes and fees are estimated to capture less than 50% of the total stumpage value.

Nicaragua: Forest policy with contradictory goals for conservation and industry has resulted in illegal activity constituting up to 70% of all logging.

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CONSIDERATIONS FOR FOREST FISCAL REFORM

- Forest fiscal systems not only raise funds, but also attain broader policy goals like SFM.
- Accountability and transparency in the use of forest revenues for social and community development is needed.
- Increasing revenue collection from formal operators combined with failure to control illegal or informal operators creates market imbalances and disincentives.
- Fiscal incentives for SFM should be introduced in the context of the overall fiscal policies of the government.
- Fiscal policy must create a predictable and level playing field for private sector investment.
- Partnerships must be developed between ministries responsible for the forest sector and finance.

being economically efficient, administratively feasible, and supportive of broader social and environmental objectives.

Instruments frequently employed include an area tax, stumpage tax and export taxes. Clear policy objectives, clear roles and stakeholder dialogue are good practices that help to minimize inconsistencies between different fiscal instruments.

An area tax is often favored because it has a high recovery rate and low administration cost for implementation. Clear, verifiable procedures for concession management and auctions are important to assure “clean” results and avoid corruption.

An advantage of a stumpage tax is that it is based on extractive use. Such a tax should be differentiated by species, and a market-based approach to setting the price is often preferred. Clear administrative procedures and third party involvement contribute to ensuring a transparent process.

Export taxes on unprocessed timber provide an incentive to domestic industry for value-added products. However, such a policy bears some trade-offs. One approach to balance the potential benefits and drawbacks would be to impose such a tax for a limited period sufficient to foster a domestic infant industry.

How Should Revenues be Allocated?

In general, collected forest fees should be allocated to support objectives such as SFM, good governance, poverty reduction, and environmental conservation. Decisions on resource allocation should be based on clear criteria and take into account projects and programs required to achieve objectives at regional, national, local and community levels. The allocation of resources should be transparent to build in accountability in resource use.

Revenue distribution structures should not be legislated, as the circumstances and associated needs in the forest sector can change and flexibility is required to meet such changes. Additionally, earmarking funds should only be for a specific, targeted use and only for a certain period of time.

In cases where resource allocation is decentralized, delegation of responsibilities without clear rules can undermine effectiveness of resource use. Guidelines for revenue use at the local level can help to improve effectiveness. Incentives for local officers should be created to motivate enforcement and combat corruption.

What are Tactics for Managing Politics in a Reform Process?

Overcoming vested interests and creating a level playing field for all stakeholders are challenges in a reform process. Which stakeholder should participate in a reform process should be determined by who the potential beneficiaries and losers are, and identification of interest groups. Strategies to overcome vested interests of government or industry include ensuring a transparent process, timing the reform to avoid elections, and balancing trade-offs among interest groups in a mutually-beneficial way when possible. Access to information by all stakeholders and opportunities for dialogue to learn other stakeholders’ perspectives may facilitate reform. Finally, forest fiscal reform processes must take into account other national reform processes.

Country Fiscal Reform Processes In Brief

BRAZIL

Earlier efforts to improve sustainability in the forest sector through regulations and monitoring and assessment resulted in land conversion for agricultural use to avoid regulations. Now, policy is focused on motivating forest producers toward sustainable practices and markets through technical assistance, information and technology, subsidies and innovations such as the clean development mechanism. As a next step, a forest concession system is envisioned to allocate forests for protection and production in the Amazon, 70% of which is publicly owned. A national forest information system and a third party logging control system are also in the works.

FOREST REVENUES ALLOCATION

Brazil: All revenues go to the federal budget except for the Forest Recovery Fee.

Cambodia: 20% of revenue goes to the Forest Department.

Cameroon: 50% of revenue goes to the federal government, 40% to local councils, and 10% to villages.

Indonesia: Tax and non-tax revenues are differentiated from non-tax revenues used for reforestation.

Honduras: Revenue from timber sales go directly to COHDEFOR.

Nicaragua: Resource allocation is decentralized. In the Atlantic region 25% goes to local communities, 25% to regional government, 25% to indigenous

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CAMBODIA

In 1992, Cambodia introduced a concession-based forest management system. In response to problems encountered with the system, reforms were introduced, including mandatory long-term management plans for each concession, approved annual harvesting volumes, a forest product export quota, and a round timber export ban. Cambodia is working to illuminate illegal logging through a log tracking system and independent forest monitoring.

CAMEROON

Forest sector reforms in Cameroon have focused on broadening the tax base and improving enforcement through decentralization. In 1999 the Ministries of Finance and Environment and Forestry initiated a Forestry Revenue Enhancement Program and reforms including a bidding system, increased area taxes, mandatory forest concession management plans, and a system of bank guarantees. This reform has resulted in significant increases in forest revenues.

However, the private forest industry sees the reforms as having reduced the profitability of many enterprises, and believes that fiscal policy must provide incentives for legal operations and good governance. Cameroon would like to harmonize forest policies in the Central Africa region to help regulate trans-boundary timber movements.

GHANA

In 1995, Ghana implemented a log export ban to counter the rapid and unsustainable growth of the forest sector in the 1980's. Additional reforms have been introduced, including a competitive bidding procedure for resource allocation, revision of stumpage rates to reflect international prices, an export levy on lumber by species, a value-added tax for domestic sales, removal of log import duties, and a levy on veneer and lumber exports. Future priorities for Ghana include a broadened decision making process with stakeholder participation, interministerial collaboration, and a log and product tracking system to improve revenue collection.

HONDURAS

Honduras is now in the process of simplifying its forest legislation and reforming the forest fiscal system to promote protection of environmental services, incentives for reforestation, increased value added, non-timber forest product promotion, and use of smaller wood diameters. Future priorities for Honduras are to link forest fiscal reforms to the national poverty reduction strategy, to develop a national dialogue, and educate politicians about forests' contribution to poverty reduction.

INDONESIA

In Indonesia illegal logging poses many problems in terms of lost revenues and distorted timber markets and incentives. Taxes and levies in Indonesia now include a one time area-based utilization fee, a reforestation fee based on cubic meters harvested, a forest resource tax of 10% of log check price. Since 2001, forest management has been decentralized and regions now impose taxes without informing the central government. Better monitoring and data and information is needed to inform fiscal policy, optimize fees and address illegal activities.

NICARAGUA

In June 2003, Nicaragua passed new forest legislation establishing a system for conservation and sustainable development. Forest resources have been returned to land owners, and the forest administration is being decentralized. Provisions in the new law include incentives for export and for legal operators. However, the private sector is concerned about the long-term stability of the forest fiscal rules. Next steps in Nicaragua include harmonizing agriculture and forest sector policies, and improving registration and control systems to help combat illegal logging.

Next Steps

Building on the dialogue at the Workshop, an informal learning group will continue to share experiences with forest fiscal reform processes. PROFOR will support continued exchange by providing a space to post and share documents on its website (http://www.profor.info). The experiences and lessons learned from the group will be communicated to a broader audience, such as the fourth session of the United Nations Forum on Forests (UNFF) in May 2004.

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