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POLICIES TO SUPPORT WOOD-PROCESSING DEVELOPMENT

Secretariat Note

Introduction

1. Recent international attention to forestry has tended to focus on social and environmental dimensions, including those relating to forest conservation, forest restoration and rehabilitation, provision of ecosystem services – including carbon sequestration – and poverty alleviation. However, for many governments in the Asia-Pacific region, development of wood-processing capacity remains an integral objective in national forestry policies and plans. Wood processing may provide significant potential for forestry to contribute to the wider economy by generating employment, economic development and value addition in the utilization of natural resources.
2. Wood-processing development is financed in two primary ways in Asia and the Pacific:
 - (i) In some countries, state-owned wood-processing facilities are financed by governments. In this instance, wood-processing development is dependent on effective advocacy in government budget allocation processes; or
 - (ii) Private sector investment in wood-processing facilities, including small-scale enterprises operated by communities or individuals. In this instance, the primary consideration is whether investors can earn an adequate rate of return with an acceptable degree of risk.

Factors affecting wood-processing development

3. Development of large-scale processing facilities producing wood products for sale in export markets may be dependent on national competitive (and comparative) advantages. Competitive advantage is based on an industry's capacity to innovate and upgrade and derives from four core elements: (1) factor endowments; (2) firm structure, strategy and rivalry; (3) demand conditions; and (4) related and supporting industries. For many countries in the Asia-Pacific region, competitive advantage in forestry – where it exists at all – derives mainly from factor endowments in terms of having large natural forest resources, the ability to grow trees quickly and large pools of relatively cheap labour. However, a smaller number of countries has been highly successful in developing globally significant wood-processing sectors based on other elements of competitive advantage including development of highly integrated wood-processing industries, strong infrastructure and enabling business environments.

4. Secure access to wood supplies is a fundamental driver of investment in wood processing. Without long-term, secure and enforceable wood supply arrangements, investment in wood processing is usually too risky and unattractive to the private sector. Patterns of forest ownership and tenure may be crucial in this regard. In most countries in Asia and the Pacific, the vast majority (68 percent region-wide) of forests are owned or administered by governments, 28 percent of forests are owned by – or designated for the use of – communities and indigenous groups. Only 4 percent of forests are owned by the private sector (individuals or firms). Relative to private owners, governments may be more likely to be compelled to consider wider public good aspects of forest utilization, including for biodiversity conservation and provision of other ecosystem services. This is particularly likely for natural forests compared with plantation forests. These aspects may compromise the certainty and stability of wood supplies to processing facilities. Historically, in countries where private sector ownership of forests is allowed, large-scale wood-processing companies have often shown a marked preference toward vertical integration – through ownership of both timberlands and processing facilities – to ensure control and stability in the price and volume of significant proportions of their wood supplies. In recent times, the emergence of new ownership models such as Timberland Investment Management Organizations has enabled some firms to divest their forest holdings while retaining confidence in supply security. Regardless, smaller processing companies, without sufficient capital to invest in forest ownership, are able to operate effectively provided that wood supply contracts are sufficiently robust.

5. Infrastructure development is a key component in locating wood-processing facilities. In particular, transport and energy infrastructure are critical determinants of the viability of wood-processing facilities. Regarding transport, an adequate roading network, including bridge payloads, is required to transport logs from the forest to processing mills, while more roads or rail are required to transport processed products to secondary processing facilities, consumer markets and/or exporting facilities. Insufficient capacity to transport logs and wood products may also be a constraint, for example, where too few log trucks are available. Various other infrastructural weaknesses may also constrain wood-processing development. For example, installed electricity distribution capacity is a major constraint to investment in wood-processing facilities in many rural areas.

6. A number of issues relating to labour supplies may constrain the development of wood processing. In many countries, access to adequately skilled labour – including in supporting industries – may constrain development of some wood-processing industries. In many countries, unwillingness to work in forestry and wood-processing industries, which are often considered difficult, dirty and dangerous occupations, may be a significant constraint. Capacity to offer wage rates in forestry and wood processing that are competitive with wages in other sectors may be a significant issue in some countries.

7. In some countries, direct and indirect incentives have been used to encourage wood-processing development. Direct incentives include the use of instruments such as grants, subsidies, tax concessions, subsidized loans and price guarantees. Indirect incentives include factors like government extension, market development activities, research and development and trade restrictions such as tariff protection. While such incentives have been successful in stimulating industrial development in some countries, they also impose significant costs on other sectors of the economy. Incentives may also merely ‘buy participation’, distort economic decision-making and result in unsustainable development that collapses when the incentive is removed.

8. For large-scale processing facilities, access to investment capital is likely to be a significant constraint in many countries. This is particularly likely in developing countries where domestic investment capacity may be weak, investment regulations may severely restrict or preclude foreign direct investment or the investment environment may otherwise be perceived as risky or unattractive.

9. Outdated, unnecessary or inadequate government policies, legislation and government regulations may constitute significant impediments to investment in wood processing. These may include

elements beyond the purview of the forest sector including deficiencies in regulations governing investment, macroeconomic settings, taxation policies, governance and law enforcement, as well as corruption, obstructive bureaucracy and other endemic factors that reduce profits and increase risks to investors. Within the forest sector, policies that restrict access to (and security of) wood supplies; harvesting and tree planting; active forest management; transport of timber and processed products; and market access are some of the factors that may severely constrain development of wood processing.

10. For smaller scale wood-processing facilities that primarily serve local markets (such as those run by communities, families or small firms), normal market attributes, including economies of scale, may disadvantage small producers. Additional issues may be created by rules and regulations that are implicitly biased against small enterprises. In particular, compliance costs associated with start-up procedures may preclude development of small-scale processing or force processors to operate illegally or in the informal sector.

11. Secondary wood processing and remanufacturing facilities should generally be less constrained by issues of supply security, but other factors may constitute significant constraints. For secondary wood processors, especially in developing countries, access to high-value export markets is likely to be critical to success. Market access restrictions including non-tariff barriers may be key impediment to processing development in many countries. Economies of scale may also severely constrain secondary wood processors, particularly in market development and promotion. In these cases, producer associations and cooperatives may provide avenues to increased viability.

12. The overall objective for governments seeking to promote the development of wood processing should be to create an environment that encourages and enables investment. It is generally clear that investment is forthcoming when risks are perceived to be low and governments signal unambiguous support for private sector involvement in development. A key element of an enabling environment is to identify and remove significant impediments to investment, as well as providing an environment conducive to easily doing business. This includes good governance, macroeconomic stability, provision of basic infrastructure and clear and enforceable property rights.

Heads of Forestry dialogue

11. The Commission will discuss ‘Policies to Support Wood-processing Development’ within a Heads of Forestry dialogue format. Delegates may wish to consider experiences and challenges in encouraging wood-processing development, identify key impediments and constraints that have been encountered and share successful approaches and potential solutions. The Commission may wish to consider:

- Identification of the principal constraints to investment in wood processing in Asia-Pacific countries;
- Ways in which forestry agencies can help to create enabling environments for wood-processing investment; and
- The value of a targeted regional study or other regional initiatives that might assist countries in promoting wood processing.