Civic Response

Policy Institutional and Legislative Reforms to Support Ghana's Forest Sector Governance

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BRIEFING PAPER

INDUSTRY

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BACKGROUND

In 2001 forest sector policy analysis brought to the fore the challenge of the State's inability or unwillingness to exact an appropriate "forest tax" that reflects the real value of timber resources. While this revelation influenced the course of NRMP by including policy reform in the forest agenda; later followed by a partial success of the reform negotiation with the private industry (competitive bidding and its frustration by political interference;, events were overtaken by the emergence of the drive towards Timber legality through a VPA. A subsequent fiscal assessment in 2006 of the likely outcome of timber legality for the forest fiscal and revenue distribution also showed that the FC institution was a problem: it contributes to high transaction costs of the industry and communities, while the loss of confidence of landowners (Traditional Authorities) in the FC institution has led to a *de facto* imposition of "tax" (by chiefs) on timber operators. Institutional reform and a fiscal regime that mutually and consistently align with each other was, therefore, embraced as a more comprehensive approach to dealing with the bottom line issue of inadequate forest rent capture and inequitable distribution of whatever the State exacted from the industry. Today, the dual objective remains largely unachieved. Overharvesting and forest depletion continues, the delivery of competitive forest management services by FC remains questionable and the forest structure is rapidly changing as a result of depletion, making it important to get the policy right over the next timber felling cycle.

The above developments have implications for Ghana's poverty reduction strategy and the way it has been approached in the past. Poverty reduction still depends significantly on policies and institutions and how they promote markets and income re-distribution. It is, therefore, important to understand the import of the new dimension to the forest policy analysis introduced by the above studies which moves away from the practice of discussing forest fiscal and institutional reforms as separate issues. In another related matter the challenge today for Ghana's forest institutional governance is that forest regulation and its procedures sometimes make it cheaper to bribe, if they cannot be avoided without cost, than comply. Sometimes too, it creates incentives for enterprises to exit the formal sector. While reducing state monopoly in the overall regulatory regime in order to reduce transaction costs, it becomes expedient to use legal enforcement and sanctions as balancing acts. Economic growth (creation of wealth) and poverty reduction (distribution of wealth) are not sustainable events without the fiscal, institutional and legal enforcement linkage.

CHARACTERISTICS

The industry comprises formal small independent loggers, integrated logger-processors, stand alone wood processors and formal small and medium furniture and joinery producers.

State of competition in the formal sector

The formal forest industry is shrinking, with a smaller number of companies (20 in all) accounting for over 70% of exports, the major orientation of timber production. This has happened largely as a result of a continued log export ban policy and its effects of depressing domestic prices and a consequent overharvesting. An over-protection of inefficient processing has also occurred from these policy failures and processing mills have found incentives to integrate backwards into logging. Small-scale logging has conversely declined sharply due to depressed prices and eventual financial insolvency of many of the members of the Ghana Timber Association.

Consolidated Industry (Size and control of timber resources)

A wood scarcity has occurred. At the same time, control of the log market observed in the 2001 study to have about 90% in the hands of integrated logger-processors still have as high at about 70% under control of integrated logger-processors. The relative decline is the result of new small-scale property mark entries in both forest and off-reserves.

Over-capacity and low level technical efficiency

There is an industry perception about resource availability that has resulted in the industry moved industry to expand capacity by 200% between 1990 and 1999. Particularly since the second half of the 1990s, increased investment in existing establishments has become a major factor in explaining the increase in capacity than in the number of new entries into the forest industry. These findings apply more to saw mills than other wood processing sub-sectors. By global standards, Ghana's wood industry is generally inefficient. It recovers grade timber at about 40% of input, compared with about 65% in Europe. The industry's break-even performance is sustained by a volume intake that has 50% illegal timber content.

What the industry pays

The forest industry faces a number of financial charges emanating from the forest sector. Some of these are "taxes" in nature. Others are part of their operating costs. The taxes comprise stumpage fees, Timber Rights Fees (TRF) and Export levies.

This Briefing Paper is extracted from "Synthesis Of Political Economy And Fiscal Studies On Ghana's Forest Sector: Working Document," Forest Watch-Ghana; February, 2011

Industry as a source of employment

Industry is an important source of employment and livelihoods, but this is based on unsustainable wood supply. The level of industry employment, estimated 100,000 in 1999 is claimed by industry to have declined by about 50% in 2007. Labour retrenchment experience in the wood sector points to the conclusion that generation of employment is based on unsustainable wood supply.

INDUSTRY'S RESPONSE TO POLICY AND IMPACTS OF SECTOR INTERACTIONS

Industry's operating environment

The forest industry operates in an environment partly characterized by the State's practice of administrative allocation of resources and the maintenance of a log export ban which protects the processing industry depressing domestic prices of timber. The State also implements an administrative Annual Allowable Cut (AAC) limit of 2 million m^3, twice the legal limit. Industry benefits from these policies. In its own assessment, it needs sufficient throughput to break even.

The wood industry generally does not have the urge to improve efficiency on account of a Log Export Ban Policy that depresses domestic price of logs. This poor signal is worsened by the State's discretionary allocation of resources that encourages the industry to seek integration of logging and processing. By not paying appropriate prices, industry generally subtracts from real value. This runs counter to economic growth.

Under-collection of revenue and loss of real value

Industry enjoys a subsidy from the State in the form of the State's under-collection of revenue and a non-adjustments and/or partial adjustments of stumpage fees to take account of inflation. The industry also practices a laundering of timber species in order to attract lower stumpage fee rates. About 40% of what the wood processing industry uses is also not recorded.

Wood scarcity

Implementation of Ghana's VPA is expected to bring about a significant reduction in the legal cut limit. VLTP Fiscal Studies summarize RMSC estimates in terms of a harvest volume range between 600,000 (pessimistic scenario) and 840,000 (optimistic scenario). These estimates are based on the expectation that VPA will bring about a stronger enforcement and control of removal of trees under the allocated yield in forest reserves, which will in the future be by far the major source of timber harvest for the formal industry: OFRs face a high risk of depletion, well below the present official harvest level of some 300,000 m^3

Domestic market

The domestic market has become over-dependent on illegal wood due to failure of policy to address the problems of under-pricing of timber that has created price distortions between formal (export) and informal sector (chain saw) lumber on the domestic market. The log export ban also contributes to a strong export incentive. The price distortion keeps formal sector lumber out of the domestic market, leaving the supply gap to be filled by illegal sources and at the expense of the environment. It is estimated that illegal harvesting with its attendant deforestation and forest degradation is costing the economy about 5% of GDP.

Economic Rent Wastage[1]

The State has been unable to capture a sizeable portion of the economic rent in forest fees, largely because a log export ban is in place and domestic prices of logs generally remain low. This policy has encouraged the maintenance of low efficiency in processing which also makes it impossible for the industry to pay close to international prices and survive. Over the last decade and a half, the effect of the policy of timber under-pricing (low stumpage fees) has shifted the economic rent distribution more from loggers to wood processors which in turn wasted a large portion of this rent through low technical efficiency. Economic rent has been distributed to or "harboured" by the following stakeholders:

a. Loggers
b. Wood processors

1 Economic rent is the value of the standing tree in its highest valued market, and it is that value which remains after deducting cost of extracting the tree and a reasonable profit margin for the operator that will keep him in business. Since the State (Forestry Commission to be precise) has monopoly over forest management and regulation, the value of the standing tree includes costs of performing these functions. The State captures economic rent principally through stumpage fees [According to (Reg. 21(3), of L.I 1721), stumpage fee is collected to cover forest management costs and leave a margin for landowners]. The payment of export levies at the port is also part of this value. Then, the introduction and payment of Timber Rights Fees are supposed to mop up uncaptured economic rents, since the State has had an aged problem of leakages in stumpage fees. When the State fails to use any or all of these fiscal measures to "tax" the economic rent, the rent stays with the industry. It either remains with it as an excess gain or it is wasted. So the economic rent harboured by the industry does not all end in its pocket. Either way, gain or loss it is a bad policy outcome. If the State compromises with industry on the grounds that it is not making profit, the States forgiving inefficiency, and this runs counter to the declared goal of making the private sector and engine of growth (Vide Ghana's MDGs stated in Annual Budgets).

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c. Forest owners; and

d. A large portion that is lost through technical deficiencies in milling

Failure to address this fiscal deficiency or accompanying the log export ban policy with other appropriate measures has shifted economic rent distribution more from loggers and processors to the wastage bracket.

By2005, the State's forest revenue was still below 25% of the size of economic rent. The State allocates an inequitable share of this forest revenue to forest owners. In the share that goes to landowner, District Assemblies collect the largest share (55%) but are not transparent in their appropriations. Though an under-collection of revenue (about 42% in 1999) has improved to about 90% by 2006, the State has been losing real revenue overtime through a non-adjustments and/or partial adjustments of stumpage fees to take account of inflation. Revenue leakage is also occurring through a laundering of timber species and unrecorded timber.

Unemployment

The wood industry has in the last decade undergone progressive consolidation as a result of wood scarcity. Along with it there has been retrenchment of labour. The Industry in 2005 indicated that about half of its labour force had been retrenched.

Environmental risks

Current forest practices and the existing governance regime as reviewed under this Synthesis Study point to a potential resource crash, deforestation, loss of biodiversity and degraded ecosystems. These mean in the future a high financial risk in the form of foregone carbon and other payments for ecosystem services.

Transaction costs under wood scarcity

Wood scarcity and declines in the scale of industry operations expose the cost of doing business with the State as a constraint to longer term industry profitability and the state's future approach to taxing economic rent. An institutional non-alignment is costing the industry US$15 per m^3 in transaction costs and informal payments for forest access. If the State reforms its institutions and saves the industry these cost, the actions and expected responses could form the basis of reopening fiscal policy reforms in the forest sector.

THE VPA SCENARIOS

A Scoping study carried out on the likely impacts of Ghana's VPA reviews forest policies and stakeholder perceptions and assesses the likely impacts of VPA under three scenarios: The Baseline Scenario (representing "Business-As-Usual");The Legitimate Scenario (VPA unaccompanied by major reforms, and Sector Reform Scenario (VPA accompanied by comprehensive sector reforms). The business as usual scenario spells disaster for both the industry and future livelihoods. The legitimate scenario promises a significant degree (but not total) of legal compliance with industry structure virtually unchanged and turnover declines arrested at some point in time; the likelihood of environmental governance and co-existence of legality with reduced livelihoods in the forest sector. The sector reform scenario, more than the legitimate, corrects significant policy and market failures, provides opportunity for "soft landing measures to mitigate short term adverse impacts of implementing a VPA. These measures will include development the tertiary industry, particularly the informal or small and medium scale enterprises which will in turn offer opportunities for employment generation.

CONCLUSION AND RECOMMENDATIONS

The synthesis study points to insufficient capture of timber rent which is largely wasted by the forest industry. Forest revenue distribution is also characterized by inequity, forest owners being the losers. This inequity, accompanied by non-transparency in the appropriation of forest owners' share, has not engendered forest owners' support for sustainable forest management and forest protection. Though forests are contributing to economic growth, they have not lived up to expectation, that is , making a positive impact on the livelihoods of forest people. Even though the forest industry has made some contribution to employment this is based on unsustainable timber.

Failure to adopt comprehensive reform measures to correct these policy failures have accentuated already existing market failures and worsened timber rent capture. The State has been unable, in the face of industry resistance, to push for further fiscal reforms. There is sufficient evidence that the approach to poverty reduction through distribution of revenues and engagement of communities in paid labour plantation programmes has not worked. There is need for simultaneous pursuit of economic growth and income re-distribution.

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The following specific recommendations are made by the VLTP Fiscal Studies:

a. Devolution of Forestry Commission functions
   - » Shared FM&R responsibility with the private sector
   - » De-regulation of off-reserve resources
   - » Role of the Ghana Institute of Foresters (GIF)
   - » Training of semi-professionals and professional staff

b. Fiscal reforms that provide incentives for sustainable forest management and value addition2

c. Managing the global responsibility of forest governance

d. (d) Transitional measures
   - » Engagement of local governments and civil society in discussions of off-reserve issues;
   - » Engagement of GIF
   - » Outsourcing of grading and inspection functions
   - » Private sector dialogue and
   - » Strengthening capacity of forest trade associations

These recommendations are consistent with sampled opinions of stakeholders under a VPA Impact Assessment Study in 2007.

2 This will largely entail the retention of a portion of economic rent by timber operators with best practice in SFM

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