Addressing subcontracting issue to improve timber production

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A shift in the international timber trade

Exports in EU declining, China have become the first client, India and Vietnam more active on African markets.

In 2017, Gabon exported 420,000 m³ of sawnwood to China, more than Indonesia or Malaysia.
Crisis of EU companies

• In early 2018, the Africa branch of Rougier announced its bankruptcy
  • Rougier sold its concessions in Cameroon and CAR to a Cameroonian company, and will focus on Gabon (Congo Bzvl ?)
  • FSC certificates in Cameroon not renewed before the sale

• Wijma (the first company FSC certified in C. Africa) sold two concessions to Vicwood (China), one to SFE (China) and one to a Cameroonian company
  • FSC certificates suspended

• The Italian Cora Wood in Gabon, had to sell one of its concessions to a Chinese company to pay off its debts

• Total area of FSC certified had declined in the last two years from 5.5 million hectares to 4.8 million ha
The end of a cycle?

• Difficulties closely linked to the deficit in main commercial species (Sapelli for Rougier in Cameroon, Azobé for Wijma) by the end of the first felling cycle (less productive AAC entering in production)

• Shift to “lesser known species” not achieved, plantations lagging behind, investment in technical/marketing innovation not sufficient

• Markets for “Forest Management” certified timber narrowing with the new trade flows and the competition with “legality certificates” for due diligence requirements for EUTR

But not all certified companies in economic turmoil: some successful companies (Precious Wood, CBG) in Gabon and a wealthy Olam (2 million ha) in Congo
Uneven playing field

• Large European companies have gradually complied with legal standards by preparing Forest Management Plans (FMPs) and get certified

• Apart from Olam (2 million ha in Congo, 1,3 M certified), no Asian company has seriously sought to become FSC-certified, so far.
  • Asian companies often pinned for illegal activities, as in Gabon, recently.
  • The export of timber, logs included, in containers randomly inspected, facilitates trafficking.
  • Law enforcement is poor, partly explaining the differences in profitability between companies

• European concessionaires gradually selling their assets to Asian investors
  • Emerging national companies to compete for exports (e.g. Cameroon), but often with Asian partners (e.g. “ventes de coupe” in Cameroon)

• But, likely difference in behaviour between Chinese state-owned companies and private Chinese companies
  • State-owned companies under scrutiny from Beijing’s government
  • Some of them look for certification (PAFC or FSC)
Subcontractors: the Achille’s heel of many Asian companies

- Outsourcing to contractors is a typical feature of current capitalism
- Allow to reduce costs, by removing large companies’ obligations to provide social advantages and give high flexibility in case of economic downturn (no need to fire staffs...)
- Dilute responsibilities within the production process, especially when remunerations are oriented toward volume delivered rather than quality of work
- Some institutional arrangements create « perverse incentives », such as I found in 1993 in East-Kalimantan (Indonesia)
Progressive payment for quantities supplied by contractors (Indonesia, 1990’s)

An incentive for fast harvesting, disregarding wastes and damages (and rotation constraints...)

$\text{m3/year}$

Purchase price of timber to contractors

In SE Asia (e.g. Indonesia) the “contractors” are operating on the concession itself.

Is such a system used by Asian companies in Central Africa?
Designing the right incentives

• For companies using subcontracting, financial incentives to contractors should be linked to their compliance with forest and labour regulations (rotation, minimum diameters, wastes, social specifications...) rather than on the volume delivered
Special Economic Zones: from vertical integration to “contractors-based” system?

• Traditionally, forest enterprises tended to be vertically integrated, combining log harvesting and wood processing
  • A model encouraged by public policies, for employment and economic activities in remote regions
• A new trend since the setting of the Gabon Special Economic Zone, close to Libreville (to be followed by Congo)
  • Several new processing industries without forest concession: “log buyers”
  • Better conditions for achieving downstream processing (skilled labor, less spare part stocks, possibility of industrial clusters…)
  • Can work only with log suppliers (“Italian model”), opposite to vertical integration
Special Economic Zones: additional considerations

- Specialization has theoretical advantages: investment can be concentrated on efficiency improvement in wood processing.
- But, given the log export ban, specialization can also prevent adaptation of the processing activity to the diversity of species and qualities of the stand (diversification).
  - In Gabon, GZES demand is focused on high-quality Okoumé (for peeling), which is reflected by its high prices.
- In Gabon, all the logs entering the GSEZ must be certified (legality), which can be seen as a one way to address the risk associated with inadequate practices of subcontractors.
What public policies can do?

• Prohibiting all subcontracting might prove difficult and not relevant, as outsourcing is sometimes an appropriate solution for specific activities

• A more promising avenue would be to provide incentives for forest management certification

• If the demand (price premium) is not sufficient to increase certified tropical forest areas, incentives might be considered upstream, in terms of costs
The Compensated Reduction of Forest Taxation for certified concessions (CRFT) proposal

- Compensating governments granting tax cuts for certified concessions (CRFT)
  - In Africa, forest taxes (area fees and felling taxes in priority) could be reduced significantly for certified surfaces
  - Governments will consent to do so only if fully compensated for their budget
  - Full compensation (by a coalition of donors) could be guaranteed for Public Treasury for a given period (6-7 years?), than reduced progressively or suppressed

- A reduction in costs would provide an incentive even for companies (e.g. State-owned Chinese companies) whose markets do not demand (yet?) certified wood

- A proposal considered with interest by various donors: the feasibility study is on tracks