PROGRAMME ON FORESTS

PROFOR VIET NAM

Study on Financing Strategy for Sustainable Forest Management in Vietnam

Overview of Financing Mechanisms for Sustainable Forestry Development in Vietnam

by

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Note:
This document was established as a contribution to the Regional Seminar on Market-based Instruments for Sustainable Forestry Development and Forest Conservation, organized by MARD and FAO in Hanoi, 21 to 25 June 1999, with the participation of delegations from China, Mongolia, Myanmar and Vietnam. The paper is based on tentative findings of a broader study on financing mechanisms for sustainable forest management which is being implemented by UNDP PROFOR Vietnam. The present paper is not yet a final version but an incomplete draft for discussion. Comments are welcome. Please address comments to <profor.vn@fpt.vn>

List of Abbreviations

ADB Asian Development Bank
BOT Building-Operation and Transfer
BT Building-Transfer
C&I Criteria and Indicators
CDM Clean Development Mechanism
DARD Department of Agriculture and Rural Development
EEAF Environmental Enterprises Assistance Fund
EU European Union
FAO Food and Agriculture Organisation of the United Nations
FDI Foreign Direct Investment
GDP Gross Domestic Product
GEF Global Environmental Facility
ha Hectare = 10,000 square meters
IDA International Development Association
IDB Inter-American Development Bank
IMF International Monetary Fund
MARD Ministry of Agriculture and Rural Development
MB Management Board
MIF Multilateral Investment Fund
MOF Ministry of Finance
MPI Ministry of Planning and Investment
NEAP National Environmental Action Programme
NFP National Forest Programme
NGO Non-governmental Organisation
NSDS National Sustainable Development Strategy
ODA Official Development Assistance
PIP Public Investment Program
PROFOR Programme on Forests of UNDP
SBV State Bank of Vietnam
SFE State Forest Enterprises
SFM Sustainable Forest Management
SIDA Swedish International Development Authority
TFAP Tropical Forestry Action Programme
1. Forestry Development Policy

Vietnam has abundant and diverse forest resources which produce valuable timber and other forest products. Forests have long been important for the life of tens of millions of people, at the same time playing an important role in the national development and defence. Three categories of forest land are defined with estimated areas (Table 1).

Table 1: Forest land according to the forest legislation in Vietnam

<table>
<thead>
<tr>
<th>Forest land category</th>
<th>Definition</th>
<th>Area (million ha)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Protection forest</td>
<td>Critical watersheds, wetlands, etc.</td>
<td>5.7</td>
</tr>
<tr>
<td>Special use forest</td>
<td>Nature reserves, national parks, etc.</td>
<td>0.9</td>
</tr>
<tr>
<td>Production forest</td>
<td>Forest production areas</td>
<td>12.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>19.0</strong></td>
</tr>
</tbody>
</table>

The first two categories of forest land are to be allocated to and managed by state-run management boards. Production forests are to be allocated to State Forest Enterprises (SFE) or to private individuals, households or companies. Presently, 25% of the total forest land area and 38% of the production forest area is under the 412 SFEs.

In the past several decades, Vietnam’s forest resources have been declining seriously; a trend that still continues. It is estimated that there were 14 million ha of forests in Vietnam in 1943. The respective forest cover was 43%. In 1975 the national forest inventory showed that the forest area was 11 million ha, i.e. the forest cover was reduced to 34%. By 1997 the forest cover is estimated at 28%, with a total forest area of 9.3 million ha. The forest area per each Vietnamese is 0.12 ha per person which is well below the south-east Asian average of 0.42 ha per person. Table 2 presents the changes in forest area. It is estimated that 10 million ha of forest land has become "bare land".

Table 2. Changes in Forest Area in Vietnam

<table>
<thead>
<tr>
<th>Year</th>
<th>Natural forest</th>
<th>Planted forest</th>
<th>Total area</th>
<th>Forest cover (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>1000 ha</td>
<td></td>
</tr>
</tbody>
</table>

UNCED United Nations Conference on Environment and Development
UNDP United Nations Development Programme
UNFCC United Nations Framework Convention on Climate Change
UNICEF United Nations Children's Fund
USD United States Dollar
VAT Value added tax
VBARD Bank for Agricultural and Rural Development
VBP Vietnam Bank for the Poor
VND Vietnam Dong
WB World Bank
WFP World Food Programme
The forestry sector is facing demands by the country's industrialisation and modernisation as well as sustainable economic development needs. The sector has to manage better and protect the existing forests. Deforestation has to be stopped to ensure safe environment for the country and for agricultural production while meeting the increasing demand for timber and other forest products.

At its second session, the tenth National Assembly of the Socialist Republic of Viet Nam adopted a resolution on "Project to Plant 5 Million Ha of Forest in 1998-2010 Period". On 29, July 1998, the Prime Minister signed Decision 661/QD/TTg on the targets, tasks, policies and implementation organisation of the project to carry out the National Assembly's resolution.

The targets of the 5 million ha project are:

- To plant 5 million ha of forests together with protecting the existing forests to increase the national forest coverage to 43%, helping to ensure safe environment, reduce natural calamities, improve water-generating capacity, preserve the gene pool and biodiversity.
- To effectively utilise unused land, barren hills and mountains, create more jobs, contribute to the elimination of hunger and poverty reduction, promote sedentary farming and living, raise income for rural and mountainous population, stabilise the society, and improve the national defence and security especially in border areas.
- To provide wood as raw material for the production of paper, wood-based boards, timber, firewood and other forest products for domestic consumption and export, as well as develop the forest product processing industry, turning forestry into an important economic branch contributing to social-economic development in mountainous area.
- To plant 2 million ha of protection and special use forests of which tending and restoring with enrichment planting on 1 million ha, and planting 1 million ha of new forests combination with settling down nomadic people.
- To plant 3 million ha of production forests of which about 2 million ha of production forests for producing raw material for the paper industry, wood-based board production, pit props for mining, and specialty and precious timber for furniture and construction industry; about 1 million ha of long-term industrial tree crops and fruit trees; to encourage all organisations and people to plant scattered trees on any unused land.

Forest planting plans for each period are:

**Table 3: Forest Planting Plans**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New forestry</td>
<td>700 000</td>
<td>1 300 000</td>
<td>2 000 000</td>
<td>4 000 000</td>
</tr>
<tr>
<td>Tending, restoring</td>
<td>350 000</td>
<td>650 000</td>
<td></td>
<td>1 000 000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1 050 000</strong></td>
<td><strong>1 950 000</strong></td>
<td><strong>2 000 000</strong></td>
<td><strong>5 000 000</strong></td>
</tr>
</tbody>
</table>

According to the Vietnamese constitution all the land and forests thereon belong to the people of Vietnam and the State manages the land and forest resources on behalf of the people. Has the State managed the forest resources prudently according its mandate? It is estimated that the forest cover was 43% in 1946. By 1997 the forest cover was reduced to 28%. This provides one answer to the question above. It can be now asked if
the management mandate of the state should be revoked, and the land and forests returned back to the people, in the very concrete meaning of the words.

What has this radical statement to do with financing strategy for sustainable forest management? Experience from all over the world suggests that sustainable forestry, and maintenance of stable forest cover, is possible only if the costs of forest management can be kept lower than the income from forest produce (both wood and non-wood combined) is, i.e. forestry must be profitable. Furthermore, the rate of profit must be equal or higher than any possible alternative land use can provide. Otherwise forests are gradually converted to other uses. This is exactly what has been happening in Vietnam. Naturally, the strictly protected forests, such as national parks, need to be supported by the state and the society at large, unless adequate income can be generated for instance from tourism.

2. Financing Mechanisms for Sustainable Forest Development in Vietnam

2.1 Financing Framework

A simple analytical framework for the present study is presented in Figure 1. According to it, investments (and respective financing needs) in forestry sector can be divided in two broad categories: (i) investments in productive forestry which should be strictly profitable, and (ii) investments in protective and conservation forestry which need to be subsidised by the state society at least until adequate means for income generation e.g. from tourism or sales of carbon sequestration or biodiversity services and be-put in place. In reality the productive and protective / conservation forestry are often somewhat inter-linked, but this does not change the main arguments here.

The investment decisions in productive forestry must be allowed to be made by the resource land owners without external pressures and unnecessary steering from the state. The investment decisions will then reflect the market expectations and individual cost and benefit calculations by the resource owners who are at the same time highly motivated to make their investments successful and profitable. Independent decision making power and related commitment are crucial aspects which must be respected although this is not always mentally easy (anywhere in the world) for the government staff who feels that it is their morale duty to intervene for the purpose of the common good. Vast experience has however demonstrated that such interference is usually not helpful, not for the investor nor for the society. On the other hand, the success and profit by individual or enterprise will benefit both the investor and the society in the form of increased production, employment and tax revenues.

Figure 1: Analysis framework of the study
2.2 Financial Sources for Forest Development

The main financing sources for forest development are:

i. State investment
ii. Domestic private investment
iii. Foreign direct investment (FDI)
iv. Official development assistance (ODA)
v. International forest development funds and portfolio investments

Global long term experience has demonstrated that state is less efficient manager of forest resources than enterprises or individuals. This means that state forestry is usually much less profitable than forestry organised by enterprises or private individuals, such as farmers, provided that the state does not interfere too much with the management objectives and decision making by the enterprises and individuals.

How much is too much? It is argued here that the state should limit its role only in establishing and enforcing minimum adequate forest management standards, such as developed widely in many countries under the framework of criteria and indicators (C & I) for sustainable forest management (SFM), and / or similar forest certification standards. This traditional normative role together with the provision of extension, education, training and research in the sector should be continued and strengthened. All the other roles, with particular reference to productive activities, should be left to private enterprises and individuals.

The trend of international financing for investment in general and for forest development in particular shows that private investment has played an increasing role (Figure 2 & 3).

Figure 2: Net Resource Flows to Low and Middle Income Countries
Financing for sustainable forest development should focus on creating a sound investment environment where the state financing will enable promoting private investment.

On the other hand, national sustainable forest development policy in developing countries has attracted international concern. Developing countries could be provided international assistance for their forest development by ODA and other financial sources (Figure 4).

**Figure 3: Relative Shares of Net Resource Flows**

**Figure 4 ODA Flows to Forestry**

2.3 Framework for the Forest Financing in Vietnam

The tentative calculations of the Permanent Office of the Executive Committee for the implementation of the 5 million hectare project indicate that the cost for the period of 1998 - 2010 is about 35 650 billion dong or USD 2.2 billion of which some USD 975 million is expected to come directly from the state budget. In addition, some USD 1.3 billion would be needed from other sources, e.g. form the state banking sector (and thus ultimately from the state budget) and from official development assistance (ODA) and foreign direct investment (FDI). It is likely that some alternative ways and means need to be found, not only for finding the funding, but also for forest management and afforestation. It is argued here that the present plans for the 5 million ha project are too expensive, and thus not feasible.

The financial requirements for the implementation of the 5 million ha project can not be met by the Government alone. Therefore all public and private, foreign and domestic sources for financing the project have to be mobilised. In this context, adequate policies for stimulating domestic and international investment into forestry and to use existing sources in a most effective and efficient way have to be applied. Some of these are already in place, others still have to be formulated, especially with regard to the mobilisation of local investment by farmers, who are expected to be the driving force in the realisation of the 5 million ha project.

Also the preconditions for larger scale investment of the domestic private sector and FDI as well as for increased ODA have to be established.

Well organised and clear forest resource ownership is a prerequisite for profitable, and thus also potentially sustainable, forestry. Should this not be in place, like it is not yet presently in Vietnam, the forest resources will be decimated regardless how much the state injects subsidies in forestry. Besides, very few country can afford to pump in a continuous flow of money to a sector which cannot stand on its own.

2.4 Lessons from the 1993 - 1998 Afforestation Programme (327)

The government formulated and guided the implementation of a major afforestation programme from 1993 to 1998 (called as 327 programme) with the objectives of:

- re-greening barren hills and mountains, protecting the forests and the environment, utilising unused land in mountains and midlands, coastal land and water surface to increase the production of commodities and materials for industrial production;
• completing the settlement of nomadic people, combining economic development with social development;
• stabilising and improving the material and spiritual life of people in new settlements;
• increasing the state's capital formation;
• strengthening national defence and security.

After three years of implementation, the programme's target was revised (Decision 556/TTg) to focus on planting new protection forests and special use forests, with the main tasks of planting, restoring and tending forests, and protecting forests in selected areas. During the six years of implementation, the state had invested VND 2 981 685 billion in:

• Managing and protecting 1.6 million ha of forests.
• Planting 1 360 801 ha of forests, including restoring and enriching 700 000 ha, and planting 640 000 ha of new forests.
• Planting 88 729 ha of industrial tree crops and fruit trees and 31 290 ha of family gardens.
• Generating jobs for 466 67 8 households.
• Building 5 009 km of rural roads, 86 505 m² of schools, 16 755m² in of medical stations, thousands of small irrigation projects, and supplying safe water for more than. 20 000 households.

Programme 327's achievements and progresses in food production and tree planting in mountainous areas have helped to slow down deforestation. At present, the acreage of forests planted every year has surpassed the acreage of deforestation. There are, however; reports which argue that the deforestation still surpasses the rate of afforestation and reforestation (e.g. World Bank 1998). Forest area in a number of provinces has expanded remarkably. Forest protection, restoration and care has improved. Many model forest farms of high economic efficiency have been established, and a number of households are benefiting from forestry production.

Lessons and experiences drawn from the implementation of Programme 327:

• There should be a close coordination among all branches of the administration at all levels from the central to local and grassroots levels, in particular in close management and coordination by different levels of the provincial authorities.
• Households should be strongly supported, and the allocation of land and the provisions of the forest management contracts to households, organisations and individuals for forestry development uses should be accelerated. The boundaries of each owner should be marked clearly in the field.
• To choose suitable farming methods and land use forms as well as types of plants of high productivity according to the local conditions. The farmer is assumed to know the best his/her capacity. However, good quality technical assistance and extension services are needed to provide training and disseminate new profitable production systems.
• To develop appropriate policies and mechanisms which comply both with the state's and people's interests, and combine immediate interests with long-term benefits.
• There should be local production plans (simple farm plans), and inspections should be made regularly to detect and correct any shortcomings timely as well as remove obstacles and difficulties for the grassroots level.

Previously, the markets and marketing of eventual forest products were not considered when planning tree planting on production forests. Tree planting was driven by the supply of public subsidies which were allocated as evenly as possible throughout the country. Equality considerations superseded any profitability or business considerations. The dispersal of small-scale plantations throughout the country has resulted in difficulties in selling the end products and particularly it has resulted in low prices and high harvesting, transport and marketing costs. Many individual farmer has got disappointed as the expectations on the profitability of tree plantations were not met.

The investment decisions in productive forestry must be allowed to be made by the resource land owners without external pressures and unnecessary steering from the state. The investment decisions will then reflect the market expectations and individual cost and benefit calculations by the resource owners who are at the same time. highly motivated to make their investments successful and profitable. Independent decision making power and related commitment are crucial aspects which must be respected although this is not always mentally easy (anywhere in the world) for the government staff who feels that it is their morale duty to intervene for the purpose of the common good.

Regarding the protection and special use forests, the legislation stipulates that they should be allocated to
and managed by state-run management boards. However, in reality large areas of protection and special use forests are under e.g. State Forest Enterprises which have been encouraged to contract their management out to SFE workers and local farmers. The 327 programme provided a fixed payment of VND 50 000 per ha per year to such contractor. Most observers are of the opinion that this amount is too little to provide adequate incentive for the contractor to protect and manage the area effectively. On the other hand, the MARD evaluation on the 327 programme concluded very clearly that according to the field interviews the VND 50 000/ha/year payment is sufficient and appreciated by the contractors (Ministry of Agriculture and Rural Development 1998). It has been reported that some SFEs have applied even lower payments (down to VND 30 000 per ha per year) in order to cover larger areas than the government provided funds would otherwise allow. On the other hand, some other SFEs have reportedly paid considerably higher fees (up to VND 1 million per ha per year) in order to make the contract truly binding and effective.

2.5 Rural Credit Framework

Rural credit and rural investment have been promoted during the economic reform in Vietnam since 1990. The latest resolution on rural and agricultural development issued in November 1998 pointed out several directions for rural credit and investment. The main features of rural credit and investment were reconfirmed as following:

- Increased state investment into agriculture and rural areas.
- Investment should focus on infrastructure such as rural road system, irrigation system, power supply, schools, and health centres.
- Special attention will be given to investment in rural mountainous and remote areas.
- Local people, domestic and foreign investors are encouraged to invest in the fields that contribute to rural and agricultural development.
- Expanded credit services in rural areas.
- Increased supply of middle and long-term credit to industrialisation in agriculture and in other rural fields.
- Rural development credit should be provided with soft terms (low interest and long-term). The loan terms will be consistent with the life cycle of planted tree species, animal types, and the amortisation of agricultural machinery.

The rural credit and investment policies and strategies that state has been implementing have following remarkable features:

First, the state increases its investment and credit provision in rural areas and particularly for agriculture. To realise this objective, rural banking institutions (Bank for Agricultural and Rural Development, 1989; Bank for the Poor, 1995; People’s Credit Fund, 1993) have been established. In addition, some 20 national programs have been established to provide investment and credit to rural areas.

Second, subsidised credit approach has dominated the thinking in rural credit. Most credit to rural areas apply interest rates established by Vietnam Central Bank. Market approach in interest regulation has not been applied. Table 2 illustrates rural credit policy of different schemes.

Table 4: Rural Credit Schemes

<table>
<thead>
<tr>
<th>Bank and Program</th>
<th>Target</th>
<th>Interest rate</th>
<th>Additional inputs</th>
</tr>
</thead>
<tbody>
<tr>
<td>VBARD</td>
<td>Rural households, small business, state program</td>
<td>1.2%</td>
<td>No</td>
</tr>
<tr>
<td>VBP</td>
<td>Rural poor</td>
<td>0.8%</td>
<td>No</td>
</tr>
<tr>
<td>People’s Credit Fund</td>
<td>Rural households</td>
<td>1.5%</td>
<td>No</td>
</tr>
<tr>
<td>Job Creation Programme</td>
<td>Households, small business</td>
<td>0.6-1%</td>
<td>No</td>
</tr>
<tr>
<td>Reforestation Program 327</td>
<td>State forestry enterprises</td>
<td>0.1-0.4%</td>
<td>Infrastructure</td>
</tr>
<tr>
<td>Reclaiming Unused Land</td>
<td>Rural households</td>
<td>No</td>
<td>Resettlement</td>
</tr>
</tbody>
</table>
To stimulate afforestation in watershed areas that bring benefit to the whole society, special decree on credit for afforestation on watershed areas was issued by government in 1992. The decree 264-CT of 22nd July 1992 by the Chairman of the Council of Ministers on "Investment Policy for Forest Development" has highlighted key issues relating to afforestation credit. This decree stated that:

- Forest authority of state will be responsible for allocating forest land to forest contractors.
- Afforestation credit is provided from the state budget.
- Credit for buying seedlings that are planted on forest lands and that will provide products within less than 20 years (such as plants that provide products for pulp and paper industry, mining, wood chips for wood processing industry, and for pine resin extraction) will have an interest rate which is 30-50% of normal existing interest. Credit with low interest will be provided for the first production cycle only.
- Repayment of principal and interest will be collected at the end of the production cycle. Compound interest is not counted.
- After the first production cycle, forest contractors could borrow credit with normal interest rate; Interest of loan to mountainous and island areas is 15 per cent lower than the normal existing interest.
- Forest lands that are designated for planting trees with production cycle more than 20 years (such as protection forest area, national seedling production forests, and special forests) will be allocated to state forest enterprises. State will provide funds from the state budget to develop forest on these lands.
- State provides zero-interest credit to farm households that receive forest land to develop protection forests as well as to plant production forests in new resettlement areas.

The rural credit and investment policies are implemented in consistent with different decrees (The Decision of Prime Minister 661/QD-TTg, 29 July 1998 on Five Million Hectares Reforestation Program; Resolution 28, 3 February 1999, of MARD and Ministry of Finance guiding to implement Decision 661; Law on Domestic Investment, Promotion on 20 May 1998). The rural credit policy demonstrates that the government intends to increase state investment in rural areas and to provide concessionary credit to rural development projects.

**The Law on Credit Institutions:** At the 2nd session, 10th legislation of the National Assembly held in December 1997, the "Law on Credit Institutions" governing the operations of the central bank and commercial banks was passed. This 131-article Law on Credit Institutions is characterised by following features:

First, it stipulates that the state shall establish banks which operate on a non-profit basis for the purpose of serving the poor and other underprivileged persons, and for implementing socioeconomic policies of the state (Article 4). The state shall issue preferential credit policies on financing, interest rates, lending conditions and duration applicable to the poor to facilitate the development of their businesses and production (Article 10).

Second, Article 13 of the Law confirms that banking activities of non-bank organisations shall be subject to the relevant provisions regarding permitted banking activities.

This law has had a number of important effects on rural credit services:

i. The state will continue to provide cheap credit to the rural area and to the poor. This policy is in conflict with market approaches.

ii. The law does not only cover the operations of formal credit institutions but also banking activities of all informal non-credit institutions. Therefore informal credit services provided by mass organisations, associations and international NGOs will be granted with a legal status when following the law. Otherwise, informal credit services will have no legal status and will be governed by the Civil Code.
This rural credit policy will hamper sustainability and expansion of rural credit schemes. Low efficiency of credit service, and unbalanced credit demand and resource allocation are presently the major problem in rural credit.

To promote rural credit, government stipulated recently that rural households could borrow up to VND 10 million without collateral (Decree 67/1999/QD-TTg, 30 March 1999). The Decree 13/1999/QD-TTg, 4 Feb. 1999 of Prime Minister on Credit Policy for 1999 confirms that the interest rate is 0.81% per month and maximum credit term is 10 years. State owned enterprises continue to have preferential access to credit as no collateral is requested from them or they can use invested assets as collateral. Credit for national programs such as Clean Water Provision, Poverty Alleviation, 5 million ha project will have tailor-made credit regulations. This means that there is no unified rural credit policy in terms of interest, loan term, repayment, and targeted beneficiaries. The government induced investments may lead to low efficiency in resource allocation. In fact, the programs of 1 million ton of refined sugar production, off-shore fishing, and pulp and paper tree planting are already facing problems of repayment.

It is proposed here that to increase the efficiency in forestry credit, it is important to pay attention to the following issues:

- Allowing commercial banking institutions to set the interest rate through market mechanism. The state should only monitor the interest rates.
- Abandon tied credit policy: it is not likely that the state can identify profitable investment opportunities. Borrowers should have the right to choose profitable investment opportunities themselves.
- Identify well and narrowly targeted beneficiaries for special rural credit schemes.
- Improve investment environment in forestry by providing land use right certificates, rural road building, and removal of macro-economic barriers to forest sector business development.
- State subsidies and credit for forest investment should be provided directly to forest land owners, and not to middle organisations, such as state forest enterprise.
- Existing credit policy focuses on state financing only; private forest financing has not been paid attention; there is no mechanism to leverage private investment in the forest development policy.

2.6 State Budget Investments

The state budget will be used for investments in developing special use and protection forests in critical and very critical areas. For 1999, state provides VND 318 billion for 5 million forest program. This investment covers forest plantation, and forest development cost (maintenance, services). For example, state budget contribution for forest development cost should not exceed VND 50 000 per ha a year for a maximum period of five years. Forest tending and restoration in combination with enrichment planting will be subsidised by not more than VND 1 million per ha per year for a maximum period of six years.

People contracted to plant critical and very critical protection forests will receive an average VND 2.5 million for each ha. Organisations and individuals investing in planting production forests of precious timbers with exploitation cycle of over 30 years receive an average VND 2 million for each hectare. The state will pay in advance the costs of producing of tree seedlings for forest planting.

**Subsidies for afforestation:** The economic justification for subsidies is based on the existence of market failures which cause a difference between the benefits accrued to the owner of the resource (i.e. forest) and the national economy. This is the only valid justification for subsidies. The forestry sector is affected by many market failures, mainly related to environmental and ecological benefits which are important for the society, but the forest owner or manager cannot catch income from them. Also the notable difference in the time preferences of the society and the farmers is harming the forestry sector significantly in Vietnam. Therefore, the carefully-targeted subsidies for forestry sector are justified particularly those related to forests which are under some level of protection, and thus the commercial production is limited by the state.

The **quantity of the subsidy** must be based on the criteria of efficient use of scarce resources. The present system of providing a fixed lump sum of grant or credit may cause irrational use of the funds. The land owner has an interest to present an application with **inflated costs**. Similarly, the management fee is a fixed percentage (5%) of the costs of the project. Often the same organisations which prepare the individual project proposals receive also (part of) the management fee. Natur0y, they have a motive to present big and expensive projects.

**It is necessary to change the present system** of incentives. The system of incentives should be based on
economic criteria. The procedure should be simple and transparent, and it should provide a special incentive to the land owners who have a comparative advantage in timber production and/or forest protection, i.e. have lowest relative costs. Some time in the future, the forest owners themselves must compete for the funds, each of them indicating the minimum subsidy which he / she would require for his / her project. The intended project area, and the required subsidy should be indicated in the application.

The payment of the subsidies should be organised in an easy and transparent way, with low administrative costs. For example, one third of the approved funds could be given upon the signature of the contract, another third after the first year of the work, and the final third after three years, provided that the inspections of the project prove the fulfillment of the agreed requirements. The first payments could be, in the case of the violation of the contract, subject of restitution by the authorities, with an interest rate equal to the average lending rate by the bank system.

High quality technical assistance is important for the success of individual projects. The efficiency and quality of technical assistance could be improved through a training programme directed to the involved technicians. Donor financing could be sought for the training programme. Training courses could be organised for the technicians on subjects such as:

- legal issues of incentives
- participatory extension
- participatory planning of projects
- social and gender issues
- species selection and nursery operations
- plantation techniques and maintenance of plantations
- wood and non-wood forest products and their markets
- marketing and prices of wood and non-wood forest products
- forest management planning
- natural regeneration and enrichment planting

The 5 M ha project need a standardised monitoring system for following-up the achievement of the objectives and targets of the programme. Standard and regular monitoring reports would assist the Provincial and National Steering Committees and donors in the follow-up of the programme.

There has been considerable debate on the true costs of forest protection and tree planting in Vietnam, i.e. if the subsidies provided by various programmes have been / are sufficient and realistic. Ogle et. al. (1999) have compiled the Table 5 providing information on subsidies by some of the key programmes.

**Table 5: Subsidies for tree planting in Vietnam (VND 1000 / ha)**

<table>
<thead>
<tr>
<th></th>
<th>327 Vinh Paper</th>
<th>Phu VijaChip Danang</th>
<th>Guidelines for 5 million ha project</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Protection/special use</td>
<td>Grant for valuable</td>
<td>Credit for fast growing</td>
</tr>
<tr>
<td>Establishment</td>
<td>1200</td>
<td>2400</td>
<td>2900</td>
</tr>
<tr>
<td>Maintenance yr. 1</td>
<td>300</td>
<td>200</td>
<td>637</td>
</tr>
<tr>
<td>Maintenance yr. 2</td>
<td>300</td>
<td>200</td>
<td>442</td>
</tr>
<tr>
<td>Maintenance yr. 3</td>
<td>300</td>
<td>200</td>
<td>221</td>
</tr>
<tr>
<td>Maintenance yr. 4</td>
<td>0</td>
<td>1000</td>
<td>221</td>
</tr>
<tr>
<td>Maintenance to yr. 7</td>
<td>0</td>
<td>1000</td>
<td>221</td>
</tr>
<tr>
<td>Total</td>
<td>2100</td>
<td>5000</td>
<td>4642</td>
</tr>
</tbody>
</table>

Previously the SFEs had preferential access to credit for forestry activities. This policy has been phased out. Currently, the SFEs must borrow from the banks with normal interest rates, unless they are applying for the credit funds under the 5 million ha project (Ogle et al. 1999). Most banks and other lenders (credit funds, private money lenders) are reluctant to Provide credit for forestry purposes due to the long pay-back period
and the high risk compared to other loans. Similarly, the SFE directors are reluctant to borrow funds for tree planting because they are held personally responsible for the repayment of the loans. Therefore, afforestation or reforestation of production forests without special government schemes is not common. Large areas of previous production forests have been reportedly (Ogle et al. 1999) re-classified as protection forest simply to qualify for government grants, without any major protection value of the area.

The "right" size of subsidy for tree planting has been heavily debated in every country that provides public subsidies for forest planting. Many countries have elaborated complicated systems which combine subsidised credit and/or some grant financing with technical assistance. Quantities provided vary depending on the income of the applicant, area to be planted, tree species, region in the country, etc. Complex disbursement schemes combined with control and field verification systems are often applied. The “better” (i.e. the more fair and secure) the system gets, the more expensive its administration gets, and the more ingenuous the farmers / investors get in finding loopholes.

2.7 Bank for Agricultural and Rural Development - VBARD

VBARD was established in 1988 and presently it plays dominant role in rural financing. It has representatives in 61 provinces, 527 districts, and 604 communes of the 9 801 communes in the country. VBARD provides commercial loans to targeted customers with interest rates that are directed by the Central Bank of Vietnam.

The total capital of the VBARD was VND 24 017 billion in 1997. Saving interest rate ranges from 0.5% for demand savings to 1% for 12-month savings. Saving mobilisation is becoming the main source of the VBARD capital: it has increased from 50.4% of the capital in 1993 to 80.4% in 1997. This means that VBARD is becoming closer to a commercial credit institution. On the other hand, it has started to face more difficulties under the credit policy of the government.

Table 6 Outstanding Loans of VRARD by Customers

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Outstanding (billion VND)</td>
<td>% of total</td>
<td>% delayed repayment</td>
</tr>
<tr>
<td>State enterprise</td>
<td>2 484</td>
<td>20</td>
<td>4</td>
</tr>
<tr>
<td>Cooperative</td>
<td>100</td>
<td>1</td>
<td>29</td>
</tr>
<tr>
<td>Private companies</td>
<td>293</td>
<td>2</td>
<td>16</td>
</tr>
<tr>
<td>Joint venture companies</td>
<td>2</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>Households</td>
<td>9 478</td>
<td>77</td>
<td>3</td>
</tr>
<tr>
<td>Short term</td>
<td>7 459</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle term</td>
<td>2 018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>12 359</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Providing small loans to rural households increases the credit service costs of the bank. However, under the interest regulation policy, VBARD can not decide the interest rate to cover its service cost. In fact, many district branches of VBARD which deal directly with customers are reluctant to expand credit service to small rural households. Better off farmers can access credit service easier than the poor ones. Large scale farmers can borrow bigger loans than small farmers. The increase in outstanding loans to households reflects the government policy which is conflicting with the business interests of the bank.

In order to reduce risk, there are 3 approaches in delivering credit: (i) provide credit directly to individual households; (ii) lending through mutual-guarantee groups, and (iii) lending to farm enterprises.
Loan to forestry development occupy only a small volume within the total loans to rural households. In 1998 forestry loans were 2.5% of all the outstanding loans to rural households.

**Table 7: Outstanding Loans of VBARD to Rural Households**

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Out-standing (billion VND)</td>
<td>% of total</td>
<td>% delayed repayment</td>
</tr>
<tr>
<td>Individual household</td>
<td>7,989</td>
<td>84</td>
<td>2.7</td>
</tr>
<tr>
<td>Mutual-reliability groups</td>
<td>178</td>
<td>2</td>
<td>2.7</td>
</tr>
<tr>
<td>Farm enterprises</td>
<td>1,295</td>
<td>14</td>
<td>4.9</td>
</tr>
<tr>
<td>Loan to forestry</td>
<td>38</td>
<td>0.4</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td><strong>9,464</strong></td>
<td><strong>11,912</strong></td>
<td><strong>13,858</strong></td>
</tr>
</tbody>
</table>

**2.8 Private Companies**

There is very little statistical data available on private investments in forest sector in Vietnam. The private sector investments are decided on the basis of expected profitability of investment. Expected revenues (cash inflow) must exceed the costs (cash outflow) taking into account the time factor, i.e. all the expected revenues and costs are usually discounted to the same point of time. In addition, the profitability of an investment should be equal or higher than alternative investment opportunities. Otherwise it would be more rational to invest the money elsewhere.

In forestry sector, the investment opportunities are related to the profitable production of various forest products and services (timber and non-wood forest products, government subsidies for protection and conservation services, etc.). Wood production has traditionally been the most important category of production (and source of income) in forestry sector in Vietnam. There is a need to remove all the unnecessary barriers (ownership, investments, company establishment, etc.) for profitable forest sector enterprise development in Vietnam.

**2.9 Small-scale Investment by Individuals, Families and Collective Bodies**

The investment of individual, households and private companies, has increased from 20.6% in 1997 to 21.3% (equivalent to VND 20 500 billion) of total investment in 1998 in Vietnam. The Law on domestic investment issued in 1995 was amended in May 1998 to promote private investment.

It is estimated that billions of Dongs have been invested into forest development by the farmers who have received the certification of forest land use rights (so called red book). 11.5 percent of forest land area was allocated to 0.8 million farming households. It is expected that private investment on forest development will increase when forest land allocation would be accelerated. Government has issued a plan to accelerate forest land allocation under the 5 million ha project.

**2.10 Foreign Direct Investments**

To promote foreign investment, the Law on Foreign Investment was issued in November 1996. Several decrees have been made to guide the implementation of the law. The total foreign investment commitments have increased from USD 3.8 billion in 1993 to USD 8.5 billion in 1996, but then fallen to USD 4.06 billion in
1998. In 1988-1998 period, 2,468 projects have been committed with total commitment of USD 35.8 billion.

The actual / disbursed FDI investment in agriculture, forestry and fishery is only USD 740 millions, which is about 5% of the total FDI.

According to the World Investment Report 1998 (United Nations 1998), the world-wide foreign direct investment (FDI) continued their upward climb in 1997 for the seventh consecutive year. The global growth of FDI was 19% for 1997. The statistics for 1998 are not yet available. It is clearly demonstrated by the World Investment Report that the FDI inflows vary greatly from country to country. A framework for determinants for successful FDI pulling in by a host country are outlined by the same report.

Table 8 Distribution of FDI in Vietnam - Disbursement by Economic Sector

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Excluding investment by domestic joint venture partners</td>
<td>620</td>
<td>295</td>
<td>869</td>
<td>1,048</td>
<td>1,780</td>
<td>1,813</td>
<td>2,011</td>
<td>8,437</td>
</tr>
<tr>
<td>Sectors (%)</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Industry</td>
<td>24.2</td>
<td>13.5</td>
<td>27.5</td>
<td>41.5</td>
<td>36.0</td>
<td>39.6</td>
<td>43.7</td>
<td>36.8</td>
</tr>
<tr>
<td>Oil, gas</td>
<td>11.0</td>
<td>21.1</td>
<td>42.4</td>
<td>29.0</td>
<td>19.8</td>
<td>14.2</td>
<td>0.0</td>
<td>16.8</td>
</tr>
<tr>
<td>Construction</td>
<td>14.4</td>
<td>2.0</td>
<td>5.0</td>
<td>3.4</td>
<td>6.3</td>
<td>14.2</td>
<td>9.0</td>
<td>8.6</td>
</tr>
<tr>
<td>Transport communication</td>
<td>7.4</td>
<td>6.0</td>
<td>2.6</td>
<td>6.4</td>
<td>4.9</td>
<td>1.4</td>
<td>2.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Real estate</td>
<td>23.1</td>
<td>17.3</td>
<td>12.2</td>
<td>14.9</td>
<td>25.8</td>
<td>23.6</td>
<td>23.1</td>
<td>21.4</td>
</tr>
<tr>
<td>Agriculture, forestry fisheries</td>
<td>8.7</td>
<td>3.8</td>
<td>3.1</td>
<td>2.9</td>
<td>6.0</td>
<td>5.9</td>
<td>12.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Other</td>
<td>11.3</td>
<td>32.7</td>
<td>7.2</td>
<td>1.9</td>
<td>1.2</td>
<td>1.0</td>
<td>9.7</td>
<td>5.7</td>
</tr>
<tr>
<td>Total</td>
<td>732</td>
<td>351</td>
<td>1,027</td>
<td>1,500</td>
<td>2,075</td>
<td>1,985</td>
<td>2,193</td>
<td>9,863</td>
</tr>
</tbody>
</table>

Source: MPI and IMF

Foreign investors are allowed to invest in most fields and regions. They can also choose appropriate investment pattern: joint venture or 100% foreign-owned enterprise, BOT (Building-Operation and Transfer) or BTO (Building-Transfer-Operation) and BT (Building-Transfer). Most of joint venture projects are implemented between state enterprises and foreign companies.

More than half of foreign investments came from Asia. The recent economic crisis in Asia has had a negative effect on FDI flows to Vietnam. Bentley (1999) provides an excellent overview of legal issues and bottlenecks hindering FDI, and economic development in general, in Vietnam. He points out that the fundamental elements of a market-oriented legal framework which are not presently in place in Vietnam include: (i) a clear and complete definition of property and property rights and the means to exercise them, (ii) a clear and complete system of rules for making contracts, and (iii) courts and other government supported mechanisms providing for the speedy and effective enforcement of legal rights, including contract and property rights, and settlement of disputes. According to Bentley, the main bottlenecks for FDI in the current Vietnamese legislation include, among others:

- Out-dated and unnecessarily restrictive Companies Law placing several stumbling blocks on the market entry and establishment of companies
- Non-existence of modern National Enterprise Register
- Overly complex and excessive income tax (both for foreigners and national), as well as company taxes
- Overly restrictive and discretionary land ownership / land tenure legislation
- Out-dated and un-functional credit legislation with serious difficulties in securing adequate but flexible collateral (pledges and mortgages)
- Out-dated banking and financial legislation which does not encourage savings (deposit insurance and bank secrecy laws utterly inadequate), capital formation, productive credit, and efficient financial transactions
- Non-existence of adequate securities and stock legislation, and respective national markets which in all
industrialised countries form the back-bone of financial markets for enterprise and business development

- Unnecessarily restrictive trade controls, causing red tape and delays in both exporting and importing
- Continuous over-valuation on Dong against foreign currencies, causing continuous shortages in the availability of foreign currencies in Vietnam, and un-competitiveness of the Vietnamese export industry.
- Inadequate accounting standards and lacking annual audits by independent auditors, particularly in the state-owned enterprises, including SFEs and other forest sector enterprises.

In the United Nations (1996) Report "Catching Up - Capacity Development for Poverty Elimination in Vietnam" the benefits of FDI are clearly described: "...private foreign direct investment can be one of the most effective means for transferring management and business know-how as well as technology to accelerate the development of a country's productive capacity. Well directed capital and technology can enrich everyone, including the people of the host country, as well as foreign investors." Since the beginning of the doi moi reform, Vietnam has recognised these benefits and sought to attract FDI. Many sectors have been fairly successful, however, forestry sector not being among them.

Of all the FDI projects approved so far (USD 35 billion), only 39% (about 1000 projects) have been actually realised (Table 5). Apparently the Vietnamese business environment is not considered attractive enough by the potential investors. The Asian crises has been blamed for. However, according to surveys among investors the real reason is that the Vietnamese investment climate is considered very poor with high costs, legal and bureaucratic obstacles and financial risks for production and business compared to other Asian countries. The key obstacles and risks have been quoted as:

- Slow and bureaucratic investment procedures
- Difficult and expensive access to land
- The highest personal income taxes in Asia for foreigners and even higher taxes Vietnamese which are costs usually borne by the business employing them
- Restricted and difficult access to foreign exchange
- The requirement that all labour must be hired and paid through a government employment service centre which charges an administrative fee
- High costs for power, water, communications, internal transportation and house rents
- The "dual price system" under which the foreigners and foreign-invested enterprises pay higher prices than Vietnamese enterprises for services and utilities including those mentioned above
- High cost of corruption.

Due to the above reasons, the main problem for FDI is that it appears to be difficult — if not impossible — for many foreign-invested enterprises to make profits in Vietnam either from exports or from sales to the domestic market because of the high cost of production and doing business (Bentley 1999). This holds also for the forestry and forest industries sectors which are facing on the top of the above problems, the global problem related to sustainable forestry which is the long gestation period required by forestry investment.

To recover FDI, several policies have been established. Decentralisation policy provision allows local authorities to provide license (Decree 10/1998/ND-CP 31 Jan. 1998 and Decree 41/1998/QD-TTg 20 Feb. 1998) to a FDI project.

The land rent was revised to give more attractive incentives to FDI in terms of price and payment (Decree 179/1998/QD-BTC, 24 Feb.1999). Land rents have been reduced, on average from USD 2/m² per year down to USD 0.5/m² per year for construction areas. Land rent for tree planting in forestry area is something like USD 50 / ha per year which is generally considered prohibitively high.

The land rent is regulated by provincial authorities, and therefore the actual rate can be less than the average figure. In addition the recently adopted land law amendment now permit private sector companies to contribute land use rights as all or part of their contribution to the capital of a foreign-invested joint venture. Previously this was possible only for the state-owned enterprises (such as SFEs).

Since 1998, 532 foreign invested enterprises benefited from adjusted profit tax and a longer period of tax reduction and exemptions, 560 benefited from reduced land rent, and 30 were allowed to increase sales in the domestic market. 15 joint ventures had their type of investment modified; e.g. 7 joint ventures became 100% foreign-owned enterprises.

Following the meeting with foreign investors on 25 March 1999, the Decree 53/1999/QD-TTg on 26 March
1999 was issued by Prime Minister providing more incentives to foreign investors:

1. Removing price discrimination: from 1 July 1999, the price of electric power will be reduced from about 15 cent to 7.5 cent/kWh; The price of telephone installment, domestic calls and water supply will be the same as for Vietnamese; Price for telephone service will be reduced from USD 100 to USD 10 per head per month; There will also be a 10% reduction in the prices of international calls.
2. Fee adjustment: remove all fees on industrial park entry; apply same fees for foreigners and Vietnamese on notary and on visiting services; Collect one time enterprise registration fee of VND 1 million and there will be no fee for extending the validity of registration.
3. Using only VND in all payments and transactions domestically.
4. Salary will be paid to Vietnamese employees in VND instead of USD.
5. To simplify the issuance of working permit to foreigners who work for FDI enterprises.
6. To allow foreign enterprises to recruit labour directly if the Government Labour Service Agency can not meet the need of labour in 30 days from notice.
7. VAT will not be applied to imported inputs and equipment that FDI enterprises need to manufacture export goods.
8. Domestic enterprises are allowed to sell products to export processing enterprises without export tax.
9. Provision of land use certificate to FDI enterprises that are located in industrial and export processing parks.
10. FDI enterprises can rent land with the lowest rate to build infrastructure and dormitories for their employees outside industrial and export processing parks.
11. Other incentives such as reducing tax on transferring profits abroad down to 5%, land rent exemption to enterprises that export more than 80% of their products, employ more than 500, using more than 30% of domestic resource or, locate in difficult areas.

In order to receive complaints from investors, to strengthen private/public dialogue, and to better understand constraints faced by private foreign investors, a hotline was established in February 1998 to enable private foreign investors to call directly to MPI and its representative offices in provinces. Language barriers (hotline operators speak mostly only Vietnamese) and busy lines have reportedly been the main problems with the hotline service.

2.11 Development Cooperation Projects

The WB has been operating in Vietnam since 1994. The selected indicators of project implementation during 1996-1998 show that the number of projects has increased from 11 in 1996 to 18 project in 1998.

Table 9: Projects Funded by WB in Vietnam

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of invested projects</td>
<td>11</td>
<td>14</td>
<td>18</td>
</tr>
<tr>
<td>Duration of project implementation (years)</td>
<td>1.27</td>
<td>1.84</td>
<td>2.13</td>
</tr>
<tr>
<td>Disbursement rate (%) in the year to the total non disbursement amount</td>
<td>6.28</td>
<td>19.32</td>
<td>18.60</td>
</tr>
<tr>
<td>Investment per project (million USD)</td>
<td>132.78</td>
<td>94.87</td>
<td>68.15</td>
</tr>
</tbody>
</table>

The WB has planned to invest in several fields during 1996-2002 in Vietnam:

Table 10 Projected WB Investment in Vietnam

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Committed funds (USD million)</td>
<td>645.2</td>
<td>372.6</td>
<td>480.1</td>
<td>728.0</td>
<td>865.0</td>
<td>820.0</td>
<td>845.0</td>
</tr>
<tr>
<td>By fields (in %)</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
In agricultural sector, the WB offers the IDA assistance for several rural development programs. It is expected that the funding for forest development would increase when forestry could be shown clearly to contribute to poverty alleviation and sustainability of environment in Vietnam. Therefore, the improvement of forest development policy will create an opportunity to have higher assistance to afforestation. Policy improvements should focus on the aspects of forest land allocation and the protection of private ownership rights on forestry property.

Table 11: IDA Rural Development Projects in Vietnam

<table>
<thead>
<tr>
<th>Activity</th>
<th>Years of support</th>
<th>Amount of support (USD million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agricultural Rehabilitation</td>
<td>1994-1999</td>
<td>96</td>
</tr>
<tr>
<td>Irrigation Rehabilitation</td>
<td>1995-2002</td>
<td>100</td>
</tr>
<tr>
<td>Rural Finance</td>
<td>1996-2000</td>
<td>122</td>
</tr>
<tr>
<td>Forest Protection and Rural Development</td>
<td>1997-2005</td>
<td>21.5</td>
</tr>
<tr>
<td>Agricultural Diversification</td>
<td>1998-2005</td>
<td>67</td>
</tr>
<tr>
<td>Mekong Water Resources Development</td>
<td>1999-2003</td>
<td>100</td>
</tr>
<tr>
<td>Coastal Wetlands Protection and Development</td>
<td>1999-2003</td>
<td>70</td>
</tr>
<tr>
<td>Community-Based Rural Infrastructure</td>
<td>2000-2004</td>
<td>100</td>
</tr>
<tr>
<td>River Basin Management</td>
<td>2001-2005</td>
<td>130</td>
</tr>
<tr>
<td>Upland Poverty Reduction</td>
<td>2002-2005</td>
<td>200</td>
</tr>
<tr>
<td>Inland Wetlands Protection</td>
<td>2002-2006</td>
<td>80</td>
</tr>
<tr>
<td>Barren Hills Afforestation</td>
<td>2002-2006</td>
<td>100</td>
</tr>
<tr>
<td>Rural Structural Adjustment Credit</td>
<td>2001-2002</td>
<td>150</td>
</tr>
<tr>
<td>Rural Finance</td>
<td>2002-2006</td>
<td>200</td>
</tr>
</tbody>
</table>

Source: WB
2.12 NGOs

Some 300 international non governmental organisations (NGOs) are active in Vietnam. Published data for the largest 96 of NGOs with annual budget in excess of USD 100,000 indicate that their total contribution was some USD 58.1 million. Of the 96 largest NGOs for which there is data, support is most frequently provided for healthcare and people with disabilities (69 NGOs), education (42 NGOs), agriculture and rural development (33 NGOs), environment (10), and forestry (5).

NGOs have promoted different rural micro finance schemes to help the poor and rural households to access credit services. The patterns of rural credit schemes introduced and developed by NGOs have contributed to improve farmers’ income. Most successful rural micro credit models are: Funds Linking with Bank Credit; Revolving Credit Fund; Savings and Credit Groups.

It is noted that many credit schemes are striving to achieve sustainability through: (i) market oriented interest rates, (ii) participatory planning approaches, and (iii) local savings mobilisation. Besides, the integration of credit with forest land allocation, agriculture and forest extension services and primary health care have supported sustainable rural development.

3. International Financing Mechanisms

Some preliminary comments on two examples of international financing mechanisms are provided below:

3.1 Clean Development Mechanism (CDM)

The Kyoto Protocol of the UN Framework Convention on Climate Change enables the industrialised countries and economies in transition to obtain credit for greenhouse gas emission reduction through projects which enhance carbon sequestration or reduce emissions in forestry or energy sectors in developing countries. This facility is called Clean Development Mechanism (CDM). The CDM has raised high expectations by forestry sector. For example, it has been expected to assist in filling the gap of about USD 30 billion between current ODA for forestry and the annual funding needs estimated by UNCED.

Smith et al. (1999) argue that the expectations on CDM have been too optimistic. They estimate that the potential annual market for C02 carbon sequestration by forestry could range from USD 0.3 to 5 billion, a figure which is still substantial but clearly below some earlier presented estimates.
Emission reduction projects that qualify for CDM have to comply with "additionality" rule which means that the emission reductions would not occur without the project. In the case of tree planting (carbon sequestration) the project should not be financially feasible without CDM or there would be non-surmountable barriers to the project which can be removed only with additional (CDM) financing. In addition, the project should not cause "leakage" of deforestation in neighbouring countries or other areas.

According to a recent study (Newcombe 1998), the first investors in CO$_2$ markets consider forestry projects riskier than energy sector projects. Particularly the investors were concerned about risks associated with countries prone to economic and political instability.

### 3.2 Terra Capital Fund

In late 1998, a consortium made up of the Environmental Enterprises Assistance Fund (EEAF), a Brazilian Bank (Banco Axial) and Sustainable Development Inc. (SDI), working with the World Bank's International Finance Corporation (IFC), announced that they had secured the capital necessary to establish a private, for-profit, environmental venture capital fund for Latin America called the "Terra Capital Fund". The fund obtained money from a variety of sources, private and multilateral (including from the IDB through MIF), in order to invest in small, private businesses that meet a set of environmental criteria. In addition, Terra Capital received grant money from the GEF (US$ 5 million) to: (i) establish the technical and managerial capacity needed to operate such a fund; (ii) monitor and evaluate the environmental impact of investments; and (iii) cover any additional costs that will be incurred by the fund when screening projects for their biodiversity/environmental value.

The fund was initially capitalised at US$ 15 million and will make investments of between US$ 500,000 and US$ 3 million (with an average investment of US$ 2 million) in projects related to sustainable forestry, agriculture, ecotourism, and other biodiversity-based businesses. The fund is expecting returns of anywhere from 14 to 20 percent on its investments.

The fund had its initial closing in October 1998, though the concept was first proposed as early as 1995. Some of the reasons for this long start-up period appear to have been:

1. the difficulty in identifying willing and able investors familiar enough with the fund's investment focus,
2. difficulty in finding qualified and knowledgeable local partners and management,
3. difficulty in developing a high quality pipeline of potential investment projects.

Terra Capital fills a much-needed niche in the provision of risk capital to emerging biodiversity-based businesses. Expected returns of venture capital funds are high, but are commensurate with risks taken. These return requirements may yet prove to be too steep for many local enterprises. Still, Terra Capital appears to have lower return requirements than more traditional venture capital funds, presumably because it has received a US$ 5 million grant facility from the GEF.

Since Terra Capital will be the first environmental venture capital fund of that size in the region, it will be able to be highly selective in its investments. At the same time, being the first fund of its kind will likely prove to be a boon for its investors. However, the drive to provide quasi-market returns on investments will probably force the fund to look at more established businesses, rather then pioneering, ventures in the early stages of development. For this reason, a key challenge for the fund will be the design of its environmental investment guidelines. If Terra Capital is to successfully help achieve biodiversity conservation, these guidelines need to meet the dual needs of profitability and sustainability.

### Table 13: National Level Structural Requirements for SFM in Vietnam

<table>
<thead>
<tr>
<th>Category</th>
<th>Requirements</th>
<th>Possible options for meeting requirements</th>
<th>Situation in Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Appropriate strategic investment framework</td>
<td>Mainline investment strategies within sectoral development plans (e.g., NFP); inclusion of sectoral financing facilities within generic development plans</td>
<td>Strong link through the previous 327 programme and the present 5 Million Hectare Project, however, no comprehensive national strategy for forest sector</td>
<td></td>
</tr>
<tr>
<td>Policy (incl. Legal and political)</td>
<td>(e.g., NEAP, NSDS)</td>
<td>(TFAP Vietnam out-dated)</td>
<td></td>
</tr>
<tr>
<td>-----------------------------------</td>
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</tr>
<tr>
<td>Secure land tenure arrangements</td>
<td>Consultative reform / long-term stabilisation of property rights regimes</td>
<td>Recent reforms have improved the situation, but it is still a major bottle-neck for forestry development. Land tenure and owner’s decision making power restricted in reality.</td>
<td></td>
</tr>
<tr>
<td>Clear and enforceable forest policy</td>
<td>Multi-stakeholder awareness campaigns; streamlined judicial process for forest policy infringements; enforced penalties</td>
<td>Forest policy is clearly spelled out in government directives, but policies are changing frequently and not always consistent.</td>
<td></td>
</tr>
<tr>
<td>Clear definition of public and private sectors’ roles and responsibilities</td>
<td>Public-private consultative process leading to: consensual definition of roles; criteria for private sector forestry investments; defined scope of public sector interventions</td>
<td>This is one of the key problems in Vietnam. Public sector interference and regulation on private sector is still very common. Public sector heavily involved in productive sectors.</td>
<td></td>
</tr>
<tr>
<td>Improved rent capture for public-sector forestry</td>
<td>Appropriate product pricing through market mechanism &amp; adequate but not excessive taxation</td>
<td>Public sector rent capture very high through high taxes &amp; various fees. Administratively set timber prices very low.</td>
<td></td>
</tr>
<tr>
<td>Value full range of forest resources</td>
<td>User/service fees, e.g., water, carbon sequestration; global externalities (e.g., via objective-led revolving funds)</td>
<td>Non-existent yet in Vietnam, but under early consideration.</td>
<td></td>
</tr>
<tr>
<td>Appropriate national accounting systems</td>
<td>Changes in natural capital stocks to be recognised</td>
<td>Statistical information on forest resources and their valuation still rather poor, however improving.</td>
<td></td>
</tr>
<tr>
<td>Dynamic &amp; efficient public-private interface</td>
<td>Creation of autonomous investment and forest management agency with private sector expertise; staff from private sector</td>
<td>Would be needed in Vietnam.</td>
<td></td>
</tr>
<tr>
<td>Increased efficiency in use of and capacity to absorb concessionary funding (e.g., ODA)</td>
<td>Reduce bureaucracy; harmonise rules &amp; regulations; streamline project approval cycle; increase involvement of local operators; autonomise/decentralise implementation bodies</td>
<td>High level of ODA which has been recently channelled increasingly directly through provinces reducing the main bottle-necks in Hanoi. Still much of scope for improving.</td>
<td></td>
</tr>
<tr>
<td>Coherency between relevant policy departments</td>
<td>Strategic coordinating policy body; systematic meetings and information-exchange between departments</td>
<td>Inter-ministerial groups exist.</td>
<td></td>
</tr>
<tr>
<td>Market and forestry related risk mitigation mechanisms</td>
<td>Strategic planning, e.g., NFPs; market development and capacity-building; provision of investment risk guarantees</td>
<td>Political and market risks still very high in Vietnam reducing the FDI and also domestic investments in forestry.</td>
<td></td>
</tr>
<tr>
<td>Incentives for SFM / disincentives for UnSFM</td>
<td>Identify perverse subsidies; reform/structure tax and</td>
<td>Problem realised by the government, although</td>
<td></td>
</tr>
</tbody>
</table>
Table 14: Strategy Framework for Forest Financing in Vietnam

<table>
<thead>
<tr>
<th>Type of forest</th>
<th>Present management</th>
<th>Problems</th>
<th>Strategy: Short term</th>
<th>Strategy: Medium to long term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special use</td>
<td>Management Boards</td>
<td>MB’s do not have capacity: they contract forests to farmers who do not always have enough incentive to protect</td>
<td>State provide adequate subsidy to MBs and / or farmers; ODA; develop tourism</td>
<td>1. State should manage &amp; cover the costs (additional income from tourism, global biodiversity funds).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Limited control inadequate subsidies</td>
<td>Develop clear rules for controlled sustainable utilisation</td>
<td>2. Prohibit illegal migration</td>
</tr>
<tr>
<td></td>
<td>• SFEs</td>
<td>- Contracted to farmers</td>
<td>3. Provide income for local residents by creating livelihoods for them with (i) allocating land; (ii) organising cooperatives; (iii) employ them to work</td>
<td></td>
</tr>
<tr>
<td>Protection:</td>
<td></td>
<td>- Low profitability</td>
<td>4. Analysing the main barriers for profitability of business &amp; start farmers eliminating those barriers</td>
<td></td>
</tr>
<tr>
<td>very critical &amp; critical</td>
<td></td>
<td>- Low interest in reforestation &amp; afforestation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production</td>
<td>• SFEs</td>
<td></td>
<td></td>
<td>Instead of continuing subsidising, reduce the barriers for business profitability (unnecessary regulation, bureaucracy, too high fees).</td>
</tr>
<tr>
<td></td>
<td>• Provincial DARDs</td>
<td>- Allocated to farmers</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Allocated to some companies</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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