Overview of the Lao wood processing industry

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The complete study can be downloaded at
http://www.laosaft.org/phocadownload/DTIS/DTIS2012.pdf

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14.3 Wood processing

The Lao wood processing industry contributes 40 per cent of the country's annual US$500 million non-resource merchandise exports (excluding electricity and minerals), up from about US$110 million in 2000. The industry employs about 20,000 workers including those in supporting industries.

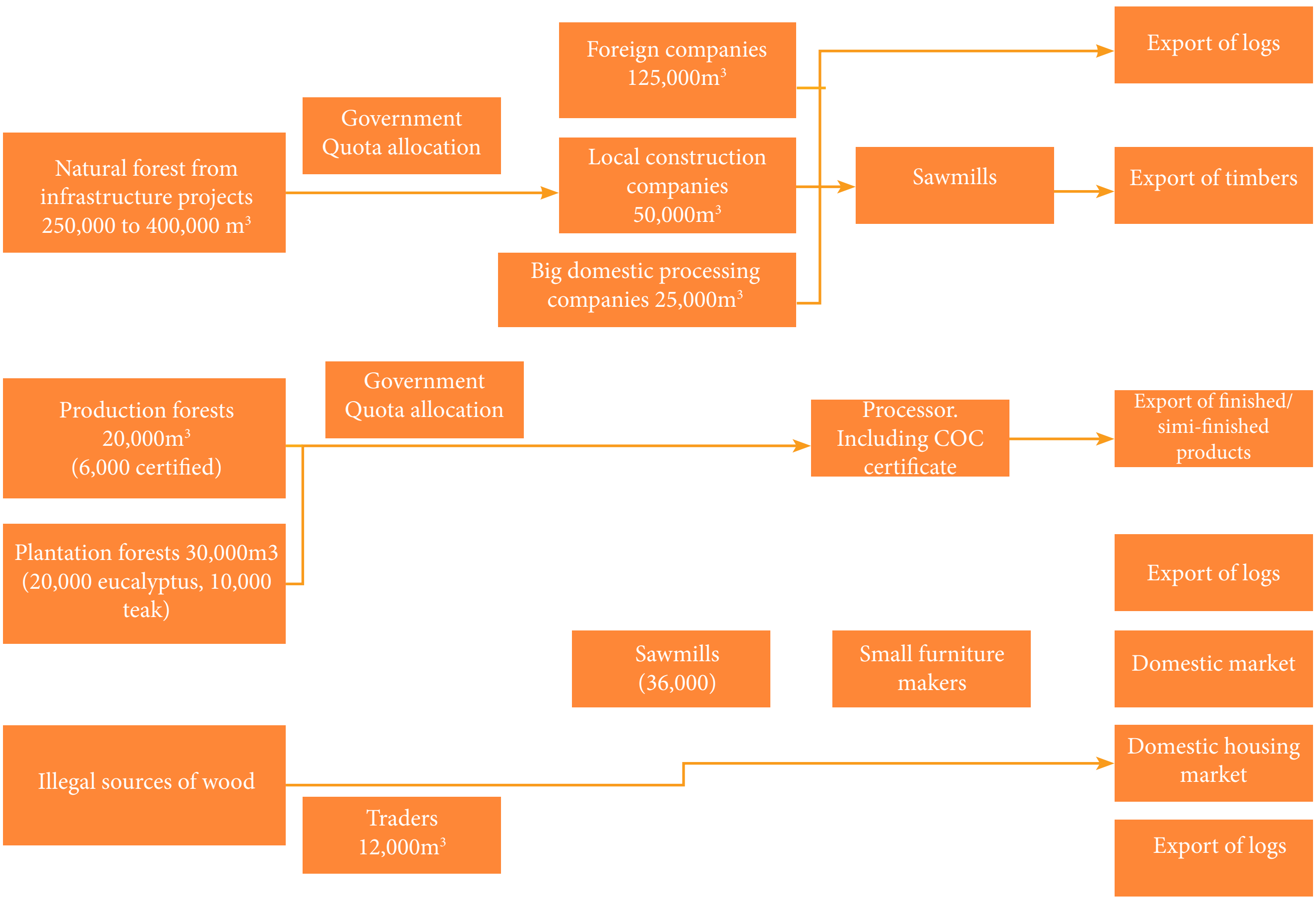
Wood processing is characterized by low value-addition and efficiency, the non-transparent allocation of logging quotas and low capacity utilization. To operate at full capacity, the wood processing industry would require an equivalent to three to five times the sustainable annual allowable cut. On present trends and without significant reform in promotion and regulatory policy and improvement of private sector capacity, the industry will be unable to contribute meaningfully to the economy in the near future.

Products

The main semi-finished product is sawn wood, which is sold on the domestic market and to small factories producing finished products that do not have log quotas or sawing capacity of their own. The finished products can be broadly divided into four categories: joinery products; flooring; furniture; and handicrafts. The first two categories are the main raw materials for further processing in larger sawmills. Some furniture factories buy logs and saw them, while others purchase sawn wood and other raw materials on the local market. Most furniture factories are small, but they make up the largest number of enterprises, accounting for 655 of a total of 945 wood processing enterprises (MAF, 2011). The main joinery products are sawn timber for construction, wall and ceiling panelling, door and window frames, and doors. Flooring products consist of both parquet and strip flooring. Output from furniture factories ranges from relatively low-priced bedroom and living room units produced in large quantities, to standard designs and chairs and sets of traditional Lao chairs, benches and tables, made from solid wood and commanding a high price.

Apart from the domestic market, the principle markets for Lao wood products are in Thailand, Vietnam and China, with small amounts going to the EU and other countries. Although there

Figure 42: Key players in the wood industry



is an official ban on the export of logs and sawn wood, Lao timber is still mainly exported in the form of logs or different kinds of primary wood processing products. These include sawmill items, with additional minor quantities further processed into strip parquet flooring, furniture and other secondary wood processing products.

There are significant differences between the different sources of official export statistics and the mirror import statistics for the main countries importing Lao wood products. For example, for the latest year for which data is available (financial year 2006/7), MoIC data shows exports with a total value of US$72.53 million, while the Customs Department shows US$45.86 million, and importing countries report US$201.8 million for 2006 and US$105.5 million for 2007.[199]

According to detailed import data of wood products by major importing countries such as Vietnam, Thailand, China, Japan and EU presented by the Lao Sustainable Forestry and Rural Development Project (SUFORD), round sawn and squared wood accounts for about 95 per cent of total imports from Lao PDR, while manufactured wooden products account for only about 5 per cent.

Some of the main challenges facing businesses include high financing; the cost of raw materials (associated with upfront payment for logs and sawn wood); labour costs (resulting in the need to recruit foreign skilled workers); export administration (which is expensive and time-consuming); and land transport costs to Thailand.

Interviews with industry representatives revealed that export procedures for processed wood remain lengthy and costly. On average it takes about 10 days to complete all the paperwork for export. This entails significant resources on the part of the exporting companies, who must allocate staff for export clearance procedures. Usually this process involves a number of people, including significant management resources, to oversee the documentation process. Unofficial payments at every step of export clearance are still common and unofficial fees generally exceed official fees.

A more fundamental problem is the lack of investment in the secondary wood processing industry, either by the existing wood processing industry itself or new entrants. This is for a number of reasons, including uncertainty in raw material supply, the lack of strong business links with processors in neighbouring countries, and restrictions on FDI.

One prerequisite for the long-term sustainable development of the industry is greater certainty about the future supply of raw materials. Without this, investment in production facility and human resources becomes difficult, and existing industries are forced to take a short-term approach, neglecting strategic competitiveness in both domestic and international markets.

Strict enforcement of the ban on the export of logs and sawn wood could potentially stimulate investment in the secondary industry by both existing and new entrants. It would be supplemented with a medium-term plan for the supply of raw materials from all main sources, including production forests, plantations, land clearance related to agriculture, road construction and hydropower projects. This could potentially lead to natural consolidation of the industry, which could in turn gradually achieve the promotion of high value-added processed wood products. Sustainable forest resource management could be pursued by lowering output and raising the productivity of the primary industry, whilst raising the capacity and productivity of the high value-added secondary industry.

It is advisable to keep a window open for new innovative, serious enterprises to enter the secondary processing industry (however restrictive policy regarding entry into the primary processing industry should be maintained), as these enterprises may introduce new technology, products and markets.

During 2007-9, an estimated average annual quota of 300,000 cubic meters was issued by the Government. About two thirds of logs came from hydroelectric power projects and the remaining third came from production forests, plantation and land clearance related to agriculture and road construction projects. Of the latter, 80 per cent came from production forests.

The Forestry Department estimates that the annual allowable cut from 3.6 million ha of production forest (of which 1.9 ha is heavily degraded) will be between 200,000 to 300,000 cubic meters. Half of these will be new species of wood that have not been used widely. The volume coming from land

199. SUFORD, 2011.

clearance related to infrastructure and investment projects in hydroelectric power and agriculture will be hard to estimate. Most current plantations are developed by international investors linked to pulp paper or cellulose fibre production. In the near future, the estimated harvest from plantations owned by smallholders is unlikely to exceed 5,000 cubic meters a year.

Another major issue is the current discretionary and distorting log quota allocation system, which results in an unfair allocation of quotas, creates uncertainty for individual enterprises and deters investment in secondary processing. The Government has introduced both direct allocation and a system based on competitive bidding, but the initial application of the system has not produced desirable results. A more competitive system would result in the survival of the most competitive and the closure of less competitive firms. This would support the much-desired reduction in capacity in the industry.

The situation of the wood processing industry is summarized in Table 41.

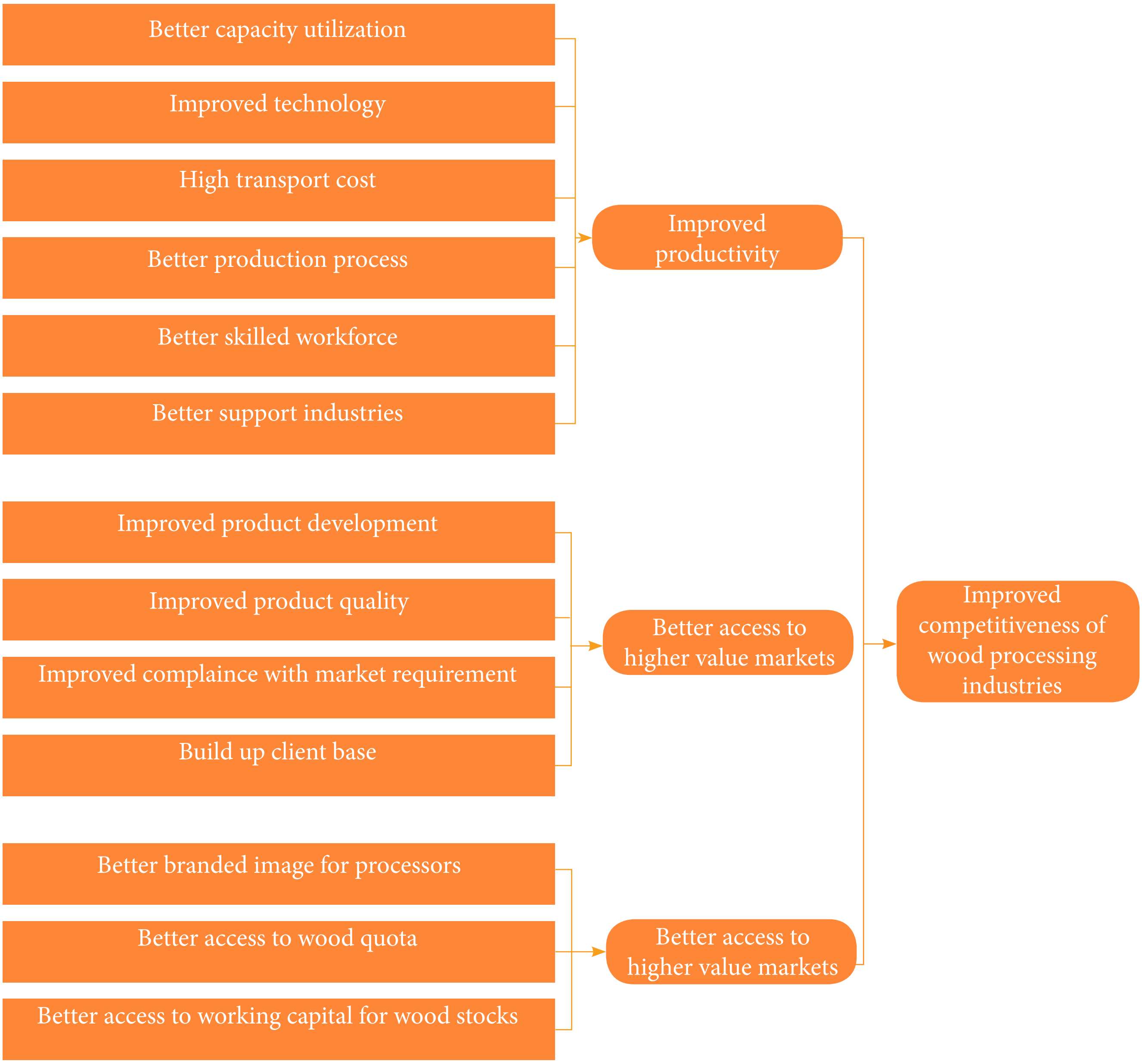
Since the supply of natural wood will continue to decline, it is imperative for the industry to increase the value added from the available supply of raw material. The industry will have to adjust its strategy by increasing the value added to high-value species for regional markets, and penetrating the high value-added markets in Europe and the USA with processed products using less known species by improving product quality and complying with legality and sustainability criteria.

Improving the performance of the wood processing industry will require major action, including: the creation of a predictable policy environment for the supply of raw materials; measures to encourage investment in the secondary processing industry; and a productivity improvement programme. Key industry competitiveness issues are summarized in Figure 43.

Table 41: SWOT analysis of the wood processing industry

<table>
<tr><td>Strengths
Large Forest Stewardship Council (FSC)-certified forest area (more than 80,000 ha)
Large production forest area (3.1 million ha)
Availability of high-value certified species
Strong policy to promote high value-added processing industry</td><td>Weaknesses
Lack of complete FSC chain of custody
Strong links with regional processing industry
Weak relationship with high value-added wood markets
Of 51 certified production forest areas, only 8 have completed inventories and sustainable management plans
Inability to meet traceability and legality requirements under EU-FLEGT/EUTR and US Lacey Act
Lack of availability / awareness of market information, outdated production facilities
Only two companies are FSC Chain of Custody (CoC)-certified</td></tr>
<tr><td>Opportunities
EU (FLEGT) and US (Lacey Act) legislation on the legality of wood imports creates a market pull (through Vietnamese and Thai markets) on the Lao wood industry for legal and sustainable wood products
Strong demand for Lao hardwood in international markets</td><td>Threats
Regional markets will continue to source unprocessed wood from Lao PDR
Strong links between logging businesses in Lao PDR and the regional processing industry
Lack of acceptance of ‘Lesser Known Timber Species (LKTS)’</td></tr>
</table>

Figure 43: Key industry competitiveness issues in wood processing



Major actions to be considered include:

(i) Improving readiness for and compliance with the EU Timber Regulation and Timber Legality Assurance systems by promoting industry certification systems (for example, FSC CoC, ISO 9001, 14001).

(ii) Conducting an assessment of the international demand and price points for different product groups in the different markets, and general market trends leading to recommendations for competitive niches.

(iii) Establishing a strategic partnership between Lao wood processors and leading processors in neighbouring countries to improve productivity and improve access to high-value export markets.

(iv) Improving access to working capital to increase the added value of wood exports.

(v) Carrying out an assessment of all plantation crops by species, and conduct production forecasts giving the volumes that can be expected to be harvested by size or diameter classes for periods of five years until 2020.

(vi) Carrying out an assessment of the natural forest, and conducting production forecasts under sustainable management conditions by species classes for periods of five years until 2020.

(vii) Relaxing temporarily and restrictively the ban on foreign investment in secondary wood processing based on natural forests.

(viii) Improving and extending the system of competitive bidding for log quota allocations.

Recommendations

(i) Increasing the added value of wood exports

Lao exports the bulk of its timber resources unprocessed. At the same time its embryonic wood-processing sub-sector is operating well below installed capacity. The aim of this intervention is to assist wood processors to increase their access to approximately an additional 100,000m^3 of logs.

The modern wood processing industry consists of approximately 50 medium-sized enterprises employing about 5,000 people and exporting the bulk of its production. The enterprises currently source raw materials either from plantation forests that produce eucalyptus and teak, or from a government auction system that manages production forests. This amounts to about 40,000m^3 of logs per annum, which is only about 30 per cent of the demand from the Lao processors. For these processors to reach their present full capacity they would need approximately an additional 100,000m^3 of logs every year.

It is estimated that between 250,000 to 400,000m^3 of wood leaves the country as round or square logs. The allocation of these logs is managed through a government quota system, mostly in lieu of cash payments to foreign and local companies that are implementing infrastructure projects on the part of the Government. This timber is then exported at world market prices to either Vietnam or Thailand where it is further processed. This intervention aims to assist Lao wood processors to access long-term working capital financing of up to approximately US$22 million for the purchase (at market prices) of up to 100,000m^3 of logs per annum. The effect of this would be to triple the current output of processed wood products for export. The processors would not enter into the transactions related to the exiting quota system but would rather offer themselves as an alternate market for the unprocessed logs currently leaving the country, paying a fair market price to the existing exporters.

(ii) Improving the productivity of Lao wood processors

In addition, Lao processors working below capacity also face problems with productivity and market access. The aim of this second intervention is to improve productivity and to establish stable marketing channels for the export of processed wood products.

Initially 10 to 15 of the 50 Lao processors would be linked with five or six wood processors in Thailand or Vietnam that are exporting to the EU, US and Japan, and who are members of the Global Forest and Trade Network (GFTN), in a business relationship through which the Lao processors would supply the foreign firms with wood components for final assembly in Vietnam or Thailand. As part of the deal between Lao and foreign firms, the Lao firms would receive technical assistance from the foreign firms in upgrading their production processes, training their staff and introducing them to new technologies. At the same time, the Lao processors would ensure that they are fully compliant with whatever forestry standard (such as the FSC) is most relevant to the foreign exporters. If this relationship between the Lao and foreign firms is maintained for about five years, it may then be possible for these local processors to competitively enter into the international market on their own and in full compliance with international standards. If this relationship works with the initial 10 to 15 Lao firms, this model may be scaled up to the others in this sub-sector.

These two interventions are integrated in the sense that access to additional raw materials is essential for the second intervention to be attractive to the Lao processors and foreign exporters. The hoped-for combined impact of these interventions would be to triple processed wood exports in the next three years.