

ASSESSMENT ON VPA-FLEGT COMPLIANCE AND NEEDS FOR IMPROVEMENT OF THE HOUSEHOLD BUSINESS IN DONG NAI PROVINCE



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ABBREVIATIONS

CED	Center for Education and Development
COPE	Centre for People and Environment of the Central Highlands
CRD	Centre for Rural Development in Central Vietnam
CSO	Civil Society Organization
EU	European Union
FAO	Food and Agriculture Organization of the United Nations
FLEGT	Forestry Law Enforcement, Governance and Trade
FSC	Forest Stewardship Council
HH	Business households
LD	Legal definition
OCS	Organization classification system
OSH	Occupational safety and health
SMEs	Small and Medium Enterprises
VAT	Value Added Tax
VNTLAS	Vietnam timber legality assurance system
VPA	Voluntary Partnership Agreement

1. Background

After 7 years of negotiations, in October 2018, Vietnam and the European Union (EU) signed a Voluntary Partnership Agreement (VPA) on Forestry Law Enforcement, Governance and Trade (FLEGT). According to VPA, Vietnam will build a timber legality assurance system (VNTLAS) to verify the legality of exported wood and products; and the EU only accepts FLEGT-licensed timber to be imported into the EU when the VPA is signed and the licensing system is in operation.

When the VPA is enforced all businesses and business households participating in domestic and international supply chains must comply with legal timber requirements and participate in the organization classification system (OCS). Accordingly, the enterprises must i) Comply with dynamic evidences of supply chain control to ensure that only legal timber enters the supply chain; ii) Meet the requirements for listing and reporting supply chain controls; iii) Comply with status evidences; iv) ensure a clear violation status.

To support the implementation of the Agreement, the Centre for Rural Development in Central Vietnam (CRD), the Center for Education and Development (CED) and the Centre for People and Environment of the Central Highlands (COPE) jointly implement the Project *"Supporting small businesses holders comply with the legality definition requirements in order to effectively participate in national and global legal timber supply chains"* funded by the EU-FAO FLEGT Program through United Nations Food and Agriculture Organization of the United Nations (FAO). One of the main activities of the project is to assess the ability to meet legal requirements and demand for capacity building of provincial stakeholders including wood processing companies / businesses, and households to comply with the legal timber definition (LD), VNTLAS, as well as OCS in the future.

In order to implement the project, a survey was conducted in Dong Nai province¹ with two specific objectives, i). Understanding the need to improve technical capacity of provincial stakeholders such as business associations and CSOs in providing support for local small businesses in the VPA / FLEGT process; and ii). Evaluate capacity of SMEs /households in complying with LD and VNTLAS.

In the assessments in Dong Nai, households doing business and producing wood products emerged as a popular group. Initial observations show that this group is characterized by a timber wood processing village, although it uses a considerable amount of wood but is under less pressure to enforce legal regulations. A deeper understanding of this group of wood business households (HHs) is very interesting and can reveal some current policy gaps. This report summarizes the results of the survey on this household group in Dong Nai province.

2. Methodology and Process

The wood production and business households in this report are picked from the overall survey in Dong Nai province which was implemented on two main target groups, including (i) Businesses and households operating in the wood supply chain focusing on small and super small groups and: (ii) Provincial-level related organizations such as state management agencies, business associations, and local CSOs from 6/2018 to 12/2018.

The survey results are based on a set of survey tools including SSI and questionnaire that was developed, field tested, and implemented by trained enumerators. The questionnaire has 3 main parts including: 1).

¹ One of the leading provinces in wood processing industry, adjacent to Hochiminh city, south of Vietnam

General information about businesses/business households; 2). The ability to meet LD / VNTLAS / OCS; and 3). Enterprises' understanding of VPA / FLEGT and support needed.

3. Result of the survey

3.1 Overall information

In Dong Nai, out of 942 entities registered to operate in the wood processing sector, there are 439 business households doing wood production. These households are concentrated mainly in Trang Bom District and Bien Hoa City². There are 67 timber business households surveyed with the results summarized below:

- The majority of wood processing households has less than 10 employees, most of the HHs have both full-time and part-time workers. This is true for the fact that surveyed HHs often remain in small scale with full-time members usually consisting of a director, an assistant/administrative staff and an accountant. For larger scale households, the workforce is often hired seasonally to reduce costs and HH's responsibilities (such as insurances, etc.). Table 1 below provides data on the importance of seasonal workers for business HHs.

Table 1. Labour distribution in wood business HHs

Business HHs	Less than 10 laborers	From 10 laborers up	No answers
HHs with seasonal laborers	45	2	20
HHs with full-time laborers	61	2	4

- According to the self-reported classification, the revenue of the majority of HHs is 1-3 billion VND (90%), 9% of the households have income from 3-50 billion VND and only 1% of more than VND 50 billion. The actual analysis of revenue of 53 households in 2017 shows that all households have revenue below 50 billion VND, of which 38 households have revenue of less than 1 billion VND or 72% of the total.

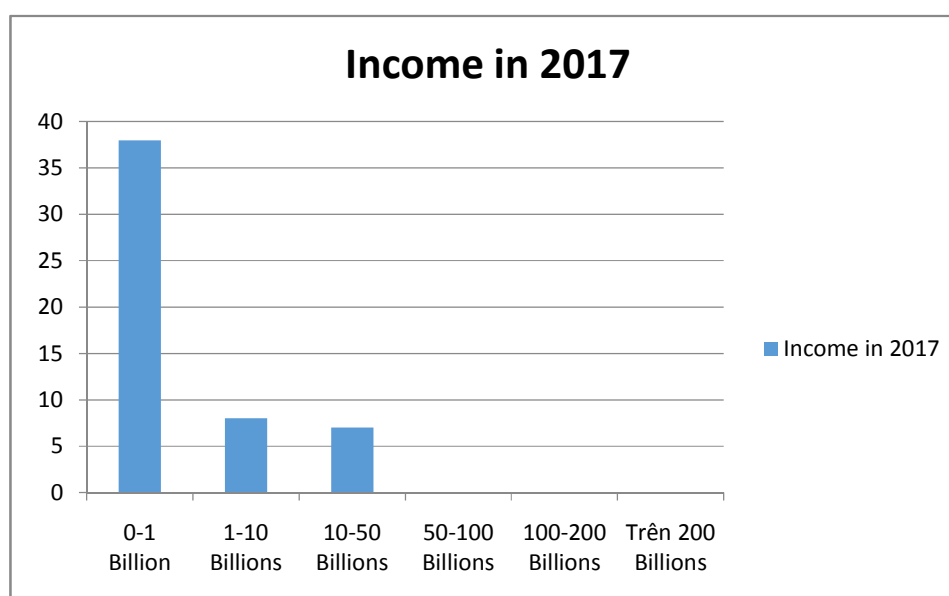


Fig 1. Income of the wood business HHs

²It should be noted that many of the registered households are not operational.

- Many business HHs implement two or more production types at the same time. The two main occupations of the households are the production and processing of wood and wood products (28 households) and the purchase and sale of domestic timber and wood products (15 households). No household specializes in wood transportation. Although none of the households self-reported their main occupation is the export of timber and timber products, the following analysis shows that there are 10 households related to the sector. This discrepancy is probably due to the fact that these HHs carry out product processing for export enterprises, often under a contractual arrangement or the export is not classified as a significant activity of the HHs. The main and secondary production activities according to self-HH classification are presented in Figure 2 below

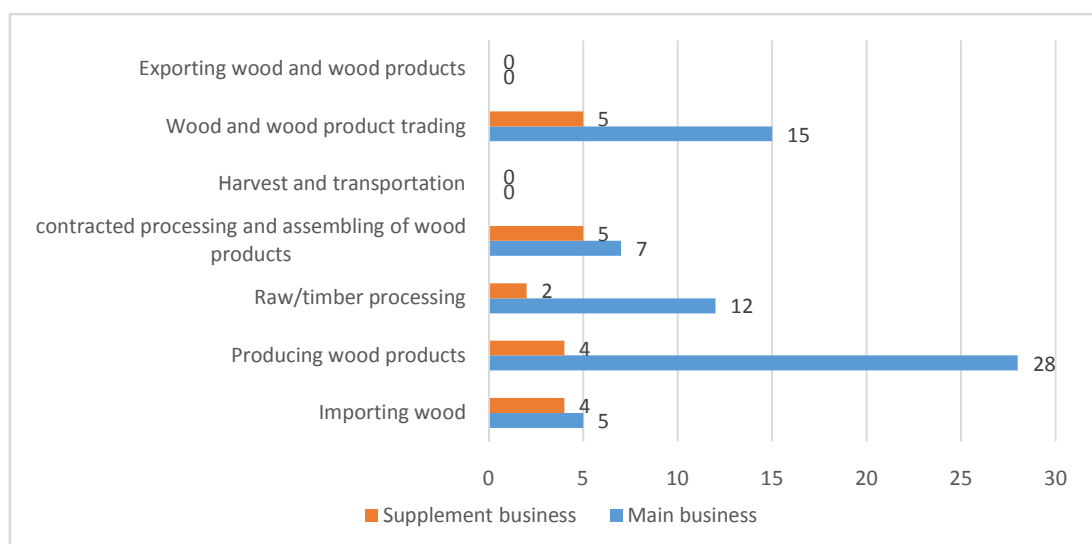


Fig 2. Main and secondary business of HHs in wood industry

- 35 households responded to the question on the origin of timber used. The result showed that the woods in Dong Nai are from diverse sources of all continents. Some households use wood from different sources. Source of wood from high-risk countries is being used widely, especially from South Africa and Ghana. Only 4HHs use imported wood from safe countries such as Australia, USA and New Zealand. Specifically, the number of HHs using wood from different sources is shown in Table 2 below:

Table 2. Sources of wood used by business HHs

Countries	Number of using HHs
Ghana	15
Nigeria	1
Congo	1
South Africa	15
Indonesia	3
Cambodia	3
Laos	3
Malaysia	2
Columbia	1
Brazil	1
Russia	1
New Zealand	1
Australia	2
USA	1

- As regards certified timber, most households using imported timber do not know and are unconcerned about certified wood. They think that importers should have all the required documents to get customs clearance. Almost all HHs do not know much about wood certification. Of 20 HHs responding to this question, only one household said he used FSC certified timber.



Fig 3. *Afzelia pachyloba* (Gỗ đỏ) imported from Africa

The volume and value of wood used are quite sensitive information to HHs. In the 40% of households that responded, most of the value of timber purchased in 2017 was under 1 billion VND (27/28 households). In 33 households that answered, up to 29 households (88%) used less than 100m³ and the left 4 use from 100m³ to 500m³.

Wood products of most HHs serve the domestic market (58 HHs). However, there are a few households that have exported goods to other markets mainly China (9 HHs). In addition, there is one household (registered as a cooperative) having products exported to the EU through a licensed exporter,...

3.2 Legal compliance of the Households

Wood households understand that they do not meet all the legal requirements especially in wood production and processing. Some HHs said that is the reason why they continue their business as an informal sector or HH firm instead of a registered enterprise where the state regulations are enforced more strictly. Many HHs said the regulations in the control of supply chains are also not suitable to the way doing business and wood processing of Dong Nai households.

As mentioned, a total of 67 business households were surveyed, of which many households are implementing two or more types of business at the same time. By major categories, there are large

groups as follows: Wood product/furniture manufacturing group (33 HHs), raw timber processing group (13 HHs), contracted product processing group (8 HHs), timber and wood products trading (25 HHs). Although it is not classified as a main occupation, there are still 10 households with products exported, mostly to China (9/10). Besides, there are 9 households self-classified as timber importers, but the detailed information shows that these are households buying and selling imported timber, so they are included in the group of trading households (make it up to 25 HHs as shown above).

Thus, based on the types of wood related sector surveyed and regulations for the timber industry, the main analytical results are presented in the following groups i). General indicators that all business HHs need to meet ii) Important indicators for raw-wood processing, contracted product processing and wood product manufacturing groups (50 HHs); iii) Important indicators for timber and timber product trading groups (25 HHs); iv) Important indicators for households that have exported timber and timber products (10 HH). In the analysis, some indicators will not be analysed if the information is not clear or the number of samples is too small.

i). Common indicators

Some common indicators required for business households are business registration, tax, insurance, etc. The analytical results are summarized below:

- Basically, the obligations to the state are fully complied by business households: Only 1/67 households does not have business registration certificate. There are 4/67 households having no tax documents, of which 3 households said that they are exempt from tax. The remaining household paid taxes to tax collectors but did not collect any papers. The non-compliant HHs believed that they produce in small-scale of traditional products so they are not subjected to the regulations and do not need the required papers.
- 10/66 households have labour contracts for employees (15%) and only 5/67 households have social insurance and health insurance for workers. Meanwhile a lower rate of only 2/66 households bought unemployment insurance for their employees. Many households explained that they did not meet these requirements because it is not appropriate due to the fact that they paid the workers based on daily or weekly basis, workers were siblings, relatives, or just oral contracted due to the small scale of production.
- Up to 18/67 HHs do not store trading information or important documents in doing production and business including profiles/records required for forest products. For the other HHs, the common form of storage is hard copy.
- Most HHs do not pay attention to the risk of imported timber because they said they bought timbers from respected importers/companies or buy timbers from acquaintances /relatives.
- 6/67 HHs have been fined for administrative violations with common errors such as processing forest products of unknown origin, lack of forest product list, failure to update the timber monitoring book, and violation of fire preventing regulations.

ii). Wood processing households

The group of raw-timber processing, contracted product processing, and product manufacturing is a large and important group in the supply chain, accounting for 50/67 HHs. This group must meet a number of similar legal provisions including the main regulations on the origin of legal timber for processing, regulations on environmental protection, fire prevention and protection, occupational safety and health (OSH), as well as tax regulations. The survey results are presented below:

- Most of the households comply very well with household registration (only 1 household does not register) and paying taxes to the state.
- Papers proving the origin of timber used such as Forest Product List and timber record book are also highly complied by the household group with 80% (40/50) and nearly 90% (7/63) respectively.
- However, the response to other requirements is low. Households engaged in wood processing are responding poorly to other legal timber documents such as regulations on the Purchase and Sale Contract and VAT Invoices with less than 50% of HHs complying.
- Besides, the rate of responding to the rights of labourers is low, in which only 4/65 households have labour contracts for workers, and only 2/67 households have health insurance, social insurance and unemployment insurance for their workers.
- The compliance with regulations on environmental protection (having environmental protection plans), regulations on fire prevention (having plan and approval on fire protection plan), OSH (plan and safety rules) is also not high with only 10-20% HHs complied.

The non-complied HHs said that they do not fulfill their obligations to workers due to the tradition of using oral contracts, the use of seasonal or family labour. Furthermore, they believe that HHs operating business in small scale do not have to comply with environmental regulations, fire protection, and OSH requirements. Some households do not know about these regulations. For the absence of forest product lists, related households believe that they just do the orders (processing) for other companies who should be responsible for the list, or they only work on cheap wood, plantation timber (acacia) so they do not need to have the packing list. For regulations on VAT invoices and sales contracts, similar to research data from Dong Ky wood village in the Red River Delta area -North Vietnam, many households only provide invoices on the request of a customer. However, most of the customers do not require this invoice to avoid an increase of the price by 5-10%.



Fig 4. A large piece of African red wood for sale in Dong Nai

iii) Wood and wood product trading households

For this group (25 households), the basic documents to be complied are commercial/VAT invoices (if the timber is purchased from an organization), the list of forest products (packing list) and internal delivery paper (depending on the case), forest rangers' hammer record (for some types and sizes of wood). Survey results are as follows:

- For households who buy, sell, and transport timber/wood products, the provision of invoices according to the regulations of the Ministry of Finance when selling goods as well as obtaining invoices when purchasing timber from organizations are quite high complied by about 80-90% households.
- However, the rate of having packing list and forest rangers' hammer record (for timber with this requirement) is lower with only 35-40% HH complied.

Similar to the reasons mentioned above, the majority of households believed that they do business on a small scale, so the regulations do not apply to them (and should not apply).

iv). Wood and wood product exporting households

There are 10 households including 1 cooperative having products directly or indirectly exported abroad, of which 9 households sell to China. The cooperative exports fine art products and furniture to Europe through export consignment. Although 8 out of 10 HHs provided purchase and sale invoices in accordance with regulations of the Ministry of Finance, all of these households refused to answer about the compliance to export regulations such as export documents (customs declaration form by export enterprises, sales contracts, export packing list, CITES license, plant quarantine certificate, etc.). It is possible that these households export through unofficial routes, through other intermediaries, so they lack many required papers (as indicated in the study of Dong Ky wood village).

3.3 Access and understanding of households on VPA/FLEGT

Household survey on accessibility and understanding of VPA/FLEGT has resulted in a low rates presented below:

- Only 9/67 households used to participate in events and activities related to legal timber regulations (FLEGT, VPA, LD, VNTLAS). Among them, most of the HHs only heard about but did not understand the conveyed contents, so they do not know how to apply them. Only 1 HH said they knew about VNTLAS and implemented some related requirements in production activities.
- Based on the interview on regulations, there are only 9/67 households said that they are able to change to meet the requirements of VPA / FLEGT if they are provided with additional information and support. The remaining HHs said their scale is too small to change and they do not really have the capacity to meet the requirements as an enterprise. Most HHs do not need support (54/67) because they lack information, do not know what they need, or what they must comply. The rest of the HHs want to be supported on technical issues like calculation of timber production rate; a few others want to know more about laws and regulations.
- Information to support business households should be presented briefly and concisely through means such as brochures, leaflets and disseminated by the provincial Forest Protection Department.

4. Conclusions

The analysis of business HHs in Dong Nai wood industry shows that many issues need to be addressed to ensure an effective implementation of VPA / FLEGT. The HHs surveyed can provide important

information on activities of 3 main groups including the group of wood processing HHs, trading HHs, and HHs with exported wood and wood products.

In spite of the fact that Dong Nai has many households doing wood business with quite a large turnover, the survey shows that, in general, the business scale of many HHs is still small to very small with the main work consisting of processing wood/products for large enterprises or producing and supplying wood products to the domestic market, although some HHs supply the export market (mainly China).

One aspect of concern is that for most HHs in Dong Nai there is a heavy reliance on high risk source countries, especially African and Southeast Asian countries. Currently business HHs do not pay much attention to the sources of timber. They do not ask the sellers to provide necessary papers or to check any documents to ensure legality of the timber. Some HHs get invoices when necessary, but mostly trading HHs only pay money, receive timber, and only so. They argue that the legality of timber is the responsibility of the sellers and many sellers are their long-time customers, acquaintances, or relatives so they fully trust them.

Therefore securing legal timber in the supply chain of wood processing households may be a concern in the current context reflected in the low compliance of HHs with regard to timber legality control regulations. From this analysis of major household groups the following conclusions can be made:

- Business HHs comply quite well with basic obligations for a business HH, including business registration, tax obligations.
- However, obligations to employees and other regulations show a very low compliance. Specifically, households do not sign labour contracts for employees and hardly any pay social insurance, health insurance, and especially unemployment insurance for employees.
- In general, the wood processing production group has higher compliance with requirements on timber supply chain control, especially with those supervised by the forest rangers such as packing list and production monitoring book. They have low compliance with regulations on financial procedures such as purchase and sale contracts and invoices regulated by the Ministry of Finance. In contrast, the wood trading group has higher compliance with financial requirement, but low compliance with supply chain control requirements.
- Compliance with regulations on environmental protection, OSH, and fire prevention is low.
- Many business households do not comply with regulations on storage of supply chain control information or important papers in production and business including forest product records.
- Some HHs have products exported to China but almost none have any documents required. This is also a matter of concern as regards ensuring VPA implementation effectiveness.

The reason why business households do not follow the regulations strictly is explained mainly by the small scale or household basis of production, use of mainly family labour, etc. In addition, law enforcement for HHs is also "lighter" currently than law enforcement applied to enterprises in terms of taxation, labour contracts, regulations on environmental protection, etc. Because of this, many business HHs, regardless of whether they are able to grow well, are hesitant to upgrade themselves to enterprise category.

The survey also showed that awareness and knowledge of the HHs on forestry laws and, especially VPA / FLEGT including the VNTLAS is very low. Most households have almost no information to be able to make demands for future support. Hence, the provision of information, materials for HHs on VPA / FLEGT and legal timber production and business regulations are very necessary.

In general, HHs respond very poorly to the provisions of the law due to the family-based/small-scale production and the slack law enforcement in this sector. Survey results show that it is necessary to support all groups of woodworking households in Dong Nai province. Support includes the provision of VPA / FLEGT information, legal regulations, and business management. In the long term, it is needed to support them to improve their capacity in conducting collaborative and cooperative production and trading. The information provided to the HHs should be concise; and it is necessary to approach the HHs through a functional local authority such as the Forest Protection Department.

It is also necessary to recognize the fact that in the current context, most households do not meet the legal requirements. When the VPA / FLEGT is implemented, the current production and trading model of some households will no longer be appropriate, some household groups will be unable to adapt and must leave the industry. Households who want to survive in the context of VPA implementation need to work together to strengthen capacity (knowledge, capital) to meet the new conditions. A few households at present have a solid foundation that can grow into enterprises. Clearly central and provincial government will need appropriate policies and regulations related to HH groups to reduce severe negative impacts; for example, it will be necessary for them to develop roadmaps to minimize unwanted impacts and to increase the effectiveness of the VPA implementation.