



Challenges and opportunities for China's small and medium forest enterprises (SMFEs)





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Xinjian Luo
Lanying Lin
Pan Guiying

Ran Li
Xuefeng Gao
Enlong Xia

Li Jie

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EXECUTIVE SUMMARY

Small and Medium-sized Enterprises (SMEs) have contributed significantly to economic livelihood and local employment in China. They have come to form an integral part of the Chinese economy under a series of supporting policies and a rising market economy since the 1980s. Although Small and Medium-sized Forest Enterprises (SMFEs) share many features with non-forest SMEs, they also face peculiar challenges in terms of the complexity of government support, finance and market access, specialized associations and labour issues. Moreover, systematic data collection and research on SMFEs at the national level are rare in China.

This study is intended to enhance the understanding of the nature and activities of SMFEs and the related evolving political and economic environment in China. This diagnostic study was made possible thanks to international cooperation between the Food and Agriculture Organization of the United Nations (FAO) and the State Forestry Administration (SFA) of the Chinese Government.

This diagnostic study should help fill the gap in the knowledge about SMFEs in China, identify useful data and draw the attention of decision-makers, businesses and financial service providers on this sector.

According to an incomplete estimation (Sun and Chen, 2003), approximately 87 percent of the forestry enterprises in China are classified as small (based on an assessment of their fixed capital). Most of them are located in the eastern and southern provinces along the coastline. This is the reason why this diagnostic study focuses on the SMFEs of these regions. Moreover, this study investigated 48 SMFEs in Fujian Province, and 60 SMFEs in Zhejiang Province, both of which for years have been ranked in the leading positions in terms of production, by virtue of the large number of SMFEs they host. A number of forestry administration officers and other related stakeholders involved with SMFEs were also interviewed.

GOVERNANCE AND POLICIES RELATED TO SMFEs AND THEIR IMPACT

Governments can play a critical role in supporting economically-viable SMFEs. The evolving policy environment for SMFEs in China brings about a series of opportunities and challenges:

- a policy framework has been preliminarily formulated in order to improve the operational environment of SMFEs;
- forestry policies, major ecological forestry programmes and tenure reform exert significant influence on the well-being of Chinese SMFEs;
- transitional market economy, globalisation and international trade policies have expanded market access but also escalated the degree of market competition for SMFEs.

MARKETS AND FINANCE

Poor access to finance is one of the bottlenecks for SME development, and SMFEs are particularly affected by this obstacle. Sufficient financial services and market access are critical for the start-up and development of SMFEs:

- Forestry taxes and fees used to be an obstacle for farmers to develop timber plantations and processing; however, the central government has recently adjusted taxes and eliminated fees to encourage the development of SMFEs.
- More favourable indirect financing policies have been issued recently to sustain SMFEs; however, our field survey shows that local SMFEs still suffer from capital shortage due to lack of financing support.
- Direct financing mechanisms such as Initial Public Offerings (IPOs) in the stock market used to be hardly possible for most SMFEs to access until the Small and Medium Enterprise Board was founded; the latter may become a new source of funding for SMFEs in China.
- Considerable efforts have been made to strengthen the existing capacities of SMFEs by facilitating access to the market and technical information. However, the decreasing volume of exports in 2008 caused a number of factories in the coastal region to go out of business.

ASSOCIATIONS

There are no associations solely devoted to SMFEs; however, there are associations related to specific forestry products such as furniture, bamboo, timber processing, etc., in various places. These associations, although classified as non-profit organizations, to some extent are semi-government organizations.

From our survey it emerged that SMFEs have mixed feelings about joining an association. Some of the functions that industry associations might provide for SMFEs are currently provided to greater or lesser degrees. In contrast, heavy dependence on external support, few meeting and actives, slight market connectedness and weak negotiation capacity with the government undermine the effectiveness of these associations.

LABOUR ISSUES FOR SMFEs

In China, small and medium-sized forest enterprises have significant potential in terms of creating employment opportunities. SMFEs enjoying significant labour-cost advantages and having access to low labour costs have been a key driving force for many woodworking sectors in China.

On the one hand, the central government was very careful to exploit its advantage in terms of labour resources, and actively developed labour-intensive industries and small and medium-sized enterprises (SMEs) with considerable employment capacity.

On the other, a new labour contract law and rising wages would have negative effects on SMFEs since the latter probably cannot have at their disposal an inexhaustible supply of cheap labour.

MAIN THREATS AND OPPORTUNITIES IN THE SMFE SECTOR

The main threats to SMFEs' sustainable development should not be neglected: export rebate adjustments, RMB appreciation, the new Labour Contract Law in force, great hikes in the prices of raw materials and energy, and economic growth slowdowns in the West due to the Sub-loans Crisis, etc., eroding SMFEs' competitive power and their profit.

On the other hand, an all-round collective forestry tenure and regulation reform is expected to help SMFEs with reference to financing, the socialized service system, looser Annual Allowable Cuts (AAC), more accessible and abundant material resources, pointing at good opportunities for SMFEs' rapid and sustainable growth.

PROSPECTS

The main prospects for the development of SMFEs in China are the following:

- creating an enabling legislative and policy environment for SMFEs;
- improving the capacity of industrial associations;
- enhancing SMFEs' competitiveness and cooperation among enterprises.

TABLE OF CONTENTS

EXECUTIVE SUMMARY - III

ACRONYMS AND ABBREVIATIONS - VIII

INTRODUCTION - I

DEFINITIONS AND CURRENT STATUS OF SMFES IN CHINA - 3

GOVERNANCE AND POLICIES RELATED TO SMFES AND THEIR INFLUENCE - 10

FINANCE AND MARKET ISSUES - 21

ASSOCIATIONS FOR SMFES IN CHINA - 29

LABOUR ISSUES - 33

KEY OPPORTUNITIES AND THREATS IN THE SMFE SECTOR - 35

PERSPECTIVES - 41

REFERENCES - 44

ANNEX 1 - 48

ANNEX 2 - 50

ANNEX 3 - 52

ANNEX 4 - 52

ACRONYMS AND ABBREVIATIONS

AAC	Annual Allowable Cuts
CCICED	China Council for International Cooperation on Environment and Development
CCP CC	Chinese Communist Party Central Committee
FAO	Food and Agriculture Organization of the United Nations
IIED	International Institute for Environment and Development
IPO	Initial Public Offerings
MOA	Ministry of Agriculture
MOF	Ministry of Finance
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
NETC	National Economic & Trade Commission
NDRC	National Development & Reform Commission
PICC	People's Insurance Company (Group) of China
RMB	Renminbi, Chinese currency
SAT	State Administration of Taxation
SFA	State Forestry Administration
SME	Small and medium enterprise
SMFE	Small and medium forest enterprise
VAT	Value added tax
WTO	World Trade Organization

INTRODUCTION

Small and medium-sized enterprises have played a significant role in the Chinese economy. Most of them belong to the non-public sector of the economy. China has formulated a series of general and specific policies and regulations to promote their growth. Thanks to government support and the development of a market economy, they have already contributed considerably to income growth, employment growth, export expansion and economic structure optimisation, among others. Until 2006, Small and Medium Enterprises (SMEs) amounted to 42 million. They are responsible for 75 percent of employment in townships and 60 percent of the Gross Domestic Product of China (NDRC, 2007).

For a long time, there had been a tacit assumption that the organizational theories and models developed for large firms could be directly applicable to SMEs. However, there is now a greater understanding of the fact that smaller organizations differ significantly from their larger counterparts (De Berranger and Tucker, 1999). They are confronted with severe constraints to survive, including less access to financing, lack of socialized services, and thresholds for their own management, among others. The same approach was adopted by research studies on forestry, and while more attention was given to improving the conditions for large-scale forestry enterprises, much less was granted to the small or medium-scale groups, which also produce a high proportion of forest products and involve very large numbers of people (Sun and Chen, 2003).

Small and Medium Forest Enterprises (SMFEs) share many features with non-forest SMEs, but they also face unique and complex challenges such as resource tenure and contradiction between sustainable development and commercial profitability. Hence, this report has reviewed the relevant literature and legislation regarding SMFEs to reach general conclusions on effective supportive approaches, estimated the effects of national and local policies, and assessed the needs for the further development of small and medium forest enterprises in China.

No nation-wide data and investigations exist about SMFEs. According to an incomplete estimation (Sun and Chen, 2003), approximately 87 percent of the forestry enterprises in China are classified as small scale (based on an assessment of their fixed capital), and most of them are located in the eastern and southern provinces along the coastline. For years, Fujian Province has been ranked at the top in terms of production, followed by Zhejiang Province and Guangdong Province; for years these regions, the home of a large number of SMFEs, have ranked high in terms of production. As a consequence, this diagnostic study investigates 48 SMFEs in Fujian Province, and 60 SMFEs in Zhejiang Province. The situation of the SMFEs in Guangdong Province was also studied with the help of the Forestry Bureau of the Guangdong Province. Based on this, this study, which focuses on SMFEs in the said regions, tries to represent some of the main issues at nation-wide level in SMFE development.

With the help of the Customs Bureau and Business Department, researchers from the Research Institute of Forestry Policy and Information and the Chinese Academy of Forestry submitted questionnaires to and interviewed the managers of SFMEs. In the next sections of this paper the main findings of the literature review and field survey are presented by focusing on six different topics. More in detail: a) Definitions and current status of SMFEs; b) Policies and institutions, and their influence on SMFEs; c) Finance and market issues; d) Enterprise links and associations; e) Labour issues; f) Main threats and opportunities in the SMFE sector. The conclusions and implications for future research are discussed at the end of the paper.

DEFINITIONS AND CURRENT STATUS OF SMFES IN CHINA

So far it has proven impossible to come to an exact definition of SMFES, SMFES are not clearly aware of their actual situation nor do they have a clear perception of their advantages and disadvantages; hence, they are unaware of opportunities and threats, and as a result they do not know how to improve their competitive position. Nevertheless, SMFES can represent a way out of poverty and play an important role in the socio-economic development of the forestry region.

DEFINITIONS

There is no single, universally accepted definition of small and medium forest enterprise in terms of number of employees, sales revenue, total assets, etc., in the different countries and research studies conducted. In practice, various meanings can be found to apply to different contexts (Robert Kozak, 2007). For instance, Macqueen (undated) defines SMEs within a context of sustainable development as those enterprises with less than 100 employees, without any lower cut-off. In another report, Macqueen (2008) defines SMFES as business operations aimed at making a profit from forest-linked activities, employing between ten and 100 full-time employees, or with an annual turnover between US\$10 000 and US\$30 million, or with an annual round wood consumption between 3 000 and 20 000 m³. Spantigati and Springfors (2005) provided a somewhat more general definition as forest-based enterprises whose economic activities are undertaken mainly at the individual or household level, usually employing members of the family or close relatives and neighbours, and where salaried labour is negligible. Besides that, a detailed classification of SMFES is provided by the "Classification Criteria of Large, Medium and Small Industrial Enterprises" according to fixed capital (SFA, 2000). Based on an assessment of their fixed capital, approximately 87 percent of the forestry enterprises in China are classified as small scale (Sun and Chen, 2003).

Table 1. Classification criteria for large, medium and small industrial enterprises in China in terms of fixed capital

Units: RMB 10 000 Yuan

Industry	Large		Medium		Small
	I	II	I	II	
Timber logging	≥15 000	6 000–15 000	4 500–6 000	3 000–4 500	≤3 000
Wood Processing & Forest chemical industry	≥10 000	5 000–10 000	3 500–5 000	2 000–3 500	≤2 000

Note: Super-large forest industry firms refer to enterprises with fixed capital of 600 million Yuan or more.
Source: Sun and Chen (2003).

In summary, the definition provided by Macqueen is more applicable, with specific measurement indices in terms of employment and turnover, than that defined by Spantigati and Springfors. In accordance with the Chinese categorizing criteria on small and medium-sized enterprises (SMEs), newly amended by the State Economic and Trade Commission, the State Development Planning Commission, the Ministry of Finance and the National Statistics Bureau (SETC, 2003), the definition of SMFES used here is defined as an industry-specific type of small and medium enterprise (SME) situated within the

forest sector, employing less than 2 000 people, or with an annual turnover of less than RMB 300 million, or with total assets less than RMB 400 million. However, based on the field surveys and interview carried out, most of the SMFEs in this report, both wood-based forestry enterprises and non-wood ones, are far smaller than the national definition.

OVERALL STATUS OF SMFEs IN CHINA

Forestry enterprises in China consist in a diversified range of ownership types such as state-owned, collective, joint venture, and private, with different enterprise scales. They cover a wide range of production activities such as timber and non-timber forest products (NTFP) production, forest product processing, and the supply of environmental and recreational services. Since the early 1990s, following the reform of state-owned forestry enterprises, a number of subsidiary enterprises broke away from the mother company and were acquired and managed by non-state or private entities. Moreover, with China's increasing demand for forestry products in the said years, new forestry enterprises emerged in the eastern and southern provinces along the coastline thanks to increases in investments from Hong Kong, Taiwan, and from a number of American and European manufacturers as early as the late 1980s (Sun *et al.* 2005). These privatised forestry enterprises and newly established ones represent the main body of SMFEs in China.

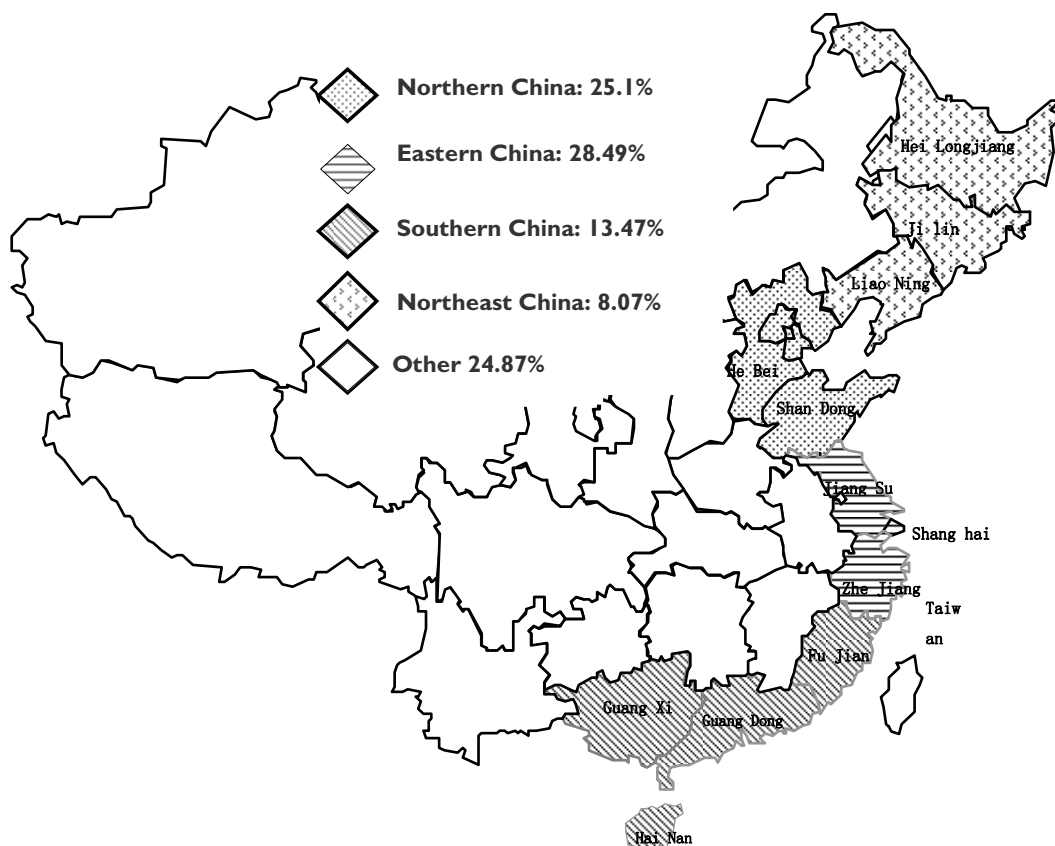
Just like other kinds of forestry enterprises, SMFEs in the broadest sense cover three specific industries, namely (Sun and Chen, 2003):

1. the timberland management-based primary industry;
2. forest-based secondary industry including logging, wood processing, forest chemical industry, pulping and papermaking industry;
3. forest service-based tertiary industry.

In 2007, the total annual output value of forest industries reached RMB 1 170 billion with an increase of 9.85 percent compared with RMB 900 billion in 2006 (SFA, 2007). It was estimated that more than 90 percent of the total value of wood products in China is generated by SMFEs (Sun and Chen 2003), and their expansion has become a driving force behind the fast growth of Chinese forestry. Until 2005, the number of timber processing and wood, bamboo, rattan, palm, and straw product manufacturers amounted to 42 thousand. Among them, there are 40 448 small-sized and 199 medium-size enterprises (First National Economic Census, 2005), accounting for 96.78 percent of the total amount.

In China, most small-scale forestry enterprises are located in the eastern and southern provinces along the coastline. As Figure 1 shows, most Chinese forestry firms are located in four regions from the south to the eastern coastline. These four regions contribute 75.13 percent of the total output. Eastern and southern China together produced more than half of the total domestic production in 2005 (SFA, 2006); Fujian has been ranking at the top in terms of production for years, followed by Zhejiang, Jiangsu, Shandong and Hebei. This can be explained by the fact that to survive and develop, SMFEs should be established close to either raw materials or product market. Is for this reason that this study decided to focus on the SMFEs located in these regions.

Figure 1. Industry gross product in different areas in 2005



Source: SFA (2006)

Similar to other developing countries, information on the contribution of SMFEs to the economy is relatively limited. It is however known that SMFEs make significant contributions to the livelihoods and well-being of the rural poor living in or near forested landscapes. Rough estimates suggest that they make up over 50 percent of forest sector employment. SMFEs play a critical role in securing poor people's basic needs, spreading wealth locally, enabling local innovation, and preserving cultural identity and practices. SMFEs grouped together in clusters or associations can reduce transaction costs for the poor, develop strategic alliances, and shape the policy environment through lobbying on behalf of the poor (Macqueen, Figueiredo *et al.* 2005; Macqueen, Vermeulen *et al.* 2005).

There are many reasons explaining why SMFEs are effective poverty-reduction tools in developing regions, many of which are fairly self-evident: (1) they tend to be labour-intensive and consequently can make positive and long-term contributions to employment and economic development; (2) they are capable of thriving and growing given an enabling environment, favourable market conditions, and the appropriate business structures; (3) they cater to local and domestic markets which are growing in

importance; and (4) they rely on the empowerment of local entrepreneurs who have vested interests in making their businesses successful. Nevertheless, SMFEs typically pursue multiple objectives beyond employment and wealth creation, including "distribution of dividends among stakeholders, community development, greater participation in political dialogue, and improved local safety nets" (Donovan *et al.*, undated; Donovan *et al.*, 2006).

Like other kinds of SMEs in China, SMFEs have a strong impact on the environment. In Dongguan, Guangdong Province, the discharge of waste water from paper-making enterprises represents 46.24 percent of the total volume (Teng Jing, 2006). In Sanming, Fujian Province, there are two small-sized paper-making enterprises that discharged COD in waste water at a rate of 1318.2 mg/L, i.e. 12.18 times the standard rate (Xiong Minzhen, 2008). Despite the contribution of paper-making enterprises to job creation and regional economic development, eight small-sized ones were closed in Dongguan, and two small-sized ones were closed down in Sanming. The same occurred in Jinlin Province where 93 small-sized paper-making or pulping enterprises, 44 percent out of the total, were closed down for environment protection reasons (Liu Lili, 2007).

THE CASES OF FUJIAN, ZHEJIANG AND GUANGDONG PROVINCES

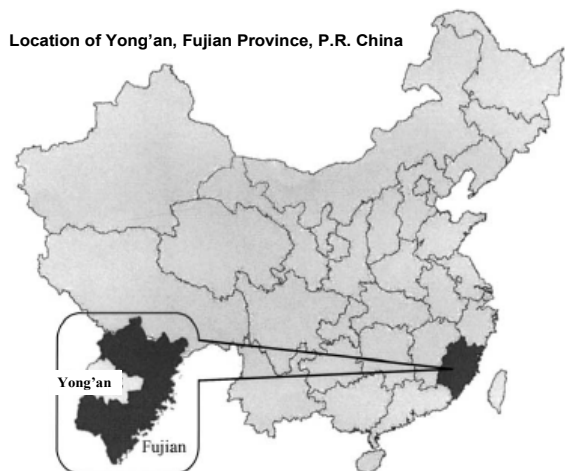
SMFEs in Yong'an, Fujian Province

Yong'an is a county-level city in China's Fujian Province, on the Sha River, a tributary of the Min River. It is located approximately 120 miles southeast of Fuzhou, an area rich in bamboo groves and forests. From 2003 to 2008, the third forestry tenure and regulation reform was implemented in Fujian Province with Yong'an playing a representative role. This reform aims at helping forestry farmers and small and medium-sized forestry enterprises with reference to aspects such as financing, marketing, technical training, cooperation with different kinds of associations, etc..

Yong'an is an important collective forested area with a large amount of small and medium-sized forest enterprises.

As far as SMFEs' ownership is concerned, out of the 48 effective interview samples, thirty-four are private-funded enterprises, four are shareholding corporations limited type, one of them is a private partnership enterprise, and one of them is a collectively-owned enterprise. Individual private enterprises account for 70.83 percent of the total SMFEs interviewed.

All the SMFEs interviewed were set up between 1986 and 2008, but



most of them started up recently. The total employment in all the 48 enterprises is 2 096 people, with an average of 44 people per enterprise, which is much lower than the SMEs classification criteria of China.

Local labour is the main source of employment. There are 1 159 local people working in these SMFEs, accounting for 55.3 percent of the sum total.

SMFEs in Anji, Zhejiang Province

Jiashan is located in the northwest area of Zhejiang Province, near the large cities of Shanghai, Hangzhou and Suzhou. The forestry cover rate of Anji is 69.4 percent, and its forestry land area is 132 thousand hectares. Anji is rich in bamboo forest resource and has a large-scale bamboo industry. It is famous as the home of both Bamboo and the Bamboo Industry. The bamboo industry and the wooden chair industry are the key industries in Anji with 55.4 percent on the total GDP. At the end of 2007, there were 400 wooden-chair enterprises producing 30 percent of the chairs at world level. Forestry industry development promotes local forestry farmer living conditions. In 2007, the GDP of the forestry industry in Anji was 10.51 billion Yuan, and forestry farmers' average revenue was 9 196 Yuan with 6 078 Yuan coming from the forestry industry¹.

Most of the wood industry in Anji is represented by small and medium-sized forestry enterprises. Before 2002, the proportion of SMFEs was about 90 percent. In 2004, the proportion was about 81 percent. That means that, similarly to other forestry industrial areas, SMFEs are useful in supporting large-sized forestry enterprises by supplying raw materials or semi-finished products.

To promote the development of SMFEs, several preferential policies are implemented by the local government:

- a small-sized enterprise development program. Every year five million Yuan are allocated by the Anji government to help SMEs access the market and technical training;
- credit guarantee. The local government encourages cooperation in the field of credit guarantee, cooperating with SMEs to help them obtain credit from local banks;
- human resource development. The government encourages cooperation between SMEs and local technical academies to promote technology, management training, etc..

SMFEs from the wood processing industry in Guangdong Province

Guangdong Province is one of the most advanced regions in the field of wood processing in China. It has established an integrated and strongly competitive industry, which includes various sub-sectors processing saw logs, panels, wooden furniture, bamboo flooring and pulpwood in the manufacture of secondary forest products.

¹ In 2007, 100 US dollars were equal to 756.51 RMB, according to the standard price.

Table 2. Wood processing industry status in 2006, Guangdong Province

Categories	Gross production(¥)	Output	Export	Number of enterprises
Saw log	0.6 billion	814 thousand m ³	45 thousand m ³	3 000
Panel	8.0 billion	5 493 thousand m ³	469.9 thousand m ³	260
Wooden furniture	105.0 billion	—	US\$6 913 billion	6 000
Wooden flooring	12.0 billion	0.12 billion m ²	—	130
Paper pulp	1.8 billion	400 thousand tons	—	10
Total	127.4 billion	—	—	11 000

According to an incomplete statistics, Guangdong Province had over 11 000 wood processing enterprise and 200 million employees up to 2006, which in all yielded an output value exceeding RMB 126 billion Yuan and exports around RMB 61.81 billion Yuan (US\$7 748 billion²) (Cao Yunqian, 2007).

With respect to the industrial structure (see Table 3), 99.64 percent of the processing enterprises are small and medium-sized, and they tend to form clusters around very few large ones. These small and medium-sized units are either vertically integrated or indirectly involved in the different stages of wood processing. They, along with few large enterprises, constitute a competitive industrial cluster. On the one hand, links between small and large firms are becoming evident. Large firms are increasingly willing to outsource parts of their production and services to smaller firms. If, by way of example, we consider the furniture industry, famous furniture production clusters in Dongwan, Shenzhen, Zhongshan and Shunde consist mainly of SMEs supporting few large enterprises, in the form of raw material supply, logistic transportation, and design, etc.. They have contributed almost half of the furniture export of China.

Table 3. Industrial structure of wood processing enterprises in Guangdong Province

Enterprise scale (in terms of capacity)	Number of enterprises	Percentage
Small enterprises (below 10 000 m ³)	10 901	97.54%
Small to medium enterprises (10 000–50 000 m ³)	235	2.10%
Medium enterprises (50 000–100 000 m ³)	19	0.17%
Large enterprises (100 000–200 000 m ³)	12	0.11%
Extra large enterprises (above 200 000 m ³)	9	0.08%
Total	11 176	100.00%

On the other hand, the large number of SMFEs in Guangdong has also had a negative impact on the overall development of the wood-processing industry. Firstly, in sharp contrast with the leading enterprises which enjoyed continued success with advanced technologies and high quality products, some SMFEs (especially small-scale plywood manufacturers) are unable to buy more advanced equipment or even to use their

² In 2006, 100 US dollars were equal to RMB 797.82 Yuan according to the average exchange rate.

existing machinery efficiently, which usually leads to low-quality production and environmental pollution, and even impacts on the product quality standard of the downstream enterprises. In addition, a lot of small to medium-sized wood-processing firms are homogeneous. This results in fierce resource contest and vicious competition, which simultaneously reduces profit margins and causes market chaos. In addition, because of capital and technology shortages, most of small to medium-sized end-product manufacturers are inclined to adopt the production patterns of OEMs (Original Equipment Manufactures). This kind of production patterns depending on low process rate makes the SFMEs more vulnerable to fierce competition.

GOVERNANCE AND POLICIES RELATED TO SMFES AND THEIR INFLUENCE

Small and medium-sized enterprises form a vital part of the Chinese economy thanks to their increasing importance. In order to improve their operational environment, increase employment in both urban and rural areas, and exert their important influence on national economic and social development, a policy framework system has been preliminarily formulated to promote the development of small and medium-sized enterprises. By the end of 2006, more than ten provinces and regions had published their administrative rules and regulations for promoting the development of small and medium-sized enterprises, and the corresponding authorities and departments of the central government had issued 24 documents concerning market access, the fiscal-monetary mix, improvement of government supervision and administration, technological innovation, exploitation of foreign markets and construction of service systems for small and medium-sized enterprises (NDRC, 2007).

Forestry policies, major ecological forestry programmes and forestry tenure reform also exert significant influence on the ecological and economic well-being of Chinese small and medium-sized forest enterprises. Moreover, as the development of the market economy and globalisation takes form, more and more environmental and international trade policies are impacting the sustainable growth of SMFES.

MACRO LAWS AND POLICIES CONCERNING THE PROMOTION OF SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs)

The Chinese government has formulated a series of general and specific laws, policies and regulations related to the development of SMEs. In 2003, the first specialized law for promoting the development of small and medium-sized enterprises was issued by the National People's Congress - the Small and Medium-size Enterprise Promotion Law. In general, it provides support to SMEs by improving the operational environment, increasing the use and provision of financing and other necessary social services, etc.

In the same year, the Securities Law and Cooperation Law were amended to provide SMEs with an equitable position and treatment according to the law. Moreover, the Program of the 11th Five-Year Plan of Development of the National Economy and Society raised the requirements to implement the project supporting small and medium-sized enterprises in 2006 (NDRC, 2007).

According to corresponding laws and regulations, an RMB 3.51 billion special support fund was provided by the Ministry of Finance for the development of SMEs (MOF, 2008). It appears that this fund will benefit SMFES in terms of technological updates, specialization, expanding markets and by enabling a favourable environment.

If all these general laws and regulations are enforced in the foreseeable future, they may come to represent a great force and solid foundation for the development of all SMEs, including small and medium-sized forest enterprises.

FORESTRY POLICIES AND TENURE REFORM

Environmental policies and ecological programmes

China has implemented significant forest sector reforms in the recent years. While a market economy for forest products is developing, the priority for China's forestry sector has shifted away from a narrow emphasis on industrial development to include ecological protection measures. This change in policy direction is broadly described by the Six National Key Forest Programmes. These six programmes, intended to span the period from 2001 to 2015, are:

- the Natural Forest Protection Program (NFPP);
- the Program for Conversion of Cropland to Forest;
- the Sandification Control Program for Areas in the Vicinity of Beijing and Tianjin;
- Key Shelterbelt Development in the "Three North" and the Yangtze River Basin, etc.;
- the Wildlife Conservation and Nature Reserve Development Program; and
- Forest Industrial Base Development in Key Regions with a Focus on Fast-growing and High-yielding Timber Plantations.

Environmental conservation programmes have given SMFEs in China a range of unprecedented opportunities, which may have positive impacts on the sustainable management of forests that have been seriously depleted in the past five decades by state logging firms, and also on the long-term sustained supply of raw materials for the SMFEs in China. However, the reduction in domestic timber production resulting from government ecological programmes may restrict the growth of those SMFEs located in regions that have been placed under the so-called Logging Ban on Natural Forests as part of the Natural Forest Protection Program (Sun and Chen, 2003). A likely effect of the logging bans and depleted stocks of standing timber is that logging in China's natural forests will provide a decreasing proportion of the wood needed to satisfy both domestic consumption and international competition. Moreover, shortage of wood, particularly large-diameter logs, forces many small and medium-sized forest enterprises to outsource, which further increases their costs and operational risks. It has been estimated that China will need to import a massive 125 million cubic meters (RWE) in the year 2010 to fill its wood and fibre supply gap (Zhu *et al.*, 2004).

Alternatively, the Forest Industrial Base Development in Key Regions with a Focus on Fast-growing and High-yielding Timber Plantations will help fill the gap in some product types. Two million hectares of plantations are planned to be established by the end of 2015 with diversified investors, including (Wang, undated):

- pulp forests: 0.67 million ha
- panel forests: 0.60 million ha
- rare tree species forests: 0.06 million ha
- other: 0.67 million ha

At the same time, some small and medium-sized forest enterprises have improved their technology and equipment to enhance the multipurpose utilization rate of wood when facing up to raw material shortage and fierce competition. Up to now, the averaged

wood utilization rate of SMFEs can reach 90 percent in Zhejiang Province, even higher than that of American enterprises.

Controls on pollution from paper mills

In rural China, an extensive network of small pulp mills traditionally relied on straw and other agricultural residues (at a three to one ratio over wood fibre) for raw fibre inputs (Hyde, 2003). In the late 1990s, concern about water pollution and a rising need for high-quality paper and packing material led the government to close down over 4 000 small-scale pulp mills. In 2008, the Discharge Standards of Water Pollution by Pulp Mills came into force. It can be expected that the surviving pulp mills will upgrade or change their production equipment to reduce the amount of polluted water discharged, which will cause a number of small-scale pulp mills to go out of business or accept higher production cost. This development, coupled with incentives for foreign direct investment, is prompting a broad switch to larger and cleaner paper mills using predominantly wood-based fibre. (Zhu *et al.*, 2004).

Wood saving and substitution policies

The Chinese government attempted to curb domestic demand for wood by requiring an increased use of non-wood substitutes, and issued the Regulations for Economic and Rational Applications of Wood and Wood Substitutes in 1983. Its efforts, however, were not entirely successful as the regulations were suspended in the mid-1990s probably due to rigid timber demand at the time, and were never formally applied to imported wood products (Zhang *et al.*, 1998).

On the other hand, in 1999 the Ministry of Construction and the State Forestry Administration jointly issued a national policy banning the use of timber from natural forests as raw material in doors and windows for public offices and residential buildings. This policy mandated the use of substitutes such as iron and cement in infrastructure such as railways, telecommunications and construction. A recent World Bank report estimates that such demand-dampening policies save China up to 15 million cubic meters of timber per year (Rozelle *et al.*, 2000), and also impact on the production patterns of small and medium-sized enterprises, though no supporting analysis has been provided.

In November 2005, twelve ministries and commissions jointly proposed guidelines on wood saving and substitution. Several objectives were set up: the multipurpose utilization rate of wood should be increased to 65 percent and above, and 400-500 billion cubic meters should be saved each year (SFA, 2006). China's wood processing industries are encouraged to recycle formwork plywood and other materials. The private sector and the government could promote research and technology transfer to develop cleaner, more efficient, technologies for small-scale, non-wood fibre mills.

In conclusion, wood-saving and substitution policies are intensifying competition especially for small and medium-sized enterprises; on the other hand, they are promoting industrial upgrading, structural optimisation, and growth by changing market demand and the investment structure.

Restrictions on disposable wooden chopstick manufacturers

In order to promote an efficient and rational use of timber, in 2005 the State Forest Administration (SFA) issued a regulation on the production and trade of disposable wooden chopsticks. Eleven manufacturing companies were closed down while a number of deforestation operations were punished for producing disposable wooden chopsticks. Moreover, the SFA also requested a ban on the establishment of wooden chopsticks manufacturing companies with the exception of bamboo chopstick manufacturers (SFA, 2006). However, it appears that small-scale chopsticks enterprises resist such restrictions because wooden chopsticks production can yield huge profits and does not threaten forest resources. As a result, the impact of restrictions on small-scale wooden chopstick enterprises was not particularly severe, since the imports of wooden chopsticks during the first half of 2007 was 18.46 percent less than in 2006.

Forest harvest quota management

In 1985, a harvest quota controlling the commercial harvesting of logs was instituted nationally for all forestland, irrespective of ownership. Forest harvest quotas are commonplace in other countries around the world; however they are almost exclusively government initiatives in the case of public forests (Bull and Schwab, 2002). In China, the SFA sets the log-harvesting quota based upon statistics from the national forest survey and the volume harvested during the previous year. The quota is divided and distributed at each level of government beginning with the SFA and resulting in the ultimate assignment of sub-quotas across the nation at the local level.

However, like taxation, the distribution of logging quotas has favoured state enterprises. This seriously hampers efforts by non-state entities in timberland management as a result of being unable to access harvest quotas (Liu Lunwu and Liu Weiping, 2001). In addition, illegal logging activities and corruption have arisen in areas previously unaffected by such practices. Although there are some cases of environmental improvement, there is speculation that these environmental achievements could have been made without diminishing management incentives and tenure security in collective forests (Miao and West, 2004).

Forestry tenure reform

Tenure reform clarity and strengthening of tenure rights at community level allow a set of small-scale enterprises, that otherwise would be unable to emerge, to contribute significantly to local development, while creating opportunities for community-company partnerships, a new shape of the processing industry (including timber and non-timber products and services). (CSAG, 2008)

Ambiguity and insecurity of property rights plagued Chinese forestry for decades (Zhang, 2001). The reforms that began in agriculture spread rapidly to other sectors. In forestry, households gained land use rights on collective forestland (a "contract responsibility system" comparable to the "household responsibility system" in the agricultural sector) as the third component of the so-called "three fix" policy: stabilizing the rights and ownership of forests and mountains, identifying the boundaries of household plots, and establishing a forest production responsibility system. The change was rapid. By 1984, 30 million hectares or 60 percent of the land area in collective forests had been

transferred to 57 million individual households and many households began drawing on their own resources to reforest the new lands they managed (Yin and Newman, 1997; Liu and Edmunds, 2003).

Recently, the state has implemented a policy of extending contractual rights to land, including timberland, for another 30 years. This would allow contractors time to manage timberland for at least two rotations in fast-growing plantations (Xu and Wang, 2001). The Forest Law and its implementation regulations also allow market transactions of land use rights for timberland, economic timberland and fuel woodland (Chen, 2002). In addition to changing timberland use rights, the monopoly of state ownership in forest management has also been changed by the introduction of private businesses.

As improved property rights have been a feature of China's market reforms and of the tenure security developed over the last quarter of a century, a period in which China has afforested or reforested more than 20 million hectares, China now has more than 47 million hectares of forest plantation, approximately one-quarter of the world's total (FAO, 2001). A recent empirical assessment confirms that improved land tenure was an indisputable incentive for longer-term forest management (Hyde, Wei, and Xu, 2008).

Table 4. Types of tenure arrangements

Five types of tenure arrangements:
<ul style="list-style-type: none"> • Private plots • Village household contract • Village household partnership • Market allocated plots • Collective management

After the Resolution on Accelerating Forest Development (2003) and the Opinion on Impelling Collective Forest Tenure Reform in All Ways (2008) by the CPC Central Committee and the State Council were issued, the flow of corporate capital into forestry thanks to guaranteed property and revenue is expected to accelerate. A greater number of managed forest and capitals may provide more inputs and security to the development of small and medium-sized enterprises. Furthermore, following the reduction in the cost of forestland tenure access, more SMFEs even tried to hold their own timber plantation base to fight against up-going wood prices. However, it is hard to evaluate the performance of an institutional reform over such a short period of time, especially when such a diverse set of enterprises are involved. The situation varied even within the same area.

Our survey involving 48 small and medium-sized enterprises in Yong'an, Fujian Province showed that 50 percent of them did not experience any changes following the tenure reform, 32 percent regarded the reform as beneficial and 18 percent thought it had adverse consequences.

Table 5. The various effects of forestry tenure reform on SMFEs in Yong'an

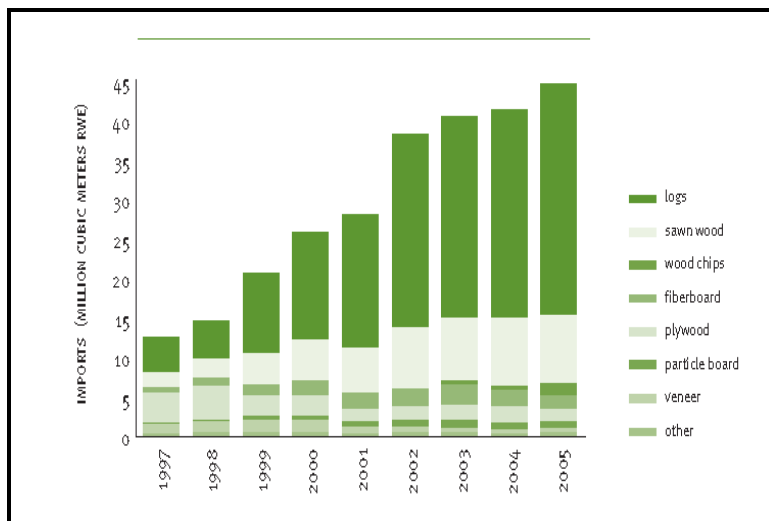
Positive effects (32%)	Negative effects (18%)
<ul style="list-style-type: none"> • Lower transaction cost • More purchase channels • More raw material supply • Easier to attain tenure of raw material plantations 	<ul style="list-style-type: none"> • Higher wood prices • Decentralized forestland, increasing transaction cost • Harder to purchase raw material due to harvest quota

TRADE POLICIES

China's trade policies have changed significantly over the last 15 years as a result of opening-up, participation in APEC and accession to the World Trade Organization (WTO), including reduction of trade barriers and tariff levels. Zero tariffs on logs/lumber and pulp/waste paper imports began in 1999 to supplement the insufficient domestic supply (AF&PA, 2004). These changes have resulted in significant shifts in trade flows (Zhu *et al.*, 2004). China is now a key link in a vast global wood product chain. A fast-growing share of the wood grown in China or imported into the country is exported in the form of finished or semi-finished manufactured products, paper and wood chips.

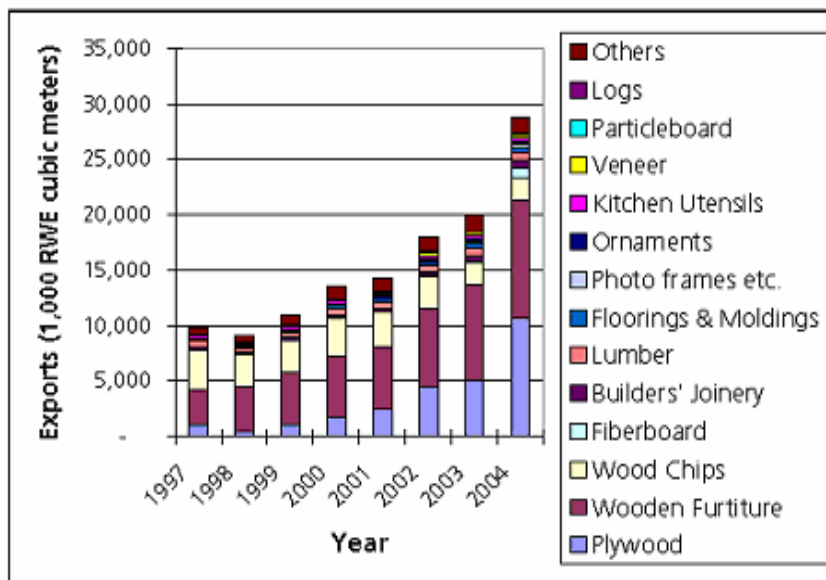
Figure 2 shows the composition of China's wood product exports over the last decade. Growth in the export market has been driven in large part by wooden furniture, plywood and, since 1999, paper. This trend is consistent with the Government's efforts to restrict exports of primary products and encourage exports of value-added products. Most of the products are coming from small and medium-scale enterprises located along the east coast. According to a research study conducted on timber processing and furniture manufacturing in Zhejiang Province, in 2002 54.23 percent of the total output was exported to other regions or abroad, far exceeding local consumption (Liu, 2006). The study also indicated that most of the enterprises within the industry are small and medium-sized firms, and that they played a significant role in exports. With the entry into the WTO and thanks to favourable export and international market exploitation policies, Chinese SMFEs became increasingly involved in the global market.

Figure 2. The main forest product import structure in China (1997-2006)



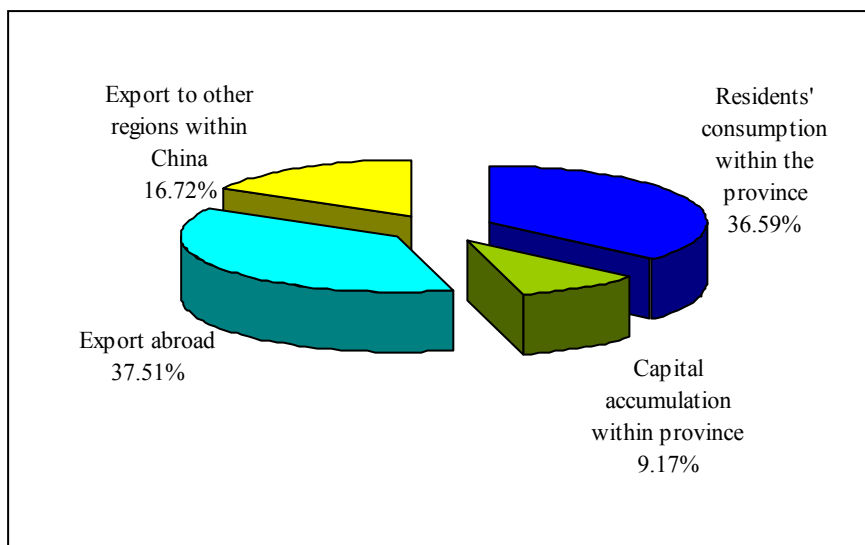
Source: Andy White et al., 2006

Figure 3. China's timber product exports by product type (1997-2004)



Source: China's forest product exports: an overview of trends by segment and destinations (Sun et al., 2005).

Figure 4. Structure of final destination of timber processing and furniture manufacturing (TPFM) in Zhejiang in 2002



Source: Input-output analysis of Zhejiang timber processing and furniture manufacturing (Liu, 2006).

However, after entering the WTO, most forest products will probably lose the tariff protection they currently enjoy accompanied by a reduction in the domestic market prices of lumber and wood products, as well as of pulp, paper, and allied products (Gan, 2004). The whole industry will face tough competition, given its overall inefficiency (Sun and Chen, 2003). Globalization has made the vulnerability of Chinese SMFEs, especially export-oriented ones, more visible.

Table 6. Import tariff rates on wood and wood-based products (2008)

Enterprise scale (in terms of capacity)	Number of enterprises
Logs and sawn wood	0%
Veneer	0%
Plywood	15%
Fibreboard and particleboard	8.9%
Wooden furniture	0%

Source: Chinese Customs Office

Although VAT rebates are gradually being phased out, especially on commodities such as timber and pulp, it is expected that they will remain in place for the foreseeable future on value-added products (i.e., fibreboard, plywood) to promote exports of these goods. Any further reductions of VAT rebates on these value-added goods are expected to be marginal (AF& PA, 2004). In order to escalate the industrial structure, China recently adjusted its international trade policies. In 2006, China slashed the VAT rebates on some wood products. Taking furniture as an example, its VAT rebate decreased from 13 percent to 11 percent, resulting in the increase of production costs. As a consequence, manufacturers are forced to raise product prices or lose some profit

margin. According to reports, the average profit rate of most furniture manufacturers is between 5 and 8 percent, and many small and medium-sized enterprises regard VAT rebates as their main source of profit constitution. Hence, decreasing rebates have jeopardized the survival of small and medium-sized furniture firms, and will probably drive them out of a market affected by fierce competition.

Furthermore, prospects concerning the exchange rate represent an additional risk factor. A recession in the United States or an excessive easing of the U.S. monetary policy could contribute to further sharp declines in the dollar. The main impact of a precipitous decline of the dollar would weaken export and investment growth throughout the global economy (World Bank, 2008). The appreciation of the RMB against a depreciated dollar would have similar negative consequences for the Chinese SMFEs, resulting in a reduction in external demand and exporters' profit.

Suffering from such an unfavourable situation, around 70 percent of the furniture manufacturers in Zhejiang Province are confronting deficit, and three-hundred firms have moved their factories to Viet Nam³.

The recent global economic crisis has generated significant negative impacts on the Chinese SMFEs. In order to stabilize the exports of forest products, the policy on forest product VAT rebates was adjusted three times in August, November and December 2008. As the result, VAT rebates have been increased in 117 kinds of forest products, mainly bamboo products, wood-based panels, flooring (increased from 5 to 9 percent), and furniture products (increased from 11 to 13 percent). (SFA, 2009).

POLICIES PROMOTING NON-PUBLIC FORESTRY ENTERPRISES

Non-public forestry enterprises developed on the wake of market reform or as a consequence of the process privatising public and collective forestry enterprises. From the 1980s to the present day, state-owned forestry enterprises have suffered due to the forestry resource and financial crises which have led to the forestry regulation reform in state-owned forestry enterprises or the privatisation of public forestry enterprises. Since 1978, China's market reforms spread rapidly across the entire country, from the agricultural to the forestry sector, and to the collective forestry sector in particular. In the collective forestry region, land use rights have been transferred from the collectives to individual households. However, this is not the end of the story, and following the decrease of government quotas and government procurement prices, some forestry farmers became dissatisfied with simply farming the forestry land they had. For this reason, some have turned their forestry land into shares, or used it as equity or in cooperative joint ventures for forestry enterprises.

The property law of the People's Republic of China

On 16 March 2007, the property law of the People's Republic of China was implemented. It legally protects the non-public economy and private property, and helps to consolidate and promote forest tenure reform, while improving the forestry market mechanism. It is believed that thanks also to the protection afforded by the property law,

³ According to an Officer of the State Forestry Administration interviewed (2008).

a greater amount of social funds will be invested in afforestation and timber production activities, thus answering the growing timber requirements of SMFEs.

Resolution by the CCPCC and the State Council on Accelerating the Development of Forestry

In June 2003, the Resolution by the Chinese Communist Party Central Committee and the State Council on Accelerating the Development of Forestry was issued. It is useful to SMFEs because: a) it acknowledges the legal status of non-public forestry and provides for a fairly competitive environment; b) it stipulates the reduction or elimination of taxes and fees on the forestry industry and lower management costs; c) it lays great stress on the provision of financial support and on answering the capital requirements of SMFEs.

Local preferential policies

In order to speed up regional economic and industrial development and deepen the reform of the forestry management system, provincial governments enacted a number of new regional preferential policies and measures favourable to industrial non-public investments to improve the development of SMFEs. Such policies include: a) the reform of the forestry administration system and of collective forest property rights by granting property rights on forests to household and householders, putting an end to the long-term monopoly on collective forests by villages or townships; b) the reduction of taxes and fees, providing meeting opportunities for timber and bamboo producers and buyers, and implementing transfer payments to promote afforestation and job creation in SMFEs; c) preferential policies to promote professional associations, new types of forestry cooperation organization with family co-operation; d) forest rights-based mortgage for credit. In cooperation with the local forestry administration, the rural credit sectors can provide loans to farmers through forest rights-based mortgage.

THE CAPACITY OF SMFEs TO INFLUENCE POLICIES AND INSTITUTIONS

What emerged from interviews with the managers of small and medium-sized forestry enterprises is that the capacity of SMFEs to influence directly policies and institutions is very small. Practically, the only effective way for SMFEs to express their ideas and complaints is through associations, i.e. indirectly. The functions of associations will be discussed in other paragraphs.

To sum up all these policies, the influence of Forestry Policies and Tenure Reform on SMFEs is the strongest and more direct. The main forestry policies, such as Environmental Policies and Ecological Programmes, Wood Saving and Substitution Policies, Restrictions on Disposable Wooden Chopsticks Manufacturers, Forest Harvest Quota Management, and Forestry Tenure Reform, not only affect the survival of SMFEs but also impact on their management costs and profits. On the other hand, trade policies are the second factor by importance affecting SMFEs, since a large portion of the products of SMFEs will eventually be supplied to export enterprises, and changes in trade policies will influence SMFEs' production. Compared with Macro Law and Policies for Promoting SMEs, policies on Promoting Non-public Forestry Enterprises are more important. The Property Law of the People's Republic of China, and the Resolution by the CCPCC and the State Council on Accelerating the Development of Forestry protect and encourage SMFEs'

development through finance or market solutions. In addition, the local government has been taking preferential policies to attract social funds to invest in SMFEs.

FINANCE AND MARKET ISSUES

Creating an enabling political-legal framework is necessary to the development of SMFEs. Financial services and market access are also critical for their start-up and development.

It has been estimated that 80 percent of SMFE financing around the world comes from owners, their friends, and families (Mayers, 2006). SMFEs in China are also confronted with severe financing obstacles, especially following the forestry tenure reform (Chen and Qin, 2008). The national input has been mainly channelled into infrastructure construction and key forestry programmes, which do not directly focus on SMFEs. Providers of financial services have been reluctant to offer services because of the real (or perceived) high risks involved in SMFE development. Perception of high risk stems from the remoteness and isolation of many SMFEs, the cumbersome political-legal frameworks in which they operate, and their limited possibilities for insurance against risk (collateral), in addition to poor understanding of forest product markets. Additionally, SMFEs themselves lack adequate direct financing channels, which also hinders their further development.

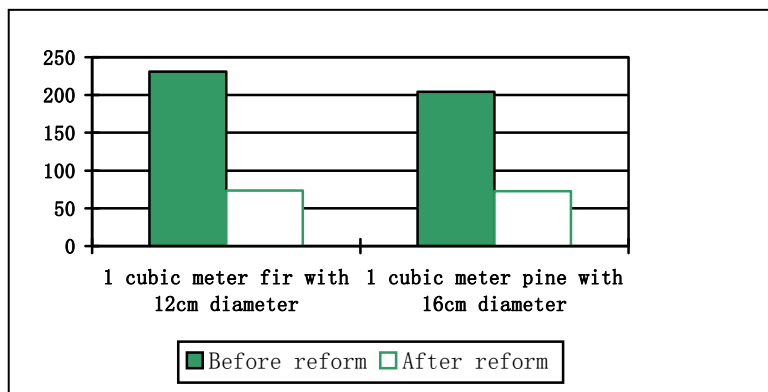
In order to overcome some of the challenges of the financial services' market, a number of preferential policies have been issued by the central and local governments to promote and encourage SMFEs. An overview is here provided covering aspects of the related policies and regulations such as taxation and investments, direct and indirect financing, forestry insurance, and access to the market.

TAXATION AND INVESTMENTS

As an economic tool, the government can redistribute resources and impact the development of the local economy and employment through taxation and fee adjustment. Forestry taxes and fees used to be a disincentive for farmers to develop timber plantations since they absorbed between 35 and 60 percent of the sale value of timber, depending on the locality (Hyde *et al.*, 2003). In addition, China's forestry tax policy burdens the poor disproportionately, and is unfair to the large public corporations, foreign investors and non-state owned small-to-medium groups (Liu, *et al.*, undated).

However, the Chinese government is currently reviewing its taxation and fee system, with the broad aim of adjusting taxes and eliminating fees that discourage the development of timber plantations and processing, while ensuring that this does not result in over-logging. The Central government undertook measures to reduce and finally eliminate agriculture fees and taxes in 2006 as a stimulus to rural development (Han, 2008). Meanwhile, the State Forestry Administration (SFA) modified its own policy on forest charges, and began consultations on merging all SFA-approved charges into one (greatly reduced) levy (Liu, *et al.* undated). Furthermore, many unauthorized local charges have been abolished as well. For example, the total taxation and fees of 1 m³ fir with 12 cm diameter in Jiangxi Province was RMB 230.94 Yuan before. Now it is only RMB 73.6 Yuan, showing a decrease of 68.13 percent (Wang, 2006) (Figure 5).

Figure 5. Forestry taxation and fee changes in Jiangxi Province

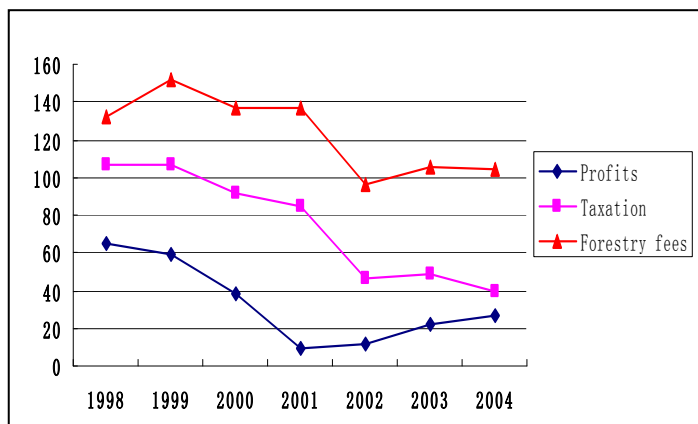


Source: Wang, 2006

An evaluation of the reform's impact was carried out in the southern collective forest area indicating that changes exerted a positive effect on the performance of SMFEs, since lower taxation and fees reduced the cost of logs and timber and enhanced the operational margin (Han, 2008). (Figure 6).

However, the reform's pace and degree varied between the different provinces. Some areas still suffer from a heavy taxation and fee burden. By way of example, in Chishui, Guizhou Province, the forestry tax and fees of bamboo products range between 22 and 27 percent of the price for tax assessment, much higher than in the case of agricultural products. Moreover, not all the favourable policies were enforced in grass-roots units and there are still unreasonable fees existing in terms of a number of compulsory industrial association fees (Wang *et al.*, 2006). Thus, SMFEs in different parts of China probably cannot compete with each other fairly enough, and some of them still struggle against high taxation and fee payment.

Figure 6. Profits, taxes and fees of forestry enterprises in Sanming City, Fujian Province



Source: Han, 2008

INDIRECT FINANCE FOR SMFES

The state-dominated financial sector is general reluctant to finance forestry activities because of the perceived long production cycles and high risks (Zhou Yanchang and Wang Binhui, 2001). Besides that, the high transaction costs due to information inequity also hamper the attempts of financial institutions to reach SMFES, which often rely on their own savings (Spantigati and Springfors, 2005).

In line with the general financial support regulated by the central government, more favourable credit policies have been issued recently to sustain and encourage the development of forestry. In 2005, the Ministry of Finance and the State Forestry Administration issued a new regulation on discounted loans for forestry (SFA, 2006). This regulation abolishes a series of restrictions on commercial banks and expands the loan targeting group as well as loan scope. Up to now, besides the Rural Credit Cooperatives, the China Development Bank, the Agricultural Bank of China and the Industrial Bank have taken part in financing SMFES in the form of policy loans and allocation of loan interest subsidies.

In practice, there are various effective financing innovations making credit accessible to SMFES, as in the Fujian Province, for instance.

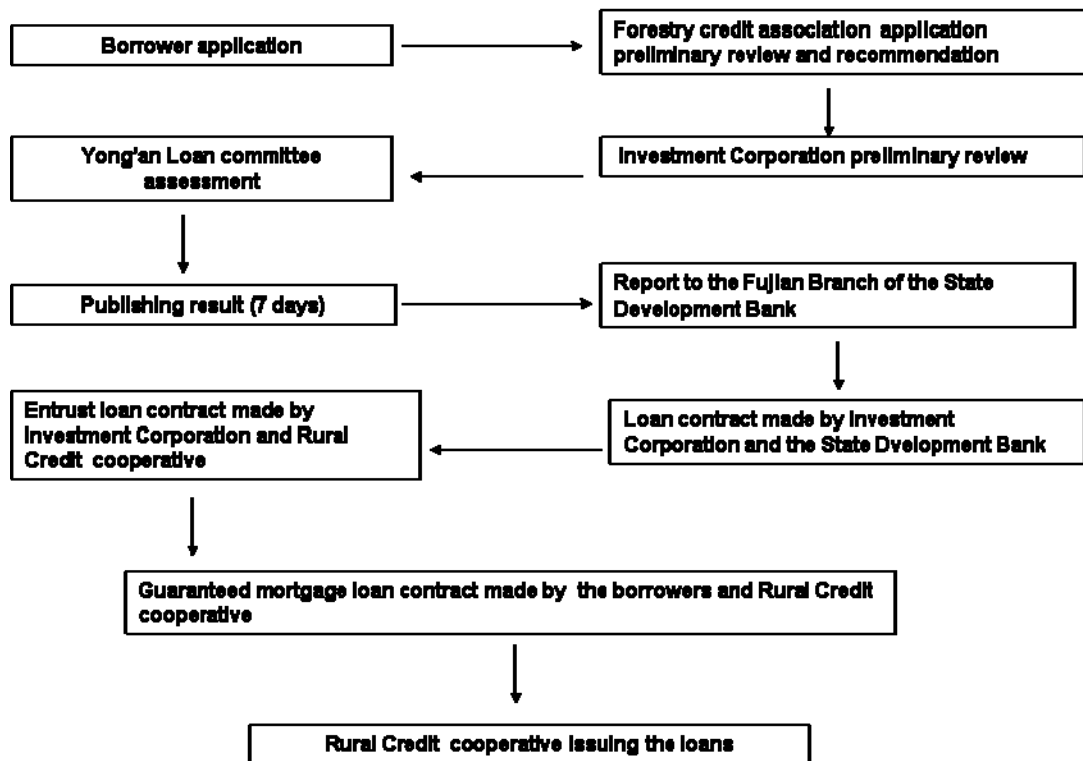
Firstly, loans from the State Development Bank can be divided into wholesale mode and direct loan mode. The former is first loaned to the State Development and Investment Corporation by the China Development Bank in the form of a wholesale loan contract. Then the State Development and Investment Corporation entrusts local credit cooperatives to release loans for SMFES and farmers. This type of loan guaranteed by the government receives the standard interest with repayment terms that can be extended to seven years at most. During past few years, 21 SMFES have obtained this type of loan for a total of RMB 44.8 million, and an average of 2 millions for each firm. On the other hand, direct loans are mainly aimed at the forestry dragon enterprises, and are independently loaned by the China Development Bank as guaranteed by property rights over forest land, the holding of shares or of other securities owned by the enterprises. In Yong'an two local enterprises have obtained low-interest loans at the standard rate with extended repayment terms up to 20 years.

Besides the policy loan, innovations in commercial loans are summarized as follows:

- mortgage loans with tenure certificate as collateral;
- petty loans;
- petty loans with mutual aid collateral.

All these categories of commercial loans are of the short-term type, with a duration not exceeding three years, and an interest between 40 and 50 percent above the standard interest rate.

Figure 7. Process flow of Loans for SMFEs and forestry farmers



Source: Wang, et al., 2008.

Furthermore, petty loan with interest subsidy was offered to farmers. In August 2006, the Fujian Forestry Bureau issued an RMB 2.1 million discounted loan in seven pilot counties with a 3 percent interest subsidy for forest plantation. However, it was questioned in terms of its sustainability and of whether the loan could be channelled into forestry production. In addition, the Ministry of Finance and the SFA issued a regulation on forestry loans with fiscal interest subsidy for two or three years in 2005, which stipulated the following (SFA, 2005):

- when the one-year loan interest offered by the financial institutions is between 3 and 5 percent, the central government will provide a interest subsidy of 1.5 percent;
- when the one-year loan interest offered by the financial institutions is between 5 and 7 percent, the central government will provide an interest subsidy of 2 percent;
- when the one-year loan interest offered by the financial institutions is beyond 7 percent, the central government will provide an interest subsidy of 3 percent.

Although significant progress has been made in this field, there is still a capital gap affecting the sustainable development of SMFEs. According to estimates, enterprises submitting formal loan applications only account for about 30 percent of the total number of enterprises requiring loans. Moreover, the majority of SMEs that easily receive loans are medium-sized enterprises or independent accounting units of relatively large scale and good performance. In actual fact, some of these firms do not urgently need a loan. By contrast, small-sized enterprises, especially private and family-run micro-enterprises, are in desperate need of money during business establishment activities and their development process, but they are not granted loans because of various factors (Wang, 2004).

Our field survey in Yong'an showed that 35 percent of the surveyed SMFEs were established thanks to self-accumulation. Among the SMEs surveyed, 65 percent, or 26 enterprises, took out bank loans; many of them feel that the formalities and applications for the loans are complicated; moreover, except for peasant household mutual aid collateral, all other loans require a mortgage or guarantee, and could be approved only if guaranteed by some large enterprises or jointly guaranteed by two enterprises. Farmers can borrow from rural credit cooperatives through mutual aid collateral. To be specific, three people can obtain a one-year 30 000 Yuan short-term loan, with the interest rate of 0.97 percent per month. The application is assessed by the credit cooperative and it may be approved within 15 days if the applicant is qualified.

Among those surveyed in Anji County, 17.7 percent of the SMFEs claimed that they never experience capital shortages; 29.4 percent said they often face such problems; and 41.2 percent said to be seldom affected by this problem. Most of the loans came from rural credit cooperatives, while 29.4 percent borrowed money from friends, relatives or non-financial institutions.

DIRECT FINANCING

Generally speaking, the registered capital of SMFEs is far smaller and owners would not like losing their shareholding. Hence, direct financing mechanisms such as Initial Public Offerings (IPOs) on the stock market used to be hardly possible to access for most Chinese SMFEs (Xie Zhizhong and Ye Feiguang, 2001). However, after the major amendment undergone by the Securities Law, the Small and Medium Enterprise Board was founded in the Shenzhen Stock Exchange in 2004, providing a new direct financing channel for SMFEs. By the end of 2007, there was only one timber and furniture firm accounting for 0.42 percent of the total issued shares, while to the present day there are three such firms that have issued stock, making up 1.25 percent of total shares (Shenzhen Stock Exchange, 2008). This indicates that more SMFEs can resort to this kind of direct financing to meet their capital shortage.

China's foreign direct investment preferential policies and the general opening of its economy, coupled with the supply of cheap wood and labour, are enlarging China's wood processing capacity. Foreign investments in forestry were concentrated in fast-growing and high-yielding plantations, bamboo and timber processing industries, accounting for 84.23 percent of the total investment quota in 2005, and they have been steadily on the rise for years. As to geographic distribution, over 90 percent of foreign

capitals were channelled into Fujian, Jiangsu, Inner Mongolia, Hubei and Guangxi Provinces (SFA, 2006).

Tax holidays are provided to attract foreign investments. More preferential terms, not governed by national laws, can be negotiated by local governments on a case-by-case basis including:

- VAT exemption if enterprises use certain grades of wood for production;
- local income taxes are sometimes returned to companies; percentages vary by region (AF&PA, 2004).

In addition to that, corporate bonds could represent another direct financing source for SMFEs in the future, as the long-term nature of forestry is attractive for funds matching long-term liability. The current difficulties for SMFEs to issue corporate bonds because of harsh restrictions may change thanks to the amendment of the relevant regulations and laws. The Chinese government issued the Opinions of the State Council on Promoting the Reform, Opening and Steady Growth of Capital Markets (the “Opinions”) on 31 January 2004 to reiterate its determination to “take the initiative in developing the bond market”. The Company Law and the Securities Law, both amended in 2005, also made changes to provisions relating to corporate bonds issuance, creating a desirable legislative environment for the continued development of the corporate bond market. Considering the ongoing legislation and governmental policies, China will deregulate a number of restrictions on issuing bonds especially for certain small and medium-sized enterprises (Zhou, 2006).

All in all, more innovative approaches and emerging ecosystem service payments such as carbon sequestration should also be taken into consideration for financing the development of SMFEs.

FOREST INSURANCE

A forest insurance contract may be signed by the owners or possessors of forest, or by a person authorized to be the user of the forest. Forest insurance affords the opportunity to insure a forest growing on land that has been identified on the basis of land readjustment and entered into the land register; it is also possible to insure the timber obtained from the forest. This ought to be categorized into property insurance. Forest insurance compensates for damage arising from:

- forest fire
- storms
- snow
- hail
- cold damage
- forest pests
- diseases

In general, forestry involves long production periods and uncertainty; as a result, forest insurance differs from ordinary commercial insurance. In China, the government has intervened in this field; however, in parallel with the development of the market

economy, especially after China entered the WTO, administrative interventions are becoming less common.

Nowadays, there are four main forms of forest insurance in China (2008) based on which the assets may be:

- primarily insured by the People's Insurance Company (Group) of China (PICC) with the Forestry Department as an agency. (Guilin, Guangxi Province; Tuitong County, Hunan Province);
 - co-insured by the PICC and the Forestry Department (Shaowu, Fujian Province);
 - insured by the Forestry Department (Benxi, Liaoning Province);
- insured by rural forest insurance cooperatives (Sichuan Province; Shandong Province).

Table 7. Changes in forest insurance in Fujian Province since 1985

Stage Project	1985—2003	From 2003 to the present day
Insurers	Proportionally covered by the Forestry Department (40%) and the insurance company (60%).	Entirely covered by the insurance company (100%).
Insurance rate	2‰ — 2.5‰	Ecological public forest and state-owned commercial forest: 4‰, others: 5‰ ; Discounted rate for no indemnity.
Premium	0.4 — 1 Yuan/acre Paid by the insurance applicant independently.	Jointly paid by the government (20%) and the insurance applicant (80%).
Insurance amount	200 — 400 Yuan/acre.	400 Yuan/acre.
Government function	Getting involved in the insurance, collecting premium and compensating according to certain proportions.	Subsidizing the insurance applicants and setting up forest insurance risk reserve funds.

Source: Xu, 2008

Following the tenure reform, some small and medium-sized forest enterprises obtained their own forest or forestland but are more vulnerable to forestry natural damage caused by fire, allied perils, flooding and ice storms, etc., which have disastrous direct effects on the timber supply and production activities. Hence, taking out a forest insurance could strengthen the risk-resistance capability of SMFEs. In addition, concerning the mortgage loan with tenure certificate as collateral in Yong'an, financial institutions would undertake higher risks compared with ordinary commercial insurance, and are therefore reluctant to loan money. Forest insurance helps to alleviate the problem and reduce capital shortages for SMFEs.

Despite twenty years of practice and development, forest insurance in China has maintained its original features, and a wide range of existing constraints need to be tackled in the manners described below.

Table 8. Constraints and consequences of forest insurance development in China

Reasons or constraints	Consequences
High insurance rates and limited coverage	Lack of demand for forest insurance
Diverse risks	Insufficient supply of forest insurance
Different interests by the government and insurance companies	Ineffective intervention by the government

Source: Xu, 2008

IMPROVING SMFES' ACCESS TO MARKETS

The central government of China has made considerable efforts to strengthen the existing capacities of SMFES by facilitating access to the market and technical information.

First of all, SMEs' social service networks have been funded to facilitate SMEs' access to information, stimulate farmer-company partnerships, and facilitate access to trade fairs and a better articulation among technical, business development and financial services. During the period from 2003 to 2006, accumulated aid funds from the central government reached 43.26 million Yuan, supporting 254 service units in 29 pilot areas of 13 cities, to provide services for 77 000 small-scale start-up. Moreover, in 2006, various organizations provided SMEs free face-to-face and remote network training exceeding 6.8 million hours.

In addition, the government has actively supported small and medium-sized forest enterprises to help them introduce advanced technologies and production processes and equipment, promoting their cooperation with large-sized enterprises.

Moreover, increased cooperation with foreign governments and international organizations has been carried out through exhibitions and sales at home and abroad. China has held successfully three editions of the Small and Medium-sized Enterprises Fair, four editions of the Technological Exchange and Exhibition for SMEs and four editions of APEC's Forum of Alliance of SMEs.

However, in the case of business development service providers, the lack of awareness of the unique scale and nature of SMFES constrains their willingness and capability to develop appropriate services. In addition, it is now still rare to find a specialized SMFE support scheme either embedded in government forest services or operating independently in the market, which may result in the inefficient implementation of policies and legislation.

ASSOCIATIONS FOR SMFES IN CHINA

DEFINITION AND FUNCTIONS

SMEs' associations are defined as "any formal or informal grouping of small and medium enterprise at the firm level with an articulated common purpose" (Macqueen, 2004), while with regard to SMFEs, their associations are embedded in social and commercial networks that affect critical business inputs, and their competitiveness depends to a large extent on the quality of these linkages (Altenburg, 2007).

Generally speaking, associations offset SMFEs' scale disadvantages, cut costs, allow surpluses to be used in strategic upgrading, and strengthen bargaining power to shape the policy environment. They also help to reduce poverty in the following manners: by securing resource rights for local communities, empowering local entrepreneurship, fostering the creation of corporate capital as SMFEs strengthen their voices in local associations, engendering greater local environmental accountability and maintaining cultural preferences and diversity (Duncan Macqueen, 2008). Furthermore, working with trusted intermediaries to support the specific training needs identified by associations is fundamental to SMFE support (Macqueen, Figueiredo *et al.* 2006; Macqueen, Vermeulen *et al.* 2005).

CURRENT STATUS OF CHINESE FORESTRY ASSOCIATIONS

Independent associations are a recent phenomenon in China. Despite possessing the institutional structure to support them, active rural associations, for instance, were largely non-existent during the 1980s and 1990s; supporting their development is now key to the central government's agricultural and rural development strategy (CCICED, 2004). Further downstream, China's manufacturing associations have traditionally been quasi-governmental organizations whose primary function is to follow the mandates of higher-level government organizations rather than providing services to member organizations (Sun and Chen, 2003).

Here follows a list of the major associations in the Chinese forestry sector and their main functions:

- China National Forest Industry Association: a) investigating the information on forestry industry development; b) making the regulations and rules for the forestry industry; c) promoting cooperation among forestry enterprises; and d) giving policy suggestions to the Forestry Department.
- China Bamboo Industry Association: a) helping the government to make plans and policies for bamboo forest resource management; b) establishing industry quality standards; c) helping forestry enterprises to develop bamboo food and establishing the related quality standards; d) investigating bamboo industry developments and providing policy suggestions or guidance on marketing, trade, etc..

- China National Forestry Product Industry Association: a) providing guidance to forestry enterprises to develop the forestry product industry (wood processing, plywood, forestry chemical products, etc.); b) helping the government to manage the forestry product industry and establishing different kinds of linkages among forestry enterprises.

No findings emerged on the existence of a federation devoted solely to SMFEs at the national level. SMFEs are usually affiliated with other actors, other sectors, and other market chains in associations embracing a wide range of activities. However, in different locations there are SMFEs associations related to specific wood products such as furniture, bamboo, timber processing. In addition, these associations, although classified as non-profit organizations, are mostly semi-governmental organizations. With their management appointment and agendas driven by the government, these associations are far from being real membership-based and member-driven civil societies. They can be useful sources of information for the industry, but their potential role in promoting SMFE development remains to be explored (Sun and Chen, 2003).

Box 1. The semi-finished bamboo product processing association in Hongtian County, Fujian Province

Since its establishment, the semi-finished bamboo product processing association of Hongtian County has been providing considerable technical training on bamboo processing and helping farmers process semi-finished bamboo products. At the same time, it set a unified purchase price of Moso bamboo at about 13 Yuan/foot for reference, which helped avoid fierce competition among different processors. Furthermore, the sustained and fair development of the Moso bamboo processing industry ensures a steady supply of bamboo, thereby protecting farmers.

The association operates according to the pattern of "Company & Association & Household", and helped Hengya Bamboo Corporation Ltd. building up a 20 000 acreage of large-diameter bamboo base, and benefiting all the companies involved as well as the farmers.

Source: Wang et al., 2008

Geographical and institutional factors have hindered the growth of industry associations in China. To date, forest associations have been affected by four main institutional problems which need to be addressed (Weyerhaeuser *et al.*, 2006):

- lack of representation: associations primarily represent state-owned enterprises;
- skewed distribution: most associations are found in sectors related to the WTO or forestry industry;
- operational ambiguity: the role and function of associations remains ambiguous;
- bureaucracy: consensus is emerging that government-run associations are not well suited to the demands of the marketplace.

Our field survey found that in Yong'an, there are ten main associations whose membership includes our interviewees. Twenty-three point eight percent of the enterprises who have become the members of some association found it necessary to do that. The bridging role that associations may play between the government and industry to improve regulatory efficiency is gaining increasing agency recognition, both in China and more specifically in Fujian. Associations may provide a feedback mechanism whereby the information they disseminate upwards to government agencies would help to inform policy design and adjustment. In addition, associations conduce to grouping of supply, mobilization of technical support (capacity building, marketing support, etc.) to the

benefit of their members, negotiations with buyer markets, acquiring market information and better understanding of policies.

Table 9. Forestry associations attended by local SMFEs in Yong'an

Associations	Membership fee (Yuan/year)	Functions or Activities
Yong'an Bamboo Incentive core Association	10 000	Provision of information and technology exchange
Yong'an Timber Processing Association	1 000	Negotiations with the government
Yong'an Young Entrepreneurs' Association	600; 2 000 - 3 000	Provision of management training, exchanging information
County Processing Enterprises Association		Provision of technological training and participation in bargaining collecting price
Yong'an Bamboo Plywood Association	Flexible, according to equipment output of previous year	Provision of information and technology exchange, negotiations with the government and organization of surveys
Yong'an Phyllostachys Association	--	Provision of technological training and participation in negotiations with collective markets
Yong'an Bamboo Associations	1 000 - 2 000	Negotiations with the government and organization of surveys
Trade Union	500	Information exchange and knowledge about relevant policies
Yong'an Furniture Association	2 000	Provision of information
Xiaotao Bamboo and Timber Processing Association	---	Communication for industry information

By contrast, 8.3 percent of the interviewees thought it totally unnecessary to participate in an association; over 80 percent of the enterprises did not express their views on associations. Forty-three percent of the total interviewees would not like to take part in any association. According to the survey, heavy dependence on external support (poor self-funding capacity), few meetings and activities, weak market connectedness and negotiation capacities with the government undermine the effectiveness of forestry associations.

In conclusion, although industry associations – and particularly associations for SMFEs – have historically not played a major role in SME development in Fujian or in greater China, throughout China there is a growing recognition of the benefits of associations as an interface between members and markets, and members and the government. There is a huge need for further developing and strengthening the associations serving SMFEs.

Table 10. Strengths and weaknesses of forestry associations

Strengths	Weaknesses
<ul style="list-style-type: none">• Information sharing• Act as bridge between the government and enterprises• Find way out of difficulties; e.g., get permits from the local administration	<ul style="list-style-type: none">• Commitment to management, but neglecting service• Poor self-funding capacity• Weak negotiation capacity with the government• Weak market connectedness• Few and irregular meeting and activities

LABOUR ISSUES

In 2005, the total population of China reached 1 307.56 million (excluding the Hong Kong Special Administrative Region, the Macao Special Administrative Region and Taiwan Province). The total urban and rural employed population reached 758.25 million, of which the urban employed population was 273.31 million, and the rural employed population 484.94 million. The annual increase in new jobs amounts to 10 million. Over 150 million workers migrate from rural to urban areas for employment. Small and medium-sized forest enterprises will be an important component of China's transition to an urban, industrial society. In some provinces, where forestry plays a more important role in the local economies, small and medium-sized forestry enterprises have significant potential as a means of creating huge employment opportunities and stimulating rural economic growth.

Generally speaking, small and medium-sized forest enterprises are almost all labour-intensive firms, requiring substantial labour inputs. By way of example, the proportion of the labour costs paid by small and medium-scale forest enterprises in Anji, Zhejiang Province, as anticipated, is 34.62 percent in the chair manufacturing industry, 25.02 percent in the saw lumber manufacturing industry and 8.45 percent in the bamboo flooring industry (see Table 11). These percentages are indicative of the great importance of labour. Small and medium-sized forest enterprises enjoy significant labour cost advantages, and access to low labour costs has been a key driving force for many woodworking sectors in China.

Table 11. Wooden product cost-profit proportions in Anji, Zhejiang Province (%)

	Raw material	Labour cost	Capital cost	Depreciation fee	Other inputs	Taxes and fees	Profit
Chair manufacturing	26.84	25.23	0.1	0.8	13	6.9	27.12
Saw lumber manufacturing	41.67	16.16	0.19	1.6	4.2	0.77	34.55
Bamboo flooring	64.20	7.73	0.31	2.56	14.17	2.56	8.5

Source: Luo and Dong, 2008.

The Chinese government has paid great attention to exploiting its advantage in terms of labour resources, and actively developed labour-intensive industries and enterprises which enjoy relative advantages and whose products are in great demand on the market, particularly private and self-employed businesses, and small and enterprises (SMEs) with big employment capacity.

The Labour Contract Law of China came into effect on 1 January 2008, to provide the necessary protection and stability to employees and employers. The law has clarified the

method of calculating economic compensations paid to workers, introduced minimum wages, and amended legal provisions concerning training, trade unions, termination of labour contract and contract mandates, etc.. However, changes in macro laws and regulations did not significantly influence ongoing SMFEs' operations in the short term. Our survey showed that both SFME employees and employers are unfamiliar with the labour contract law. Among the 108 enterprises surveyed, 43 do not resort to employment contracts, i.e. 40 percent. With regard to those who do resort to contracts, the latter have a duration which does not exceed three years. The numerous staff employed tends to be mobile, and can move easily to other jobs or terminate the contract as the employer enterprise modifies production levels or as new employment opportunities appear elsewhere.

In addition, the government has actively supported development training opportunities for the employees of small and medium-sized enterprises, by setting up various specialized technical service organizations, providing special funds and offering professional training opportunities. Although the forestry industry is generally labour-intensive, technological innovation aimed at increasing worker productivity require greater investment in on-the-job training and skill development. The main labour training facilities and centres for technological development are provided by local associations and the forestry administration. These centres are responsible for industrial apprenticeships and vocational courses, specific professional training, technical assistance and technological agreements with companies concerning the development of new products. According to reports, the Yong'an forestry professional training centre has offered more than twenty short-term training courses, benefiting over 8 000 people, issuing 8 000 copies of reading material and 800 VCDs in 2005 (Wang *et al.*, 2008). An in-depth study of the dynamics of the Chinese SMFE sector (Guangping and West, 2004) found a decreasing trend in the employment provided by forestry enterprises (from 2.8 million in 1996 to 1.3 million in 2002), while the share of employment attributed to forestry enterprises increased during the same period (from 20 to 26 percent). This means that there is a higher number of skilled workers in forestry enterprises and higher contributions of on-the-job training to the output of forestry enterprises.

Furthermore, per-capita wages in China have been rising at the average rate of 12 percent in the last four consecutive years (National Bureau of Statistics, 2008). Fifty-four percent of the SMFEs interviewed attributed great importance to labour costs, and stated that they are severely affected by the sharp wage increases which have taken place. SMFEs in China will probably be unable to draw from an inexhaustible supply of cheap labour in the long term (Han, 2008. Unpublished).

KEY OPPORTUNITIES AND THREATS IN THE SMFE SECTOR

Since 2007, China's economic development underwent significant changes, such as the RMB appreciation, the enforcement of the new Labour Contract Law, great increases in the prices of raw materials and energy, and, in particular, the recent slowdown in economic growth caused by the current global economic crisis, which have added great pressure on the development of SMFEs in China.

On the other hand, with the Opinions by the Chinese Communist Party Central Committee and State Council on Advancing Collective Forestry Tenure and Regulation Reform in an All-Round Way introduced on 8 June 2008, SMFEs currently enjoy higher opportunities to be helped by adequate financing, the socialized service system, looser AACs, more accessible and abundant material resources, all contributing to the creation of an enabling environment favourable to SMFE's development.

THREATS IN THE SMFE SECTOR

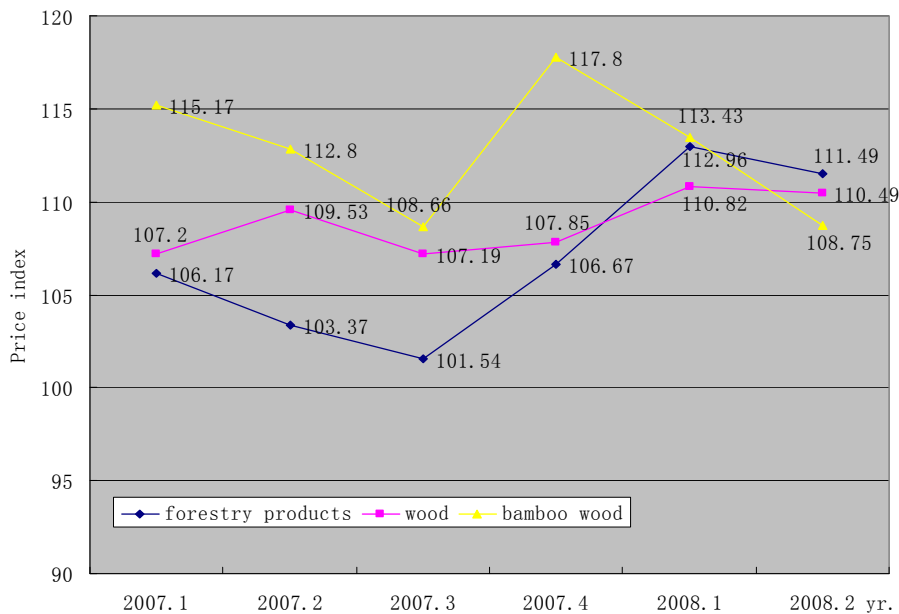
Price-hike of raw materials

As shown in Figure 8, since 2007 the prices of the main forestry products in China have risen greatly, thus directly increasing the production costs borne by SMFEs. In comparison with the prices recorded at the end of 2006, the prices of forestry products in China at the end of the second quarter of 2008 rose by 49.71 percent, the price of wood rose by 66.20 percent, the price of bamboo wood by 105.13 percent. Being positioned at the lower level of the industrial chain and owing to their weak bargaining power, SMFEs were unable fully add increased production costs to the prices of the final products when the prices of material hiked, thus eroding their profits and even causing a number of enterprises to go bankrupt.

Labour force shortage

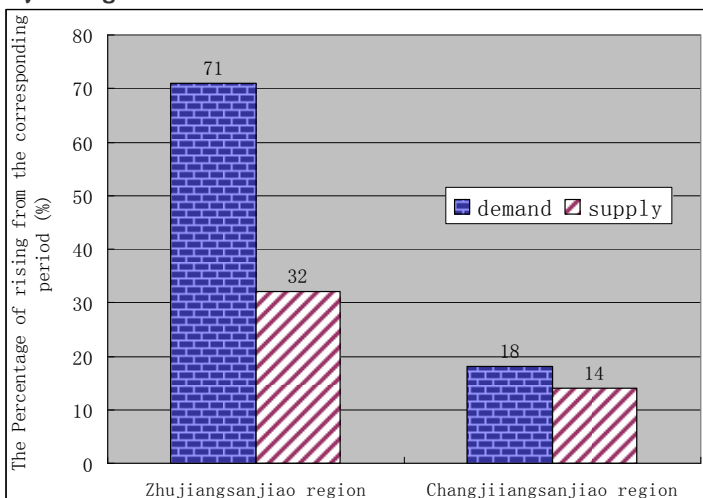
By the end of second quarter of 2008, the price of the labour force employed by private enterprises in the whole country increased by 29 percent compared with the same period in 2007; labour costs in Zhejiang Province rose by 34.70 percent, and in Fujian Province rose by 27.40 percent. The reasons behind the rise in labour costs are the Minimum Wages system formulated by New Labour Contract Law and labour force shortages. As shown in Figure 9, during the fourth quarter of 2007, labour force demand in the Changjiangsanjiaozhou Region increased by 71 percent compared with the same period a year before, while labour force supply increased by 32 percent. The same thing occurred in the Zhujiangsanjiaozhou Region, where labour force demand increased by 18 percent, while labour force supply by 14 percent. This indicates that SMFEs will have to bear higher costs while the level of production remains the same.

Figure 8. Price index for the main forestry products



Source: National Bureau of Statistics of China

Figure 9. Labour demand and supply in the Changjiangsanjiao Region and Zhujiangsanjiao Region



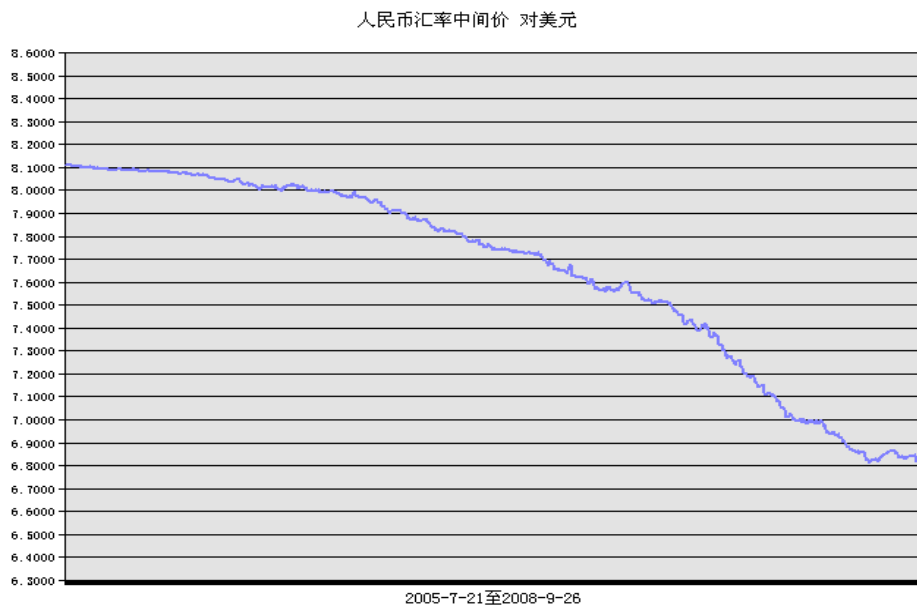
Source: www. news. china.com

RMB appreciation

Since 2005, the RMB has come under upward pressure, and its appreciation is evident. On 21 July 2005, the average exchange rate of the RMB against the US\$ was 8.11. On

26 September 2008, this value was 6.82. For three years, the RMB underwent an appreciation of 18.92 percent. However, direct influence by the RMB on SMFEs' development is rather limited since overseas markets are not targeted by most of SMFEs. Nevertheless, since large-sized forestry enterprises or the leading forestry enterprises are the main customers for the products of SMFEs, and their main markets are overseas, RMB appreciation is equal to the rising export price of forestry products, which ends up by eroding the competitiveness of exported forestry products and by reducing exports. Eventually, demand for the forestry products of SMFEs will be decreasing.

Figure 10. Exchange rate of the RMB against the US\$



Source: The People's Bank of China

Higher tariff duties on imported logs

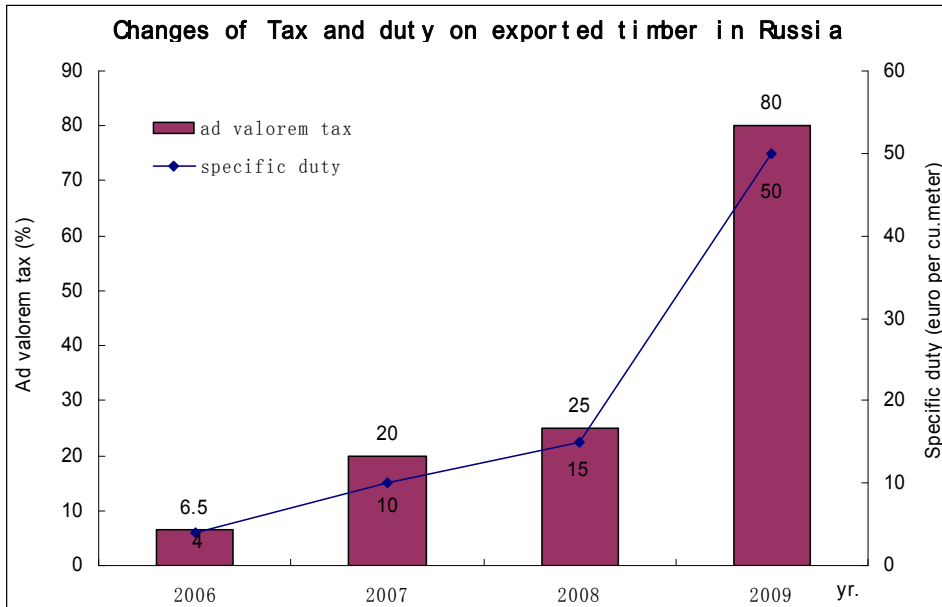
Imported timber accounts for a large section of the Chinese timber market. From 2002 to 2006, the total import of round wood and equivalent round wood was about 35.51–51.50 percent of the total timber consumption. Imported timber from Russia accounts for about 70 percent of the total. In 2006, China imported 21.83 million cubic meters of logs from Russia, accounting for 67.9 percent of the total. As a result, timber supply in the Chinese domestic market will be greatly influenced by imported timber, especially that coming from Russia.

Export taxes on logs in Russia are rising. Export tariff duties on logs from Russia are 6.5 percent and were no less than 4 euro/m³ on 1 January 2006, much lower than in the case of Brazil, Canada, America and other log-exporting countries. On 5 February 2007 Law no. 75, amending Law no. 795 of 23 December 2006, regulating several types of crude woods, was passed by the Russian government. It provides for a significant increase in export taxes on fir, pine, birch and other crude woods. In detail, the *ad valorem* duty was adjusted to 20 percent and the specific duty was adjusted to 10 euro/m³ from 1 July

2007, the *ad valorem* duty became 25 percent and the specific duty 15 euro/m³ from 1 April 2008, and the *ad valorem* duty rose to 80 percent and the specific duty to 50 euro/m³ as of 2009.

Higher tariff duties on imported logs translate into a reduction in the scale of log imports, increasing log demand, and leading, as a result, to a higher cost of logs in domestic market. Hence, in the long run, SMFEs would end up having to cope with log-scarcity while bearing the higher costs of raw materials.

Figure 11. Changes in tariff duties on logs imported from Russia



The financial crisis

Most of the world is facing up to the financial crisis started by the Sub-loans Crisis in America, and a sustainable financial crisis is changing into an economic crisis marked by a slowdown in economic growth and a considerable fall in consumption, as the export of forestry products, especially wood furniture exports, are decreasing. For the time being, no concrete data is available to illustrate the extent of the influence of the financial crisis on forestry product exports; however, our study reveals that hundreds of large-sized forestry enterprises in Zhejiang Province are losing clout. Because large-sized forestry enterprises are the main buyers of the products of SMFEs, a fall in the exports of large-sized forestry enterprises results in a fall in the demand for forestry products from SMFEs, an increasing number of which, especially in the Zhejiang Province, are going out of business or bankrupt. Hence, the influence of the financial crisis on SMFEs is significant.

Challenges peculiar to SMFEs

- Tenure and resource access is complex. SMFEs require extensive areas of land over which tenure and resource rights may be poorly defined or disputed.

Long-term sustainability depends very much on the security with which local enterprises can defend their resource rights in competition with other land users.

- Ecological sustainability requires complex technical expertise. The sustainable management of natural forests requires a detailed understanding of natural ecology and regeneration based on the application of complicated inventory, growth and yield modelling, extraction planning and reduced impact logging techniques.
- Commercial profitability is dependent on complex markets. Natural forest product sales require the ability to find markets for multiple species (both timber and NTFPs) whose prices depend on species, quality grading and known processing information. Again, this requires a high degree of technical competence and often investments in processing technology.
- Patterns of consumption are complex. Forest products (excepting some NTFPs and fuelwood) are not generally consumed on a day-to-day basis. For consumers, their purchase often involves significant lifestyle choices. Design and marketing are therefore particularly important for many SMFEs, which again require technical competence and financial investments.
- A 2008 questionnaire-based survey focusing on the main constraints affecting SMFE growth in Yongan City, Fujian Province, indicates that 67.39 percent of SMFEs are under the increasing pressure of price hikes in raw materials and energy, 54.35 percent of SMFEs are under the pressure of rising labour costs, 36.96 percent of SMFEs suffer from fund shortage. It may be concluded that these factors can be considered as the main threats in the SMFE sector.

Main opportunities in the SMFE sector

With the Opinions on Advancing Collective Forestry Tenure and Regulation Reform in an All-round Way, the following factors are expected to be useful to SMFE development, namely financing, a socialized service system, looser AACs, more accessible and abundant material resources, etc..

THE FORESTRY TENURE AND REGULATION REFORM

The new phase in collective forest tenure reform started in 2003. On 8 June 2008, the Opinions by the Chinese Communist Party Central Committee and State Council on Advancing Collective Forestry Tenure and Regulation Reform in an All-Round Way were introduced; they established that forestry land should be tenured to forestry farmers for around five years and that the property rights of forestry farmers be protected by the law.

This policy is expected to boost SMFE development as follows:

- Clear ownership establishment, operation and management promotion, transfer regulations, and tax and fee reductions are helpful to foster and develop forestry productivity, increasing the volume of collective forestry, eventually directly or indirectly ensuring material supply for SMFEs' production activities.

- SMFEs or Forestry farmers could arrange logging and hauling independently as the AAC regulation improves and timber harvest examination becomes simpler, obtaining wood or bamboo wood more easily.
- A public finance system will be established by the government to the benefit of collective development in order to subsidize afforestation and reforestation, forestry tending, forestry protection, pesticides, etc.. The forestation fund (taken from timber sales) will be reduced continuously and infrastructure construction will be invested in, thus ensuring abundant material supply at lower prices.
- A finance and investment reform will be carried out to develop forestry credit products, improve subsidiary policies for forestry loans, strongly expand forestry petty loans, improve the forestry credit guarantee system with special reference to forestry ownership mortgage loans. The forestry insurance system is encouraged to reduce the losses of SMFEs and forest farmers in the case of forest disasters. It is expected that following the implementation of the finance and investment reform, SFMEs will no longer be affected by capital shortages, building their capacity to cope with business risks.
- Greater efforts should be made to build a forestry service system. A number of special forestry associations and forestry economic cooperation will be supported to provide services such as policy advice, information communication, science-technology popularization, self-discipline and cooperation, etc..

PERSPECTIVES

In general, SMFEs represent a promising option for community poverty reduction and sustainable development in forestry as well as in the economy. This report has reviewed the current status of SMFEs in China, the effects of the main implications in SMFE support programmes and the constraints and opportunities in this sector.

SMFE development requires not only a favourable environment, including laws and policies, financial incentives and industrial associations, but also an increase in competitiveness.

CREATING AN ENABLING LEGISLATIVE AND POLICY ENVIRONMENT FOR SMFEs

In China governments can play a critical role in establishing an environment favourable to SMFEs; hence the central government and all the related departments need to:

- Improve laws and regulations regarding SMFEs by ensuring an equitable positioning and treatment for SMFEs by law, and by making good use of fiscal funds supporting SMFEs.
- Persevere in sustainable forestry tenure and regulation policies by securing tenure ownership, improving the AAC regulation and the tenure transaction system, simplifying the bureaucratic registration and operational procedures related to SMFEs, enhancing value adding opportunities and promoting wood saving and substitution.
- Establish a public finance system and improve the forestry tax and fee system by encouraging all kinds of social capital flows into the forestry sector and by providing a series of necessary preferential tax regulations for SMFEs.
- Develop financing channels and forestry insurance for SMFEs by increasing the number of financial institutions involved in indirect finance apart from the state, updating direct financing mechanisms such as IPOs or cooperation bonds, etc., expanding forestry insurance through to greater involvement and less risk.
- Facilitate SMFE access to the market and to technical information by adjusting trade policies to build SMFEs' capacity in facing the impact of globalisation.
- Set up a stronger monitoring and governance system with reference to industry standards, environmental pollution and employment.

IMPROVING THE CAPACITY OF INDUSTRIAL ASSOCIATIONS

Associations have helped to offset SMFEs' scale disadvantages, strengthen their bargaining power to shape the policy environment, and provide some forms of training. However, some associations are still semi-government organizations. They can be useful sources of information for the industry, but their potential role in promoting SMFE development

remains to be explored. Besides that, cooperation with large companies or other SMFEs is also necessary for future development.

Some of the actions to be undertaken are:

- increasing SMFEs' access to information on national legislation and funding opportunities;
- facilitating information flows along supply chains and promoting trade fairs for specialty timber and NTFPs;
- upgrading the capacities of service providers to identify and respond to the specific technical and entrepreneurial needs of SMFEs;
- promoting communication networks among SMFEs, providers of technical, business development and financial services, and other actors along the supply chain;
- identifying and strengthening core competencies and establishing partnerships with other service providers and businesses that can provide complementary services;
- promoting market-based approaches to the delivery of technical and business development services by designing and implementing effective cost/benefit sharing mechanisms with SMFEs.

8.3 ENHANCING SMFE COMPETITIVENESS AND ENTERPRISE

COOPERATION

Creating an enabling political-legal framework is a necessary, although not sufficient condition for SMFE development. Most SMFEs must overcome a series of internal weaknesses that limit their competitiveness by:

- seeking out new business opportunities and acquiring the capacities to initiate new business models;
- forming mutually beneficial partnerships with other enterprises along the supply chain, including processors and traders;
- expanding cooperation with large companies and forging strategic business partnerships;
- investing in relevant associations that unite SMFEs for increased economies of scale in processing and marketing, and greater bargaining power;
- encouraging entrepreneurship in local communities;
- referring to research, education and training; paying more attention to increasing productivity and efficiency against up-going material and labour cost.

If we accept that forestry can and should do more for sustainable development and poverty reduction, then we must do more than look for answers solely in large or micro-scale groups. Trends in forest resource scarcity, ownership, demand for forest products, governance, and forest productivity are opening up unprecedented opportunities for SMFEs. And overcoming the challenges facing SMFE development requires concerted action by the various stakeholders.

Data collection and the political and economic analysis of SMFEs in China are so far very limited. Much more work is needed to better provide an enabling environment in terms of laws and policies that promote legal access to the resource base, provide incentives

for sound forest management, support value addition and promote the formation of human, social, physical and financial capital for effective forest and business management (Donovan, 2007).

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ANNEX I

POLICIES AND REGULATIONS RELATED TO SMALL AND MEDIUM-SIZED FOREST ENTERPRISES

ID	LEGAL AUTHORITY IN ENGLISH	LEGAL AUTHORITY IN CHINESE
G1	Small and Medium-sized Enterprises Promotion Law of the People's Republic of China (2003)	(2003)
G2	Several Opinions of the State Council on Encouraging, Supporting and Guiding the Development of the Individual, Private and Non-Public Ownership Economy (Guo Fa [2005] No.3)	[2005]3
G3	The 11 th Five-year Plan of the Development of National Economy and Society	
G3	MOF and NDRC "Notice on the Management of Special Funds for SME Development" (Cai Qi [2006] No. 226)	[2006]226
G4	The Securities Law of the People's Republic of China (2004)	(2004)
G5	The Company Law of the People's Republic of China (2006)	(2006)
G6	The Real Right Law of the People's Republic of China (2007)	(2007)
G7	Notice of "Several Opinions of National Development and Reform Commission on Promoting the Development of Industrial Clusters" (Fa Gai Qi Ye[2007] No.2897)	[2007]2897
G8	Policy notification of "Policies of National Development and Reform Commission and 12 other ministries and commissions on Promotion to small and medium enterprises in technological innovation" (Fa Gai Qi Ye [2007] No. 2797)	12[2007]2797
G9	MOF Notice on Management of central subsidies special funds for local pollution-alleviation production (Cai Jian [2004] No. 343)	[2004]343
G10	National Development and Reform Commission notification on the pollution reduction and energy-saving policy to the small and medium enterprises (Fa Gai Qi Ye [2007] No. 3251)	[2007]3251
F2	CCPCC and the State Council Resolution on Accelerating the Development of the Forestry Industry (Zhong Fa [2003] No. 9)	[2003]9
F3	CCPCC and the State Council Decision on Promoting the Extensive Reform to the System of Collective Forestry Tenure Rights (2008)	(2008)
F4	MOF and SAT Notice on VAT Rebate Rate Adjustment (Cai Shui [2003] No. 222)	[2003]222

F5	MOF and SAT Notice on VAT Rebate Rate Adjustment, Cai Shui [2007], No.90	[2007]90
F6	The State Council Opinions on accelerating the lumber saving and alternative timber Study (2005)	(2005)
F7	SFA Notification on the Control and management of production and circulation of throwaway wooden chopsticks (2005)	(2005)
F8	SFA Regulations on Use Right Transfer of Forest, Forest Tree and Forest Land (SFA, 2004)	(2004)

Source: www.acfic.org.cn/cenweb/portal/user/anon/page/acfic_CMSItemInfoPage.page?metainfold=ABC00000000000021221

ANNEX 2

FINANCE POLICIES AND REGULATIONS RELATED TO SMFES

ID	LEGAL AUTHORITY IN ENGLISH	LEGAL AUTHORITY IN CHINESE
G1	MOF and SAT Circular on Certain Policy Issues on VAT, Cai Shui Zi [1994] No. 60	[1994]60
G2	MOF and SAT Circular on VAT Exemption for Products Produced with Integrated Utilization of Resources, Cai Shui Zi [1995] No. 44	[1995]44
G3	MOF and SAT Circular on Continuing with the Preferential VAT Treatment for Products Produced with Integrated Utilization of Resources, Cai Shui Zi [1996] No. 20	[1996]20
G4	MOF and SAT Circular on VAT Treatment for Products Produced with Integrated Utilization of Resources, Cai Shui [2001] No. 198	[2001]198
G5	MOF and SAT Supplementary Circular on VAT Treatment for Products Produced with Integrated Utilization of Resources, Cai Shui [2004] No. 25	[2004]25
G6	MOF and SAT Circular on Continuing VAT Refund for Dies Products, Cai Shui [1998] No. 139	[1998]139
G7	Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	
G8	Rules for the Implementation of the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises	
G9	Provisions of the State Council on the Encouragement of Foreign Investment, Guo Fa [1986] No. 95	[1986]95
G10	SAT Circular on Granting Income Tax Deduction to FIEs for Technology Development Expenditure, Guo Shui Fa [1999] No. 173	[1999]173
G11	SAT Trial Administrative Measures on Purchase of Domestic Equipment by Projects with Foreign Investment, Guo Shui Fa [1999] No. 171	[1999]171
G12	MOF and SAT Circular on the Interim Measures of Corporate Income Tax Deduction for Domestically Produced Equipment Purchased for Technology Upgrading Purpose, Cai Shui [1999] No. 290	[1999]290
G13	MOF and SAT Circular on Corporate Income Tax Credits for Purchase of Domestic Equipment by Foreign-Invested Enterprises and Foreign Enterprises, Cai Shui [2000] No. 49	[2000]49
G14	SAT Administrative Measures on Corporate Income Tax Credits for Purchase of Domestic Equipment by FIEs and Foreign Enterprises, Cai Shui [2000] No.90	[2000]90
G15	MOF and SAT Circular on Several Preferential Corporate Income Tax Policies, Cai Shui Zi [1994] No.001	[1994] 001
G16	MOF and SAT Circular on Certain Decisions Related to Corporate Income Tax Policies, Cai Shui Zi [1994] No.009	[1994]009
G17	People's Bank of China on the further strengthening of the market, cost-effective, the credit support of the SME	[2002]224

	credit guidance, Yin Fa[2002] No.224	
G18	China Banking Regulatory Commission Guiding Opinions on the Small Enterprise Loan Business of Banks, Yin Jian Fa [2005] No.54	[2005]54
G19	Interim Measures for the Administration of Start-up Investment Enterprises [2006]	(2006)
G20	Provisional Regulation of SME Credit Guarantee System and Management Methods of Credit Guarantees for SMEs, Guo Jing Wei [1999] No.540	[1999]540
G21	State Administration of Taxation Notification on the business tax exemption to the credit trust institutions, security agencies for SMEs , Guo shui fa [2001] No. 37	[2001]37
G22	MOF Provisional Measures on the risk management of financing institutions to small and medium enterprises , Cai Jin [2001] No. 77	[2001]77
G23	NDRC Notification on Establishment and alteration of inter-provincial or larger credit trust institutions for SMEs , Fa Gai Qi Ye [2005], No.1257	[2005]1257
G24	NDRC on the strengthening the construction of the credit guarantee system for SMEs, Guo Ban [2006] No.90	[2006]90
G25	NETC Several Opinions on the construction of the credit guarantee system for SMEs., Guo Jing Wei Zhong Xiao Qi [2001] No. 358	[2001]358
G26	Legislative Affairs Office of the State Council And NDRC Notification on Eliminating the Restrictions on non-public economic development [2005]	(2005)
G27	MOF Circular on Administrative Measures on Funds Earmarked for International Market Exploitation of Small- and Medium-sized Enterprises, Cai Qi [2000] No.467	[2000]467
G28	MOFTEC (MOFCOM) Circular on Implementing Rules of the Administrative Measures on Funds Earmarked for International Market Exploitation of Small- and Medium-sized Enterprises, Ji Cai Fa [2001] No.270	[2001]270
G29	MOF Circular on Interim Administrative Measures of the Special Fund for Establishment of the Service System for Small- and Medium-sized Enterprises, Cai Jian [2004] No.124	[2004]124
G30	MOF Notification on Management of central subsidies special funds for construction of service platform for SMEs , Cai Jian [2004] No.317	[2004]317
F1	Notice on Income Tax Deduction for Interest Income and Others for Foreign Companies Who Do Not Have Business Presence in China, Guo Fa [2000] No. 37	[2000]37
F2	MOF and SAT Circular on Certain Issues Regarding Forestry Tax Policy, Cai Shui [2001] No. 171	[2001]171
F3	Resolution by the CCPCC and State Council on Accelerating the Development of the Forestry Industry, Zhong Fa [2003] No..9	[2003]9
F4	MOF Notification on Tax cancellation to other Special Agricultural products Except Tobaccos , Cai Shui [2004] No.120	[2004]120
F5	MOF and SAT Circular on the VAT Favourable Policy of the Comprehensively-used Product Produced and Processed with the Three Residues and Small Firewood Materials as Raw Materials, Cai Shui [2001] No.72	[2001]72
F6	MOF and NDRC Circular on Releasing the Catalogue of Nationwide Administrative Charges and those of the Central Government Departments and Institutions in	2004[2005]6

	2004 , Cai Zong [2005] No.6	
F7	MOF and SFA Regulation on Fund Management of Forestry Loan with Fiscal Interest Subsidy Cai Nong [2005] No.45	[2005]45
F8	SFA Regulations Registration of the Forest Resource Assets as Mortgage (Tentative)	

ANNEX 3

POLICIES AND REGULATIONS RELATED TO SMFES

ID	LEGAL AUTHORITY IN ENGLISH	LEGAL AUTHORITY IN CHINESE
G1	Agricultural Law of the People's Republic of China (2003)	(2003)
G2	MOF Circular on the Interim Administrative Measures of the Fund for Specialized Cooperatives of Farmers, Cai Nong [2004] No. 87	[2004]87
G3		[2007]36

ANNEX 4

POLICIES AND REGULATIONS RELATED TO SMFES ON LABOUR ISSUES

ID	LEGAL AUTHORITY IN ENGLISH	LEGAL AUTHORITY IN CHINESE
G1	Fund for Subsidizing the Training of the Rural Migrant Labor Force: MOF And Moa Circular an Administrative Measures of the Fund for Subsidizing the Training of the Rural Migrant Labor Force, Cai Nong [2004] No. 38	[2004]38
G2	Labour Contract Law of the People's Republic of China. National People's Congress [2008].	

Forest Connect

Reducing poverty by linking small and medium forest enterprises with national forest programmes, markets and service providers

Forest Connect is an international alliance dedicated to tackling the isolation of small forest enterprises. Established in late 2007, its aims are to avoid deforestation and reduce poverty by better linking sustainable small forest enterprises to each other, to markets, to service providers and to policy processes such as National Forest Programmes (nfps).

It currently involves partner institutions in 12 countries: Burkina Faso, China, Ethiopia, Ghana, Guatemala, Guyana, Laos, Malawi, Mali, Mozambique, Nepal and recently also the Democratic Republic of Congo plus a broader network of supporters in > 60 countries linked by an international social networking site.

The Forest Connect alliance is co-managed by the Natural Resources Group within the International Institute for Environment and Development (IIED) and the Community-Based Forest Enterprise Development programme (CBED) of the Food and Agriculture Organization of the United Nations (FAO).

For more information on Forest Connect, pls contact:

Sophie Grouwels

Forestry Officer, Community-based forest enterprise development (CBED)
Forestry Policy Service, FOEP
Food and Agriculture Organization of the United Nations, FAO
Tel (39)06 570 55299 - Fax (39) 06 570 55514
Email: Sophie.Grouwels@fao.org



Webpage small-scale forest based enterprises:

<http://www.fao.org/forestry/site/25491/en>

Forest Connect: <http://www.fao.org/forestry/site/42297/en>

International social networking site: <http://forestconnect.ning.com>

