Norway’s Forest Trust Fund

Introduction

About 80% of the forest in Norway is in private ownership, largely consisting of farmers who use forestry to supplement their farm income, and only around 1% is protected by the State. There are about 125,000 forest holdings in Norway averaging around 50 hectares in size. State and community forests amount to 12% of the productive forest area, while 4% is owned by private companies. The variety of small-scale forestry creates good conditions for environmental biodiversity. As an example, the average size felling area in Norway is only 1.4 hectares.

Since the first forest inventory in 1925, the annual increment of Norway's forests has been larger than the harvest. As a result, the volume of the growing stock has more than doubled since 1925. Forests now cover some 29% of the Norwegian land area (TBFRA, 2000). Most of the plantations are located in the coastal districts of western and northern Norway, the majority of which were established in the 1960s and 1970s.

Guidelines for strategic planning of forestry at the municipality level were introduced in 1993, at which time a wide variety of forestry and environmental aspects were integrated into the planning stage to reflect an increasing environmental consciousness. Forestry activities are generally supported by providing owners with tax advantages, but all financial support schemes were revised in 1994 to improve the preservation of biological diversity. The financial support schemes now favour environmentally sound investments, and all support schemes require that forest owners take environmental value into consideration.

The economic importance of forestry declined during the 1990s, as a result of low timber prices and moderate harvesting. However, in some rural areas forestry is still important economically, and the export value of timber is considerable, corresponding to 4.3% of total exports in 1999. During the same year, the net increment (annual increment minus roundwood removals and calculated natural losses) in Norwegian forests was 11.6 million m3, or 1.7% of the total volume.

Current forest policy includes certain requirements for reforestation, economic support schemes, research and information programs. The Forestry and Forest Protection Act, established 1965, prohibits the cutting of growing forest, and provides for State funding of planting and other silviculture activities. The average support for planting amounts to around 30% of total costs, but support can vary from nothing up to some 80% of project costs.

The Forestry and Forest Protection Act is the most important regulation in terms of forest practices in Norway. The overall goal of the Act is to “promote forest production, afforestation and protection of forest land while allowing for the functions of forests as sources of recreation, major landscape features, living environments for plants and animals, and as hunting and fishing grounds” (Royal Norwegian Ministry of Agriculture, 1994).

The Forest Trust Fund

Since 1932, when the first Forest Protection Act was passed, Norwegian forest owners have been required to place a certain share of the gross income received from forestry sales into a forest trust fund. When timber is sold, 5% to 25% of the value is deposited into a trust fund for a given forest property. Each forest owner is free to set the percentage from year to year according to his or her financial situation, investment plans, etc., but permission is required to set it below 8%.

The money deposited into the Forest Trust Fund must be reinvested in the forest area from where it originated, typically in long-term investments such as forest revegetation measures. Partly as a result of these intensive measures, along with an active and goal-oriented forest policy, the annual growth of Norwegian forests has more than doubled during this century.

Essentially, the Forest Trust Fund affects how smaller private forest holdings in Norway are managed through tax incentives for private landowners. The influence of the Fund is limited to holdings with an average annual harvesting potential below 3,000 m^3 in the most important forest areas. Its tax incentives are perhaps the single most important taxation scheme for non-improved private forest (NIPF) owners in Norway.

Why did Norway develop this Instrument?

The forest situation in Norway at the beginning of this century was considered serious. In 1908, a national forest policy decision authorised community boards were to place a forest tax levy on forest harvesting. Initially the policy authorisation did not lead to extensive results, so it was replaced by a new obligatory silvicultural tax levy included in a new forestry act of 1932. This levy amounted to 1% of gross timber sales. The original objective of this silvicultural tax levy was to ensure that needed silvicultural work was conducted. This tax was the precursor of today’s Forest Trust Fund.

How does this Mechanism Operate?

In principle, the fund system requires that the buyer of the wood automatically deduct a pre-decided percentage from the sale receipts.

The forest owner makes the decision on the percentage to be deducted, with the ministry deciding on the upper and lower boundaries somewhere between 4-40% (8%-25% prior to 2003). The buyer makes the deposit into the trust fund account of the forest owner at a local bank (regulated to be a bank account or with a financial institution approved by the Ministry). This money is then assigned to the property, not the owner. The relevant account is controlled and administered by the County Governor, with the municipal Forest Service having rights of management .

In general, interest earned from the Fund is divided between the County Governor (<20%, presently 18%), the municipal Forest Service, the local Forest Owners Association and the Ministry of Agriculture (<25%, presently 18%). A small amount is used for administration of the Fund (<5%), but in general terms the Regulations state that the "interests earned should serve forestry, the forest sector and the promotion of forestry".

Claims on the deposited Forest Trust Fund are considered to be a right that follows the forest concerned and as such may not be separated from the forest through transfer of ownership, mortgage, claim enforcement or in other ways.

How are investment decisions made?

Investments are covered by regulations set out by the forest authorities, and include planting, forest road construction, forest management planning, participation in professional extension courses, boundary establishment, management measures to support special environmental values in the forest etc. Investments must be documented, and the associated work conducted according to professional standards, in order to receive payments from the forest trust account.

By regulation, the Forest Trust Fund is to be used to promote silviculture, forest production and forest operation to the advantage of the forest from where the wood is supplied, or to the advantage of other forest owned by the forest owner in the same municipality. On approval from the municipality the Fund may be transferred to forest belonging to the forest owner in other municipalities. If the municipality denies approval of such a transfer, the decision may be appealed to the County Agricultural Board if the transfer is related to forest within the county, and to the Ministry when the transfer is related to forest in another county.

The interest is mainly used to cover administrative expenses and measures that benefit Norwegian forestry at municipal and county levels. In 1995, for example, some 45% of the major long-term investments in silviculture was financed by the forest trust fund.

What happens to interest earned on the Fund?

According to Section 48 of the Norwegian Forest and Forest Protection Act (1997), accrued interests from the Fund are to be used to administer the Forest Trust Fund System and to reimburse possible losses related to the collection of the Trust fund payments. The act also specifies that to the extent that the interests are not needed for these purposes, they may be used on joint measures and other purposes to the benefit of forestry.

Forest landowners, then, do not receive the interest earned from their trust fund. According to the Forestry and Forest Protection Act, the interest is for the "common benefit of Norwegian forestry." The money is distributed to forest authorities at national and regional levels and to the forest owners' associations where it is used according to guidelines developed by advisory boards at the different levels. The interest earned from the Fund is an important source of funding for informational activities, extension services, study tours, and equipment rentals. The Norwegian Forest Society and Women in Forestry are two of the organizations supported by this fund.

How does this system affect tax liabilities?

Income tax

Forest owners pay income tax on their average net income for the last 5 years. The net annual result is calculated as income minus costs. The most important income is usually from timber sales. Harvesting, hauling, and silvicultural treatments are all costs. Forest roads are treated differently according to their quality and expected durability. A 5-year mean was originally used to reduce the effects of progressive income tax for owners with irregular harvests, a factor that is less significant after the tax reform of 1992. The system results in a delay in tax payments, which lowers the forest owners' actual tax rate. Special regulations apply when buying or selling a forest holding, which can also inflict on the actual tax payments (NLH, 1998).

Property tax

Property tax of a forest holding is paid according to the value of the forest "as a durable source of income if in appropriate use", according to a system defined by tax authorities. The average annual harvesting volume is calculated according to monitored volume stock and age class distribution. This average is then used to calculate net value according to prices and costs, which is then capitalized (NLH, 1998).

Inheritance tax

When somebody is buying a farm from a close relative, he or she has to pay inheritance tax. Special regulations apply to tax rates according to value, but the tax is paid both on the estate and on a gift, which is often a part of the agreement for such transactions. With regards to estate tax, the value is calculated according to a continuing use for agriculture and forestry production.

Why does the mechanism work?

The trust fund is effective because the forest owner does not pay income tax on the amount deposited in the fund. When money is withdrawn from the fund and applied to long-term investments, such as silviculture and road construction, a significant proportion of the money can still be deducted from annual income taxes. Depending on the owners' marginal tax rate, the tax effect may result in a 50% to 60% reduction of the total cost of the activity (Oistad et al., 1992).

What is required for this mechanism to work?

While not an incentive for afforestation per se, the Norwegian Forest Trust Fund has elements that could encourage landowners to undertake land conversion. In particular, the notion of deferring tax to encourage planting may have merit, and the ability to write off capital expenditures would help landowners to overcome the initial barriers to participation. Moreover, such a system would have a tendency to promote good forest management.

In addition, the Fund is able to reduce costs and risks by aggregating regional contributions to a scale that could only be achieved by a large public entity or a large financial corporation. This may be particularly attractive to smaller landholders, who would otherwise have little impact on regional structural conditions.

The Fund could also allow landowners to achieve other economies of scale through the concentration of forestry specialists whose expertise is made available to them. Presumably, such a Fund could be managed in a way that would achieve other economies of scale in areas such as input pricing and access to markets.

What basic elements are needed?

In order for a fund similar to Norway's Forest Trust Fund to work in other countries, a number of elements of the fund would likely have to change.

Emphasis on financial returns

For many landowners the case will still need to be made for the suitability, viability and desirability of agro-forestry. In Canada, for example, discussions with landowners have shown that there exists a cultural bias against forestry by many farmers, and while up-front tax breaks may be an incentive to those who were already interested in forestry, they are unlikely, in and of themselves, to convince other landowners to plant trees.

The Norwegian Fund was originally designed to tax forestry activities that were already ongoing, not to encourage landowners to plant trees.

Focus on fast-growing plantations

Current research by the CFS indicates that plantations based on clonal trials of fast-growing species are likely to be the only types of plantations that will provide the returns needed to incent both private landowners and investors to participate, and this is likely true in other countries. Any fund established for afforestation, then, will need to be flexible in terms of the tree species under consideration.

Formation of a forestry credit and funding system

For such a Fund to be set up in any country, some sort of financial distribution system would need to be established, particularly if support for forestry cooperatives or the distribution of loans are also to be implemented. Such a system may be feasible through an expansion of existing governmental forestry structures. Alternatively, a fund and credit system set up to run through existing financial systems, and based on government criteria, such as exists in Norway, might function better. Such financial institutions already have the ability to process loans, and the infrastructure to deal with the dynamics of regional demands.

Biography

Bergseng, E., 2004, Evaluating Financing of Forestry in Europe (EFFE): Country report – Norway, Unpublished

Center for International Forestry Research, 2000, Norwegian Forest and Forest Protection Act of May 21, 1965 with amendments, latest by L 10.01.1997 from March 1, 1997, (http://www.cifor.cgiar.org/fsfm/documents/Travel.htm#menu)

Lindstad, Berit Hauger. 2002. A comparative study of forestry in Finland, Norway, Sweden, and the United States, with special emphasis on policy measures for nonindustrial private forests in Norway and the United States. Gen. Tech. Rep. PNW-GTR-538. Portland, OR: U.S. Department of Agriculture, Forest Service, Pacific Northwest Research Station.

Oistad, K.; Eid, J.; Ellefson, P.V. 1992. Norway's forest trust fund: innovative support for nonindustrial private forests. Journal of Forestry. 90(6): 17-20.

Royal Ministry of the Environment, 2002, Norway's third national communication under the Framework Convention on Climate Change