

# Conclusions and recommendations of the National Audit Office

## Private forestry subsidies and compensations – Promoting wood production and safeguarding biodiversity

The objective of the audit was to ensure the cost-efficiency of the direct state aid and compensation schemes and tax subsidies targeted at private forest owners. The audit focused primarily on the objectives of promoting wood production and safeguarding biodiversity. It was also assessed how the different funding schemes function as a whole in relation to these two main objectives. The audit produces information to support forestry and environmental policymaking in the current situation, where forests are subject to various expectations and pressures.

The audit assessed the three forms of private forestry funding that are the largest in euro terms: the fixed-term scheme for financing sustainable forestry (Kemera), the Forest Biodiversity Programme for Southern Finland (METSÖ), and the forest deduction and other tax subsidies. In recent years, direct state aid has amounted to approximately EUR 70–100 million and indirect tax subsidies to approximated EUR 170 million a year.

## Supporting wood production requires stronger justifications

The state has supported wood production in private forests for almost a hundred years. The Kemera subsidy scheme, which falls within the administrative sector of the Ministry of Agriculture and Forestry, has hardly changed during its 25-year history even though the operating environment has undergone significant changes. The Kemera subsidies fall within state aid that must be reported to the European Commission.

There are well-functioning markets for wood. Nevertheless, the primary objective set for the Kemera scheme has been to promote wood production, and around 80%–90% of the appropriations have been used for this purpose. Subsidies are granted for types of work that do not yield short-term returns to the forest owner. The subsidies have been justified by the argument that otherwise private landowners do not necessarily want to invest in the management of their forest assets, as the proceeds from the forest will not be realised for a long time.

The information obtained in the audit is contradictory as regards the extent to which wood production subsidies encourage forest owners and act as leverage for private investments. The effectiveness of Kemera subsidies has not been monitored in this respect. Better evidence would therefore be needed of the incentive effects of supporting wood production. This is also suggested by the indicative comparison made in the audit with Sweden, where similar subsidies for wood production were abandoned in the 1990s without any significant impact on the total area of tended seedling stands in private forests.

Despite the Kemera subsidies, neglect in the management of seedling stands and young stands has increased in Finland, and the Finnish Forest Centre has found a number of shortcomings in early clearing. According to the inspections carried out by the Finnish Forest Centre, about a quarter of the area of the sites that have been granted Kemera subsidies for the tending of seedling stands and young stands has been deficiently tended in view of the terms and conditions of the subsidies.

## The effects of tax subsidies are not known nor taken into account when decisions on direct state aid for wood production are made

Private forestry is granted significant tax subsidies. One of the most important tax subsidies is the forest deduction, which is allocated to a relatively small group of forest owners. According to the Ministry of Finance's report on tax subsidies, the forest deduction amounts to approximately EUR 70 million per year, but only part of it can be considered actual tax subsidy. In 2008 the right to claim deduction was raised. At the same time, the right to claim deduction was extended to apply to all forest properties of the same forest owner instead of just the property that had been purchased. The aim of the extension of the right was to encourage forest owners to increase both wood sales and their forest assets.

Like the Kemera subsidies, the forest deduction and partly also other tax subsidies aim to promote the production and supply of wood. The impacts or incentive effects of individual tax subsidies have not been studied, nor have the total impacts of different tax subsidies. Neither has the compatibility of different tax subsidies with the direct Kemera subsidies for sustainable forestry and their combined impact been examined. The combination of different subsidies increases the risk that public subsidies will supersede private investments while also undermining the justification for public subsidies.

## The effectiveness of the environmental conditions of subsidies is not monitored

The EU Guidelines on State aid in the agricultural and forestry sectors have highlighted particularly the creation of positive environmental impacts and the prevention of environmental harm. One of the main objectives of the Kemera scheme has from the outset been to safeguard the biodiversity of forests. Since then, environmental objectives and justifications have been added to the scheme, but the types of work subsidised or their funding priorities have hardly changed.

It has been considered that biodiversity can be safeguarded primarily by means of the Kemera environmental subsidies and nature management projects. These subsidies are part of the METSO programme. In addition, individual environmental conditions concerning biodiversity and water protection, for example, have been included in the criteria for the Kemera financing of wood

production. However, the results obtained through the conditions or the effectiveness of the conditions have not been monitored.

Wood production subsidies and their granting conditions have not been fully in line with the biodiversity objective. This has led to inconsistency in the use of state funds. For example, subsidies have been available at the same time both for ditch network maintenance and supplementary drainage, on the one hand, and for preventing and remedying the damage to biodiversity and waters caused by previous drainage, on the other.

## Forest biodiversity protection has been of high quality, but its cost-efficiency can be improved

The funding of the METSO programme (2008–2025) consists of the fixed-term Kemera environmental subsidies and nature management subsidies and of the environmental protection and nature management appropriations granted by the Ministry of the Environment. The environmental administration is about to achieve its overall objective of establishing 96,000 hectares of new protected areas. However, there is a shortage of private forests that meet the protection criteria, especially in Southern Finland. It is uncertain whether the cumulative objective of 82 000 hectares of protected forests set for the Kemera subsidies will be achieved.

The effectiveness of the METSO programme is monitored regularly. According to the assessments made, the ecological quality of the implementation is good. However, the cost-efficiency and effectiveness of the programme could be further improved. This would require identifying the best sites for safeguarding biodiversity. For example, Kemera's 10-year environmental subsidies have been used increasingly for supporting small sites, although larger size and better connectivity often produce greater biodiversity. In addition, public administration has no information on whether there are such commercial forests on state-owned land in southernmost Finland that would be more significant and profitable protection sites than the private METSO sites.

Studies have shown that landowners' willingness to participate in environmental protection increases if the protection activities are voluntary and of a fixed term. However, fixed-term protection agreements involve a clear risk, as the expiration of the agreement may cause the state to lose the investment it has already made in the protection. Nor is it appropriate to apply a fixed term to the protection of long-term or permanent ecological structural features that are of key importance to biodiversity.

The compensation model of the METSO programme is not based on the size of the biodiversity benefit obtained through the protection but on the forest owner's estimated loss of income.

## The subsidy and compensation schemes lack overall management

The three ministries targeted by the audit manage, steer and monitor the private forestry subsidies and compensations separately from each other. The private forestry subsidies and compensations form a complex funding package, the transparency of which is poor as regards environmental administration. Furthermore, clearly more funding than necessary has been allocated in the state budget in recent years to support wood production. At the same time, the appropriation for forest nature management has been running out.

The cost-efficiency and impacts of private forestry subsidies and compensations are not monitored uniformly. The main challenge is to develop methods to assess and monitor the total impacts or cross-effects of different forms of funding more efficiently.

## Recommendations of the National Audit Office

1. The Ministry of Agriculture and Forestry and the Ministry of Finance should assess whether the direct state aid and tax subsidies granted to wood production are up to date as well as their total impacts and benefits in relation to their costs.
2. The Ministry of Agriculture and Forestry, the Ministry of the Environment and the Ministry of Finance should develop the allocation, conditions and monitoring of the subsidies and compensations granted to private forestry in a coordinated manner so that the subsidies and compensations overall serve as many of the objectives set for private forests as possible.
3. The Ministry of Agriculture and Forestry should strengthen the monitoring of the effectiveness of the different types of work in wood production, including the monitoring of their impacts on biodiversity and other environmental impacts.
4. The Ministry of Agriculture and Forestry and the Ministry of the Environment should together explore ways to develop the cost-efficiency and effectiveness of the protection of forest biodiversity in Southern Finland. A study should be conducted at least on the appropriateness of fixed-term protection agreements, performance-based compensation models built on conservation benefits and the cost-efficiency of the protection of private forests in relation to the protection of state-owned forests.