

## **Due diligence and implementation of the “Illegal Timber” regulation 995/2010**

This commentary has been prepared in order to assist implementation of Regulation 995/2010<sup>1</sup> (referred to herein as the Illegal Timber regulation), particularly because it does not yet seem evident that due diligence systems which underpin that regulation will reflect the nature, quantity and sources of supply of the wood-based products which are already being placed on the EU market and which are likely to comprise Illegal Timber.

The apparent failure of the amended Lacey Act to reduce US' imports of what is probably Illegal Timber suggests that the quality and quantity of resources devoted to implementation of the Illegal Timber regulation should differ substantially from those deployed to implement the amended Lacey Act.<sup>2</sup>

The monitoring of EU member states' monthly imports of wood-based products covered by the regulation will (after a time lag of a few months) clearly indicate any changes in patterns of trade. There is no proposal for Competent Authorities to carry out such an analysis. (In order to cross-check trends in member states' reported imports, it would be possible to monitor the monthly export statistics of a number of the countries which supply much of the quantity of wood-based products which member states import.<sup>3</sup>)

*The following charts<sup>4</sup> and text refer solely to the imports of EU-27 member states from outside the EU and exclude imports from EFTA, Australia, Canada, New Zealand and the USA.*

The charts focus on imports from *tropical* Africa, Brazil, China, Eastern Europe, Indonesia, Malaysia and Russia. This is because these countries and regions (with Chile) account for a large majority of the wood-based products which are imported into the EU and because, if one accepts the literature,<sup>5</sup> these countries and regions<sup>6</sup> are likely to include those which supply the great majority of the Illegal Timber which is imported into the EU.

It is very important for readers to bear in mind that, although forests supply a substantial proportion (by volume or weight) of the sawn wood, plywood and mouldings & joinery which is imported into the EU from Brazil, plantations are the source of most of the wood-based products which is supplied from Brazil.<sup>7</sup> Although Brazil's bilateral trade statistics do not – but should (if their value is to be maximised) – distinguish between plantation-grown hardwood (most notably eucalyptus) and tropical timber, estimates can be made.

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<sup>1</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:295:0023:0034:EN:PDF>

<sup>2</sup> US' imports of products likely to comprise Illegal Timber from Brazil's tropical forest, China, Indonesia, Malaysia and elsewhere increased during 2010 having, during last decade, declined less and for a shorter period than low risk alternatives from Brazil's plantations sector, Canada and the EU.

<sup>3</sup> Those exporting countries include Chile, China, Ghana, Indonesia, Japan, Malaysia, South Korea, Taiwan, Thailand and the USA – as well as each EU member state – see Footnote 2 <http://www.globaltimber.org.uk/RWEvolume.htm>

<sup>4</sup> The charts are based on monthly CN8 statistics from Eurostat <http://epp.eurostat.ec.europa.eu/newxtweb/> Estimates of roundwood equivalent volume has been derived from weight or volume as indicated in <http://www.globaltimber.org.uk/RWEvolume.htm>

<sup>5</sup> Misleadingly, almost all published analyses of trade in Illegal Timber assume that all exports of wood-based products from one country to every other country always have exactly the same Illegal Timber content, irrespective of, for example, whether this is FSC-certified or from long and legally established plantations, or whether traders in the importing country have robust policies to exclude Illegal Timber. It is simple to construct a set of matrices by product, destination, year and type of illegality, from which reasonable estimates of a country's bilateral trade in Illegal Timber can be derived. These should of course be refined iteratively with key stakeholders. In contrast, as the Chatham House report of July 2010 suggests, wood balance modelling can not generate credible estimates of the Illegal Timber content in trade.

<sup>6</sup> Eastern Europe tends not to be included in that literature.

<sup>7</sup> A number of observers question whether one should assume that these plantations have been established, or are operating, in compliance with the law, even if they are FSC-certified.

Chart 1 – Wood-based products (trends 2000-2010)

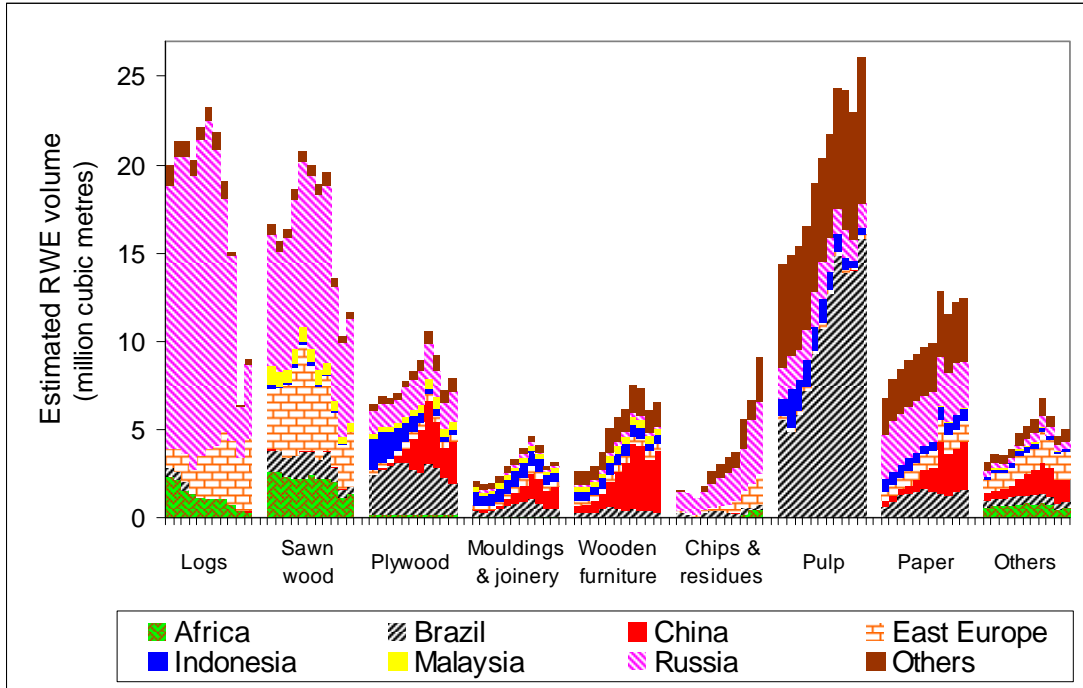


Chart 1 illustrates the substantial changes in quantity and source of supply which took place during the last 11 years. Russia and, to a lesser extent, Africa and Eastern Europe dominated in respect of the logs and sawn wood. Africa no longer exports large volumes of logs (except illegally to China, perhaps for export after combination with other wood).

The only other products from Africa which are now supplied in substantial quantity are wood chips (from rubber and eucalyptus plantations) and veneer.

Pulp and, to a lesser extent, plywood and paper comprise the great majority of the products imported from Brazil.

China has only been very significant as a supplier (of plywood, mouldings & joinery, wooden furniture and paper – also wooden ornaments and picture frames) for a few years.<sup>8</sup>

Imports from Eastern Europe primarily comprise logs, sawn wood, chips & residues, panels other than plywood and paper. The quantity of logs and chips is on a rising trend.

Indonesia remains relevant primarily as a supplier of plywood, mouldings & joinery, wooden furniture, pulp, and paper – despite well-established allusions to illegality and unsustainability.

Sawn wood, plywood, mouldings & joinery and (predominantly rubberwood) wooden furniture account for almost all imports from Malaysia. The great majority derives from rubberwood plantations or MTCC-certified forest in Peninsular Malaysia – usually without chain of custody.

Russia is the leading supplier of logs, sawn wood, and wood chips.<sup>9</sup> It is also a leading supplier of plywood and paper – much of both being FSC-certified.

Chile, (in recent years) Uruguay and, to a lesser extent, South Africa also supply substantial quantities of Paper Sector products.

<sup>8</sup> Low “overhead” structures (including levels of legal compliance in relation to wood production locally and imports of wood-based raw material) which would not be acceptable in the EU, and state support (not only a “managed” exchange rate), will have contributed to this surge in market share. Legality and sustainability arbitrage will also have contributed - EU-based investors and importers exploiting (China’s) advantages until (like now) constrained.

<sup>9</sup> The steep reduction in imports of logs and the rise in imports of wood chips is attributable in part to increased tariffs on exports of logs.

Imports during 2010 (as the most recent year) rather than previous years should of course be the focus of those who seek to implement the Illegal Timber regulation.

Chart 2 – Timber Sector<sup>10</sup> products (2010, by member state)

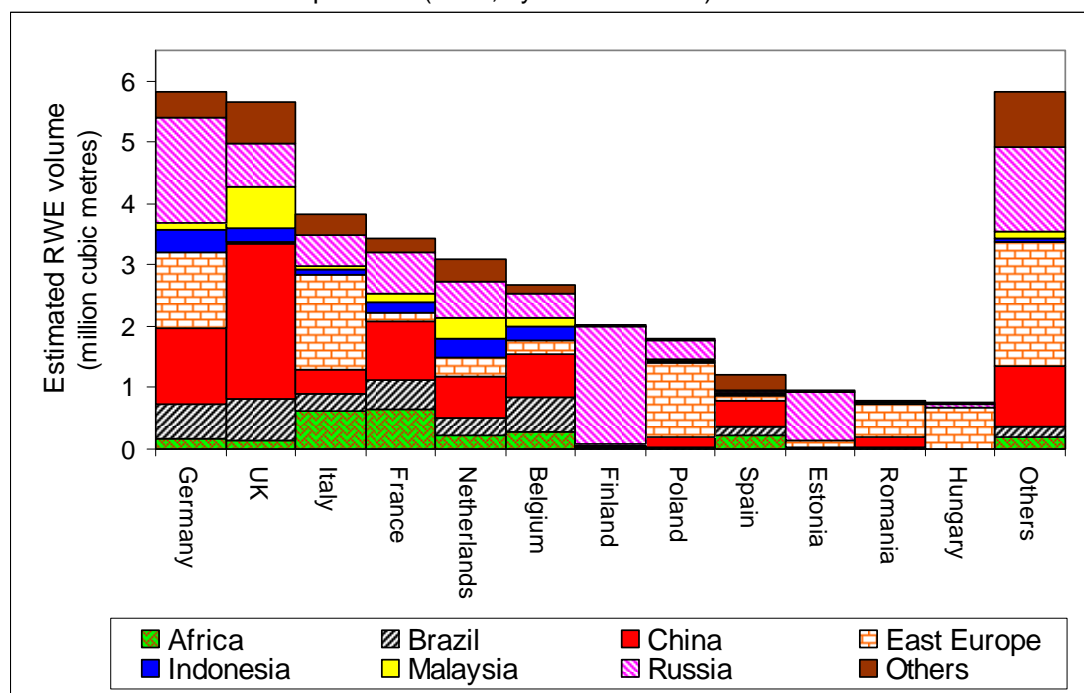


Chart 2 indicates the relative scale of a number of member states' imports of Timber Sector products from particular countries and regions.

Unsurprisingly, Belgium, France, Germany, Italy, the Netherlands, and the UK are the leading importers, particularly from tropical Africa, Brazil, China, Indonesia and Malaysia.

The UK has much the largest share of imports from China and Malaysia. France and Italy together account for most imports from tropical Africa.

Consequently, it would seem reasonable to expect those three member states to take a lead in establishing robust due diligence to exclude Illegal Timber from those countries and that region respectively – and to make their expertise in doing so available to other member states (specifically their Competent Authorities).

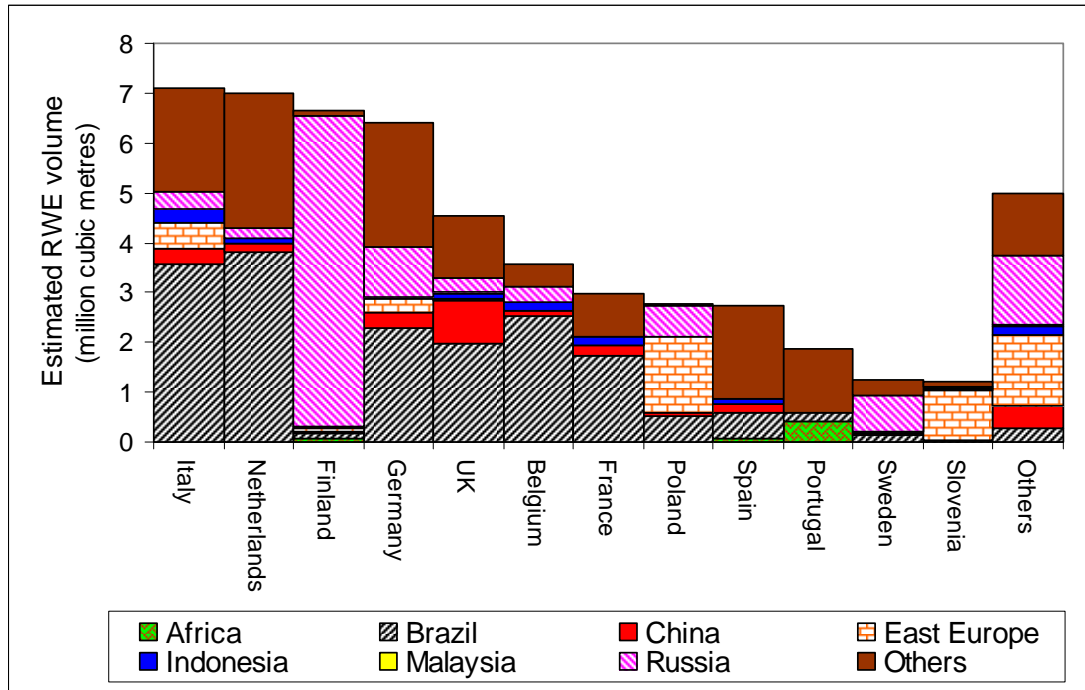
Eastern Europe and Russia account for most of the imports of member states in northern and eastern parts of the EU. It would seem reasonable for those member states to focus their implementation of the Illegal Timber regulation on imports from those suppliers – perhaps with Finland and Estonia taking a lead with Germany in respect of imports from Russia.

Corporate groups in Finland's Timber and Paper Sectors have for several years developed systems to ensure transparent (legal) chains of supply from Russia. Therefore, bearing in mind the need for commercial confidentiality, Finland's Competent Authority could presumably contribute much to counterparts in other member states concerning due diligence in respect of Russia. However, most of this experience relates to the supply of logs.

Illegality in Vietnam would not be covered by the Illegal Timber regulation – because furniture made from imported wood accounts for (almost) all Vietnam's exports to the EU.

<sup>10</sup> Given differences in their industries' structures and sources of supply, it is appropriate to subdivide wood-based products according to their likely end-use – as paper (Paper Sector products) or otherwise (Timber Sector products). Fuel wood is excluded from this assessment, except for the (currently) small quantities which recent changes in product classification now make it possible to identify. In this analysis, logs are included in the Paper Sector if source statistics classify them under codes 44032019, 44032039, 44032099, 44039930 and 44039959.

Chart 3 – Paper Sector products (2010, by member state)



Brazil, Russia and (included in Others) Chile supply most imports of Paper Sector products.

As with Timber Sector products, Belgium, Finland, France, Germany, Italy, the Netherlands, Poland, Spain and the UK are the leading importers.

Russia supplies the great majority of the imports of Finland Sweden's imports.

Indonesia continues to supply substantial quantities of pulp and/or paper to several member states. Those imports<sup>11</sup> might decline less under the Illegal Timber regulation than under the recently agreed SVLK (VPA) – if each were implemented credibly. Given the small share of member states' imports, even cessation of imports is unlikely to cause structural change.

The UK accounts for roughly one third of the total (all of which comprises paper) supplied from China. Much of this might derive partly from FSC-certified pulpwood from Russia or Brazil – but without credible chain of custody. Much might also derive partly either from pulpwood supplied illegally from within China or from Indonesian pulp. EU-based groups might make at least some of that paper – which would tend to facilitate due diligence.

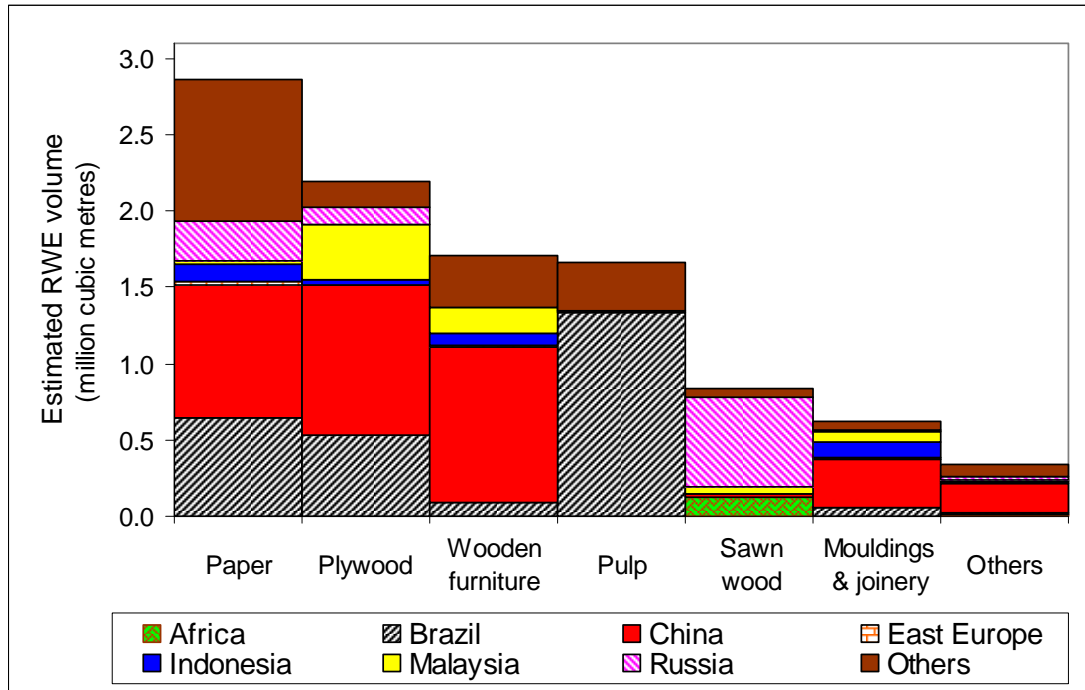
The Illegal Timber regulation does not yet cover printed paper, despite the concern of many, perhaps most, major (UK and perhaps German<sup>12</sup>) retailers that one controversial group has cornered the market for supplies from East Asia.

Monitoring Organisations might not be well placed to address the range of products which member states import in substantial quantity, particularly if their expertise relates primarily to products which account for only a proportion of the total quantity imported.

<sup>11</sup> This relates pulp and paper made from Indonesian pulp – Indonesia's paper industry also uses pulp based on waste paper. Indonesian pulp mills tend to use tropical hardwood and/or acacia magnium as their wood raw material. Those species are rarely used in pulp mills elsewhere. Determining the species from which pulp and paper is made is said to be simple and inexpensive. Supplies of plywood and mouldings & joinery are likely to decline in parallel with those of pulp.

<sup>12</sup> "Tropical Forest Destruction for Children's Books - An Analysis of the German Book Market" WWF (2010) [http://assets.panda.org/downloads/full\\_study.pdf](http://assets.panda.org/downloads/full_study.pdf)

Chart 4 – The UK’s imports (2010, by product and source of supply)



For example, the UK’s Timber Trade Federation might have little knowledge of supply chains in the Paper Sector or in relation to furniture, which, as shown in Chart 4, account for the majority of the total which the UK imports.

Due diligence systems sufficient to address supplies from China, Indonesia and Russia are likely to suffice also in relation to imports from all other countries – because illegality in those three countries’ supply chains are likely to reflect a wider set of illegalities than elsewhere. [An introduction to relevant illegalities is provided at the end of this commentary.]

However, a generic due diligence system might not be appropriate for use across the EU and across all products. A due diligence system which depends on (unenforceable, easily fabricated) responses to questionnaires, statements of commitment and internal management control of materials submitted by suppliers outside the EU would be ridiculed.

Concerning composite timber sector products, due diligence systems should focus particularly on the species (or group of species) which gives the product its primary marketing attribute – for example its surface layer in flooring, plywood and furniture.

In the case of blends of pulp or paper based thereon, the due diligence system should explicitly require data about whether any of that pulp derives from tropical timber or acacia magnium – which would tend to make the whole consignment of paper or pulp unacceptable (- see footnote 11 above). Whether or not that pulp is illegal, failure to declare the inclusion of those species’ would be fraudulent – and the first placer would be handling Illegal Timber on at least one count.

Ensuring transparency along complex chains of supply does not appear to present difficulties for well managed enterprises in the food or vehicle manufacturing industries. This reinforces the view that exceptions should not be made for imports of wood-based products which have complex supply chains, although a *comprehensive* list of species and countries of origin might be acceptable. The industry should adjust to legislation rather than *vice versa*.

Charts 5, 6 and 7 describe member states’ imports from China Indonesia and Russia. Chart 8 introduces member states imports from the countries which comprise Eastern Europe.

Chart 5 – Imports from China (2010, by product and member state)

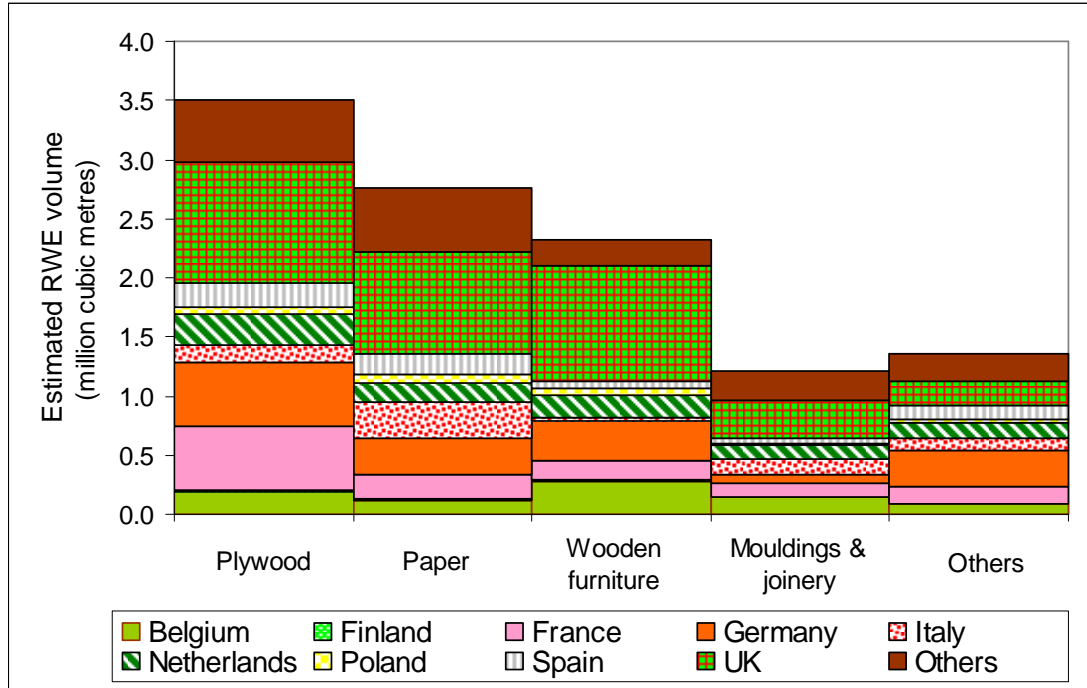


Chart 6 – Imports from Indonesia (2010, by product and member state)

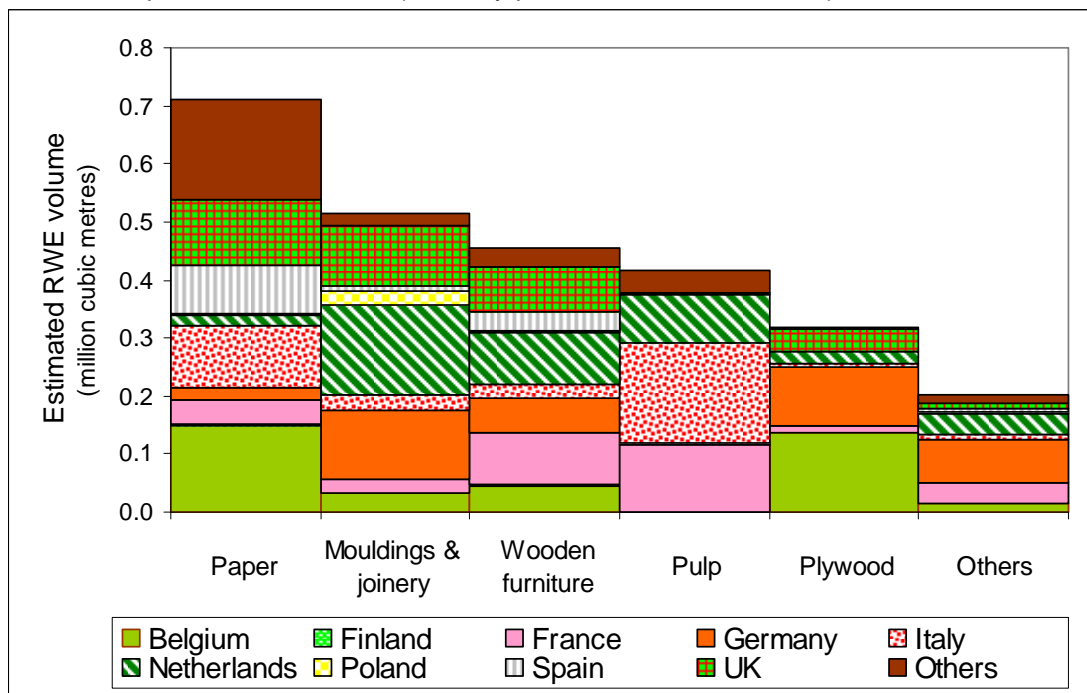


Chart 7 – Imports from Russia (2010, by product and member state)

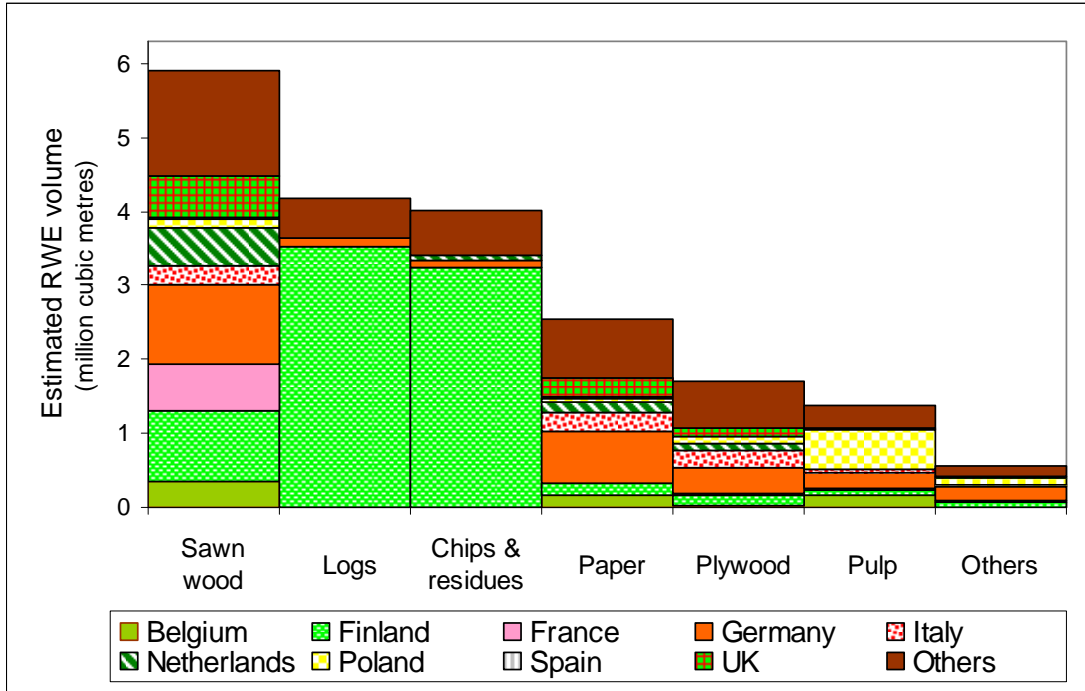
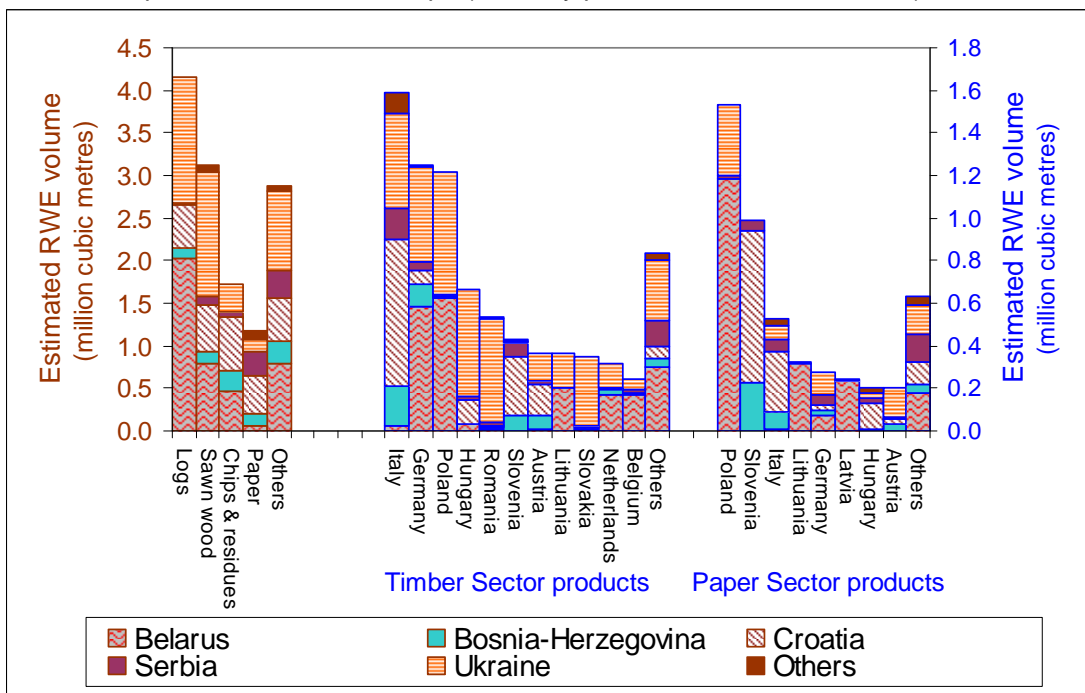


Chart 8 – Imports from Eastern Europe (2010, by product<sup>13</sup> and member state)



Imports from Eastern Europe are supplied mainly from Belarus, Croatia and Ukraine.

<sup>13</sup> As mentioned in footnote 10 above, logs destined for use as pulpwood are included in the Paper Sector

## An introduction to illegalities in China, Indonesia and Russia

Having considered the following notes (particularly those concerning China and Indonesia), which are neither exhaustive nor in order of relevance, it seems reasonable to conclude that due diligence systems which are designed to assess the legality of products first placed on the EU market from woodland within the EU would be wholly inappropriate when addressing the legality of *imports* of products covered by the Illegal Timber regulation.

The EC seems negligent in so far as that regulation ignores illegalities downstream from forest gate. This damages EU business by reinforcing the competitive advantages of those who export to the EU Illegal Timber whose illegalities occur downstream from the forest gate (indicated below in blue italics) – particularly in the Paper Sector, Indonesia and China.

### **China**<sup>14</sup>

A large proportion (perhaps 30% to 50%) of industrial roundwood production is unreported. Ownership rights to standing timber are not always clear and might be improperly assigned. Imports of tropical timber and timber from Russia – which might be transformed into the surface layer of products for export - tend to have a (much) greater Illegal Timber content than most other countries' imports of such timber.

Government does not accept that any imports are illegal.

Composites are implicitly illegal if any of their components derive from Illegal Timber.

Due to extensive subcontracting, quality control tends to be poor.

*Products have a reputation for not meeting minimum specifications.*

Fraudulent product descriptions (particularly in relation to the naming of species).

Corruption; controlled court system not open to foreign lawyers.

Government-owned businesses (including subsidiaries which import or log overseas).

*Manufacturers' and suppliers' employment practices.*

Government – in effect – does not allow independent international auditing of supply chains (including in relation to the national certification scheme which it plans soon to establish), and is unlikely to accept that any logs from land under government jurisdiction are illegal.

### **Indonesia**

*Fraudulent financing of pulp mills.*

*Plywood mills in breach of financial agreements.*

Corruption; compromised legal system.

Failures concerning gazettement of forest areas before and during logging or conversion.

Failure to log sustainably or failure to manage conversion as required.

Invalid designation of land for conversion.

Designation of peatland for logging or conversion.

Overlapping "rights" to forest land; conflicting laws.

Non-availability of authentic, necessary documentation.

Ineligibility of concessionaires or their contractors.

Laundering of logs through other concession areas.

Products made elsewhere in the region from smuggled Indonesian wood.

Foreign donor support promoting sustainable logging might serve to launder prior illegality.

### **Russia**

Forestry Code seems dysfunctional (low priority placed on the environment and local peoples) and has been revised a number of times since 2006.

Lack of clarity, particularly in relation to decentralisation.

Insufficient monitoring by the authorities.

Corruption (including in response to pressure on enterprises endeavouring to be legal).

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<sup>14</sup> China's exports are a composite of locally grown an imported wood-based raw material – except for some Timber Sector products (which derive wholly from Germany, Russia or perhaps elsewhere) and, due to opaque supply chains, an as yet indeterminate (perhaps declining) proportion of China's export of paper.