

Global Markets for Verified Legal Wood Products: Are SMFEs Prepared?



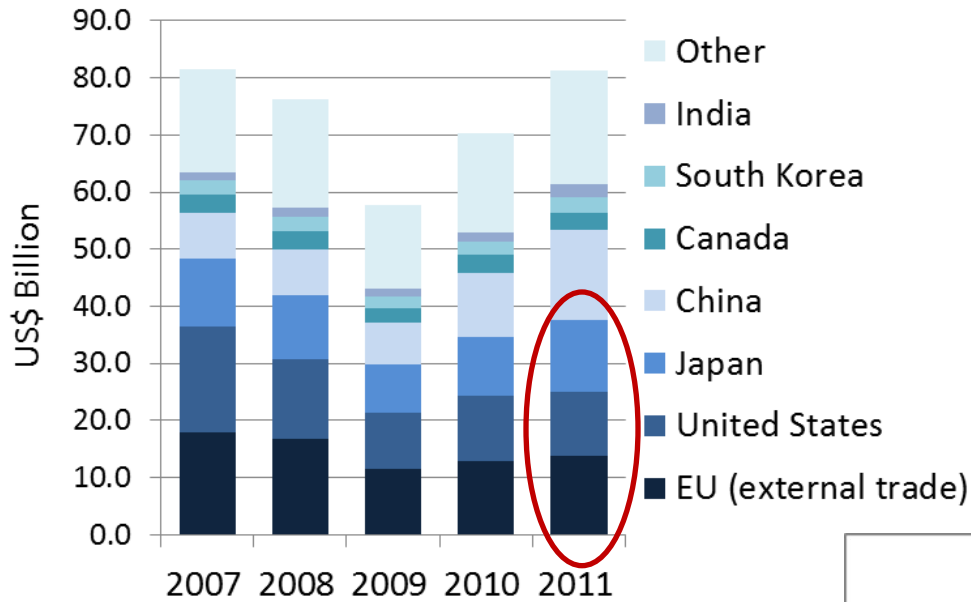
Kerstin Canby
Forest Trends
May 2013

Market Shifts in Europe, USA, Japan

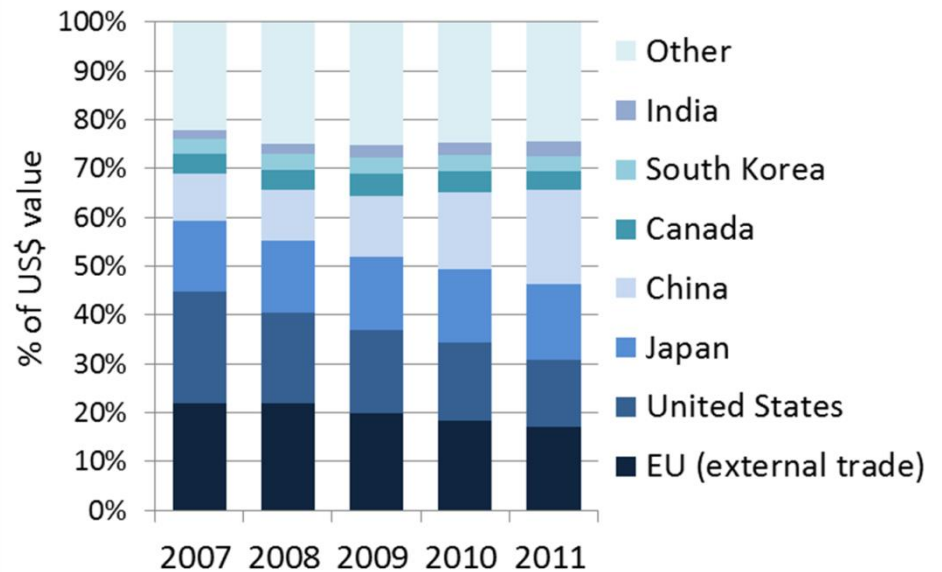
Objective of presentation: Explain major changes in requirements for wood products exported to Europe, United States, Japan and Australia.

For SMFEs (or in fact any) businesses wishing to export wood products to high value markets in the US and Europe, verification of legality may be a challenge, particularly for products manufactured from imported wood sourced from countries with poor forest governance.

Value of international trade in timber products by importing country 2007 to 2011



% share of international trade in timber products by importing country 2007 to 2011



Source: FII Ltd/European TTF analysis of Eurostat data

Market Shifts in Europe, USA, Japan

1. Consumer demand for sustainable wood products

1990s: European and American consumers started demanding wood products certified for sustainability.



Market Shifts in Europe, USA, Japan

1. Retailer demand for certified wood products (FSC, PEFC)

Retailers interested in corporate social responsibility (CSR) and protecting reputation, starting in 1990s.

FSC and PEFC certification standards developed, which include independent 3rd party verification and chain-of-custody (CoC). Many national standards were also developed during this time.

Certification is still a requirement for many retail buyers today.

Market Shifts in Europe, USA, Japan

1. Retailer demand for certified wood products (FSC, PEFC)

Major international companies, such as WalMart or IKEA, now require suppliers to be able to not only document country of origin of timber sources, but also demonstrate sustainability through the use of third-party certification systems.

Many are doing risk profiling of their sources.

The UK Timber Trade Federation established strict purchasing policies for all its members, which resulted in several contracts with major Indonesian and Chinese suppliers being cancelled.

Market Shifts in Europe, USA, Japan

2. International fora focus shifted from dialogue on *sustainability* to *legality* of timber trade

- G-8: 1998 Foreign Ministers launched Action Programme on Forests that featured illegal logging
- 2001 – 2005 FLEG Ministerial Conferences committing producer and consumer countries to actions to combat illegal logging (Africa, SE Asia, Europe and North Asia)
- 2002 – present: Major FLEG workprograms at ITTO, World Bank, FAO, ASEAN, CIFOR, etc.
- G-8: 2005 Environment & Development ministers committed themselves to actions to combat illegal logging

Market Shifts in Europe, USA, Japan

3. Green procurement policies for public works

Mid 2000s: UK, Denmark, Germany, France and other European countries require 3rd party evidence of **legality** of wood used for government contracts

Japan has its own procurement policy (GoHo wood)

Increasingly, European governments are requiring 3rd party evidence of **sustainability**.



Market Shifts in Europe, USA, Japan

4. Amendments to the US Lacey Act (2008)

Makes it illegal to import or sell any timber product taken in violation of laws of the United States **OR** any foreign country

FOR THE FIRST TIME: jail, forfeiture or fines

Requires declaration of origin and species.

Introduces concept of “due care”: punishment depending on degree to which a company knew or *should have known* it might be handling illegal wood products.

Market Shifts in Europe, USA, Japan

4. Amendments to the US Lacey Act (2008)

In 2010, Gibson Guitar was the first case investigated by the US Department of Justice (Madagascar mahogany)

In 2011, a shipment of ebony and rosewood fingerboards being shipped from India to Gibson Guitars was seized due to questions about the legal sourcing of these products... USDOJ is refraining from enforcement actions.

Wake up call!



Market Shifts in Europe, USA, Japan

5. EU Timber Regulation (March 2013)

Requires operators who first place timber products on the EU market to undertake “due diligence” such as risk assessment of illegality.

Makes it an offense to place illegal forest products on the EU market.

Like US Lacey, no specific certification or verification standard gets a “green light” *except FLEGT licensed timber.*

Market Shifts in Europe, USA, Japan

6. Australia

Now has its own legal requirements against the import and processing of both domestic and imported timber.

Very similar to the EU Timber Regulation and US Lacey Act with “due diligence” requirement where importers must conduct risk assessments and ensure legality.

Same Same but Different

All have similar, but slightly different, requirements

All share some fundamental similarities such as demonstration of “due care” or “due diligence”

All share the requirement that operators must be able to document the source of origin of the harvested wood.

Most retailers are looking for 3rd party verification from a robust, interationally recognized standard.

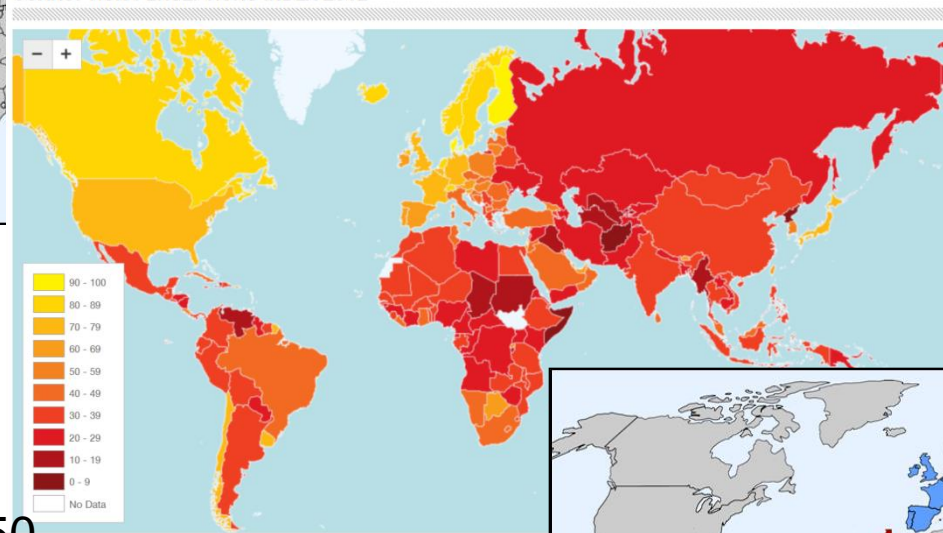
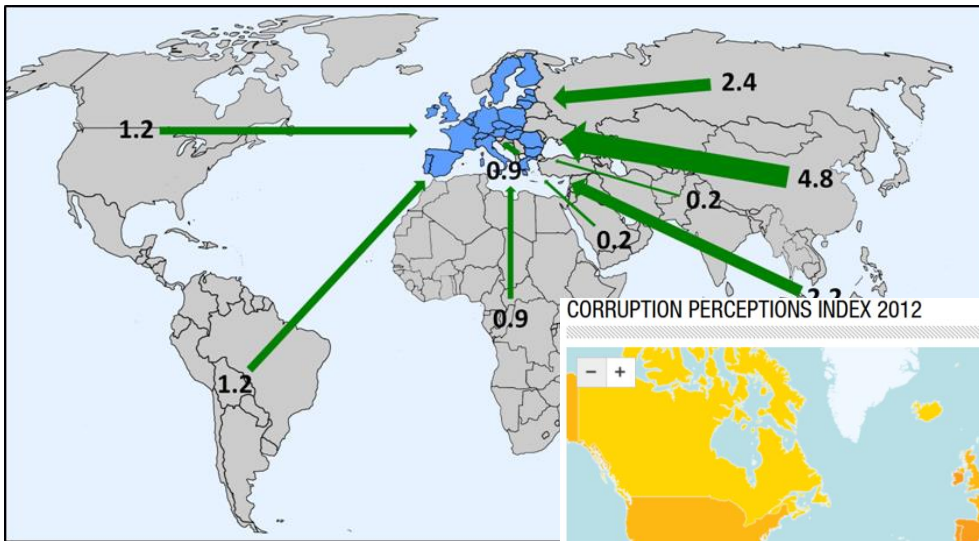
Credibility is an important asset

Certification & FLEGT licenses

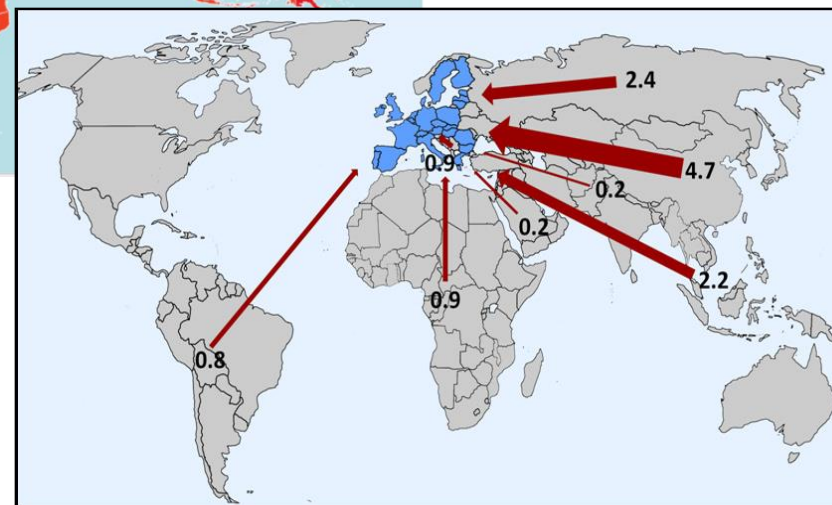
No international certification or verification standard (FSC or other) is officially acknowledged by the US government or EU as being automatically compliant with Lacey or EUTR

However ... it is very likely that both EU and US systems will be well covered by *robust, high quality* systems which use 3rd party verification and have high standard of definition of legality as defined by stakeholders.

Risk Profiling – based on TI CPI

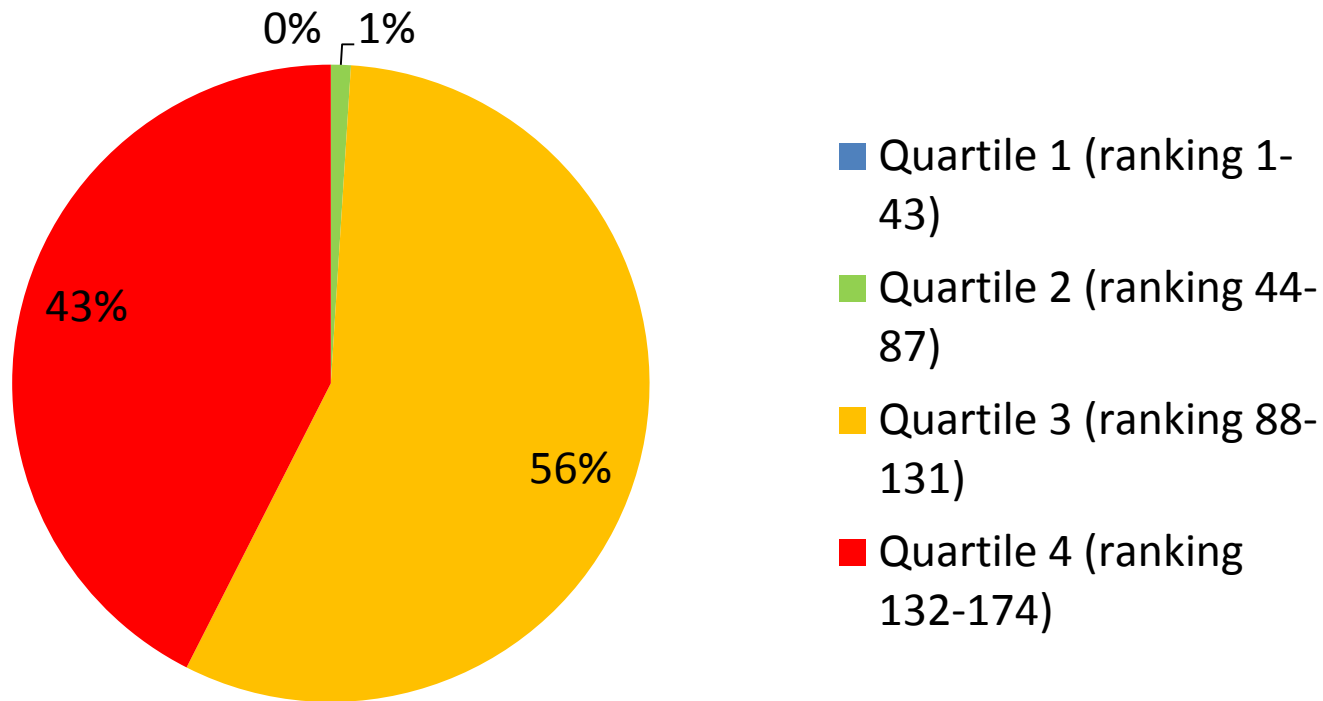


- Assume “high risk of exposure” to illegal trade in imports from country TI CPI < 50
- Inconsistencies exist
- Simple and transparent
- Some evidence of link between CPI & illegal logging



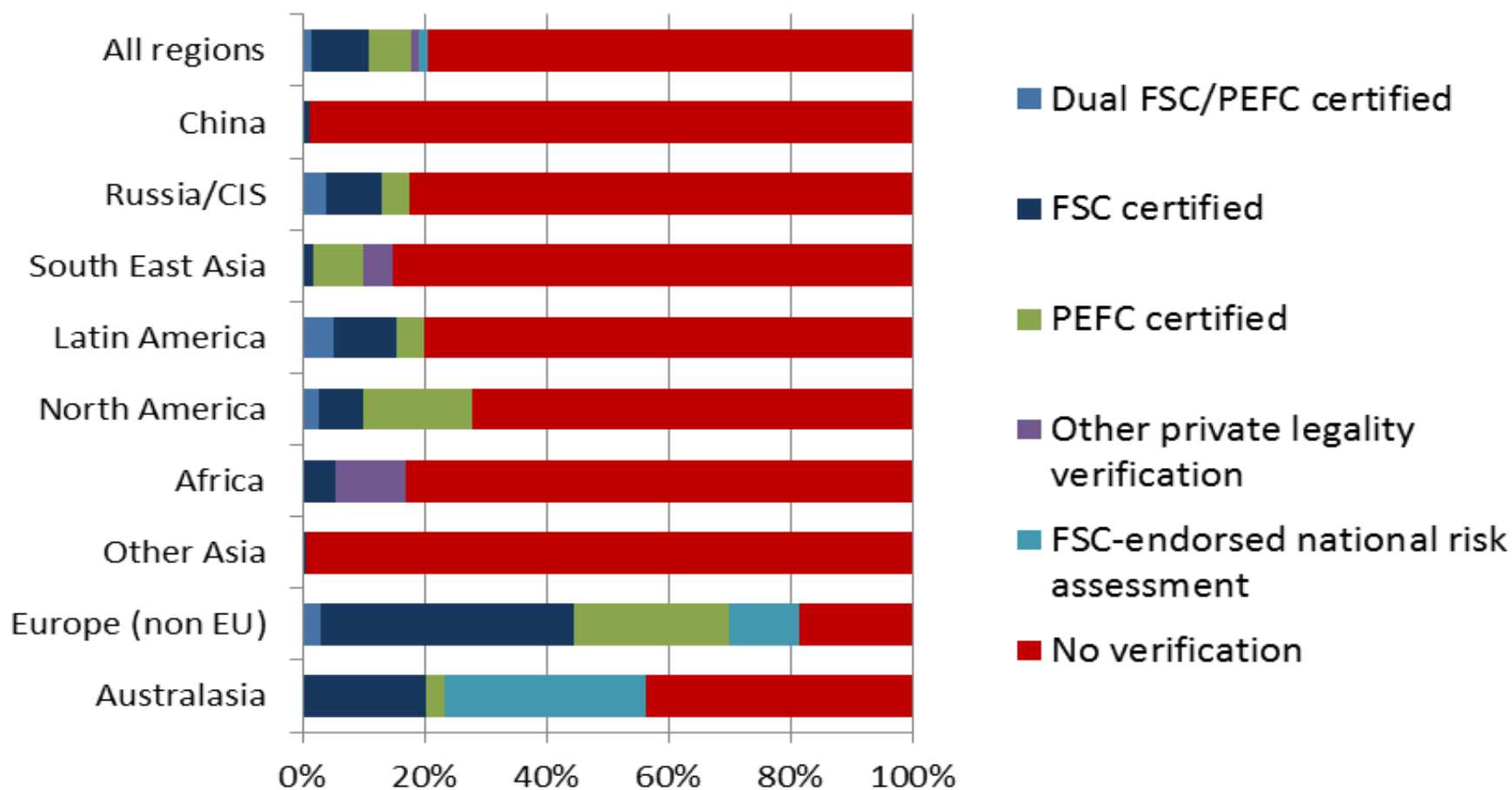
Sourcing teak: high risk countries

Governance Index for Top 13 Teak Producing Countries



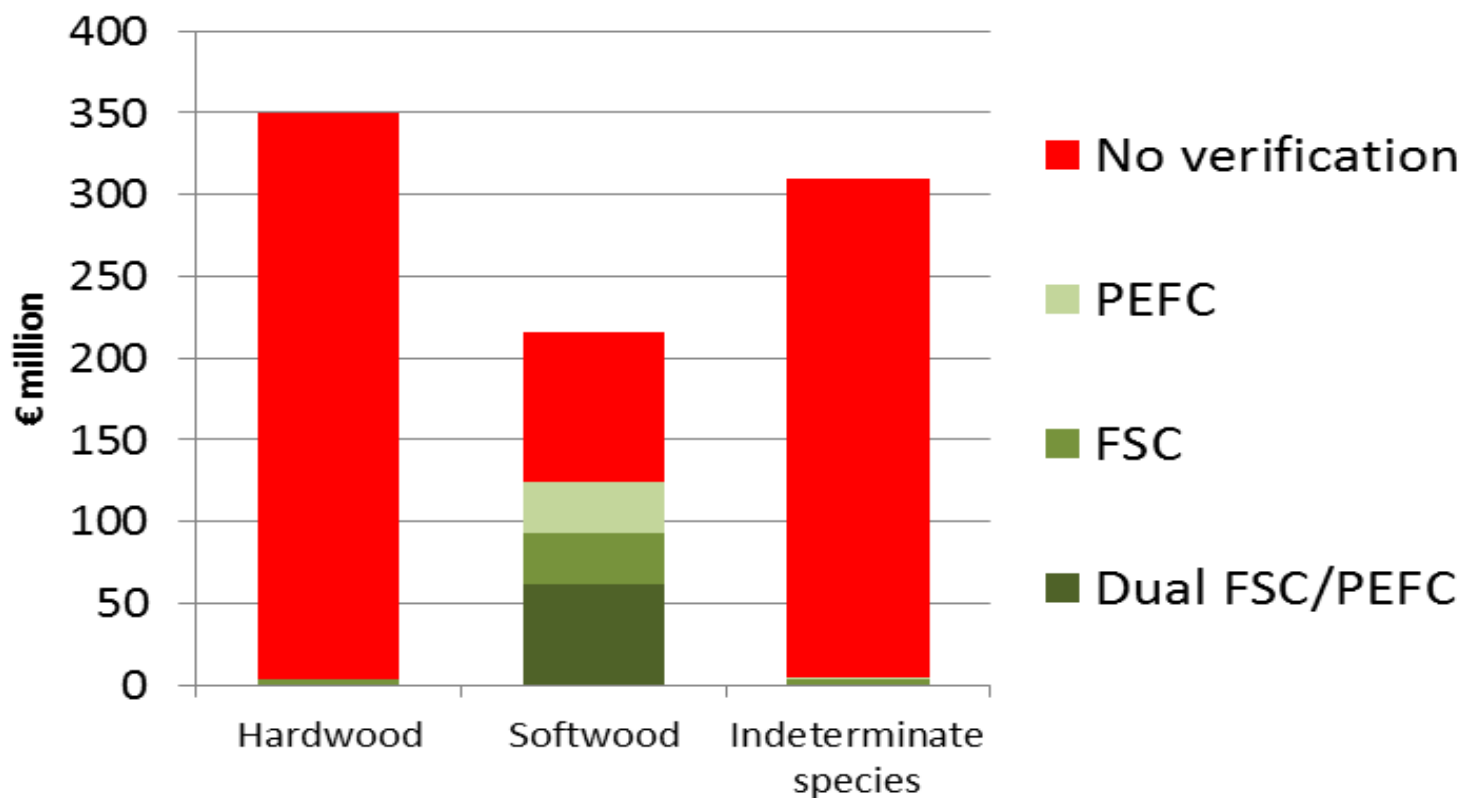
Risk Profiling

Chart 1: % "exposure" to 3rd party verification systems of EU imports by region in 2011 (measured in € value)



Risk Profiling

Chart 19: EU-27 value of 2011 imports from high risk countries in Latin America, by species and private sector legality verification status



Risk Profiling

Chart 13: EU-27 value of 2011 imports from high risk countries in SE Asia, by VPA status

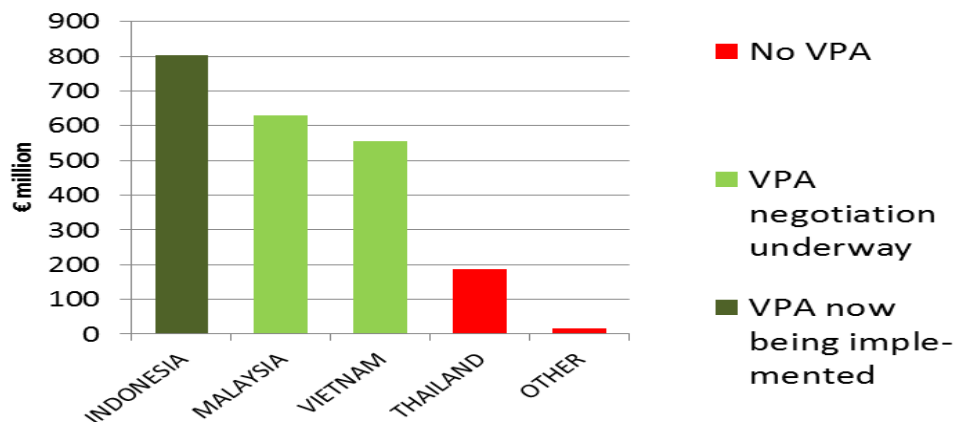
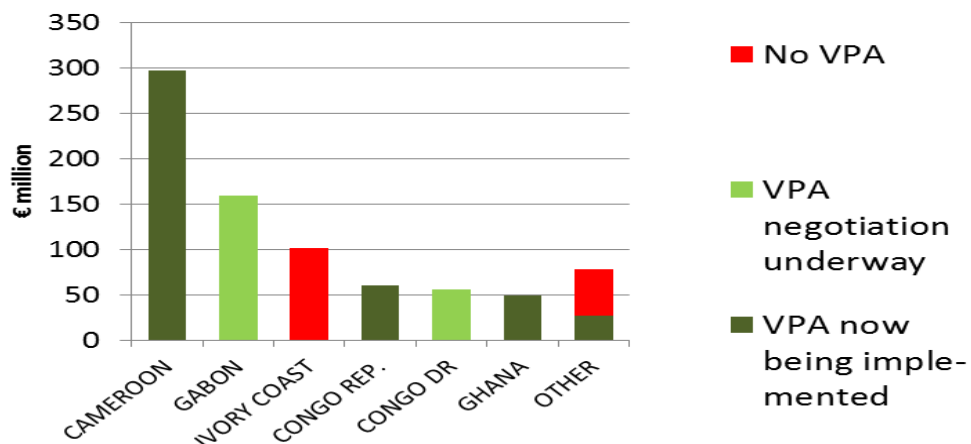


Chart 21: EU-27 value of 2011 imports from high risk countries in Central Africa, by VPA status



SMFE Opportunity or Challenge?

As with any market shift, producers and manufacturers can either try to take advantage of new opportunities to gain greater market share, or possibly watch their existing markets dwindle

Only 8% of the world's globally traded wood products are certified (FAO 2009) Countries which are able to supply EU, US and other markets first with certified or verified legal product will gain market share.

Are SMFEs vulnerable to these shifts, or can seize this as an opportunity *especially vis a vis their major competitors*

SMFEs: Compliance Burden

Meeting legality verification requirements for export markets will be similar to the burdens that SMFEs have had in obtaining certification.

- Regulatory, legal and tenurial barriers to be “recognized legal”
- Cost of certification
 - Auditing, management changes (e.g. establishing CoC)
- Human resources / skills
- access international markets where certification may be more highly valued

Many big retailers and their suppliers have already have a 5-10 years experience in requiring sustainably produced wood.

Example: Vietnam SFMEs & Furniture

U.S and EU account for over 80% of export value

\$200m: Total value of exports of timber and non-timber forest products by wood “wood craft vilages”

“Wood villages” use 80% imported wood, 20% domestically sourced wood.

Very little knowledge about legality of supply:

- Little documentation of origin
- No information about relevant regulations (let alone compliance
- No outreach on why they need to know

Example: China

In 2011, 53% of China's wood import volume from high risk countries (CPI<50), down from 85% in 2007

Fragmented supply chain in China

- 100,000 individual companies, mainly SMEs
- Some consolidation in recent years in the export sector

On-going initiatives

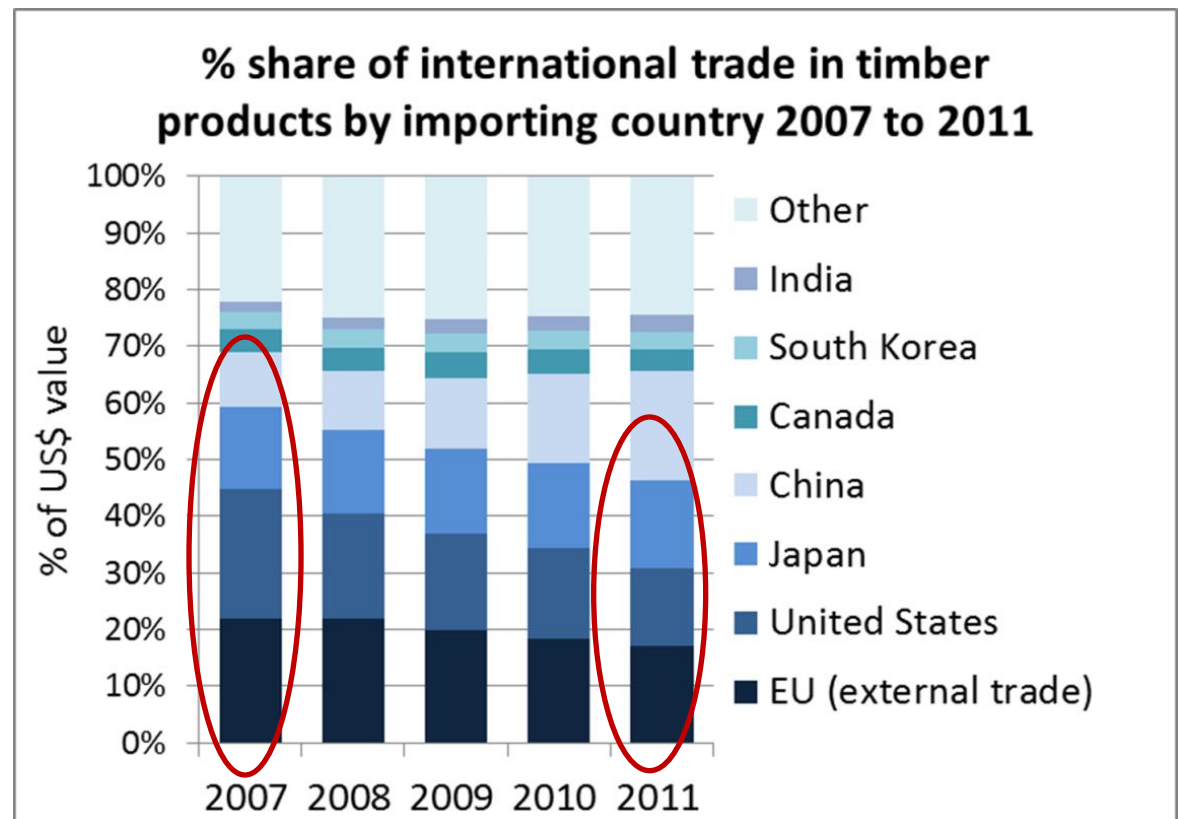
- Forest Management System seeking PEFC endorsement
- National Timber Legality Verification system launched 2009
- Forest industry association due diligence systems mirroring EUTR requirements

Bifurcation of Exports?

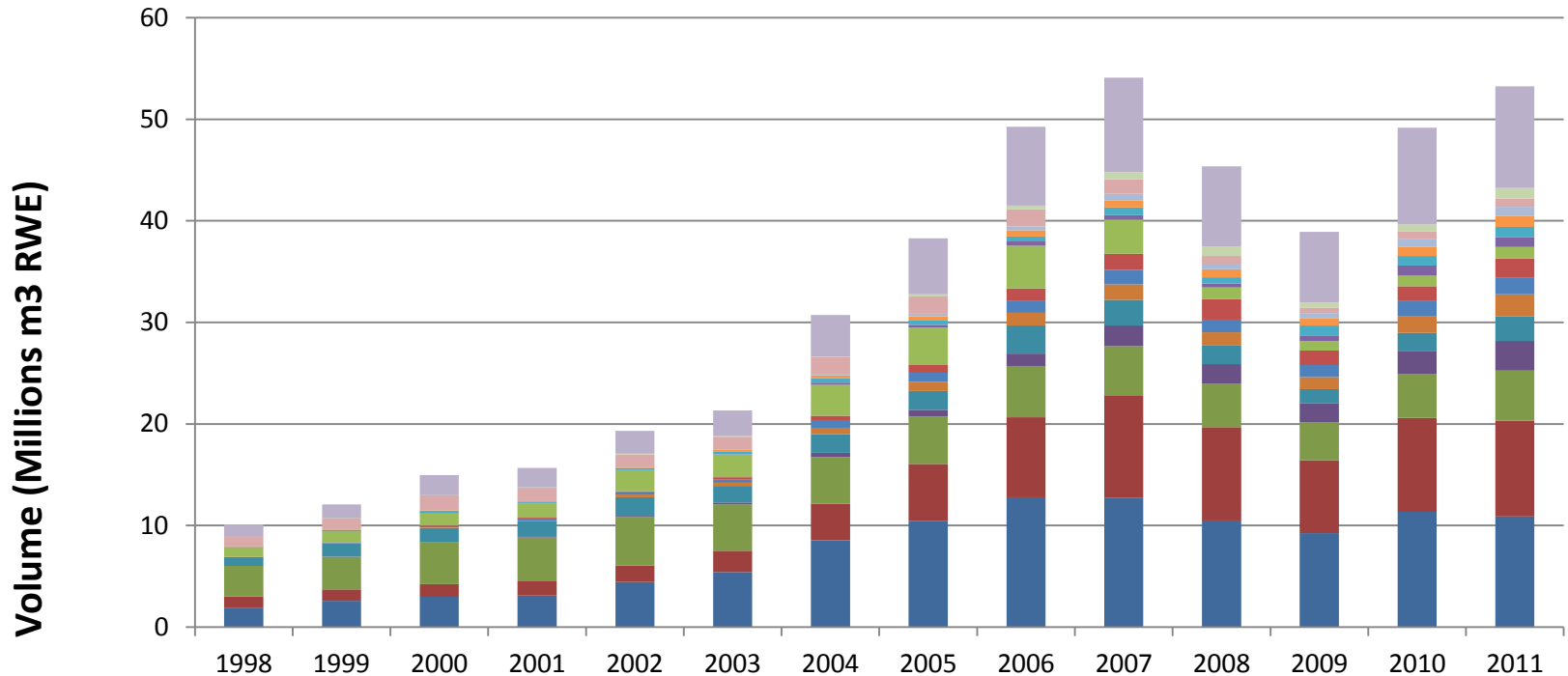
Will companies that cannot export to US, Europe, Japan and Australia shift to buyers without environmental and social requirements?

Absolutely:

- Domestic markets
- Middle East, India



Bifurcation of Markets / Exports?



■ United States
■ Africa
■ Canada
■ Thailand

■ European Union
■ South Korea
■ United Arab Emirates
■ Singapore

■ Japan
■ Saudi Arabia
■ Hong Kong
■ Australia