EUROPEAN TRADE FLOWS AND RISK
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Forest Trends, Washington DC
Forest Industries Intelligence Limited, UK
LIST OF ACRONYMS

CIS  Commonwealth of Independent States
CPI  Transparency International Corruption Perceptions Index
ETTF  European Timber Trade Federation
EU  European Union
EUTR  EU Timber Regulation
FAO  Food and Agricultural Organization (UN agency)
FII  Forest Industries Intelligence Ltd (UK Company)
FLEGT  Forest Law Enforcement, Governance and Trade
FSC  Forest Stewardship Council
Ha  hectare
INTERPOL  International Criminal Police Organization
ITTO  International Tropical Timber Organization
JFSQ  Joint Forest Sector Questionnaire (annual UN survey)
m³  cubic meter
MTCS  Malaysian Timber Certification System
OLB  Origine et Légalité des Bois (private sector standard)
PEFC  Program for Endorsement of Forest Certification
SVLK  Sistem Verifikasi Legalitas Kayu (Indonesian Timber Legality Verification System)
TI  Transparency International
TLTV  Timber Legality Traceability Verification (private sector standard)
VLO  Verification of Legal Origin (private sector standard)
VPA  Voluntary Partnership Agreement
WWF  Worldwide Fund for Nature
This report was drafted by Kerstin Canby and Rupert Oliver with contributions and insight from Rob Oberndorf, Marigold Norman, Sun Xiufang, Ed Pepke, Tomi Tuommasjukka, Jade Saunders, Hugh Speechley, and Rachel Butler. Unless otherwise stated, all trade data derives Eurostat as compiled and analysed by Forest Industries Intelligence Limited or Chinese customs as compiled and analysed by Forest Trends.
1 Illegality in the international wood and products trade

"Environmental crime and the illegal grabbing of natural resources is becoming an ever more sophisticated activity requiring national authorities and law enforcement agencies to develop responses commensurate with the scale and the complexity of the challenge to keep one step ahead" INTERPOL, 2012

1.1 Background

Illegal logging, as defined in the EU Timber Regulation (EUTR), is the harvesting of timber in contravention of the laws and regulations of the country of harvest. Illegal logging is a global epidemic with significant negative economic, environmental and social impacts. Recent studies indicate that illegal logging accounts for 50–90 percent of the volume of all timber production in key producer tropical countries in the Amazon Basin, Central Africa, and Southeast Asia, and 15–30 per cent globally.

In economic terms illegal logging results in lost revenues from taxes and other duties that could be used by producer countries for sustainable development purposes and other benefits. In environmental terms illegal logging is associated with deforestation, water pollution, spread of disease, climate change and a loss of biodiversity due to habitat destruction. In social terms illegal logging can be linked to conflicts over land and other resources, the disempowerment of local and indigenous communities, the loss of lives and livelihoods, human rights violations, corruption, and armed conflicts.

Illegal logging also undermines international security, supports organized crime and money laundering activities, and leads to unfair competition in the marketplace that negatively impacts the sincere efforts of responsible operators in Europe and other regions of the world to comply with the law.

1.2 Illegal practices leading to production and trade of “illegally harvested timber”

In some of the world’s most important producer countries, notably in the tropics, the enforcement of laws to regulate timber harvesting and trade is often beyond the capacities of state forest administrations. In some cases, government officials are complicit with illegal activities and unwilling to enforce laws and regulations. In fact, Transparency International’s published measures of political and judicial corruption reveal a close correlation between corruption and illegal logging.

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Several publications in the past decade have attempted to catalogue the types of irregularities in the production and trade of timber. Most are relatively similar, although some will focus on certain aspects more than others. Reports of note include:

- INTERPOL’s 2012 report *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the World’s Tropical Forests. A Rapid Response Assessment* which notes that in the last five years, illegal logging has moved from direct illegal logging to more advanced methods of concealment and timber laundering, which it cites as augmenting the amount of officially processed timber by 300-3000% (and also constituting tax fraud). More than 30 types of illegal activities are listed, with most common methods including falsification of logging permits, bribes to obtain logging permits (in some instances noted as US$ 20–50,000 per permit), logging beyond concessions, hacking government websites to obtain transport permits for higher volumes or transport, laundering illegal timber by establishing roads, ranches, palm oil or forest plantations and mixing with legal timber during transport or in mills.

- FAO and ITTO’s 2010 *Forest Law Compliance and Governance in Tropical Countries: A Region-by-Region Assessment of the Status of Forest Law Compliance and Governance and Recommendations for Improvement* lays out regional variations.

- *Corrupt and Illegal Activities in the Forest Sector: Current Understandings and Implications for the World Bank* has a summary list, reproduced in Annex 1, as well as a list of types of corruption — paying of bribes, political patronage, etc — which allow many illegal activities to occur or allow them to proceed unchecked or unpunished.

The EUTR itself spells out the broad boundaries of what would constitute illegal practices that result in the production of “illegally harvested timber”. These include:

- Violation of the rights to harvest timber within legally gazetted boundaries;
- Failure to make any legally required payments for harvest rights and timber, including duties related to timber harvesting;
- Violation of any provisions of national forestry or environmental protection laws, where the violation is directly related to the harvesting of timber;
- Violation of third parties legal rights relating to resource access, use and tenure arrangements, where the rights involved are affected by timber harvesting;
- Violation of any trade or customs related laws that are related to the forest sector.

### 1.3 Defining risk and tools to help risk profiling

Listing countries as high risk for illegal timber can become politically sensitive. It is therefore unlikely that specific listings of high risk countries and trade patterns will ever be published, even though such listing of controversial sources and routes would help operators and competent authorities create risk profiles for the legality of timber arriving in the EU. The difficulties of assessing risk are compounded by the fact that laws surrounding land tenure, forest management, harvesting and transparency often vary even within a country, making it difficult to categorize an entire country as high or low risk. Considering species

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3 FAO and ITTO, by Jurgen Blaser. 2010. *Forest Law Compliance and Governance in Tropical Countries: A Region-by-Region Assessment of the status of forest law compliance and governance, and recommendations for improvement*
alongside information on the source country and trade routes is consequently important in making a risk assessment.

Therefore formal legal or political guidance on country or trade flow risks is lacking. Information remains patchy and even non-government sources have shied away from defining entire countries, regions or trade flows as higher risk. However, tools are being developed by civil society organizations and the private sector to help. These are still in the early stages of development. Examples include:

- The Forest Legality Alliance Risk Information Tool developed by WRI and EIA is one of the most developed sites collecting data on forest laws, enforcement challenges, CITES status and transparency indicators in one place. To date, only six countries have been assessed and no guidance is given on how the different information might inform an assessment of risk for a country or species.

- NEPCon, Rainforest Alliance and the Forest Stewardship Council have developed a Global Forest Registry which covers 150 countries and attempts to assigns an overall risk category. However, countries are labelled as “low risk” or as being an “unspecified risk” based on Transparency International’s Corruption Perception Index. Once again, there is a lack of clarity around how to use the information provided to make an overall risk assessment.

Other sources such as Chatham House, the UK and European Timber Trade Federations and Global Witness provide some country specific information but more information is needed to better inform assessments of where illegal timber is most likely to originate as well as the routes it is likely to pass through on its way to the EU.

1.4 Assessing EU imports from high risk sources

Despite data problems, various previous studies have attempted to assess the level and sources of EU timber imports from illegal sources.4 The approach typically adopted is to combine import trade data with expert testimony on perceived levels of illegality in forest production at national level in export countries. However this approach is not used here for the following reasons:

- Coverage of illegality estimates is far from comprehensive with respect to countries supplying timber and timber products to the EU.

- Where they exist, estimates of illegality in different countries are of variable quality and comparability, typically based on different definitions of illegality and using a range of time frames, are often out of date, and may be influenced by researcher bias.

- Even where reasonably robust estimates of illegality in national wood production can be identified, there is no clear relationship between this and the actual proportion of illegal wood that ends up being exported. Differing market drivers, distribution networks and regulatory regimes for wood destined for export and local markets often leads to wide variation in the proportion of illegal wood entering each supply chain.

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A large proportion of wood imported into the EU is traded via third countries (notably in China and South East Asia) and estimates of illegal harvest in third countries has little bearing on the legal origin of timber used to manufacture products in those countries.

Due to these concerns, this report adopts a much simpler approach to assess likely level of exposure of EU imports to risk of illegal practice. It assumes high risk of illegality where timber products are imported directly from any country where the Transparency International Corruption Perception Index (CPI) falls below 50 (out of 100). Clearly there are inconsistencies in this approach. For example, Singapore ranks 5th in the CPI overall with a score of 87 due to high level of integrity in overall national governance, however allegations have been leveled by environmental groups against Singapore-based companies for laundering illegal wood through the city-state. Similarly, there are countries, such as several now engaged in the FLEGT VPA process, with very low scores on the CPI, but which nevertheless have made considerable efforts to improve forest-sector governance. Still, the approach has the virtue of transparency and builds on the conclusions of other studies that there is a reasonable correlation between the CPI and incidence of illegality in the timber industry.

A detailed analysis of EU imports from countries with a CPI of less than 50 is contained in section 2.

### 1.5 FLEGT VPA countries in EU trade

Timber products imported with a FLEGT VPA License are exempt from EUTR control. The status of FLEGT VPA countries in relation to EU trade is shown in Table 1. In 2011, countries currently developing VPA licensing systems (but not yet exporting any FLEGT licensed timber) supplied the EU with 3.25 million m3 (roundwood equivalent) of timber products with a value of €1.2 billion, 5% and 8% of total EU import volume and value respectively.

In time, the risk profile of these countries in relation to EUTR is expected to move from high to low risk. However, even where VPAs have been agreed, there is likely to be a time lag, in some cases quite prolonged, between enforcement of EUTR and issue of the first VPA Licenses. Furthermore, introduction of VPA Licenses is likely to be phased by product group, so for any particular VPA country, there will be a period of only partial coverage of products subject to EUTR regulation. Nevertheless, VPAs have strong potential to fill the gap in alternative risk mitigation options in Africa and South East Asia.

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<th>1000 m3</th>
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<td>466</td>
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1.6 Private sector legality verification and certification

EUTR recognizes that risks may be mitigated by use of private sector third party certification and legality verification systems. Unfortunately there is no direct way to assess the actual volume of timber trade covered by these systems. With very few exceptions, the governing bodies of systems do not monitor certified or verified timber production volumes, only the area of forest covered.

However, FII Ltd, working with the European Timber Trade Federation (ETTF), has prepared rough estimates of the "level of exposure" of EU trade flows to wood which is "verified negligible risk" drawing on area data from a range of third party verification systems. These estimates rely on a very simple assumption that there is a direct relationship between the proportion of forest certified in a country and the volume of certified timber product available for export.

The results of the FII/ETTF analysis are shown in Chart 1. It indicates that the level of exposure to 3rd party verification systems of EU imports varies widely by region. In regions considered high risk, exposure to these systems tends to be very low, being negligible in China and below 20% in Russia/CIS, South East Asia, Latin America and Africa. To date, third party verification has been applied more extensively in regions usually regarded as already exhibiting good forest governance, including Europe, Australasia and North America.

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5 The FII/ETTF ‘level of exposure’ data is broken down by verification system, including FSC, PEFC, or system of legality verification (such as SGS TLTV, Smartwood VLO, or OLB). For this exercise, FII also considered wood from countries covered by FSC-endorsed National Controlled Wood Risk Assessment as ‘verified negligible risk’. To avoid double counting, areas dual certified to FSC and PEFC are accounted separately.

6 For example, if 40% of its forest area is known to be independently certified or legally verified, the ‘level of exposure to verified negligible risk’ of a country’s wood products is assumed to be 40%. Adjustments by species group are made for a few countries, such as Brazil, where there is a big difference in the level of certification of hardwoods (mainly from natural forests) and softwoods (mainly from plantations).
2 EU timber and timber products imports from “high risk” sources

2.1 Overview

In 2011, EU-27 imports of solid timber and timber products\(^7\) (excluding internal EU trade) had a value of €15.11 billion and estimated roundwood equivalent (RWE) volume of 64.3 million m\(^3\). Figure 1 shows the source of these products by region of origin. According to the basic definition of “high risk” used here (national CPI of less than 50 out of 100), 52.7 million m\(^3\) (82%) with a value of €12.4 billion (82%) of total EU imports derived from high risk countries. Figure 2 shows the source of EU imports from “high risk” countries by region of origin. It highlights that with the exception of North and South America, the overwhelming majority of timber from all supply regions outside the EU is from high risk countries.\(^8\)

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\(^7\) This analysis focuses on EU imports from outside the EU of solid timber and products. It includes coverage of all products in CN Chapter 44 and wood furniture products in Chapter 94. It has not yet been extended to pulp and paper products.

\(^8\) Significant low risk American supply countries are Canada, Chile, Uruguay and the United States.
from outside the EU. In this respect, the leading Member States are the UK, Germany, France, Italy, the Netherlands, and Belgium.

Chart 3 shows that EU imports from high risk countries are dominated by wood furniture, with moderate amounts of sawnwood, plywood and veneers, low amounts of logs, flooring, and energy wood, and negligible amounts of joinery products and composite panels (like OSB and MDF).

2.2 China

In 2011, China was by far the largest external supplier of timber to the EU, contributing €4.7 billion of product, nearly 40% of all timber product imports during the year. Imports include a wide range of timber products (Chart 4) and wood furniture products (Chart 5). Amongst EU countries, the UK is the largest importer of timber and wood furniture products from China, accounting for 30%, followed by Germany (15%), France (14%), Netherlands (8%) and Belgium (7%) (Chart 6).
joinery sector and continue to strongly favour domestic European manufacturers. During the recessionary period in Europe, China has lost some of its former competitiveness in the EU market due to the rising value of the yuan-euro exchange rate and increasing labour costs in China. Nevertheless, China is expected to remain an important supplier of many wood products to the EU for the foreseeable future.

Today, China sits squarely in the middle of the world’s wood products commodity chain (Forest Trends 2006b). It is the world’s leading importer of logs, and its exports of wood-based products have tripled in volume and quadrupled in value in recent years. In the past decade, China’s strong economic growth, large population base and rapidly expanding processing capacity, coupled with export demands from markets in the United States, Europe, Japan and increasingly countries in the Middle East and Africa for low-cost furniture, plywood, molding, flooring paper and other products, has led it to become the wood workshop of the world, capturing almost a third of the global trade in furniture over the last ten years (Chart 7).

In order to meet this domestic and export-oriented demand, huge amounts of raw wood materials must be either produced domestically or imported from abroad. Domestic supply of industrial wood has failed to keep up with China’s industrial manufacturing needs, due to low level of per capita forest resources, and government policy to protect natural forests. Instead, China has imported materials. From 1997–2011, Chinese imports of forest products and secondary fibre increased from 40 million m³ to 185 million m³ RWE, more than twice the level of total domestic production of 81 million m³ in 2011. The country now
imports almost double the amount of forest products and secondary fibre than it produces domestically.

The high risk of China comes mainly from its imports (Chart 8) – especially for tropical hardwood imports. Illegal harvesting is not widely perceived to be a significant problem within China itself, although issues of land tenure and rights for local peoples, as well as difficulties documenting supply chains are sometimes mentioned. Wood availability from domestic plantations has increased in recent years. With 53 million ha, China has the largest plantation resource in the world, and 24 million ha are considered to be available for industrial purposes. Oak, Masson pine (Pinus Massoniana), Chinese fir (Cunninghamia Lanceolata), Birch and Larch are the dominant species from China's forest.

Chart 8: China’s Imports by Country

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume (million m³ RWE)</th>
</tr>
</thead>
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<td>1997</td>
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</tr>
<tr>
<td>1998</td>
<td>20</td>
</tr>
<tr>
<td>1999</td>
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<td>90</td>
</tr>
<tr>
<td>2006</td>
<td>100</td>
</tr>
</tbody>
</table>

New plantations in China consist of poplar and eucalyptus species, and the plantation area is expected to continue to increase. Much of this wood is fast-growing, and therefore often of relatively low grade and durability and unsuitable for decorative applications. China is therefore likely to remain heavily dependent on imports for much of its wood consumption.

An analysis of China's wood imports by Chatham House in 2010 suggests that the volume of illegal wood imports has been falling in recent years, but remains significant. It's estimated that China imported the roundwood equivalent of 20 million cubic meters of illegally sourced timber and wood products in 2008, worth around US$3.7 billion. The recent downturn in illegal imports was due partly to the economic recession, but also due to a decline in illegal logging in Indonesia and the reduced imports of illegal logs from Indonesia misdeclared as Malaysian. A reduction in imports of illegal logs from Myanmar also played a small part. These reductions were offset to some extent by increased imports from Russia, Papua New Guinea and the Solomon Islands.

Obtaining reliable assurances of legality from Chinese exporters is likely to be a significant challenge for companies wishing to comply with the EUTR. Only a tiny proportion of China’s domestic forest area (less than 1%) is currently covered by a recognized third forest certification system, although this may change quite quickly following submission in December 2012 of the China Forest Certification Scheme (CFCS) for review and possible endorsement by PEFC. The many Chinese manufacturers that are heavily dependent on imported product are also likely to struggle to obtain the necessary assurances due to the

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9 Illegal Logging and Related Trade Indicators of the Global Response, Sam Lawson and Larry MacFaul, Chatham House July 2010
length and complexity of supply chains, and the fragmented nature of timber distribution chains and manufacturing sector in China.

2.3 Russia and the CIS

In 2011, the EU-27 imported timber products valued at €2.44 billion from member countries of the Commonwealth of Independent States (CIS), around 20% of all timber product imports during the year. Imports consisted of €1.56 billion from Russia, €559 million from Ukraine, and €302 million from Belarus, with only negligible amounts from other CIS countries (Chart 9).

EU imports from this region consist mainly of primary processed wood products including sawnwood, plywood and logs (Chart 10). EU imports of logs from the CIS region have declined significantly in recent years following implementation of steep log export tariffs by the Russian authorities. However EU imports of sawnwood and plywood from CIS countries are expected to remain an important, potentially increasing, component of overall European timber supply in the future. A very wide range of EU Member States import a significant proportion of timber product from CIS countries (Chart 11). Germany is the largest importer from the region, followed by Finland, Poland, Italy and the Netherlands.

Illegal logging and trade has been a significant problem in supply of Russian products to the EU. According to a 2009 report by Wageningen University,

“Inadequate forest and customs legislation in combination with ineffective enforcement in remote areas further contributes to the problem [of illegal logging in Russia]. Tracking of wood from the source to the customer is still relatively poorly organized in Russia. Currently
it appears to be not very difficult to circumvent official requirements regarding legality of wood products and trade. The main reason identified as shortcomings in the official requirements are the paper-based licensing systems that is vulnerable to forgery and fraud and is very time consuming to verify”.\textsuperscript{10}

Drawing on a variety of sources, the Wageningen University report estimates the proportion of wood from illegal sources in the North West of Russia as between 5% and 15%.

On the other hand, the larger private companies dealing with Russia have for many years been implementing corporate due diligence and tracking systems. Many of these systems are ISO and/or EMAS certified. As long ago as 2005, it was reported that about 75% of the timber that goes from North West Russia into the EU was covered by such ISO certified systems.\textsuperscript{11} More recently, European importers of wood products from Russia have played a key role in encouraging the development of forest certification systems in the country. Although these systems cover only a minority of Russia's vast national forest area, European buying of wood products from the country is already heavily oriented towards those areas that are certified.

European trade contacts also report that the Russian Federal Ministry of Natural Resources has been taking steps to improve enforcement and thereby facilitate use of state regulatory documentation by importers in their due diligence systems. According to recent statements, the Ministry now exercises management controls of forest concessions through 29 year lease agreements and government regulated systems are being implemented, which aim to assure traceability of all logs and processed wood from forest to point of export.\textsuperscript{12}

Illegal logging is also a problem in Ukraine, a fact acknowledged by all key actors including governmental authorities, businesses and NGOs.\textsuperscript{13} The state owns 99% of all forests in the country and the vast majority is managed directly by the State Forestry Committee (SFC). However changes in market conditions have led to the flourishing of small private sawmills operating without permits, a rise in market outlets for illegal wood to domestic consumers, and illegal wood exports. Estimates of illegal wood in the Ukrainian supply vary widely. According to the SFC, the total volume of illegal logging in Ukraine in 2008 was about 20,000 cubic meters of wood, while according to experts from the Swiss-Ukrainian Forest Development Project in Zakarpattya (FORZA), financed by the Swiss Agency for Development and Cooperation, the average annual volume of illegal logging in Ukraine is approximately 1.25 million cubic meters of wood.

The total area of certified forests in Ukraine is now around 1 million ha. According to the SFC, this level of certification demonstrates that Ukrainian forest management is sustainable and corresponds to international requirements. On the other hand, a large area remains uncertified while investigations carried out in the Zakarpattya region indicate that large areas of certified forests are apparently combined with high volumes of illegal logging.\textsuperscript{13}

\textsuperscript{10} Arets et al, Wageningen University, 2009, Sustainability of the wood chains between the Russian Federation and the Netherlands.

\textsuperscript{11} Ottitsch et al, Impacts of reduction of illegal logging in European Russia on the EU and European Russia forest sector and trade. Technical Report 19, European Forest Institute. 2005

\textsuperscript{12} Statement by Peter Hammersley, Churchill and Sim and representative of the Russian Federal Ministry of Natural Resources, UK TTF Workshop on temperate wood in EUTR, London, September 2012

\textsuperscript{13} Anatoliy Pavelko and Dmytro Skrylnikov, July 2010, Illegal Logging in Ukraine (Governance, Implementation and Enforcement), Diagnostic audit, Regional Environmental Center for Central and Eastern Europe (REC), Szentendre, Hungary
In Belarus, the problem of illegal logging and challenges of legality verification are probably less severe than in other countries of the region. Over the last five years the number of forest-related offences has been steadily decreasing as a result of a number of official measures to combat illegal activities in the forest sector. All forests are owned entirely by the state and regulated by the Ministry of Forestry. All state forests are now FSC certified.

2.4 South East Asia

In 2011, the EU-27 imported timber products valued at €2.19 billion from high risk countries in South East Asia, around 18% of all timber product imports during the year. Imports from the region came primarily from Indonesia (€804 million), Malaysia (€629 million), Vietnam (€555 million), and Thailand (€186 million). Imports from the region are concentrated in a limited number of EU countries. The UK is the largest importer from high risk countries in the region, accounting for 25% by value. The top six EU importers (UK, Netherlands, Germany, France, Belgium, and Italy) together account for over 85% of all EU imports from high risk countries in SE Asia.

EU imports from SE Asia are dominated by wood furniture and other secondary processed wood products. (Chart 12). In recent years, only the Netherlands and Germany have continued to source significant volumes of sawnwood from the region, mainly meranti used for manufacture of window frames. The region was formerly a significant supplier of plywood to the EU, but this role has diminished dramatically in the last 5 years due to increasing competition from lower cost plywood products from China and substitution by a widening range of cheaper panel products produced in Europe. South East Asia is one of the few regions from which the EU imports reasonable volumes of joinery products (most of which are produced domestically in the EU), mainly glulam and doors.

In the past, most wood furniture imported into the EU from SE Asia was garden furniture manufactured from tropical hardwoods harvested in the region. However, the profile of the region’s furniture and other wood manufacturing industry has changed radically during the last decade. A large and increasing proportion of furniture, joinery and panel products from the region are manufactured using plantation species, including rubberwood and acacia grown within the region, and wide range of other species imported from elsewhere (such as eucalyptus from South Africa, or radiata pine from New Zealand). There has also been a strong trend towards importing temperate hardwoods, such as oak, beech, ash and walnut, for manufacture of timber products, which are then re-exported to Europe and North America.

Illegal logging is a widespread problem in many countries of South East Asia, while the length and complexity of supply chains throughout the region creates significant problems in establishing traceability to legal origin. On the other hand, the largest SE Asian supplying countries, Indonesia and Malaysia, have invested considerable resources in ambitious programmes to verify legality and sustainability of their wood product exports. Most forest areas in West Malaysia, the main source of Malaysian wood exports to the EU, is certified by the third party Malaysian Timber Certification System (MTCS), now endorsed by PEFC. Indonesia has made a commitment to extend its SVLK system, a national third party certification framework, to all wood product exports within the next two years.

14 www.enpi-fleg.org, website of the The ENPI FLEG Program “Improving Forest Law Enforcement and Governance in the European Neighbourhood Policy East Countries and Russia”
Active participation in the FLEGT VPA process also forms an important part of South East Asia’s response to the EU Timber regulation (Chart 13). Indonesia has already signed a VPA with plans to use SVLK as the backbone of the legality licensing system. Both Malaysia and Vietnam are engaged in negotiations towards a VPA.

Thailand is the only significant supply country in South East Asia currently neither engaged in a VPA process nor developing national-level procedures for independent third party certification. This is a potential challenge for EUTR implementation. Verification of legality is difficult due to the highly fragmented domestic wood supply in Thailand (much comprising rubberwood, teak and eucalyptus from plantations managed by farmers) and widespread reports of illegal trade between Thailand and neighbouring countries.

### 2.5 East Europe

In 2011, the EU-27 imported timber products valued at €877 million from high risk countries outside the EU in Eastern Europe, around 7% of all timber product imports during the year. The relevance of this region as an “external” supplier of wood to the EU will decrease significantly after 1 July 2013 when Croatia becomes an EU member. In 2011, Croatia accounted for €422 million of imports from this region. Most of the remainder came from Bosnia (€276 million) and Serbia (€141 million) (Chart 14).

Most imports into the EU from this region are destined for Italy, Germany, Slovenia, and Austria (Chart 15). Germany’s imports from the region consist mainly of wood furniture, while Italy, Slovenia, and Austria take a relatively higher proportion of sawnwood and energy wood. The countries of the former Yugoslavia are particularly renowned for supply of high quality hardwood logs and lumber, notably oak.
Long term prospects for supply from the region are uncertain. Judging by discussions at the 2nd Congress of the Sawmill Industry of Southeast Europe held in Croatia at the end of 2011, the region's wood products industry faces many challenges. The press release of the meeting notes "Every country of the Southeast European region, apart from Slovenia, is experiencing raw material shortages and overcapacity of production lines which often lack lumber for optimal efficiency. Unstructured state-owned forestry companies, which are the main suppliers of raw material, often have ramifications on the competitiveness of sawmills. Sawmilling in the region is becoming a less popular second-rate profession because state strategy favours the production of composite final wood products. The marginalization is visible not only in the distribution of financial aid, but also in the educational system as young adults are becoming less interested in a vocation in the wood-processing sector". The press release also notes that only 33% of lumber exported from Croatia matches the quality specifications detailed in the export documentation while the rest is mislabelled.

Third party certification of forests is well established in the region amongst the state forest services which play the leading role in commercial timber supply within the region (Chart 16). Nearly all Croatia’s forest area and close to 50% of Bosnia’s forest area is now FSC certified. Obtaining assurances of legality for wood derived from privately owned forests, which are more fragmented, not subject to tight regulatory control and rarely certified, will be more challenging.

2.6 Latin America

EU imports from high risk countries in Latin America had a value of €875 million in 2011. Nearly 80% of this valued derived from Brazil, with most of the remainder coming from Argentina, Paraguay, Ecuador, and Bolivia (Chart 17). EU imports from high risk countries in South America are mainly destined for France, Germany, the UK, Belgium, and the Netherlands (Chart 18).
Sawnwood makes up 32% of import value from high risk countries in the region. The vast majority of this (over 95%) is hardwood, mainly from natural forests in the Amazonian region. Key species include sapupira (a heavy duty flooring species), tauari (a light general joinery species), tatajuba (a heavy duty joinery species), jatoba (dark species favoured in flooring), ipe, garapa and massaranduba (the last 3 all decking timbers).

Around 25% of products imported by the EU from high risk countries in the region consist of plywood. Unlike sawnwood, this is primarily softwood derived from elliotis pine plantations in Southern Brazil. Trade in tropical hardwood plywood from South America has been declining steeply in recent years and now accounts for less than 10% of all EU imports of plywood from the region.

The EU also imports a relatively small but still significant volume of wood furniture from Brazil each year, much of it destined for France and the UK. Brazil’s furniture industry is the largest in Latin America and accounts for 2% of total world furniture production. Furniture production is concentrated mainly in the Southern states of Brazil, outside the tropical region, although there is also a significant presence in the Northeast. The sector has attracted substantial foreign investments not only from traditional investors in Europe and the US, but also from emergent economies, notably China.

EU timber product imports from high risk Latin American countries other than Brazil are dominated by charcoal, notably from Argentina and Paraguay.

Illegal logging is not considered a significant problem in the softwood and eucalyptus plantation forests of Southern Brazil and other temperate regions of Latin America. These plantations are generally managed by large companies and over 50% of the area is certified (Chart 19).

Verifor reviewed the measures to prevent illegal logging and promote sustainable forestry in the Brazilian Amazon in 2006. Verifor note that recent reforms have led to a coherent set of instruments for the verification of legal forest production. Over the previous 10 years, Brazil underwent a steady process of adaptive improvement in the normative framework regulating forest management and land-use change, driven in large part by a concern over deforestation in the Amazon. A particularly significant recent legislative change is the 2006 Law on Public Forest Management, which allows (for the first time) legal timber production on public forest land under a concession system. With perhaps as much as 45% of the

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15 Verifor, May 2006, Giants Don’t Leap: Verification in Brazil’s Process towards Sustainable Forestry, Verifor Case Study 5, Hans Thiel and Marcel Viergever, Series Editor David Brown
Amazon under this type of tenure there is now the opportunity to regularise a considerable quantity of timber production that was previously illegal.

While the intent is there, there remain significant obstacles to effective forest law enforcement in the Brazilian Amazon. The current reform process must be seen against a backdrop of uncertain land tenure. Lack of capacity within the State administrations for the issuance of land title continues to undermine efforts to secure legal compliance. Unresolved land tenure remains a significant constraint to verifying forest legality in Brazil. Furthermore, recent devolution of regulatory functions has created additional challenges in a Federal system, where the division of responsibility between the different levels of government is not well defined. Some forest-rich States, particularly in the Amazon, are amongst those whose environmental agencies responsible for forest monitoring and enforcement are seriously under-resourced.

The private sector in the Brazilian Amazon has been actively engaged in efforts to implement forest certification mainly through the FSC scheme. However certified areas still constitute only a small proportion of forest area in the Amazon region.

2.7 Central Africa

EU imports of wood products from high risk countries of the Central African region had a value of €802 million in 2011. Imports from this region were destined primarily for eight EU countries: France, Italy, Belgium, Spain, Netherlands, Denmark, the UK and Portugal (Chart 20).

Imports from Central Africa now consist primarily of rough sawnwood and veneers. EU imports of logs from the region have declined dramatically in recent years in response to African government controls designed to encourage primary processing within the region prior to export. EU imports of plywood from the region have also fallen significantly due to competition from cheaper Chinese products. A significant proportion of plywood produced in sub-saharan Africa is now sold into African regional markets.

Illegal logging is a very serious problem throughout the Central African region. Part of the problem in some areas is that industry has developed excess installed processing capacity and therefore frequently
suffers from a shortfall in log supply. This problem is exacerbated by strong demand from artisan producers and local communities which, while operating on a small-scale individually, consume large quantities of timber in aggregate.

Concerted efforts have been made by national governments in many parts of the region to increase the regularity of control, improve tax collection, and reduce infractions. New policies are being developed and implemented which aim to be more inclusive of different forest sector interests and equitable in distribution of benefits. Many of the largest concessionaires which dominate supply to the EU market have made far-reaching voluntary commitments to sustainable forest management and have implemented forest certification standards. African governments have been enthusiastic supporters of the FLEGT VPA process (see Chart 21). All major supply countries to the EU, with the important exception of Ivory Coast, are now actively engaged in the process.

However problems persist. The timescale for roll-out of VPA legality licensing covering the full range of timber products remains uncertain and may in some cases be extended. Government forest authorities in many parts of the region still lack support to put sustainable administrative and economic systems in place. Challenges to obtaining verification of legality remain in some areas, and particularly where timber is purchased through third party traders in the region rather than direct from large concession holders.

The timber supply situation varies significantly between countries in Central Africa (Chart 22). In order of importance to the EU market in 2011, the main supply countries are as follows:

- **Cameroon**: the country now has the greatest timber industry capacity in forested Africa. The vast majority of EU imports from Cameroon comprise sawn wood, with smaller volumes of logs, veneers and mouldings. Plywood production and exports are insignificant. Logs now represent only a small proportion of total exports from Cameroon. Much of the log volume shipped out of Douala port in Cameroon is in transit from the Central African Republic and northern parts of Congo Republic. As timber production has declined in West African countries in recent times, and a larger proportion of production from the Congo is now destined for China, EU buyers have increasingly focused on supply from Cameroon. This is particularly true of large importers in Belgium and Italy, both of which now play a significant role in delivery of tropical hardwoods to other parts of the European continent. Ayous, sapele and tali represent the largest proportion of Cameroon timber exports. Use of third party certification and legality verification amongst Cameroon suppliers to the EU market is well established. Around 6% of national forest area is FSC certified, and an additional 32% covered by other private sector legality verification systems.

- **Gabon**: until recently, Gabon’s log exports focused heavily on okoume logs, traditionally destined for France and lately for China. However, following a ban on exports of logs of most commercially valuable species from May 2010, Gabon’s industry is reorienting towards exports of processed products including sawnwood, veneers and plywood. France remains the main European destination for Gabon wood exports. Around 10% of Gabon forest area is now FSC certified, the area dominated by large concession holders supplying the EU market.

- **Ivory Coast**: a short and brutal civil war in 2002 split the country in two, divided between government- held territory in the south and rebel-held territory in the north. A fragile peace reigned until the disputed 2010 presidential election led to the Second Ivorian Civil War. These political
problems severely damaged the nation’s forests and associated industry, formerly one of the most advanced in Africa. The nation’s forests have now been heavily logged and significant areas of former forest reserve have been converted to plantation and invaded for agricultural land. Much of the wood industry is managed with a short-term view to maximising immediate profits. Most wood is now exported as rough sawn or veneer with the main commercial species comprising ayous, sapele and iroko. Although EU commentators have occasionally referred to Ivory Coast as a potential candidate for a FLEGT VPA, there are no reports of progress being made to open negotiations. There are no 3rd party certified or legally verified forests in Ivory Coast.

- Republic of Congo (Brazzaville): the EU imports mainly logs from the country, although tightening restrictions on log exports have shifted the emphasis more to sawn timber in recent years. The Republic of Congo is now the only major supplier of African redwood logs into the EU, notably sapele and sipo. Both species are used for the manufacture of high value joinery products in the EU. The majority of wood exported to the EU from Congo Republic derives from European-owned companies operating concessions in the northern part of the country. Much of this area is now 3rd party legally verified. In total, around 12% of forest area in the country is FSC certified and an additional 14% under other private sector legality verification systems.

- Democratic Republic of Congo: the sheer size of the nation’s forests suggests it has potential to be a significant supplier of timber to the international market. However this potential is severely constrained by the unstable political environment. The devastating civil war between 1997 and 1999 led to the complete destruction of industrial capacity throughout much of the country. Sporadic fighting has continued in the eastern parts of the country ever since, disrupting the reconstruction process. Foreign businesses have curtailed operations due to uncertainty about the outcome of the conflict, lack of infrastructure, regulatory uncertainty, and the difficult operating environment. EU imports from the country are destined mainly for Belgium and France and consist primarily of logs and rough sawn timber. Recent NGO reports claim widespread misuse of community logging permits to overcome a government freeze on new concession agreements implemented since 2002. There are no FSC certified forests in DRC, but several large concessions with a total area of nearly 2 million hectares are covered by private sector legality verification certificates.

- Ghana’s capacity to supply tropical wood products to the EU market has been diminishing in recent years. Levels of harvesting have for many years exceeded long term sustainable levels, particularly outside the forest reserves, and the availability of good quality hardwood logs is now declining. A key underlying factor has been very high population pressure. Ghana has a per-capita forest area of only 0.07 hectares, the lowest of any major tropical timber supplying country to the EU. This has encouraged widespread forest conversion, illegal logging primarily to supply the local needs of rural communities, and also made political decisions to close down excess capacity in rural areas with few alternative employment opportunities, difficult. On the other hand, due to Ghana’s relatively accessible location and stable economic and political environment it has progressed further than any other African country in developing wood processing facilities. The country supplies mainly sawnwood, including kiln dried, and veneers to the EU market. An area of 0.5 million hectares, around 9% of total national forest area, is currently covered by 3rd party legality verification systems. Ghana is likely to be amongst the first countries operating VPA Licensing procedures for delivery of wood to the EU market.

3 Trade flow monitoring in response to EUTR

Reliable tracking of overall trade flows of timber into individual Member States and then within the EU is necessary to effectively measure impacts of the EU Timber Regulation as well as FLEGT VPA processes. Good detailed data would be able to help the European Commission identify, *inter alia*, whether:

- Imports of FLEGT-licensed timber as well as independently certified sustainable or legally verified wood products are increasing;
- Imports of high risk wood products are decreasing and possibly being replaced by other low risk wood products;
- There are increases or decreases in individual ports from high risk sources (e.g. whether traders are identifying any possible weak links in the customs process, and circumventing more rigorous inspection points).

3.1 Existing sources of trade data

Although the information exists in fragmented locations around the world, efforts to systematically compile and assess these trade flows are still in the early stages (see Section 3.3). Important sources of background data for trade flow analysis include:

- Eurostat within the EU and national statistics offices in supply countries. Eurostat provides access to bulk unprocessed statistics on wood imports and exports by individual EU Member States on a monthly basis. Eurostat also publishes occasional update reports on annual forest products trade, but this data is too infrequent and insufficiently disaggregated to assess EUTR trends.
- UN COMTRADE makes production available based on official reports of a country’s own self-reporting. The self-reported country data is, however, known to be based on differing methodologies and of varying quality. Some countries annual statistics are years in arrears.
- UNECE Timber Committee prepares an Annual Market Review covering trade within the UNECE region (North America, Europe, CIS). It is insufficiently detailed to allow monitoring of EUTR impacts.
- FAOSTAT data are provided by countries through Joint Forest Sector Questionnaire (JFSQ) conducted by FAO Forestry Department in partnership with the International Tropical Timber Organization (ITTO), the Statistical Office of the European Union (Eurostat) and the UN Economic Commission for Europe (UNECE). In the cases where countries have not provided information through the questionnaire, FAO estimates annual production and trade based on trade journal reports, statistical yearbooks or other sources. Where data are unavailable, FAO repeats historical figures until new information is found.
- ITTO's Annual Review and Assessment of the World Timber Situation aims to compile "the most up-to-date and reliable international statistics available on global production and trade of timber, with an emphasis on the tropics". The document is based on the JFSQ survey supplemented by other sources as necessary. However the quality of data has suffered from the failure of many ITTO member countries to submit annual reports. Nor are trade flows with the EU a central focus of the report.
- Certification schemes such as the FSC and PEFC monitor hectares certified and CoC certificates.
The European Forest Institute has had a database that uses UN Comtrade data for its raw data, but then applies a methodology to minimize internal errors and discrepancies. This database is currently not being updated.

Individual organizations (such as Forest Industries Intelligence Ltd, Globaltimber.org, Forest Trends and European trade organizations) work with existing sources of trade data on a report-by-report basis. Forest Industries Intelligence Ltd, for example, is developing a system for systematic review of Eurostat import and export statistics and to regularly publish this data. This is currently being made freely available on a pilot basis to interested parties.17

3.2 Data gaps

There are significant data gaps limiting opportunities to more accurately monitor trade flow impacts of EUTR. These include:

- Regular and consistent feedback is needed – by way of structured interviews and questionnaires – from individual timber traders in the EU to assess drivers behind shifts in trade flows and thereby to assess the significance of EUTR relative to other factors (e.g. product availability, quality, shipping time, competitive product trends, product innovations, currency fluctuations).

- Certification and verification systems report forest area figures and data on numbers of chain of custody certificates, but with few exceptions provide no data on productive capacity of certified forests or volumes of certified products traded. This information would be invaluable in assessing the extent to which different systems are being used to mitigate risk in line with EUTR.

- Reliable protocols for assessment of risk of illegal logging in specified supply regions need to be developed and used to prepare comprehensive databases, both for use by individual EU operators, and to allow monitoring of shifting trade flows between “high” and “low risk” areas. The FSC Risk Register is one useful initiative in this direction, but there is space for other initiatives independent of individual certification systems and specifically focused on assessment of illegal harvest risk using the EUTR definition.

- Evolution of a “Forest Governance Perceptions Index”, drawing on the Transparency International Corruption Perceptions Index but focused on the forest sector, would be another useful but potentially politically sensitive tool to monitor role of EUTR in driving both changes in trade flows and positive impact of EUTR and similar measures to help drive improved forest governance.

- Aggregated information on the volume of different forest products exported and imported with FLEGT VPA and CITES licenses should be made publicly available to assess the extent to which these regulatory mechanisms are being used as an alternative to EUTR regulation.

- Information on the numbers of “operators” and “traders” captured by EUTR at the level of individual Member States would provide insights into the extent to which the EU trade is altering buying patterns and distribution networks as a result of EUTR.

- Compilation and systematic review of official statistical trade data derived from national agencies is critical. For example, Eurostat monthly trade data needs to be regularly compiled into quarterly,

17 More details at http://www.sustainablewood.com
biannual and annual reports. Data needs to be cleaned of errors as far as possible. Ideally it should be made available through dynamic web-based systems providing free public access helping to increase transparency of trade flows and greater efficiency of trade practice.

- EU Port of Entry data - Japan, China, the US and Indonesia have detailed trade information by ports of entry. However this data is not readily available in the EU. Eurostat data provides only bulk tonnage data for individual ports with no data available for individual European ports of entry.

3.3 EUTR Monitoring initiatives

3.3.1 European Timber Trade Federation

With support from the UK Department for International Development (DFID), the ETTF has contracted Forest Industries Intelligence Limited to prepare annual reports on EU timber import trends in the light of EUTR. Reports will cover imports into the EU as a whole and also for individual ETTF member countries (Belgium, Denmark, France, Germany, Greece, Italy, Netherlands, Spain, UK). The project is also expected to involve structured interviews with market participants to gain clearer insights into market drivers.

3.3.2 Independent Market Monitor

In early 2012, the EU FLEGT Facility (based at EFI) commissioned an options paper which made recommendations for the structure and focus of a potential future Independent Market Monitor (IMM). The EC has to date not released this study or its recommendations. However, it is understood that the EC is planning to contract the IMM function to an outside agency, probably a UN agency. The priority of early monitoring is expected to be tracking the position of FLEGT-licensed timber on the EU market (volumes and price) since this is a key part of reciprocity elements of some VPAs. While there are no specific instructions for the IMM now, it is possible that the IMM could also investigate any EUTR influence on trade flows and the overall status of legal wood product entering the EU markets.

3.3.3 ITTO Market Information Service

ITTO’s bi-monthly Market Information Service has restarted following a brief break during 2012 due to lack of funds. Although not focused on EUTR-specific developments, it provides a useful overview of trade trends in regions of particular relevance to the tropical hardwood trade. Forest Industries Intelligence Ltd has been commissioned to prepare reports on the European market and is expected to cover EUTR issues on a regular basis.
4 ANNEX 1. Illegal Practices and Examples of Corruption in the Forestry Sector

Illegal Logging
- Logging timber species protected by national law.\(^{19}\)
- Buying logs from local entrepreneurs that have been harvested outside the concession.
- Logging outside concession boundaries.
- Contract with local forest owners to harvest in their land but then cutting trees from neighbouring public lands instead.
- Logging in protected areas such as forest reserves.
- Logging in prohibited areas such as steep slopes, river banks and catchment areas.
- Removing under/over-sized trees.
- Extracting more timber than authorized.
- Logging without authorization.
- Logging when in breach of contractual obligations (e.g. pre-logging environmental impact statement).
- Obtaining concessions illegally.

Timber Smuggling
- Export/import of tree species banned under national or international law, such as the Convention on International Trade in Endangered Species of Fauna and Flora (CITES).\(^{20}\)
- Export/import of tree species listed under CITES without the appropriate permits.\(^{21}\)
- Export/import of log, lumber or other timber product in contravention of national bans.
- Unauthorized movement of timber across district or national borders.
- Movement of illegally logged timber from forest to market.
- Exporting volumes of forest product in excess of the documented export quantity.

Practices Specifically Aimed at Reducing Payment of Taxes and Other Fees
- Declaring selling forest products at prices below market prices to reduce declared profits and corporate and income taxes.
- Declaring buying inputs at prices above market prices to reduce declared profits and corporate or income taxes.
- Manipulation of debt cash flows (transferring money to subsidiaries or a parent company where debt repayment is freer than the export of projects; inflating repayments allowing untaxed larger repatriation of profits, reducing the level of declared profits and, therefore, of taxes).
- Overvaluing services received from related companies to reduce declared profits and corporate and income taxes.
- Avoiding royalties and duties by under-grading, under-measuring, under-reporting and under-valuing of timber and mis-classification of species.
- Non-payment of license fees, royalties, taxes, fines and other government charges.

Illegal Timber Processing
- Processing timber without documentation (if required) verifying its legal origin.
- Operating without a processing license.

\(^{18}\) Reproduced from Corrupt and Illegal Activities in the Forest Sector: Current Understandings and Implications for the World Bank by Deborah Callister. 1999.
\(^{19}\) Some authors (Contreras-Hermosilla 1997; de Bohan, et al. 1996; Krishnaswamy & Hanson 1999) also list ‘logging timber species protected by international law such as the Convention on International Trade in Endangered Species of Fauna and Flora (CITES)’ as illegal logging. This is incorrect, as CITES’ provisions only apply to international trade and do not prescribe domestic controls over logging of CITES listed species.
\(^{20}\) Applies to CITES Appendix I-listed taxa only.
\(^{21}\) Applicable to CITES Appendix II and III-listed taxa.
- Operating without other necessary licenses and approvals (e.g. effluent disposal permits).
- Failing to meet license provisions, including pollution control standards.

Corruption — paying of bribes, political patronage and so on — operates either to allow many of these activities to occur in the first place, or to allow them to proceed unchecked or unpunished. Examples of corrupt activities which have been observed in the forest sector are given [below]. These are divided into ‘grand’ and ‘petty’ corruption, with the distinction largely based on who is acting corruptly and their rank and status in the community, rather than the size of the bribe or the scale of the impact of the resulting activity. Note that [author Deb Callister has] diverged from the definition of Tanzi (1998), by including corruption involving bureaucrats under the category of ‘grand’ corruption. Some corrupt activities can span either category, such as payment to avoid prosecution for transgressions.

‘Grand’ Corruption
- Companies providing support to political parties, bribing politicians, bribing senior government officials or military officers, to:
  - obtain a timber concession;
  - obtain extensions to existing concessions;
  - obtain approval for a timber processing venture;
  - avoid prosecution for transgressions;
  - avoid payment of fines or other fees; and
  - negotiate favourable concession/investment agreements, including tax holidays and other investment incentives.
- Politicians and high-ranking military and government officers using their status to affect the same outcomes as listed above, for their own companies or those of relatives or political allies.
- Companies bribing local communities to influence them to agree to the granting of timber harvesting rights.

‘Petty’ Corruption
- Companies bribing junior government officials, military personnel and local government officials to:
  - falsify declarations of volume or species harvested;
  - avoid reporting harvesting of prohibited species or diameters;
  - falsify export documentation or ignore document irregularities;
  - avoid reporting and prosecution for non-compliance with forest management regulations established in the concession contract;
  - permit illegal movement of timber;
  - ignore logging in protected areas and outside concession boundaries;
  - allow timber processing without the necessary approvals; and ignore infringements of timber processing regulations, including pollution controls.
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