



CBI
Ministry of Foreign Affairs of the Netherlands



CBI scenario planning

Impact of the European Timber Regulation for SME timber exporters in developing countries

As of March 3 2013 companies placing timber on the EU market have to be able to prove that this timber is sourced legally. This can be a challenge. Especially in countries where forest law enforcement and good governance is not properly functioning. The implementation of the EUTR will influence the import of timber products by EU-member states. The exact consequences of the EUTR on SME exporters in the South are unknown. However, it is possible to predict likely scenarios for this specific group of exporters. These scenarios are presented in this document. Business Support Organisations (BSOs) can use these scenarios to inform, prepare and train their member firms, so they can anticipate on these scenarios if they occur.

Setting the scene: the EUTR

In October 2010 the EU adopted a new Timber Regulation¹ to combat trade in illegally harvested timber. This is one of a number of actions under the 2003 EU Action Plan on Forest Law Enforcement Governance and Trade (FLEGT). The regulation, which will be effective starting from the 3rd of March 2013, counters the trade in illegally harvested timber and timber products. The regulation distinguishes between operators and traders. 'Operator' is defined as any natural or legal person that places timber or timber products on the EU market for the first time. A 'trader' is any natural or legal person who, in the course of a commercial activity, sells or buys on the internal EU market timber or timber products already placed on the internal market. The regulation consists of three key obligations. With regards to operators:

1. It prohibits the placing on the EU market of illegally harvested timber and products derived from such timber;
2. It requires operators to exercise 'due diligence'.

Once on the EU market, the timber and timber products may be sold on and/or transformed before they reach the final consumer. To allow for the traceability of timber products economic operators in this part of the supply chain (referred to as traders in the regulation) have an obligation to:

3. keep records of their suppliers and customers.

What is "due diligence"?

The core of the 'due diligence' notion is that operators have to undertake a risk management exercise so as to minimise the risk of placing illegally harvested timber, or timber products containing illegally harvested timber, on the EU market. The three key elements of the "due diligence system" are:

1. Information: The operator must have access to information describing the timber and timber products, country of harvest, quantity, details of the supplier and information on compliance with national legislation.
2. Risk assessment: The operator should assess the risk of illegal timber in his supply chain, based on the information identified above and taking into account criteria set out in the regulation.
3. Risk mitigation: When the assessment shows that there is a risk of illegal timber in the supply chain that risk can be mitigated by requiring additional information and verification from his supplier.

Exporters in developing countries (DC exporters) are likely to be faced with (additional) questions with regards to a legal origin of the timber they want to export (see 'Legally harvested timber'). If the country in which the DC exporter operates has signed a VPA with the EU and timber is FLEGT licensed (see text box), then legality is proven. A due diligence system of an operator can, in addition to sourcing FLEGT-licensed timber, consist of sourcing (only) certified sustainably produced timber (e.g. FSC² or PEFC³-certified) and (third party) verified legal timber. There are more ways to exercise due diligence, depending on the risk identified with regards to illegally harvesting in the country of origin.

¹Regulation laying down the obligations of operators who place timber and timber products on the market' (EU (995/2010)
<http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2010:295:SOM:EN:HTML>

² Forest Stewardship Council (www.fsc.org)

³ Programme for the Endorsement of Forest Certification (www.pefc.org)

Legally harvested timber

Within the framework of the EUTR 'legally harvested' is defined as harvested in accordance with the applicable legislation in the country of harvest. 'Applicable legislation' means the legislation in force in the country of harvest covering the following matters:

- rights to harvest timber within legally gazetted boundaries,
- payments for harvest rights and timber including duties related to timber harvesting,
- timber harvesting, including environmental and forest legislation including forest management and biodiversity conservation, where directly related to timber harvesting,
- third parties' legal rights concerning use and tenure that are affected by timber harvesting, and
- trade and customs, in so far as the forest sector is concerned.

Which products does the EUTR cover?

The EUTR covers a broad range of timber products including solid wood products, flooring, plywood, pulp and paper. Not included are recycled products, as well as rattan, bamboo and printed papers such as books, magazines and newspapers. The Annex to the regulation presents an overview of all timber and timber products to which the regulation applies. The product scope can be amended if necessary. The EUTR applies to both imported and domestically produced timber and timber products. Timber and timber products covered by valid FLEGT-license or CITES-permit (see text box) are considered to comply with the requirements of the EUTR.



FLEGT and CITES licenses

FLEGT Voluntary Partnership Agreements (VPAs) are bilateral agreements between the European Union and timber exporting countries, which aim to guarantee that the wood exported to the EU is from legal sources and to support partner countries in improving their own regulation and governance of the sector. There are currently (January 2013) six countries developing the systems agreed under a VPA⁴ and six countries that are negotiating with the EU⁵. Furthermore, there are around 15 countries that have expressed interest in VPAs⁶. The first timber shipment carrying a FLEGT license is expected in 2013.

Please also see the CBI study on FLEGT which you can download from the CBI market information platform.

CITES (the Convention on International Trade in Endangered Species of Wild Fauna and Flora) is an international agreement between governments. Its aim is to ensure that international trade in specimens of wild animals and plants does not threaten their survival. There are several tree species CITES-listed. A specimen of a CITES-listed species may be imported into or exported (or re-exported) only if the appropriate document has been obtained and presented for clearance at the port of entry or exit. These CITES-permits are accepted as proof of legality within the EUTR.

Please also see the CBI studies on CITES and other timber legislations in the CBI market information platform.

More information about the EUTR:

- http://ec.europa.eu/environment/forests/illegal_logging.htm
- <http://www.euflegt.efi.int/portal/>
- http://www.cbi.eu/marketintel_platform

⁴ Cameroon, Central African Republic, Ghana, Indonesia, Liberia and Republic of Congo (Brazzaville)

⁵ Democratic Republic of Congo, Gabon, Guyana, Honduras, Malaysia and Vietnam

⁶ FLEGT information missions have been carried out to: Bolivia, Colombia, Ecuador, Guatemala, Peru, Cambodia, Laos, Myanmar/Burma, Papua New Guinea, the Solomon Islands, Thailand, Côte d'Ivoire and, Sierra Leone

Methodology: expert views

The scenarios, threats, opportunities and considerations for action described in this document are the result of a peer group session with a wide range of experts from the Dutch timber sector. Representatives of companies who import tropical timber products for the retail sector and the construction sector, producers of finished products of tropical timber, like doors, and consultants to the industry participated in the peer group session.

The scenarios: future perspectives

Within the peer group session, the following four scenarios are regarded as potential directions in which the trade of timber products on the European market may be headed as a result of the impact of the EUTR:

1. "Legal is good enough";
2. "Sustainability is the future";
3. "Switch to substitutes for tropical timber"; and
4. "EU market will be ignored".

Each scenario is described later in more detail.

For drafting the different scenarios, several important trends and developments have been taken into account. The most important are:

1. Several European countries are in an economic crises and this (especially) affects tropical timber imports strongly. E.g. the consumption of sawn tropical timber in several of the (until recently) main tropical timber importing countries in Europe decreased significantly. E.g. in France (-37,6%), Italy (-56,2%) and Spain (-71,3%)⁷. On the other hand emerging markets and in some cases local markets increasingly have a strong need for raw materials such as timber. In general these emerging markets are less demanding when it comes to quality, volumes and sound origin.
2. In several (western) European countries there is an increased focus on sourcing sustainably produced timber. This goes beyond the legality as demanded within the EUTR. Both private and public sector have set up Green Procurement Policies with regards to timber (products). Please also see the CBI studies in the CBI market information platform. In addition, various timber trade federations have embraced sustainably produced timber as the preferred option. Next to environmental concerns, this is also motivated by a competitive advantage of timber as an environmental friendly raw material compared to other materials. A proven sustainable origin is a precondition for timber to be favoured as environmental friendly product. Increasing importance is given to (LCA⁸-based) environmental performance when developing new buildings and constructions.

3. Due to the high costs and lack of supply of sustainably produced tropical timber (in the past) and environmental concerns related to (tropical) timber, many substitutes have been developed: temperate and boreal timber is modified to improve the characteristics of the wood, composites (such as Wood Plastic Composite, WPC) have been successfully introduced and are, e.g. in decking, heavily competing with tropical timber. In addition, new products such as bamboo are introduced. Even some countries in Europe favour locally produced timber from an environmental and/or economic development point of view.

The four scenarios presented in this document are regarded by the experts as potential future directions in which the international trade of timber products on the European market may be headed. The threats, opportunities and considerations for action described under each scenario are drafted specifically for the CBI target group of Small and Medium Enterprises (SMEs) in developing countries who wish to export their timber products to the EU market, as well as the local Business Support Organizations (BSOs) that support these exporters.

Please note that the experts consider "Sustainability is the future" as the most likely scenario. This will depend for a large extent on 1) the willingness of (EU) companies to pay a fair price for (certified) sustainably produced timber and 2) the strategy of timber producing countries. If timber producing countries are only interested in high short-term profits (see figure 1), then the scenario "EU market will be ignored" might become reality. In fact, it is quite plausible that different scenarios will exist next to each other. E.g. on the short run 'legal is good enough' to meet the EUTR early 2013, while countries and forest management develops towards sustainability.

Quite a few of the considerations for action drafted for BSOs under each scenario know overlap. In addition, some recommendations are always relevant when aiming at export. E.g. all SMEs aiming at export are encouraged to market their products on the internet. It is essential that companies can be easily found on the internet and that enquiries of (potential) clients are answered quickly. In this way the (European) client is confident that the supplier approached is a professional organization. In addition, all SMEs are encouraged to access various markets to prevent dependence on one market, which makes companies vulnerable. Developing the domestic market can be considered as a prerequisite. BSOs can assist SMEs with both developing websites and conduct trainings on how to deal with (western) customers and how to develop different markets.

⁷ Source: CBI Tailored Intelligence Study Tropical Timber, December 2012 (http://www.cbi.eu/marketintel_platform)

⁸ Life Cycle Analyses



Figure 1 explains the types of products for which there is expected to be demand, if a certain scenario becomes reality. On the x-axis the value of wood based products is presented, while on the y-axis the amount of wood (m³) is presented to meet the demand for the type of products. I.e. Should Scenario 3 'switch to substitutes' become reality, than it is expected that tropical timber is only used in specific high-end (quality) products and that the amount of timber to meet market demand for these products is small. DC exporters can take this into account when considering options.

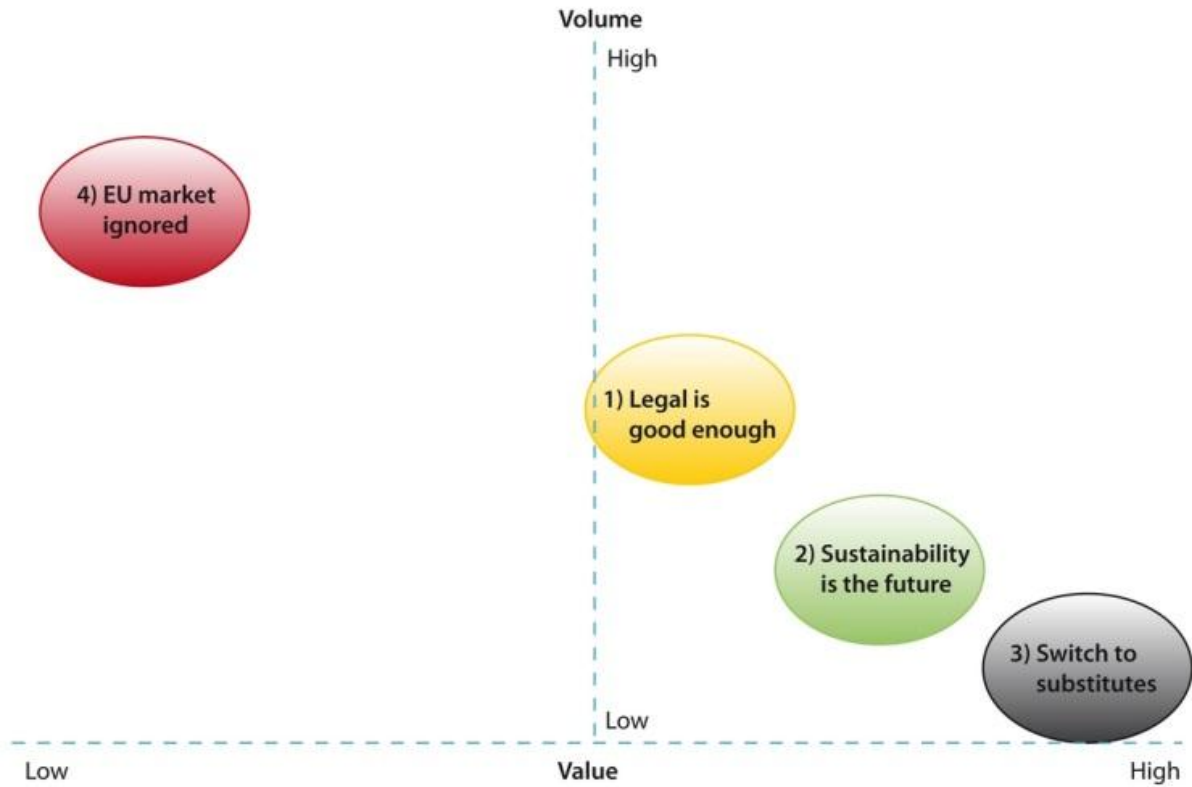


Figure 1: The four scenarios, positioned in terms of volume and value

Scenario 1 - Legal is good enough

Scenario 1 – Legal is good enough

As of March 3 2013 the minimum requirement for all imports of timber and timber products on the EU market, within the scope of the EUTR, is that its origin must be proven as being legal. In this scenario operators, including DC exporters, will meet this minimum requirement. In this scenario there is no progress towards sustainability, but the EUTR is strictly enforced. Proven legality of timber is for some EU member states already a major step forward and therefore clients (customers) are satisfied with 'just' proven legality.

Experts view this scenario as less likely in the long-term. However, it is easier to meet legality than sustainability. Therefore this scenario might on the short-term become (temporary) reality according to the experts.

Opportunities

- ✓ Easier market access on (previously) more demanding markets. It is easier to meet legality than sustainability. Certification of sustainable forest management is no longer required;
- ✓ Improved supply chain management;
- ✓ More equal level playing field. Illegal timber is prevented from entering the EU market;
- ✓ Increased European investment in processing facilities in timber producing countries to improve transparency of the supply chain;
- ✓ European companies willing to invest in e.g. partnerships to achieve total chain management (from forest to export);
- ✓ In case a FLEGT VPA with the EU is operational: easier market access for all companies in producer country. The requirements of a VPA are agreed on at the national level and must be met by all forest operators of the signatory country. I.e. all timber products listed in the VPA and heading to the EU meet the EUTR and can be placed on the EU market;
- ✓ Legality is an essential first step to achieve sustainability. Achieving sustainability can be viewed as a stepwise approach, especially when it comes to sustainable forest management. In case (in the future) sustainability is desired, the first hurdle is already taken. In addition, a closed chain of custody is needed to prove legality. A certified chain of custody is ready to also process certified sustainably produced timber;
- ✓ If all EU member states strictly enforce the EUTR and companies comply with the rules, concerns with regards to illegal logging of timber for the EU market is no longer valid. This contributes to a positive image of wood as the environmentally friendly raw material.

Considerations for action

In this scenario BSOs can help SMEs by explaining in detail how the EUTR functions and how SMEs can meet the demands of the EUTR. Case by case, but BSOs can consider to establish a system or platform explaining in detail how companies can meet the EUTR, including the kind of documents which are needed to prove legality in the country in question. BSOs can also assist in working on business links with EU companies and facilitate capacity building and total chain management. BSOs can organize joint (combined), and thus cost effective, third party verification of individual orders of timber and certification of legal origin / legal compliance which meet the EUTR.

Threats

- ✓ Loss of market access to countries which implement a FLEGT VPA with the EU (sooner). Countries which are in full implementation of the VPA and export FLEGT-licensed timber to the EU might have a competitive advantage on the EU-market compared to non-VPA countries;
- ✓ Not being able to prove legality and comply with the EUTR due to e.g. corruption, complex chain-of-custody, etc. and hence no market access;
- ✓ Exact requirements of EUTR are unclear and knowledge with regards to EUTR in timber producer countries is low, making compliance difficult;
- ✓ Not being able to meet the demand for sustainably produced (certified) timber products on markets which do (to some extent) require sustainably produced timber, such as USA, Australia and Japan;
- ✓ Loss of Unique Selling Point (USP) of timber: wood has a large potential as an environmental friendly raw-material, but only if sourced from sustainably managed forests. Proof of legality is not enough;
- ✓ Western companies are less willing to pay an additional fee for proven legality. Legal is viewed as obvious, compared to e.g. sustainability;
- ✓ Less financial incentive to invest in (certification of) sustainable forest management, with all negative consequences associated in timber producing countries. In addition, the area of certified sustainably managed forests will not increase and perhaps even decrease since there is no (financial) incentive for sustainability.

Scenario 2 - Sustainability is the future

Scenario 2 – Sustainability is the future

Companies have to conduct Due Diligence to ensure all timber products entering the EU are proven legal. I.e. undertake a risk management exercise with regards to placing illegally harvested timber on the EU market. What can be considered as proven legal (see Legally harvested timber) is defined in such a way that it is only a small step to achieve sustainability, with all associated advantages. Besides social and ecological benefits in and around the forest, there are also clear benefits from a more economic point of view, such as: (easier) market access on environmental sensitive markets, company branding opportunities and less risk for reputation damage, improved opportunities to position (sustainably produced) timber as the environmental friendly raw-material (instead of plastics, steel, etc.). In this scenario, companies opt to source only timber from certified sustainably managed forests.

Experts consider this scenario as the most likely scenario.

Opportunities

- ✓ Easier EU market access for timber producers and traders which are already Chain of Custody (CoC) certified and have access to forest resources certified for Sustainable Forest Management (SFM);
- ✓ Easier market access for SFM certified timber on the European market and also on other environmental sensitive markets such as Australia, USA, Japan, etc.;
- ✓ Improved supply chain management, which attributes to efficiency and transparency;
- ✓ Easier to achieve sustainability for companies which own or have large influence on the total chain (from forest to export). Joint ventures with European companies can contribute to achieve total chain management;
- ✓ Possible funding opportunities from (international) donors, such as embassies, Aid programmes and NGO's;
- ✓ Joint ventures with European companies (to achieve total chain management);
- ✓ Price premium for certified sustainably produced products;
- ✓ Improved branding opportunities to market sustainably produced timber as the environmental friendly raw material in construction. One of the main unique selling points (USPs) of timber;
- ✓ Easier to meet fair trade requirements and use fair trade and 'story telling' as USP of sustainably produced timber;
- ✓ Increased opportunities for Lesser Known Timber Species (LKTS) due to high demand certified timber;
- ✓ Currently more knowledge available on how to meet sustainability than how to meet EUTR Certification of SFM and COC has been in place for almost two decades, while the EUTR is relatively new and practical experiences are limited.

Considerations for action

In this scenario BSOs can help SMEs by facilitating certification of the Chain of Custody (CoC) and Sustainable Forest Management (SFM). This can be done by developing a certification manual (for both CoC and SFM), by negotiating with certification bodies for competitive prices and swift action and by stimulating group certification of SMEs and forestry companies. To push certification of SFM, BSOs can stimulate wood processing companies to demand certified timber from their suppliers. BSOs can also work on capacity building among their members with regards to lesser known timber species and how to disseminate this knowledge among their customers. Assisting SMEs with telling the story of their product (e.g. 'meet the producer' or 'meet the forester'). This information can add to improve branding opportunities for the (European) export market. BSOs can also organize the local internal market in a better way by conducting 'local CSR business round tables'. Often the local wood processing industry does not know the forest owners.

Threats

- ✓ Lack of financial resources (and knowledge) in timber producing countries to achieve sustainability;
- ✓ Duration of certification of sustainable forest management. It is a process which takes a lot of time and companies might lose market share to already certified suppliers;
- ✓ Companies only offering sustainably produced timber might be less competitive on other markets which do not demand sustainability;
- ✓ If this scenario would turn into reality overnight, there might not be enough certified tropical timber to meet demand of sustainably produced timber. Although over 400 million hectares is currently certified, only about 5% of this is situated in the tropics. Shortage of certified timber might also lead to increasing prices, making timber less competitive compared to possible substitutes;
- ✓ Price premium for certified products might not cover additional (certification) costs.

Scenario 3 - Switch to substitutes for tropical timber

Scenario 3 – Switch to substitutes for tropical timber

Since it is difficult to meet the EUTR for non-certified timber in countries where e.g. illegal logging is a major problem, timber importers in this scenario will switch to substitutes for tropical timber products. This can either be (treated and thus upgraded) timber from regions where it is easier to meet the EUTR or other materials such as aluminum, steel, WPC⁹ or bamboo. Besides the fact that timber from many boreal and temperate regions (such as Canada, US, Scandinavia) will easier meet the EUTR, it is also in general easier to source certified sustainably produced timber from these regions with all benefits associated (see scenario 2). The certified forest area is much larger than in the tropics. In addition: in some parts of Europe it is fashionable to use locally produced timber. Environmental concerns and the financial crises in Europe contributes to this development.

This scenario is already taking place (e.g. WPC for decking). However, experts expect that there will remain a significant request for tropical timber. In addition, substitutes for tropical timber have partly been developed out of concerns with regards to a sound (sustainable) origin of tropical timber. With the EUTR and availability of sustainably produced timber, these concerns are less valid. Experts thus expect this scenario not to be the dominant scenario.

Opportunities

- ✓ (niche-)products in which (only) tropical timber can excel, like wood for outside (garden) uses, for road construction and waterworks, for (luxurious exterior) doors, etc.;
- ✓ Value adding, e.g.: by producing window frames, doors, furniture, joineries, etc.;
- ✓ Lesser Known Timber Species (LKTS) which can be put cheaper on the market and thus perhaps compete with substitutes;
- ✓ Joint ventures with European companies to ensure value adding, development of niche-products and total chain management;
- ✓ Ensure sustainable forest management and highlight the benefits of using timber from the tropics, such as giving a fair value to forest products attributes to forest conservation, social and ecological benefits, etc.;
- ✓ Develop additional ways of distinguishing tropical timber from regular timber, such as: Fair Trade, 'storytelling', exotic, looks, quality, etc.

Considerations for action

In this scenario BSOs can assist SMEs with adding more value to their products produced and developing products for specific niche markets. Performing market research and technical assistance are important aspects. BSOs can share knowledge (and where necessary develop knowledge) and best practices among their member. Especially in a declining market, partnerships and total chain management are of great value. BSOs can be an intermediary and facilitate the establishment of partnerships and achieving total chain management.

Threats

- ✓ Extra efforts to meet EUTR might increase the cost price. A higher price, means a higher chance for substitution;
- ✓ Losing markets in Europe due to the switch to substitutes;
- ✓ Negative overall effect on local economy due to the lack of investments in wood sector;
- ✓ Less financial incentive to invest in (certification of) sustainable forest management, with all negative consequences associated in timber producing countries;
- ✓ Area of certified sustainably managed forests will not increase or even decrease since there is no (financial) incentive (reward) for sustainability.

⁹ Wood Polymer Composite (WPC)

Scenario 4 - EU market will be ignored

Scenario 4 – EU market will be ignored

In this scenario developing countries choose to move away their focus on the EU market to other (emerging) markets that do not have such strict requirements on legality (or sustainability) of the resource. Europe is no longer the dominant player on the tropical timber market which it was a decade ago. Emerging markets and in some cases local markets increasingly have a strong need for raw materials and are less demanding when it comes to legality (and sustainability) of the resource. In addition, emerging markets are in general also less demanding with regards to quality and volumes, making these markets attractive.

If DC exporters are only interested in high short-term profits (see figure 1), than the scenario “EU market will be ignored” might become reality. However, experts expect this scenario not to be dominant. A strong request for tropical timber will remain in Europe, which will be met.

Opportunities

- ✓ Easy market access on less environmental sensitive markets due to low requirements with regards to responsible sourcing;
- ✓ Easier market access for all types of qualities of timber;
- ✓ High short term profits due to high volumes (but less profit per m³ or per product).

⇒ *Please note that although the above might sound tempting, it results in the mid and long term in loss of forest resources and thereby loss of the resource on which the industry and people depend: wood.*

Threats

- ✓ Higher vulnerability because fewer markets are served and thereby risks are less spread;
- ✓ Less investment and work in timber processing industry and in capacity building due to high demand for basic raw-material (logs, sawn wood);
- ✓ Less additional value created;
- ✓ Negative overall effect on local economy due to the lack of investments in value adding;
- ✓ Loss of forest resources with all negative associated social and environmental impacts in the long run.

Considerations for action

Especially in this scenario it is important, as previously stressed, to not depend on one market only. Spreading risks is essential. For example, DC exporters could aim to sell high quality products on western markets, while the domestic and emerging markets can be used to position more low quality products. BSOs can stress this message to their members. BSOs can assist SMEs in developing the various markets, especially the domestic market. Conducting market research and give technical assistance are examples of the sort of activities BSOs could conduct in this regard.

