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Round Table on Sustainable Development

CHAIRMAN'S SUMMARY

**19th Meeting of the Round Table on Sustainable Development:
The Economics of Illegal Logging and Associated Trade**

8-9 January 2007
OECD Headquarters, Château de la Muette, Paris

For further information please contact Richard Doornbosch, Principal Advisor
Round Table on Sustainable Development, OECD, 2 rue André Pascal, 75775 Paris Cedex 16
tel: +33 1 45 24 14 57; e-mail: richard.doornbosch@oecd.org

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The Economics of Illegal Logging and Associated Trade
How International Efforts to Stop illegal Actions in the Forestry Sector can be Strengthened

The following is a short summary note of the discussion on 8-9 January 2007, issued under the Chairman's responsibility. Please note that, in keeping with Round Table procedures, a detailed note of the meeting will not be circulated.

1. While supply and demand side measures should not be implemented in isolation from one another, the discussion was organised under these two headings as a way of giving clarity and focus to the different approaches available. The meeting first ranged over supply-side measures, then moved to the demand side. Finally, some practical suggestions were made to strengthen the international efforts to stop illegal logging.

D) Supply side measures

There is a real danger that current efforts to curb illegal logging only end up increasing the cost of compliance for legal operators without seriously affecting illegal operations

2. There has been no serious attempt to quantify or measure the impact of current efforts on the costs of both legal and illegal operations. In general terms it was noted that the balance of international initiatives in recent years seem to have been focussed on measures that impose additional costs on legal producers. However, empirical evidence is clearly lacking.

3. From a business perspective the notion that the cost of enforcing legality is prohibitive was challenged. To the contrary, it was said, the cost of not enforcing legality is highly distortionary and undermines legal operators' profits. Illegal producers are - because of their lower costs - always able to undercut legal supply and depressing market prices. Surely this only holds when enforcement of legality can indeed be effectively commanded. If not, only the costs of legal suppliers are raised and the ultimate effect is that the undercutting of the market is aggravated.

4. This led to the observation that the effect of policy measures on the price differential between legal and illegal operations needs more emphasis and attention in policy making. In this regard it would be interesting to take a closer look at the certification schemes around the world, their costs and the differential impacts they have on competitiveness between regions and producers.

5. One reason the effect on the cost difference between legal and illegal logging might be difficult to establish was that it can be difficult to distinguish between legal and illegal activities. Indonesia was raised as a case in point. Crackdown operations seem to raise the costs of both legal and illegal logging operations because of the fine line between the two.

6. Furthermore it was mentioned that, in practice, the 'little guy with the chainsaw' will be especially affected by crackdown operations whereas the 'big guy with the bank account' might be able to pay his way around them. Also for this reason it was deemed important to broaden the discussion to other sectors such as anti-money laundering legislation and enforcement possibilities, as these may have tools better fitted to affect 'the big guy with the bank account'.

7. Besides these shortcomings several best practices were identified, including tax reforms in Latvia and Romania that lowered the burden on legal suppliers and the enforcement brigades in Russia that combine legal, policy, tax and forestry officials on the ground and facilitate fast prosecution. The brigades were installed with government support but are now self financing.

No regret policies should focus on increased transparency and information flows in producer countries

8. Enabling and strengthening information flows was widely regarded as a 'no regret' measure of paramount importance. More specifically, the interagency communication within and between countries must be strengthened. Most governments are organised as silos with inadequate or even absent horizontal information flows. Projects in Russia and Cameroon have shown that when information exchange is organised between customs, tax, policy and judiciary offices in Russia and the Ministry of Economy and Finance and the Ministry for Forestry in Cameroon, the dissuasive effect as people become aware of this is important. It was emphasized several times that engaging the ministry of finance was valuable because increasing compliance costs money before it pays off, and secondly because (extremely) high tax rates may in certain cases drive legal operators from the market.

9. Insufficient co-operation between customs offices was highlighted. Most participants were not aware of any effective system that works across borders, although CITES was regarded by some participants as a mechanism that could be better used. Furthermore, the Regional Intelligence Liaison Offices of the World Customs Organisation were mentioned as a good example of international co-operation. It was noted that given the many competing priorities of custom offices, environmental crimes are likely to be lower on the list compared with other offences such as arms and drugs trafficking. It was strongly felt that customs agencies will not pay adequate attention on their own. A push through a dedicated forum is needed to engage them. In the Asia FLEG process there has been such an effort though this certainly needs further work.

10. Another important no regret measure that was brought to the fore was the need to make better use of satellite monitoring to track discrepancies between allocated and actual cuts. It was noted that the technology is neither new nor prohibitively expensive. The key is to use it and to use it effectively. In Russia, for example, a major change was created when satellite images were allowed in court proceedings. A system used by the World Resource Institute had cost approximately \$ 1.5 million a year for Cameroon and \$ 1 million for Indonesia over a three-year period to install. The question was asked why such systems are not scaled up by producer countries with funding from the international community.

11. The log tracking system recently developed by Japan was considered to be another example of a no regret system to invest in.

Both producer countries and the international community have good reasons to invest in sustainable forest management

12. Notwithstanding the fact that there are strong possibilities for cost recovery of better forest law enforcement, as shown in several producer countries, there are compelling reasons for the international community to engage in forest conservation and the combat against illegal logging. It was noted that the international community could provide funding for the initial costs of improved enforcement such as the investment in log tracking systems. Several forest rich countries belong to the least developed countries and lack the capital and resources to do this by themselves.

Avoided deforestation should be brought under the climate change regime

13. Several participants pointed out the enormous window of opportunity that is now opening to price environmental values in the market by bringing avoided deforestation and investments in sustainable forest management under the climate change regime. This may not only address the logging for industrial purposes but also address the 80% of total round wood logged in tropical regions that is used as fuel wood.

14. In many countries where deforestation and logging has not yet gathered pace, industrial export based logging is proposed by some international development partners as the only development strategy.

Liberia and the Democratic Republic of Congo were mentioned as cases in point. But before this path is to be taken it should be explored more seriously whether this is indeed the only option for economic use of the forest or if there are indeed alternative possibilities to create value by keeping the forest standing – for example via a market for carbon credits. There is a clear need for the climate change and development community to work together on this issue and to see how carbon credits could be used to work for the forest and the people living from it.

II) Demand-side measures

The EU's FLEGT scheme is ineffective, but possible bandwagon and side-effects make it worthwhile

15. As the EU's FLEGT scheme extends in its current most optimal form to only 3% of industrial round wood and roughly 20% of all wood products from high risk countries, it was considered by the participants to be ineffective however promising it might eventually be. Besides limited geographical coverage, several other shortcomings were noted. The limitation to primary processed wood products provides a serious loophole. Furthermore, the absence of a tracking system to prevent trade displacement via third countries was mentioned. Finally, more reinforcement measures, such as procurement policies, could be taken in individual EU countries.

16. The value of FLEGT was seen by participants in signalling to market participants that it is possible to distinguish between legal and illegal products and create a discriminating market. This may lead to bandwagon effects by private companies and consumers asking for more products proven to be legal. It could also reinforce certification efforts by producer countries. In addition, several participants noted that the trade aspect was only one of the two pillars of FLEGT, the other being financial and technical assistance to improve governance in producer countries. This was seen by some of the participants as the more important pillar.

17. Furthermore, FLEGT can show that a licensing scheme is indeed possible for wood products and the built-in identification system can develop a track record. This was deemed to be important as technical issues remain to be sorted out, in particular those surrounding the need to extend coverage from primary processed products to further processed wood products. Besides the technical and capacity issues, the cost of compliance is still deemed to high by some.

The option to expand the geographical coverage of FLEGT to other important importing countries was deemed unrealistic

18. Although no one seemed to disagree that a multilateral scheme would be the most effective way of creating a discriminating market, there seemed to be a limited appetite to work on one. Participants accepted the 'political difficulty of such a scheme', as 20 years of negotiations have not much to show for themselves.

19. Some participants concluded that the bilateral system should be expanded to more producer and consumer countries as quickly as possible to make it more effective. Looking at the trade flows, it was deemed especially important for the USA, Japan, China and Russia to join in. Others considered it was naive to think that the USA and China would be willing to join a European scheme. If there had been any serious intention that these countries sign up to the system, they should have been more involved in its design at an early stage. Participants were not aware of serious consultations or dialogue between the EU and these countries and this was considered a serious omission. As one participant has put it, the logic might be all right but the politics are certainly not.

20. It was noted that FLEGT does not necessarily have to be extended to a multilateral system to be of use. The lessons learned by building up FLEGT might be taken into account when a new multilateral trade system is set up.

21. Furthermore, it might not be necessary for other countries to officially sign up to FLEGT to justify its having global reach. European and California based emissions standards have for example induced many important car manufacturers to change their default technologies, and in this way service markets with low emissions technology without regulations that require them to do so. The same may be true for licensing and certification schemes. As soon as the investments in licensing and tracking systems have been made the marginal cost of expanding the system to other markets might make it attractive to do so.

22. Finally, some emphasis was put on the time frame for FLEGT. The trade system would not be up and running before 2009 and then only in a few countries that will start negotiations in 2007 with the EU (Indonesia, Malaysia, Ghana and possible Cameroon). In theory, scaling up could be done quite rapidly as the systems and knowledge required to do so should then be available. In practice, however, no one thought that likely.

The WTO should be used to discuss trade measures to discriminate between legal and illegal products

23. It was emphasised that the WTO rules give the right to discriminate in favour of other public policy objectives such as protection of the environment and conservation of natural resources. Recent dispute settlements have shown sensitivity to retain the balance between trade and non-trade values. The WTO is a forum where discussions on trade and environment may take place. For this reason a special committee on trade and environment has been created to channel the discussion, but it has not been used to much positive effect in the past decade. There is much room for improvement in this area.

Limits to the effectiveness of certification schemes may be overcome

24. It was noted that there are still several limitations in certification that should be overcome. First of all the limited regional coverage, mainly in developed countries, is likely to continue for some time to come even if the projects that are now in the pipeline are taken into account. Secondly, the lack of coherence in the schemes was noted as different standards are applied in different countries. Thirdly, the proliferation of schemes could give rise to downward pressure on standards and risk confusing the public. Finally, the conflict of interest of accreditation officers was noted.

25. On a positive note, attention was drawn to the high growth rates of hectares under certification in recent years. Furthermore, in certain markets there were indeed price premiums of 8–25% although one participant disliked the word 'premium' as the costs of producing legal were still outweighing the higher price received. Market pressures in the form of public opinion have indeed worked to put companies and countries under pressure to clean up their acts. Considerable experience with tracking processed products has been achieved and mutual recognition of different systems is developing to save compliance costs. All in all, most participants seem to agree that the market pull of certification was critical to achieve success in producer countries.

III) How to strengthen international efforts to combat illegal logging; some practical ways forward

26. Round Table meetings are not designed to generate an outcome or action plan. However, discussions do provide an interesting opportunity to take stock of international efforts to deal with complex global problems. For that reason I would like to share a few observations on possible ways forward.

27. It was noted in the meeting that the overall context for discussions on combating illegal logging is frequently missing. If our concerns regarding deforestation and illegal logging need to be dealt with on an international level, there needs to be a global context. There is no global target, vision or objective that can evolve in a plan with a timeframe. As a result there are multiple efforts but insufficient co-operation between countries and between agencies on a global or even regional scale. Information gaps are not defined and no co-ordinated action is taken to address them.

28. Global linkages of information are crucial as illegal operators are incredibly creative. Any loophole will be used to insert illegal products into the value chain. It was noted that it would be an extremely useful idea to spend some time in a dedicated group to draw up a framework for a global information platform and to identify which existing mechanisms or organisations this could be linked to.

29. Some specific ideas tendered at the meeting included:

- engaging custom agencies and pushing them to co-operate through a dedicated forum;
- raising in the WTO the possibilities for banning illegal wood products by demanding proof of legality at borders;
- bringing deforestation and sustainable forest management under the climate change regime;
- to provide adequate development assistance to finance investments by the least developed countries in tracking systems and law enforcement;
- commencing a global dialogue between at least the EU, USA, China and Japan on the expansion of a trade based system such as FLEGT.