Preliminary Assessment of the trade impact of EUTR

Draft report by ITTO FLEGT IMM as input to the EUTR Biennial Review

Version 1

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The views expressed herein are those of the consultant and do not necessarily reflect the official opinion of the European Commission

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1. Introduction

This report aims to assess the trade impact of the EU Timber Regulation (EUTR)¹ using publicly available timber production and trade statistics. The assessment is constrained both by timing and limitations in the scope and quality of statistics. It has been prepared in June 2015 when EUTR is still in the early stages of implementation in many EU Member States. It is also produced prior to publication of any timber production data for the EU for the year 2014. There is therefore only a limited time frame during which EUTR impacts may be identified.

Reviewing the trade impact of the EUTR is also complicated by the background noise of other commercial and political issues influencing the European timber trade during the implementation period. The month in which EUTR was introduced – March 2013 – was the lowest point of European construction sector activity following the financial and economic crises. This period has been associated with significant government austerity measures, reduced access to credit and weak timber consumption. As a result, both the European authorities and timber sector are likely to have had reduced resources for EUTR implementation.

Events outside the EU region are also obscuring the impact of EUTR. Critical amongst these is strong demand for wood fibre in the emerging economies. Demand for wood products in China and other parts Asia continued to expand throughout the period of implementation of EUTR. At the same time the US economy was improving. This has meant that while internal European supply of some timber commodities has exceeded demand, availability of wood fibre in other regions of the world has been restricted. During 2013 and much of 2014, importers of numerous wood-based commodities from outside the EU reported declining availability and rising prices even while EU domestic consumption remained weak.

This analysis has been prepared with input from the ITTO Lead Consultant to the FLEGT Independent Market Monitoring (IMM) mechanism. It builds on previous work during preparation of the IMM Baseline Report which includes a systematic review of the strength and direction of thirty separate factors impacting on supply and demand for timber imported into the EU². A wide range of market issues were covered including: the economic and financial crises; rising demand emerging markets leading to reduced availability in the EU; distribution and intensity of forest management; external pressures on forests; the variable business environment in supply countries; development of technical standards; product design trends; and competition from non-wood materials. These issues were considered alongside policy initiatives including the EUTR.

The review in the IMM Baseline report highlights that, due to the complexity of factors impacting on trade, it unlikely that any changes in trade flows identified in national statistics and Eurostat statistics may be unambiguously attributed to EUTR. Such attribution will require additional surveys involving interviews of EU operators and their suppliers. Such surveys are planned by the IMM but have yet to be undertaken at time of preparing this report.

¹ EUTR includes Regulation No 995/2010 of the European Parliament and of the Council of 20 October 2010, the Commission delegated Regulation of 23 February 2012, and the Commission implementing Regulation (EU) No 607/2012 of 6 July 2012. Further details and links to all formal documents are provided by the European Commission at http://ec.europa.eu/environment/forests/timber_regulation.htm.

² The focus of the IMM Review is on the trade between VPA countries and the EU. However the review seeks to set this trade within the wider market context and therefore provides insights in factors impacting on supply and demand of all timber and timber products. However pulp and paper is specifically excluded as VPA Partner exports of these commodities to the EU are relatively minor.

2. Report structure

The report analyses publicly available statistics in the light of three specific questions identified as of particular concern to key stakeholders in the EUTR process:

- Has EUTR increased reliance on domestic production at expense of imports?
- Has EUTR led to a shift from sources perceived to be "high-risk" to those perceived to be "low risk"?
- Is EUTR leading to diversion of EU imports from "high-risk" sources away from Member States with fully implemented regulatory regimes towards those where regulatory regimes are yet to be implemented?

An additional key question – to what extent is EUTR impacting on the trade in FLEGT Licensed timber – is not included in this report due to lack of availability of any licensed timber during the period of review.

For each question, the report:

- identifies the rational, explaining why the question is considered important;
- explains how the available trade statistics will be used to test against the question;
- summarises the data and results.

The final section summarises the conclusions of the statistical analysis and expands the commentary drawing on additional data sources.

3. Scope and data sources

Import data is derived from the COMEXT section of the Eurostat bulk download facility³. Quantity data has been validated and summarised using IMM's trade database system. Production data is derived from FAOSTAT⁴ and Eurostat PRODCOM⁵.

Unless otherwise stated, data is for all EUTR-regulated timber products⁶. The majority of timber and timber-based products are captured by the legislation including solid wood, virgin pulp, paper and furniture. The main exclusions are charcoal, cork, pulps derived from recycled fibre, post-consumer waste papers, "printed papers" (such as books and magazines), and wooden seating (which is excluded from the furniture categories captured by the legislation).

Depending on availability of data and product group, data may be reported in € value (adjusted to constant 2014 prices where necessary to take account of inflation), quantity (usually cubic meters but occasionally square meters), tonnage (pulp and paper) or Roundwood Equivalent (RWE) volume (cubic meters)⁷.

³ http://ec.europa.eu/eurostat/estat-navtree-portlet-prod/BulkDownloadListing

⁴ http://faostat3.fao.org/home/E

⁵ http://ec.europa.eu/eurostat/web/prodcom/data/database

⁶ See Annex to the EUTR "Timber and timber products as classified in the Combined Nomenclature set out in Annex I to Council Regulation (EEC) No 2658/87 (1), to which this Regulation applies"

⁷ RWE data is used sparingly due to considerable uncertainties surrounding appropriate conversion factors. Conversion factors have been derived by IMM drawing on OECD and UNECE documents (see <u>http://www.unece.org/fileadmin/DAM/timber/publications/DP-49.pdf</u>).

To provide insights into whether trends in 2013 and 2014 are something new or a continuation of existing long-term trends, annual data is provided starting from 2004.

4. Has EUTR increased reliance on domestic production at expense of imports?

4.1 Rationale

The requirement for due diligence imposed on EU operators may favour timber and timber products of domestic origin and reduce dependence on imports. This might occur because risk of illegality is generally lower for domestically produced wood than for imported wood. Or alternatively there may be greater technical obstacles to demonstrate negligible risk for imports associated with the need to map longer and more complex supply chains.

4.2 How is it tested?

Lack of high quality and up to date production statistics means it is difficult to reliably assess the impact of EUTR on relative proportion of timber and timber products derived from domestic and imported sources.

EU forest products production data categorised according to the Joint Forest Sector Questionnaire (JFSQ) system, is available from the FAOSTAT website. Eurostat also provides annual production statistics for a range of manufactured wood goods in the on-line PRODCOM database. The PRODCOM system uses 8-digit codes to identify products, but these are different from the CN codes used for trade data. Both sets of data provide considerably less detail on individual products than the CN trade codes. They are also only updated annually, usually in the middle of the following year.

Together the FAOSTAT and PRODCOM data provides clues to the shifting scale and location of wood production and manufacturing across the EU, but cannot be used for analysis of the actual sources or types of wood raw material used by different manufacturing sectors. The most recent data available – for 2013 – provides little insight into changes that may have occurred in response to EUTR.

To partially compensate for this, the Eurostat trade data is also used as a surrogate to assess relative dependence on domestic compared to external production. The ratio of extra-EU imports to intra-EU imports provides a measure of the extent to which EU importers are dependent on suppliers outside the EU relative to suppliers inside the EU⁸. The measure is crude because it takes no account of production not traded between EU Member States. Nor does it account for re-exports – timber and timber products imported and placed on the market in one EU Member State before being transported into another. An increase in the level of intra-EU trade at the expense of extra-EU trade may result from:

- declining dependence on timber from outside the EU; or
- rising dependence on a more limited number of entry points into the EU leading to increased transhipment between EU Member States; or
- a combination of these two trends.

⁸ Note that a ratio of 1 implies that the value or quantity of extra-EU and intra-EU trade are exactly equivalent. A ratio below 1 implies greater dependence on intra-EU trade. A ratio above 1 implies greater dependence on imports from outside the EU

4.3 Data analysis

For this test, timber products derived from saw and veneer logs⁹ are treated separately from pulp and paper products due to their distinctive industry and market structures.

Products from saw and veneer logs

Chart 1a summarises total EU supply¹⁰ for timber products derived from saw and veneer logs in RWE terms. It combines FAOSTAT data on EU production of softwood and hardwood saw and veneer logs (in m3) with RWE volume of imports from outside the EU of all timber products derived from saw and veneer logs. The chart shows total supply of these products reached a peak 293 million m3 RWE in 2007, before falling to a low of 208 million m3 RWE in 2009 during the financial crises. Supply recovered only slowly to 224 million m3 RWE in 2013.

Chart 1b shows how between 2006 and 2013 there was a continuous shift away from imported material in favour of domestic production. The proportion of imports in total supply fell from 24% in 2006 to 17% in 2013.



Source ITTO FLEGT IMM analysis of PRODCOM & COMEXT

The fall in import share is probably due to a wide range of factors including: imposition of wood export controls by major trade partners (particularly Russia); shift to just-in-time trading which favoured shorted less complex supply chains; reduced access to credit in the EU since the financial crises which also favoured less risky shorter supply chains; improved competitiveness and efficiency of European wood manufacturing; rising prices and falling global availability of timber in regions outside the EU due to past over-exploitation; and rising demand in emerging markets leading to reduced availability to the EU.

Source ITTO FLEGT IMM analysis of PRODCOM & COMEXT

⁹ Composite panels are excluded from products "derived from saw and veneer logs" as these are assumed to derive exclusively from small dimension logs or wood waste material. While wood joinery and wood furniture products contain composite panels, trade data does not allow this to be differentiated. Therefore for this analysis it is assumed that all wood joinery and furniture is composed of timber derived from saw and veneer logs.

¹⁰ "Supply" is here defined specifically as domestic production plus imports.



Chart 2a shows the trend in total EU imports of all timber products derived from saw and veneer logs into the EU (in RWE m3) during the period 2004 to 2014. The slight rise in total imports in 2014 suggests that EUTR was not contributing to a significant increase in domestic sourcing at the expense of imports.



Chart 2b shows the product share of EU28 imports of timber from sawn and veneer logs between 2004 and 2014. The vast majority comprises sawnwood, plywood, furniture and logs. There was a particularly sharp fall in EU dependency on log imports in the period 2004 to 2009, mainly related to a reduction in imports from Russia. The share of EU imports comprising plywood has been rising, driven mainly Chinese suppliers which took a rising share from EU domestic and other external suppliers, particularly in South East Asia and Brazil.



Source ITTO FLEGT IMM analysis of COMEXT

Chart 2c shows the changing share of major supply countries in overall supply of timber products from saw and veneer logs into the EU. It highlights the big decline in share of imports from Russia in the 2004 to 2009 period. During this period China emerged as a very significant supplier to the EU, particularly of plywood and furniture products. The share of China in total EU imports remained stable (at around 20% on a RWE basis) between 2009 and 2014.







Using the most recent production data (to 2013), charts 3a to 3c show the % share of imports in total supply of individual timber product groups to the EU market. While total aggregated share of imports fell between 2004 and 2013, there were widely variable trends between product groups.

Since 2008, imports have particularly lost share relative to domestic production in the sawn hardwood and flooring sectors. This aligns with anecdotal reports suggesting a very strong trend towards increased dependence on European oak in both sectors, a trend driven by European joinery and flooring manufacturers seeking to increase consumption of readily available domestic raw material. The European flooring industry has reported a particularly significant fall in reliance on tropical timbers – particularly merbau and teak - partially attributed to environmental concerns. EUTR may have been instrumental in speeding this trend. Imports of plywood first gained share from domestic production in the period 2004 to 2007, but this trend levelled out between 2007 and 2011. In 2012, European manufacturers recaptured a little share from overseas producers, but this trend reversed again in 2013. Despite widespread anecdotal reports of importers facing challenges in obtaining necessary legality assurances from Chinese plywood manufacturers, there's no evidence that this had a significant immediate effect in 2013 to reduce overall import dependence in this sector.

The data is also ambivalent on EUTR impacts in the furniture sector (Chart 3c). EU import dependence increased sharply for certain wood furniture products in the period to 2008, particularly bedroom furniture and dining and living room furniture. At this time China and, to a lesser extent, other South East Asian countries increased market penetration in the EU. However this trend levelled off in the wake of the financial crises as imports fell more rapidly than domestic production.

In 2013, there was a slight decrease in import share for both bedroom furniture and living/dining room furniture. This may be partly attributable to EUTR effects.

Charts 4a to 4c show the ratio of extra-EU to intra-EU trade in individual timber product groups across the EU for the period 2004 to 2014. Although an imperfect measure, if EUTR were leading to a significant shift away from imports towards domestic timber products, it should show in a decline in the ratio of extra-EU to intra-EU trade in 2013 and 2014. No such consistent decline is observable in any product group. The reverse is true for some products. There was a rise in the volume of extra-EU imports relative to intra-EU imports during this period for plywood, hardwood logs, and softwood logs and sawn. For other products the trend is either flat or variable.



Source ITTO FLEGT IMM analysis of COMEXT

Pulp and paper

Between 2004 and 2013, around 145 million m3 of pulp logs were supplied to the EU each year. Apart from a short-lived dip in 2009, this volume remained reasonably consistent over the decade (chart 5a). The large majority of pulp logs supplied to the EU paper industry derive from domestic sources. In the period 2004 to 2008, around 8% of pulp logs were imported. This proportion fell to only 3% in 2009 before partially recovering to 6% in 2013 (Chart 5b).

Trends in EU pulp log imports are driven primarily by the trade between Russia and Finland which prior to 2009 accounted for 70%-80% of all EU imports (Chart 5c).







Source ITTO FLEGT IMM analysis of COMEXT



Source: ITTO FLEGT IMM analysis of PRODCOM & COMEXT



The financial crises combined with progressive implementation of log export taxes by the Russian authorities precipitated a sharp fall in imports of Russian pulp logs in 2009. Subsequent liberalisation of the Russia log export regime as a measure to gain entry into the WTO facilitated a partial recovery in EU imports from Russia between 2012 and 2014. Pulp log imports have also been rising from Norway and Belarus during this period.

The supply of pulp to the EU peaked at around 50 million tonnes in 2006 and 2007, before declining to a low of 42 million tonnes in 2009 during the financial crises. Supply recovered to around 46 million in 2011 and stabilised at this level in 2012 and 2013 (Chart 6a). The vast majority of imported pulp is chemical pulp. Very little mechanical pulp is imported. The share of imported pulp in total supply was consistently 19%-20% between 2004 and 2012 but slipped slightly to 18% in 2013 (Chart 6b).





There has been substantial growth in EU chemical pulp imports from Brazil and other South American countries (much from eucalyptus) in recent years, largely at the expense of U.S. and Canadian suppliers (mainly softwood). The slight slippage in share of imports in total pulp supply in 2013 was primarily due to a small downturn in imports from Brazil and continuing contraction in imports from Canada. As the large majority of pulp from both countries is known to be independently certified, it's very unlikely that the downturn was in any way related to EUTR. There was also a substantial recovery in imports from Brazil in 2014 (Chart 6c).



Source: ITTO FLEGT IMM analysis of COMEXT

The supply of paper to the EU peaked at around 110 million tonnes in 2006 and 2007, before declining to a low of 96 million tonnes in 2008 during the financial crises (Chart 7a). Import penetration was very consistent at around 7% to 8% of total EU paper supply in the 2004-2012 period. However import penetration slipped a little, to closer to 6%, in 2013 (Chart 7b).



Source ITTO FLEGT IMM analysis of PRODCOM & COMEXT

Although the EU imports finished paper from a large variety of countries, just seven countries consistently account for around 80% of total imports (USA, Switzerland, China, Norway, Russia, Brazil and Canada - see Chart 7c). The US and China's share in total imports increased prior to 2007 but has since stabilised. The share of Norway, Switzerland, Canada and Russia has declined in recent years. The slight fall in total EU import penetration of paper in 2013 was primarily due to a fall in imports from Norway, Russia, Brazil and Canada. Imports from China were rising in 2013. The fall in EU imports was reversed in 2014.



Source ITTO FLEGT IMM analysis of PRODCOM & COMEXT



Source: ITTO FLEGT IMM analysis of COMEXT

4.4 Result

Overall there has been no discernible shift from imported to domestic material that is directly attributable to the EUTR.

For solid timber products derived from saw and veneer logs, there was a shift from imported to domestically produced material in the year 2013 when EUTR was implemented. However this was clearly a continuation of a long term trend. It's possible that implementation of EUTR added to this trend in a few sectors in 2013 – notably flooring, bedroom furniture and living/dining room furniture. If so the effect was apparently temporary with some signs of non-EU suppliers recovering share of the market in 2014.

In the pulp and paper sector, the share of imports in total supply, while low overall, has remained quite consistent before and after implementation of EUTR. Evidence of rising imports in pulp logs, pulp and paper products from outside the EU in 2014 also implies EUTR has had little impact on the relative competitive position of imported and domestic products.

5. Has EUTR led to a shift from sources perceived to be "high-risk" to those perceived to be "low risk"?

5.1 Rationale

The object of the EU Timber Regulation is to ensure a negligible risk of any wood from illegal sources entering EU supply chains. It should lead to a shift in trade from sources where there is a high risk of illegal logging to those where the risk is negligible.

5.2 How is it tested?

There is no standard or recognised procedure for separating "high-risk" from "low-risk" sources of supply.

In practice operators implementing EUTR are obliged to assess risk by combining:

- a) specific information on the timber or timber product itself (notably the attributes of the individual supplier or trader and documentation indicating compliance with applicable legislation);
- b) general information on the wider context (notably the prevalence of illegal harvesting in the place of harvest and on the complexity of the supply chain).

Analysis of trade statistics in isolation cannot capture the effects of risk factors associated with specific timber species or suppliers. The extent to which trade statistics disaggregate data on individual species is limited and the available species-specific data is often unreliable. With very few exceptions, data on trade with individual suppliers is also not available. Nor is there any data on trade flows of 3rd party certified versus uncertified timber products.

At best, analysis of trade statistics can only be used to assess evidence of trade flows being influenced by perceptions of risk on the national context of governance in supplier countries. It can take no account of measures by individual suppliers (such as 3rd party certification) which can successfully mitigate risk even in the most poorly regulated countries.

Even the categorisation of countries into high and low risk at national level is constrained by the lack of indices with broad international coverage that focus specifically on the forest sector. Various

frameworks have been developed to evaluate forest governance at national level¹¹, but to date there are no published assessments of relative national performance using these frameworks.

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.

Despite data problems, various previous studies have attempted to assess the level and sources of EU timber imports from illegal sources. 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.
- 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 assessment adopts a much simpler approach assuming higher perceived 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)¹².

Clearly there are inconsistencies in this approach. For example, Singapore ranks 8th in the CPI overall with a score of 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-state¹³. 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 tidy up forest-sector governance.

¹¹ For example the World Resources Institute Governance of Forests Initiative Indicator Framework (http://www.wri.org/publication/assessing-forest-governance) and the PROFOR/FAO Framework for Assessing and Monitoring Forest Governance (http://www.fao.org/climatechange/27526-0cc61ecc084048c7a9425f64942df70a8.pdf).

¹² Each year, the non-governmental anti-corruption organisation Transparency International (TI) publishes a Corruption Perceptions Index (CPI) ranking countries 'by perceived levels of corruption, as determined by expert assessments and opinion surveys'. This currently ranks 178 countries on a scale from 100 (very clean) to 0 (highly corrupt). The index is not perfect as, for example, variability in a country's score can result from both changed perception of a country's performance, or a change in the sample and methodology of surveys used. ¹³ Environmental Investigation Agency, 1 May 2003, Singapore's Illegal Timber Trade and the U.S.-Singapore Free Trade Agreement

Nevertheless, the approach has the virtue of transparency and aligns with existing risk assessment guidelines in the timber trade which regularly reference the CPI¹⁴. The approach also builds on the conclusions of other studies that there is a reasonable correlation between the CPI and incidence of illegality in the timber industry¹⁵.

5.3 Data analysis

Table 1 shows the Corruption Perceptions Index for the leading 30 external suppliers of EUTRregulated products to the EU. Together these countries accounted for over 97% of the value of EUTR-regulated timber products imports in 2014. The top four countries alone - China, USA, Brazil and Russia – accounted for over 50% of import value. As a result, changes in the relative share of these countries in the mix of imports has a major effect on the overall risk profile based on the CPI. Of the four countries, only the USA has a CPI of over 50% and is therefore identified as "low risk" on the basis of this criterion. The trend in total imports of EU28 imports of all EUTR-regulated products from "high risk" and "low risk" countries for the period 2004 to 2014 is shown in Chart 8a. The relative share of total imports from both sets of countries is shown in Chart 8b. In the last decade, there has been a clear trend of rising imports from "low risk" to "high risk" countries. In 2013, when EUTR was implemented, there was stabilisation of this trend. However the trend accelerated again in 2014.

Table 1: Corruption Perception Index of the leading 30 external
supply countries of EUTR-regulated timber and timber products to
the ELL ordered by value of imports in 2014

		Value of		
	Corruption	imports into		
	Perceptons	EU28 in 2014	% 2014	Cumulative %
Supplier country	Index 2014	€million	imports	2014 imports
China	36	4601	20.0%	20.0%
USA	74	3446	15.0%	35.0%
Brazil	43	2474	10.8%	45.8%
Russia	27	2083	9.1%	54.8%
Switzerland	86	1401	6.1%	60.9%
Norway	86	1051	4.6%	65.5%
Canada	81	741	3.2%	68.7%
Indonesia	34	719	3.1%	71.9%
Chile	73	706	3.1%	74.9%
Ukraine	26	672	2.9%	77.9%
Turkey	45	509	2.2%	80.1%
Malaysia	52	462	2.0%	82.1%
Viet Nam	31	447	1.9%	84.0%
Belarus	31	400	1.7%	85.8%
Bosnia-Herz.	39	372	1.6%	87.4%
Uruguay	73	351	1.5%	88.9%
Serbia	41	338	1.5%	90.4%
Cameroon	27	229	1.0%	91.4%
India	38	226	1.0%	92.4%
South Africa	44	195	0.8%	93.2%
Japan	76	145	0.6%	93.8%
Gabon	37	144	0.6%	94.5%
Thailand	38	130	0.6%	95.0%
Rep. of Korea	55	125	0.5%	95.6%
Côte d'Ivoire	32	94	0.4%	96.0%
Albania	33	93	0.4%	96.4%
Hong Kong	74	85	0.4%	96.7%
Taiwan	61	66	0.3%	97.0%
Rep. of Congo	23	65	0.3%	97.3%
Australia	80	58	0.3%	97.6%
Other	na	558	2.4%	100.0%
Total	na	22985	100.0%	na

Source: Transparency International, ITTO FLEGT IMM analysis of COMEXT

¹⁴ For example in the FSC Controlled Wood standard, a country can be considered as low risk on legal timber harvesting only if the CPI for the given country is equal to or above 50%. Countries with CPI below this threshold are considered as "unspecified risk" for legal timber harvesting.

¹⁵Separate studies have found significant correlation between the CPI and other proxies for corruption such as black market activity and over-abundance of regulation. A 2004 study of global illegal logging for the American Forest and Paper Association also suggested a strong relationship between independent estimates of suspicious log supply in different countries and CPI scores (Seneca Creek Associates LLC, 2004. Illegal Logging and Global Wood Markets: The Competitive Impacts on the US Wood Products Industry).



Source ITTO FLEGT IMM analysis of PRODCOM & COMEXT

Analysis of imports from the leading "high risk" countries (Charts 9a to 9f) and "low risk" countries (Chart 9g) provides insight into the dynamics of this trend.

Between 2004 and 2007, prior to the financial crises, rising share of "high risk" countries in EU imports was driven by rapid increase in imports from China (paper, furniture, flooring and plywood – Chart 9a), Brazil (mainly chemical pulp and to a lesser extent sawnwood – Chart 9b), and Russia (mainly sawnwood and plywood – Chart 9c).

In 2009 at the height of the financial crises, there was a sharp drop in EU imports from nearly all countries. However the fall was particularly steep from the three largest "high risk" supplying countries (China, Brazil and Russia). This was driven by the decline in overall EU consumption combined, in the case of Russia, with tightening controls on log exports. This led to a slight fall in the share of "high risk" countries in total EU imports in 2009.



Source ITTO FLEGT IMM analysis of COMEXT

Following 2009, EU imports from China rebounded quite sharply. China has continued to increase both volume of supply and share in the EU paper market. EU imports of Chinese furniture declined sharply in 2013 – a trend which may be partly attributed to EUTR. However this trend reversed in 2014 and China once again increased share of the EU market. EU imports of flooring from China also declined slightly in 2013, but recovered ground in 2014. The pace of growth in EU imports of plywood slowed in 2013, but picked up again in 2014.



In the case of Brazil, EU imports of chemical pulp from plantations in the south of the country rose sharply in 2010, then fell back a little between 2011 and 2013 and recovered ground in 2014. EU imports of sawn wood and furniture from Brazil fell between 2009 and 2013 but stabilised in 2014. EU imports of softwood plywood from Brazilian plantations remained stable between 2009 and 2014.

EU imports of sawn softwood from Russia rebounded strongly in 2010, but then slipped in the years to 2013. In 2014 Russian softwood recovered ground in the EU market. EU imports of Russian logs, plywood and fuelwood all increased consistently year-on-year in the 2009 to 2014 period.



Source ITTO FLEGT IMM analysis of COMEXT

The rise in EU imports of wood products from Russia since 2009 is part of a wider long-term trend of increasing trade with the EU's Eastern neighbours (Chart 9d). Since 2009, there has been a consistent year-on-year increase in EU imports from Ukraine, Belarus, Bosnia Herzegovia, Serbia and Albania – all "high risk" countries on the basis of the CPI. This trend was seemingly unaffected by implementation of EUTR. Trade with Ukraine accelerated particularly sharply in 2014 despite underlying political challenges.

Long term trends in EU imports from "high risk" countries in Asia (other than China) have been highly variable (Chart 9e).







Source ITTO FLEGT IMM analysis of COMEXT

Imports from Indonesia - mainly plywood, decking, and furniture - were declining in the decade to 2013. A slight increase in 2014 may be partly due to EUTR as Indonesia has taken farreaching steps to reduce the risk profile of exported products. Indonesia is a VPA country and has required mandatory legality verification through the SVLK system for all exports of products under 26 HS codes since January 2013. SVLK will be mandatory for all timber products from 1 January 2015. The first FLEGT Licenses are now expected to be issued in Indonesia during 2016. However rising imports from other "high risk" countries in Asia during 2014 – including Turkey, Vietnam and India - not so committed to legality verification suggests it is too early to attribute Indonesia's gains to the VPA process.

Imports from high risk countries in Africa fell sharply during the financial crises (Chart 9f). For most countries, the downward trend continued between 2009 and 2013. This is in line with widespread reports of declining share of African tropical hardwood in the EU market driven by a wide range of factors, both supply-side (declining availability, long lead times and uncertain prices) and demand-side (fashion for oak, technical development of substitutes, environmental campaigns). There's no evidence that this downward trend accelerated following introduction of EUTR. For most African "high risk" countries the downward trend either stabilised in 2013 and 2014, and in some cases there was slight recovery.

Meanwhile EU import volume and market share from several key "low risk" supply countries have been declining in the last decade (Chart 9g). This is true of Switzerland (mainly paper), Norway (mainly paper), Canada (mainly pulp with lesser volumes of sawn), and Malaysia (mainly sawn, plywood and furniture).

There was significant decline in EU imports of US pulp, paper and sawn wood during the financial crises. However imports of these US commodities subsequently recovered ground. Imports of US wood pellets to supply the energy sector also increased from negligible levels in 2009 to around €550 million in 2014.

Source ITTO FLEGT IMM analysis of COMEXT

Between 2007 and 2011 there was also a significant increase in EU imports of timber products from "low-risk" plantation resources in Chile (mainly pulp and plywood) and Uruguay (mainly pulp and fuelwood). However imports from both these sources slipped a little in the period 2011 to 2014.

Chart 10 provides an overview of how the % share of total EU import of different product groups from "high risk" countries has evolved in the last 10 years. Proportions are calculated for both the € value and quantity of imports. It shows that irrespective of the units used, at least since the end of the financial crises, there has been a consistent shift towards greater EU import dependence on "high risk" countries for the majority of wood products groups. This is true of sawn timber, veneer, plywood, pulp, paper and furniture. The main exceptions are: fuelwood as a larger proportion is now being sourced from the USA; logs as Russia's imposition of export taxes encouraged a switch to Norway while EU imports of tropical logs are in long-term decline; and for mouldings/decking and joinery, for which share of imports from "high risk" countries has remained high and stable.

Chart 10 provides no indication in any product group of a significant shift from "high risk" to "low risk" countries since 2013 when the EUTR was implemented. Nor is there any indication of any slowing of the long term shift from "low risk" to "high risk" countries in those product groups where this trend is evident.

a. Fuelwood (4401)	b. Logs (4403)	c. Sawn (4407)	d. Veneer (4408)	e. Moulding (4409)
100	100	100	100	100
90	90	90	90	90
80	80	80	80	80
70	70	70	70	70
60	60	60	60	60
50	50	50	50	50
40	40	40	40	40
30	30	30	30	30
20	20	20	20	20
10	10	10	10	10
0	0	0	0	0
2002 2006 2008 2010 2012 2014	2004 2006 2008 2012 2012 2014	2002 2006 2008 2010 2012 2014	2004 2006 2008 2012 2012 2014	2004 2006 2008 2010 2012 2014
—m3 —€ value	—m3 —€ value	—RWE m3 —€ value	—m3 —€ value	—RWE m3 —€ value
f. Plywood (4412)	g. Joinery (4418)	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412)	g. Joinery (4418)	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412)	g. Joinery (4418) 100 90	h. Pulp (47) 100 90	i. Paper (48)	j. Furniture (94)
f. Plywood (4412)	g. Joinery (4418)	h. Pulp (47) 100 90 80	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70	g. Joinery (4418)	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70 60	g. Joinery (4418) 100 90 80 70 60	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70 60 50	g. Joinery (4418) 100 90 80 70 60 50	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70 60 50 40	g. Joinery (4418) 100 90 80 70 60 50 40	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70 60 50 40 30	g. Joinery (4418) 100 90 80 70 60 50 40 30	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70 60 50 40 30 20	g. Joinery (4418) 100 90 80 70 60 50 40 30 20	h. Pulp (47)	i. Paper (48)	j. Furniture (94)
f. Plywood (4412) 100 90 80 70 60 50 40 30 20 10	g. Joinery (4418) 100 90 80 70 60 50 40 30 20 10	h. Pulp (47) 100 90 80 70 60 50 40 30 20 10	i. Paper (48)	j. Furniture (94) 100 90 80 70 60 50 40 30 20 10
f. Plywood (4412) 100 90 80 70 60 50 40 30 20 10 0	g. Joinery (4418) 100 90 80 70 60 50 40 30 20 10 0	h. Pulp (47) 100 90 80 70 60 50 40 30 20 10 0	i. Paper (48)	j. Furniture (94) 100 90 80 70 60 50 40 30 20 10 0
f. Plywood (4412) 100 90 80 70 60 50 40 30 20 10 0 70 ⁶ 50^{6} 50^{5} 50^{5} 50^{5} 50^{5} 50^{5}	g. Joinery (4418) 100 90 80 70 60 50 40 30 20 10 0 20 ⁶ 10 ⁶ 10 ⁶ 10 ⁶ 10 ⁵ 10 ⁵ 10 ⁵ 10 ⁵ 10 ⁴	h. Pulp (47) 100 90 80 70 60 50 40 30 20 10 0 20 10 0 20 ⁵ po ⁶ po ⁶ po ⁶ po ⁵ po	i. Paper (48) 100 90 80 70 60 50 40 30 20 10 0 20 10 0 20 ⁶ p0 ⁸ p0 ⁸ p0 ⁹ p0 ⁹ p0 ¹ p0 ¹ p0 ⁴	j. Furniture (94) 100 90 80 70 60 50 40 30 20 10 0 20 20 10 0 20 ⁶ p0 ⁶ p0 ⁶ p0 ⁶ p0 ⁵ p0 ⁵ p0 ⁵ p0 ⁵ p0 ⁵ p0 ⁵



Source ITTO FLEGT IMM analysis of COMEXT

5.4 Result

The clear conclusion is that there is no evidence from the trade flow data of a noticeable shift from "high risk" to "low risk" countries in the wake of the EUTR. The long-term shift in the proportion of imports from countries classed as "high risk" at the expense of countries classed as "low risk" has

continued. In fact there is evidence that this trend accelerated in 2014, particularly with a resumption in growth in imports from China, Russia and Eastern European countries.

However, this test is severely limited by the lack of more reliable indices of risk associated with individual trade flows. Lack of any noticeable switch from "high risk" to "low risk" countries may be due to slow implementation of EUTR. Equally it may be due to successful implementation of mitigation measures at supplier level in "high risk" countries. In practice it is probably due to some combination of both these factors. Further insights will only emerge through surveys at the level of individual operators.

6. Is EUTR leading to diversion of EU imports from "high-risk" sources away from Member States with fully implemented regulatory regimes towards those where regulatory regimes are yet to be implemented?

6.1 Rationale

This question is frequently raised by environmental groups concerned about the efficacy of the regulation and by EU importers concerned that tougher EUTR enforcement in their host member state may put them at a competitive disadvantage relative to distributors in other EU states.

6.2 How is it tested?

As for the previous test, the Corruption Perceptions Index is used to identify timber from "high risk" sources (with all the attendant limitations previously identified).

The latest WWF Government Barometer is used to differentiate between countries with and without fully implemented regulatory regimes. This is for the following reasons:

- the survey is a wide-ranging critical appraisal and aligns reasonably well with other assessments undertaken during the same time period¹⁶.
- the timing is convenient, results are based on analysis undertaken between April and July 2014, a year after the EUTR came into effect.
- the survey includes assessment against two series of questions which effectively summarise the rigour of regulatory regime at that time: one series on the status of national legislation for enforcing EUTR¹⁷; and the other series on the wider national framework and capacity to implement the EUTR¹⁸.

¹⁶ The European Commission also publishes and regularly updates a table based on information supplied by Member States on the state of implementation of EUTR. Member States are assessed against 3 criteria – whether competent authorities have been appointed, whether penalties have been defined, and whether checks are being undertaken. Each is assessed on a 3 point scale: 0 – obligation is not fulfilled; 1 – obligation is partially fulfilled; and 2 – obligation is fulfilled. Latest data from this survey shows only slight differentiation between countries as most have now fulfilled their minimum legal obligations. It was felt more appropriate to use the WWF data for this analysis because the latter considered capacity alongside legal obligations and many Member States only fulfilled their legal obligations relatively recently. The EC data is therefore considered less indicative of the ability of Competent Authorities to effectively enforcement EUTR during 2013 and 2014 than the WWF data.

¹⁷ The WWF Barometer assessed the status of national EUTR legislation using the following questions: Has domestic legislation been enacted that provides a legal basis for enforcing the EUTR? Does the new or adapted legislation address both the prohibition and the due diligence provisions of the Regulation? Are there criminal sanctions? What do the penalties and sanctions cover and are they considered sufficiently robust? Can timber be seized throughout the supply chain? Are there established procedures to address third-party evidence? ¹⁸ The WWF Barometer assessed EU Member State capacity to implement EUTR using the following questions: Does the government have the right framework and sufficient capacity to implement the EUTR? How many

• the output is a simple points system with total scores of 0, 1, or 2 awarded for each series of questions.

For this analysis, EU Member States are defined as having a "weak" EUTR sanctions regime at time of the WWF survey if they score either 0 or 1 point out of a possible 4 across both questions. Member State scores are shown in Table 2.

Member State	Status of national	Enforcement	
Austria	1	1	2
Belgium	2	1	3
Bulgaria	1	1	2
Croatia	1	0	1
Cyprus	2	1	3
Czech Rep.	1	1	2
Denmark	2	1	3
Estonia	2	1	3
Finland	2	2	4
France	0	0	0
Germany	1	1	2
Greece	0	0	0
Hungary	0	0	0
Ireland	1	0	1
Italy	0	1	1
Latvia	0	0	0
Lithuania	2	1	3
Luxembrg.	2	0	2
Malta	0	0	0
Netherlands	2	1	3
Poland	0	0	0
Portugal	2	0	2
Romania	1	0	1
Slovakia	0	0	0
Slovenia	2	1	3
Spain	0	0	0
Sweden	1	1	2
UK	2	2	4

Table 2: WWF Government Barometer 2014 scores on EUTR related questions

staff are working on EUTR enforcement within the competent authority (CA)? Is there an annual budget for the CA that is dedicated to EUTR activities? How many operators have been assessed by the CA? How many training events for domestic timber producers, domestic operators, traders or importers have been held by the CA in the past 12 months? Have checks been made using a risk-based approach, and do they cover both due diligence and legality of timber (prohibition)? How many checks have been conducted further up the supply chain to assess implementation of due diligence requirements (one up one down) and supply chain transparency?

6.3 Data analysis

Charts 11 to 14 show the decadal trend in extra-EU imports of EUTR-regulated timber products from "high risk" countries by Member States with "weak" and "strong" sanctions regimes respectively. A tendency for EUTR to lead to diversion from Member States with "strong" to "weak" sanctions regimes would be suggested by a slowing in imports by the former relative to the latter in 2013 and 2014.

Member States with "strong" sanctions regimes were taking a rising share of all EU imports of wood (all products in CN Chapter 44) from "high risk" countries until 2013. However this trend reversed in 2014 when there was a slight increase in the proportion of wood from "high risk" countries imported into Member States with "weak" sanctions regimes (Charts 11a and 11b).



In the case of wood pulp (CN 47), the share of all EU imports from "high risk" countries destined for Member States with "weak" sanctions regimes increased in both 2013 and 2014, after a period of stability in the previous three years (Charts 12a and 12b).



The relative share of EU paper (CN 48) imports destined for Member States with "weak" and "strong" sanctions regimes remained stable in the period 2008 to 2014 (Charts 13a and 13b).



For furniture products (CN 94), Member States with "strong" sanctions regimes were taking a rising share of all EU imports from "high risk" countries until 2013. However this trend reversed in 2014 when there was a slight increase in the proportion of wood from "high risk" countries imported into Member States with "weak" sanctions regimes (Charts 14a and 14b).



Source ITTO FLEGT IMM analysis of COMEXT

Further insight is provided by Chart 15 which shows the trend in total imports of EUTR-regulated products into individual Member States with "weak" sanctions regimes respectively for timber products from "high risk" and "low risk" countries. A significant increase in the rate of imports from "high risk" countries relative to imports from "low risk" countries by these Member States in 2013 and 2014 might also suggest efforts to exploit weaker sanctions regimes. This trend is identifiable in nearly all countries with weak sanctions regimes and is particularly pronounced in Italy, Poland, Romania, and Slovakia.

Source ITTO FLEGT IMM analysis of COMEXT



Chart 15: Imports of EUTR-regulated products from "high risk" and "low risk" countries into EU Member States with "weak" sanctions regimes - 2004 to 2014 (€1000 at constant 2014 value)

6.4 Result

Overall the data presented here implies that that there may have been some diversion of "high risk" imports from Member States with "strong" to "weak" regimes following introduction of EUTR in

2013. There is more evidence for such diversion in the case of wood, pulp, and furniture than there is for paper.

However this evidence is far from conclusive and may equally reflect factors other than EUTR. An alternative narrative can explain the trends identified here drawing on shifts in the distribution of underlying European consumption, the differing pace of recovery from economic downturn, and supply side factors.

The three largest EU countries with "weak" sanctions regimes – Italy, France and Spain – have faced particularly deep recessions and recovered more slowly from the financial and economic crises than Germany and the UK, the largest EU countries with "strong" sanctions regimes. Economic conditions in countries with "weak" sanctions regimes only began to recover in 2014.

There was also a significant reduction in availability of wood from "high risk" countries in 2012 and 2013 due partly to strong demand in emerging markets, particularly China, combined with logistical problems in key African supply countries. Timber supply conditions in these "high risk" countries only began to ease in 2014.

During 2014, slowing emerging market demand also encouraged greater efforts by exporters in China and South East Asia to diversify markets, including into Western European countries just recovering from recession (France, Italy and Spain) and into increasingly dynamic Eastern European countries (notably Poland and Romania). By virtue of their position, it is also seems inevitable that these countries will increase imports from neighbouring high risk European countries such as Ukraine, Belorussia, Serbia and Bosnia. Meanwhile the weakness of the euro relative to the currencies of the USA and Switzerland has dampened EU imports from some key "low risk" sources.

Together these trends, which are entirely independent of EUTR, may explain the increase in share of EU imports from "high risk" countries destined for countries with "weak" sanctions regimes in 2014.

It should also be reemphasised that trade flow data, in isolation, is unlikely to capture trade diversion even where it is occurring. NEPCon, a non-profit forestry consultancy with extensive work experience in Eastern Europe has noted that lack of visible diversion of trade to EU states where there is less vigorous implementation of EUTR may because most imports from high risk countries are by way of larger importers which already have effective internal systems of due diligence. NEPCon suggest that efforts to divert supplies by way of countries with less vigorous sanctions regimes is only likely in the case of limited consignments traded by SMEs¹⁹.

7. Concluding remarks

This analysis of trade data reveals no clear step-change in EU trade in the direction expected due to implementation of EUTR. There has been no discernible shift from imported to domestic material that may be directly attributable to the EUTR. For imports into the EU, it's not been possible to identify any shift from "high risk" to "low risk" supply sources. If anything the results suggest that the long term shift in the opposite direction – from "low-risk" to "high-risk" countries – has not only continued but may have accelerated in 2014. This is largely due to the growth in trade between EU and non-EU countries is Eastern Europe and to China's renewed efforts to expand market share in the EU as the rate of increase in the domestic market slowed in 2014.

¹⁹ NEPCon representative quoted by EUWID in Volume 88 Issue 9 26 February 2014 "EU Member States implementing EUTR with varying degrees of aggressiveness".

The analysis also leaves open the possibility that some diversion of trade to Member States with weaker sanctions regimes may be underway. It particularly highlights the importance of ensuring that EUTR enforcement regimes are extended into Eastern European countries that are opening up new and larger trade networks with "high risk" countries on the fringes of the EU.

However to a large extent the analysis has merely highlighted the short-comings of assessment based solely on published trade statistics. It emphasises the need to undertake further research, particularly to better identify levels of risk associated with individual trade flows and of the changing trading practices of individual operators.

Consideration of the few available reports that draw on direct commentary from the EU trade suggests that EUTR may be having a significant effect to change attitudes and contribute to structural changes in trade and distribution networks. Few of these changes are likely to be observable from analysis of trade flow data. The following effects of EUTR have been identified in a variety of published sources:

- a switch to lower risk plantation-grown face veneers in the plywood sector²⁰;
- a greater focus on a more limited number of overseas suppliers better able to provide the assurances required²¹;
- greater demand for third party legally verified and/or certified products from countries where there are perceived risks of illegal harvest and shift to third party legally verified and/or certified wood products by suppliers in these countries²²;
- reduction in focus on single certification systems in responsible procurement by importers and growing interest in a wider range of legality verification systems (such as OLB from Bureau Veritas, TLTV from SGS, VLC from the Rainforest Alliance)²³;
- increased trade by way of larger EU importers with more resources for due diligence and decrease in direct imports by smaller operators²⁴;
- greater risk adversity and reduced speculative purchasing from tropical countries²⁵;
- operators suspension of all procurement and sales of specific species identified as high risk (e.g ipe decking from Brazil)²⁶;

There is also anecdotal evidence that EUTR is viewed by traders as part of a wider process of change. While EUTR may not by itself lead to a step-change, it is reinforcing processes already underway. Interviews with larger operators reported in European trade journals and association newsletters have suggested that many were already undertaking the supplier risk assessment required by EUTR well before implementation, and it has been more a question of aligning existing procedures. For example, the European Timber Trade Federation (ETTF) Winter 2014/2015 newsletter quoted the following comments by large EU operators:

• A Rougier representative: "We had our own internal due diligence system prior to the EUTR, but had to make some updates in terms of procedure to show we had all the necessary controls in place. Consequently the impact on our supplier base was insignificant".

²⁰ ITTO Tropical Timber Market Report, May 2013

²¹ ITTO Tropical Timber Market Reports July 2013, August 2013, and May 2014

²² Timber Trade Journal (TTJ), April 2014

²³ Timber Trade Journal (TTJ), April 2014

²⁴ European Timber Trade Federation (ETTF) Newsletter Winter 2014/2015

 $^{^{\}rm 25}$ Presentation by FLEGT IMM to ETTF in June 2014

²⁶ ITTO Tropical Timber Market Reports January 2015

- A Danzer representative: "We already had ISO 14001 certified procurement to verify legality and environmental impact from Africa, but since EUTR we expanded these procurement procedures to all sources, and added a new level of systematically auditing non-certified, high risk area suppliers".
- A Lathams representative: "We had to play hardball with a few suppliers on paperwork, but worked with them, visiting them worldwide, and as a result only lost one or two."

Similarly a recent trade article²⁷ based on interviews with representatives of furniture manufacturer and retailer IKEA, flooring manufacturer Kahrs, and DIY retailer B&Q observes:

"EUTR did not require major revision of their anti-illegal timber strategies. Illegality risk assessment and due diligence were already integrated into their operations, and they are also all working towards 100% certified sustainable sourcing. What the EUTR did do, however, was prompt renewed scrutiny and reappraisal of existing systems and a step up in communication on illegality risk".

The interviewees noted that EUTR prompted an extensive effort to tighten and extend existing procedures, gather additional data from suppliers and to train staff but did not generally lead to any significant change in the supply base. The interviewees said that occasionally they had to stop sourcing from companies when documentation was inadequate, but problems were almost always resolved so that trading could resume. The article concludes:

"Further proof provided of the overall effectiveness of their existing legality controls is that none of the companies had to axe suppliers post EUTR".

These interviews suggest that one reason for lack of significant change in trade flows following EUTR implementation may be a positive one. At least amongst the largest operators, much of the ground work to remove "high risk" suppliers had already been done well in advance of the regulation. Furthermore, the key overseas suppliers to these companies – including those in "high risk" countries – were able to take sufficient measures at company level to adequately mitigate risk.

Rupert Oliver ITTO Lead Consultant FLEGT Independent Market Monitoring (IMM) Mechanism 19 June 2015

²⁷ Mike Jeffree, Big brands give firm backing to EUTR, freelance trade journal article, June 2015