Options for Europe
CONTROLLING IMPORTS OF ILLEGAL TIMBER: OPTIONS FOR EUROPE

by

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Preface by David Kaimowitz

Around the world, people are waking up to the fact that illegal forestry activities are widespread and have extremely negative consequences. Not only does illegal logging damage the environment, but tax evasion by forestry companies deprives governments of billions of euros in revenues, related corruption and impunity to prosecution undermine the rule of law, and in several countries the proceeds from illegal forestry activities have financed violent conflict. Clearly something must be done.

In this paper several of Europe’s most knowledgeable experts about illegal forestry activities have put their heads together to examine what the European Commission and member states can do to address the problem. They focus particularly on trade, finance, and procurement issues, although they briefly discuss efforts to strengthen the capacity of national institutions in developing countries. One by one they go through each of the specific instruments that might be used and analyse their advantages and disadvantages and the practical aspects of their application. They conclude that steps can be taken by using existing legislation and mechanisms if the Commission and member states vigorously pursue those options, but additional legislation is needed.

The report does a good job of balancing the need to enforce existing forestry legislation to establish the rule of law with a clear recognition that much of that legislation is inadequate and must be reformed. In many countries the laws concerning forests have contradictory provisions, create an excessive administrative burden, discriminate against small-scale forest management and local communities, and fail to guarantee sustainable forest management. Given this reality, law enforcement efforts should focus on those violations that create the greatest environmental damage, harm to local communities, and loss of government revenue. And efforts to reform the forestry laws must proceed in parallel with attempts to enforce existing legislation.

Another key aspect of this report is that it recognises that financial instruments can be powerful tools for controlling illegal forestry activities. The majority of the most damaging illegal forestry activities involve medium- and large-scale companies. In the modern world such companies rely heavily on financial institutions and investors to raise capital and manage their funds. As a result, these financial institutions and investors often unwittingly receive the proceeds of crime and become parties to criminal acts. In addition, the simple fact that the companies they are financing may be involved in illegal activities creates financial risks for banks and investors. Banks and investors can be very powerful instruments of change if they are made aware of these problems and realise that it is in their best interest to try to address them.

The report clearly shows that we still have a lot to learn. It is not simply a matter of providing more resources for law enforcement. We need to figure out what works and what doesn’t, collect and analyse the relevant data, and learn by doing. This report provides one important step forward in that process.

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Executive summary

This report presents a series of recommendations for the institutions of the European Union (EU), and for the governments of the EU member states, on means to control the import of illegally sourced timber and wood products into the territory of the EU.

It identifies existing legislation that may be applicable in controlling imports; looks at ways of promoting legal products in the market and of controlling flows of investment to potentially illegal forestry activities; examines existing global frameworks that may be applicable; analyses new approaches that are currently being discussed, in particular the option of new EU legislation, including a licensing scheme for legal timber, enabling member states to control the entry of illegally sourced timber; and considers the practical issues, including identification systems, that must be addressed.

Background

Concern over the extent of illegal logging around the world has grown significantly in recent years, with discussions taking place in many international forums, including the G8 and the World Summit on Sustainable Development. This heightened awareness has developed in part as a response to growing evidence of the destruction of forests and the accompanying serious loss of government revenue. In part it is an offshoot of the growing stress on ‘good governance’ in international policy. And in part it reflects the increasing recognition of the role of consumer countries in fuelling demand for illegal products.

The effective control of illegal logging will require action across many policy areas: the promotion of good governance, action to tackle corruption, land reform, industrial and fiscal policy reform, development assistance and so on. This briefing only deals with the single issue of the control of imports of illegally produced timber into the EU. Given that the EU is the world’s largest importer, decisive action to exclude illegal products from European markets should act both as a demonstration of political will and as an incentive to pursue activities across the wider arena.

From the point of view of EU member states, the control of imports must be pursued at the European level. Not only has the single European market created a trading area without internal frontiers, but international trade policy is an area of exclusive EU competence and individual member states cannot erect trade barriers by themselves.

Targeting illegality

Intuitively, illegal products should not be allowed to enter EU markets and be put on sale. A range of existing laws and regulations, at EU level and in member states, may be effective in controlling the trade in illegal timber. These include laws on stolen goods, fraud, forgery, money laundering, bribery and corruption, as well as the Convention on International Trade in Endangered Species (CITES).
Illegal goods

Every EU member state possesses legislation on stolen goods, including buying or receiving stolen goods, and in most EU member states this applies to goods that have been stolen abroad. Stolen-goods laws can provide a legal means to halt the import of timber from protected areas and from land belonging to indigenous peoples whose land rights have been legally recognised. We recommend that:

- EU governments should assist producer country governments, or local people with land titles, to start a court case under laws on stolen property; in some cases it may be possible for the producer country government to initiate a case on behalf of local communities. One successful and high profile case could have a major demonstration effect.

Money laundering

Every EU member state possesses legislation on money laundering – the disposal of the assets of criminal activities. If illegal logging and the trade in illegally sourced timber are criminal activities under member states’ laws, then the proceeds of these activities could be subject to money-laundering legislation, provided they were deposited or disposed of within the EU. The fact that the activities themselves may take place overseas and be carried out by non-EU nationals is not relevant. A third EC Directive on money laundering is foreseen within three years. We recommend that:

- As member states are likely to expand the list of offences in the third Directive on money laundering, it is important: 1) that governments ensure that illegal logging falls within the revised definition; and 2) that the burden of proof is shifted so that banks have to report on any activity they should consider suspicious based on the information they have available.

- EU governments should inform and guide institutions that may handle the proceeds of crime – banks, accountants, lawyers, etc. – about the possibility that clients with interests in the forestry sector, particularly in countries where illegal logging is widespread, may be engaging in money laundering.

- EU member states should investigate the possibilities for taking action against illegal imports under national money laundering legislation; UK legislation in particular appears to allow for this.

CITES

The Convention on International Trade in Endangered Species (CITES) provides an existing international framework to control trade in illegal timber, though it applies only to a limited number of tree species. We recommend that:

- A more coherent approach to checking the validity of CITES export permits at the point of import should be adopted, if necessary through an amendment to the EU CITES Regulation, clarifying under what circumstances importing authorities are justified in requiring more information on the validity of export permits.

- EU governments should attempt to include more timber species on the CITES annexes and should encourage producer countries to list more timber species under Appendix III of CITES.
OECD Guidelines

The OECD Guidelines for Multinational Enterprises, though not binding on companies, are binding on the signatory governments and are of potential relevance. We recommend that:

- National Contact Points should promote and evaluate the use of the Guidelines amongst the forestry companies based in their countries (including the companies’ overseas operations) and make the results publicly available.

Promoting legal products in the market

A range of policy measures exist or can be developed to increase the market share for products that can be positively identified as having been legally produced. We recommend that:

- Forest certification schemes operational in the EU market should be encouraged to require that forest laws and regulations be abided by and to have a credible system for identifying and monitoring chain of custody.

- All EU member states should adapt their government procurement policies to incorporate legality and sustainability criteria.

- The current draft EU Directive on Government Procurement should be modified to make it clear that legality and sustainability criteria are permissible at both tender and award stage.

Controlling sources of investment

Finance from public and private sources in the EU is an important source of investment for many logging companies and other sectors of the forestry industry in producer countries; and, since much of this activity is illegal, a proportion of this money is helping to sustain illegality. We recommend that:

- EU governments should ensure that EU legislation regulating the financial sector and protecting social rights or the environment is effectively applied to the operations and projects financed and insured by EU Export Credit Agencies (ECAs); and that ECAs apply best available environmental and social practice to all their operations.

- European financial sector regulators should issue specific industry guidelines for forestry sector activities specifying that companies wishing to raise equity on EU financial markets must disclose potential risks linked to forestry crime; this should encourage all financial institutions in the EU to adopt specific policies and guidelines for investments in the forestry sector.

- EU governments should encourage marine insurers and underwriters to adopt and enforce strict rules removing all insurance cover from ships carrying illegal timber.
**New approaches**

Although the approaches outlined above provide a number of opportunities for reducing the extent of illegal logging and the import of illegal timber into the EU, none are precisely targeted at illegal logging and the timber trade. We believe, therefore, that new approaches are needed. We recommend that:

- The EU should negotiate a series of bilateral or regional agreements with as wide a range of producing and exporting countries as possible; the UK–Indonesia Memorandum of Understanding provides a model, which can be adapted to suit local circumstances. These agreements should be built around establishing a system of independently monitored legality verification in the producer country.

The control of imports into the EU, however, is impossible without new EU legislation. We recommend that:

- The EU should establish a licensing system for the import of timber and wood products, similar in principle (though different in detail) to the approach adopted under CITES, and under the Kimberley Process on conflict diamonds.

The new Regulation would need to define what type of trade would be controlled (entry for free circulation, for transit, etc.); what type of products would be controlled; the states whose exports would be controlled; the type of proof of legal production; and the competent authorities for issuing and verifying the licence. Customs agencies are already used to operating such systems (e.g. under CITES), and implementation should not prove too difficult, although of course additional capacity is likely to be necessary.

It is highly likely, however, that some producer countries would not wish to enter into such agreements with the EU. To provide an additional defence against imports of illegal timber, we recommend that:

- The new EU Regulation should include a clause making illegal the import, export, transport, sale, receipt, acquisition, or purchase of timber produced in violation of the laws of foreign countries.

**Practicalities and conditions**

A number of important practical issues must be addressed if the measures outlined above are to be effective in permanently controlling illegal activity. We recommend that:

- Any action EU governments embark on should take into account the underlying causes of illegal logging as well as the difficulties involved in defining what is legal and whether what is legal is just; crackdown actions adopted in isolation could simply backfire.

- EU governments should support and facilitate producer country governments in carrying out a detailed assessment of existing chain of custody schemes and define and develop custody schemes at national or regional level.
• EU governments should support and facilitate independent monitoring activities by local communities and local and national NGOs and, where these are not possible, by international NGOs.

• Capacity-building assistance should be provided for the design and establishment of legality verification schemes; this may include some elements of law reform in the producer countries, and should include fully participatory processes for all stakeholders.

• Capacity-building assistance should be provided for producer country customs agencies, particularly as regards establishing co-operative and data exchange relationships with EU customs agencies.

• The WTO implications of any trade-restrictive measure must be taken into account. The systems we contemplate, which revolve around bilateral agreements between the EU and producer country governments to license trade, should raise no WTO implications; nevertheless, EU negotiators should raise the issues within the WTO trade talks, and promote awareness and discussion of the issues.

Conclusion

As can be seen, there is a wide range of options available to the institutions of the EU and to EU member state governments. Inevitably, they vary substantially in terms of their complexity and implications, the amount of resources (finance, human capacity and time) they would require, and in terms of payback. Given that resources are always limited, we believe that the following measures should be adopted as key priorities for action:

• Adopt new EU legislation to ban the entry of illegally produced timber into the EU; this should include establishing systems to identify legal production in producer countries (with their agreement), and a requirement for evidence of legal production to be presented at the point of import into the EU.

• Provide capacity-building assistance to developing countries to establish legality verification systems and to reform their forestry sectors, and possibly forestry laws.

• Use government procurement policy to source legal and sustainable products, excluding illegal timber from an important section of the market.

• Regulate sources of finance for the forestry industry, steering investment flows away from potentially illegal activities.

• Where possible, use existing legislation on illegal goods and money laundering to target illegal timber.
1 Introduction

This report presents a series of recommendations for the institutions of the European Union (EU), and for the governments of the EU member states, on controlling the import of illegally sourced timber and wood products into the territory of the EU. It has been prepared jointly by FERN, the forest campaign group focusing on the EU and founded in 1995, and by the Sustainable Development Programme of the Royal Institute of International Affairs, an independent policy research institute founded in 1920 to stimulate debate and research on key issues in the international arena.

The report has been partially informed by a series of country studies – of France, Germany, the Netherlands and the UK – which covered the relevant legislation and current measures dealing with illegal logging and imports of illegally sourced timber in each country. These country studies were prepared by Frederic Castell from Friends of the Earth France (France), Jutta Kill from FERN (Germany), Wolfgang Richert from Aidenvironment (the Netherlands) and Duncan Brack from the Royal Institute of International Affairs (the United Kingdom).

Concern over the extent of illegal logging around the world has grown significantly in recent years, with discussions taking place in many international forums, including the G8, the World Summit on Sustainable Development, the Convention on Biological Diversity, the International Tropical Timber Organisation, and the United Nations Forum on Forests. This heightened awareness has developed in part as a response to growing evidence of the destruction of forests and the accompanying major loss of government revenue. In part it is an offshoot of the growing stress on ‘good governance’ in international policy. And in part it reflects the increasing recognition of the role of consumer countries in fuelling demand for illegal products. There has also been concern that in certain countries, such as the Democratic Republic of the Congo, Liberia, and Sierra Leone, the proceeds from illegal timber activities have been used to finance military conflicts. Box 1.1 (overleaf) gives a brief summary of what is known about the extent of illegal logging.

The effective control of illegal logging will require action across many policy areas: the promotion of good governance, action to tackle corruption, land reform, industrial and fiscal policy reform, development assistance, and so on. Although this report deals mainly with the single issue of the control of imports of illegally produced timber into the EU, we recognise that action in this area will not be successful in the long run unless it is accompanied by progress in many other areas. Equally, however, decisive action to exclude illegal products from European markets – and the EU is the world’s largest importer – should act both as a demonstration of political will and as an incentive to pursue activities across the wider arena.

From the point of view of EU member states, the control of imports must be pursued at the European level. Not only has the single European market created a trading area without internal frontiers, but international trade policy is an area of exclusive EU competence and individual member states cannot erect trade barriers (except in unusual and highly restricted circumstances such as risks to health) by themselves.

EU enforcement authorities face three main difficulties in controlling the entry of illegally sourced timber and wood products into EU markets. First, the matter of identification: in most cases it is impossible to tell through simple inspection whether a particular shipment of timber or wood products has been produced illegally. Second, co-operation with enforcement authorities in the products’ country of origin is, in many cases, poor or non-existent. Third, the appropriate legal framework under
which to take action is not always clear or adequate. This report is designed to examine all these factors.

Box 1.1 The growth of illegal logging and international trade in illegally sourced timber

There is no doubt that illegal logging is pervasive and causing enormous damage to forests, to forest peoples and to the economies of producer countries. Some estimates suggest that the illegal timber trade may comprise over a tenth of a total global timber trade worth more than $150bn a year.\(^1\) It seems likely that at least half of all the logging activities in particularly vulnerable regions – the Amazon Basin, Central Africa, Southeast Asia and the Russian Federation – is illegal.\(^2\)

Illegal logging takes place when timber is harvested, transported, bought or sold in violation of national laws. The harvesting procedure itself may be illegal, including using corrupt means to gain access to forests, extraction without permission or from a protected area, the cutting of protected species or the extraction of timber in excess of agreed limits. Illegalitys may also occur during transport, such as illegal processing and export, misdeclaration to customs, and the avoidance of taxes and other charges. It should be note that what is ‘illegal’ and what is not is not always clear (see also Box 7.1, page 55).

Illegal logging is not confined to countries in the South, but the problems there are worse as resources are limited, international companies which offer investment are proportionately more powerful and civil society is weaker. The allocation of timber concessions has often been used as a means to reward allies and engender patronage. Protected by powerful patrons, timber companies may evade national regulations with relative impunity. State forestry institutions may be subject to regulatory capture, becoming the clients of concession-holding industrial interests of the ruling elite, who exercise their powers as a form of private property rather than as a public service.

As in other areas, the clandestine nature of the illegal trade makes its scale and value difficult to estimate. Nevertheless, extensive unlawful operations have been uncovered whenever and wherever authorities have tried to find them. As the World Bank’s 1999 review of its global forest policy observed, ‘countries with tropical moist forest have continued to log on a massive scale, often illegally and unsustainably. In many countries, illegal logging is similar in size to legal production. In others, it exceeds legal logging by a substantial margin … [P]oor governance, corruption and political alliances between parts of the private sector and ruling elites combined with minimal enforcement capacity at local and regional levels, all played a part.’\(^3\)

To give a few examples, a joint UK–Indonesian study of the timber industry in Indonesia in 1998 suggested that about 40% of throughput was illegal, with a value in excess of $365 million.\(^4\) More recent estimates, comparing legal harvesting against known domestic consumption plus exports,

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\(^2\) For further details on illegal logging, see Duncan Brack and Gavin Hayman, Intergovernmental Actions on Illegal Logging (Royal Institute of International Affairs, March 2001) and Duncan Brack, Gavin Hayman and Kevin Gray, Controlling the International Trade in Illegally Logged Timber and Wood Products (Royal Institute of International Affairs, February 2002); both available from www.riia.org/sustainabledevelopment.


suggest that over 70% of logging in the country is illegal in some way.\(^5\) Similarly, over 80% of logging in the Amazon may not be compliant with government controls.\(^6\) A World Resources Institute comparison of import and export data for Burma in 1995 revealed substantial under-declaration, accounting for foregone revenue of $86 million – equivalent to almost half of official timber export revenues.\(^7\) Studies in Cambodia in 1997 by the World Bank suggested illegal extraction, worth between $0.5–1 billion, may be over 4 million m\(^3\), at least ten times the size of the legal harvest.\(^8\) If this level of extraction continues, the country will be logged out within ten years of the industry’s official beginning.

The scale of illegal logging represents a major loss of revenue to many countries and can lead to widespread associated environmental damage. It is also a threat to biodiversity, and in some cases a breach of CITES controls. A Senate Committee in the Philippines estimated that the country lost as much as $1.8 billion per year from illegal logging during the 1980s.\(^9\) The Indonesian Government estimated in 2002 that costs related to illegal logging are $3 billion a year\(^10\). The substantial revenues from illegal logging sometimes fund and thereby exacerbate national and regional conflict, as in Cambodia, Liberia and the Democratic Republic of Congo.

The illegal trade may also distort the entire global marketplace for a number of key timber products, thereby hampering sustainable management – which has to endure additional costs from good husbandry and proper tax declaration. As the World Bank reported, ‘widespread illegal extraction makes it pointless to invest in improved logging practices. This is a classic case of concurrent government and market failure.’\(^11\)

The report has seven sections, of which this introduction is Section 1. Sections 2–4 examine the range of policy instruments already available to EU institutions and governments, industry and civil society both to prevent illegal goods entering EU markets and to expand the market share of products positively identified as legal. Section 2 deals with the laws applicable to illegal products and behaviour, including those on stolen goods, fraud, money laundering and corruption, and the protection given to endangered species under the Convention on International Trade in Endangered Species (CITES). Section 3 examines means of promoting legal products within the market, such as certification and government procurement policy, while Section 4 analyses ways to control the flows of investment into potentially illegal forestry activities. Section 5 looks at the global frameworks – agreements and institutions – in which the issue is currently being discussed, and draws some lessons from comparable institutions.

Section 6 examines new approaches that are currently being discussed, and presents recommendations for new legislation at the EU level, including a licensing scheme for legal timber. Finally, Section 7 considers some of the practical questions that have to be addressed satisfactorily before any kind of restrictions can operate successfully.

\(^5\) Neil Scotland and Sabine Ludwig, *Deforestation, the Timber Trade and Illegal Logging* (paper for EC workshop on Forest Law, Enforcement, Governance and Trade, Brussels, 22–24 April 2002).
\(^6\) *Ibid*.
\(^10\) *Natural Resources and Law Enforcement in Indonesia* (ICG, December 2001).
The report presents a wide range of options for the institutions of the EU and for EU member state governments. Inevitably, they vary substantially in terms of their complexity and implications, in terms of the amount of resources (finance, human capacity and time) they would require, and in terms of payback. Given that resources are always limited, we believe that the following measures should be adopted as key priorities for action:

- Adopt new EU legislation to ban the entry of illegally produced timber into the EU; this should include, where possible, establishing systems to identify legal production in producer countries (with their agreement), and a requirement for evidence of legal production to be presented at the point of import into the EU.

- Provide capacity-building assistance to producer countries to establish legality verification systems and reform their forestry sectors, and possibly forestry laws.

- Use government procurement policy to source legal and sustainable products, excluding illegally sourced timber from an important section of the market.

- Regulate sources of finance for the forestry industry, steering investment flows away from potentially illegal activities.

- Where possible, use existing legislation on illegal goods and money laundering to target illegal timber.
2 Targeting illegality

2.1 Introduction

Intuitively, illegal products should not be allowed to enter EU markets and be put on sale, and individuals and corporations that operate illegally should not be able to profit from their sales within the EU. There are a number of laws within EU member states that are, in principle, applicable to this problem. In this section, we examine legislation on stolen goods, fraud, forgery and money laundering. We also look at three relevant international agreements and their implementation: the Convention on International Trade in Endangered Species (CITES), the OECD Anti-Bribery Convention and the OECD Guidelines for Transnational Corporations.

2.2 Legislation on stolen goods, fraud and forgery

**Summary:** Every EU member state possesses legislation on stolen goods, including buying or receiving stolen goods, and in all the countries included in this study this applies to goods that have been stolen abroad. These laws can provide a legal means to halt the import of timber from protected areas and from land belonging to indigenous peoples whose land rights have been legally recognised. In principle, timber harvested from these areas would fall under stolen-goods laws and can be tackled via two alternative routes: the importer and the owner.

All EU member states possess legislation on stolen goods, and in all the countries researched,\(^\text{12}\) this legislation applies to goods that have been stolen abroad. These laws vary across member states, as is detailed below. In most EU countries, criminal proceedings can be taken against a person who handles stolen goods in the country of import. Whether these laws are applicable to illegally produced timber depends on whether the timber has been defined as ‘stolen’, which in turn depends on the relevant legislation in the country of origin.

Probably only a proportion of the illegally logged timber entering EU markets could be defined as ‘stolen’ for these purposes. For example, timber would be considered stolen if it was taken from land owned by local communities who have not consented to the logging, and the same would apply to timber from protected areas and from other companies’ concessions. However the position is less clear with the products of logging beyond quota or in breach of conditions (such as a ban on logging on slopes), or with timber exported without payment of taxes.

However, as far as we know, there are no systematic studies of the extent of the different types of illegal logging in producer countries – and in some countries, where legislation is poorly written or confusing, such studies may be simply impossible. It is therefore difficult to know to what extent the laws on stolen property could be used in importing countries.

\(^{\text{12}}\text{France, Germany, the Netherlands and the UK.}\)
• **In France**, it is possible to prosecute a French national for being an accomplice to a crime committed by a foreigner abroad. However, the offence committed abroad needs to have been tried and had sentence passed in the country of the original crime. A further constraint upon prosecution in France is that the public prosecutor alone has the right to decide whether legal proceedings can be instituted. Wider room for manoeuvre seems to be given by the law on receiving stolen goods, under which the person receiving the stolen goods in France can be prosecuted even if the person who has stolen, cheated or abused confidence is not prosecuted in the country where the crime was committed. The public prosecutor has no discretion over whether to take the case, however, the plaintiff does need to prove that a crime, punishable under both French law and that of the country where the crime was committed, has taken place.

• **In Germany**, the laws that could potentially be used to address illegal logging and associated trade, include legislation on theft, damage to property, fraud, receiving stolen goods, forgery and legislation on threats to protected areas. Of particular interest could be the legislation on ‘Hehlerei’ (receiving stolen goods), under which the import of goods that have been obtained or produced using unlawful activities could be a criminal offence (‘Strafbestand’). If a timber importer has been informed that timber from a particular region or country might have been stolen, he might become complicit and therefore liable if he buys the timber.

• **In the Netherlands**, stolen goods laws are seen as a possibility to address illegal logging. If goods are stolen then they can be confiscated; the problem is finding the proof of the fact that it is stolen. Information on stolen goods is exchanged within the central information system of the Schengen countries. It might be worth researching the possibilities of this system for stolen timber.

• **In the UK**, the relevant legislation is the Theft Act 1968, which also applies to the handling of goods that have been stolen abroad. If the illegal activity has occurred abroad – which is likely with illegal logging – there must first be a request for the suspected stolen goods to be seized by a court or prosecuting authority in the country of origin, and criminal proceedings must have been instituted, or a person arrested, for the offence. This makes the application of these laws entirely dependent on the activities of the enforcement authorities in the producer countries. Possession of stolen goods in the UK is not an offence if the person possessing them can prove that they did not know they were stolen. However, once they are made aware of the fact, it is then an offence for them to sell the goods on to another person.

In most EU countries, an alternative route could be civil proceedings, which could be taken by the person or organisation lawfully entitled to possession of the products in the country of origin. The action could be brought against the ship-owner or the person who arranged the shipment of stolen goods, or both. A successful action would result in the court ordering the return of the goods to the lawful possessor or, if appropriate, an award of damages. This has the advantage of not requiring proof of theft (though some evidence that the goods are stolen is clearly required), and therefore avoids

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13 Article 113-5 of the penal code.
14 Article 113-6 of the penal code.
15 Diebstahl, §§ 242 StGB.
16 Sachbeschädigung
17 Betrug, §§ 259 StGB.
18 §§ 259 StGB.
19 Urkundenfälschung, §§ 267 StGB.
20 (Gefährdung schutzbedürftiger Gebiete, §§ 267 StGB).
21 In English law, under the tort of conversion.
police involvement in the country of origin, but its effectiveness still depends on the ability to provide evidence of legal ownership of the timber in the country of origin. In addition, courts may decline to exercise jurisdiction where they consider that the relevant activities occurred in a foreign jurisdiction and most of the relevant evidence, including witnesses, are located there.

### Box 2.1 The potential growth in timber defined as stolen

There is a transition underway with regard to ownership and control of forests. Rural communities and indigenous people are successfully asserting control over forestland and now own or officially administer at least 25% of the world’s tropical forests. Nearly one-fourth of the forest estate in the most forested countries in the South is now owned (14%) or officially administered (8%) by indigenous and rural communities, as a result of recent devolution and government recognition of local claims.\(^{22}\) This trend is expected to accelerate. With an increasing percentage of the world’s forests now legally owned by local or indigenous peoples, many of whom have filed court cases to claim their land rights, the potential for using the stolen goods laws is increasing. In a number of cases where land rights are disputed by the government, recent court rulings – the most recent one being in Suriname in September 2002 – have ordered governments or companies to halt logging until these disputes have been resolved.\(^{23}\) Logging on these lands would therefore be considered illegal.

The import of stolen goods is not of itself a customs offence. It is possible, however, that if the goods were acquired dishonestly they would then be falsely described in the accompanying documentation. This *is* a customs offence and would allow customs agencies to seize the goods – as long, of course, as they can prove that they are misdescribed.

**Recommendations:**

- EU governments could assist producer country governments, or local or indigenous peoples with land titles, in starting a court case. One successful and high-profile case could have a major cautionary effect.

- In the context of the closer customs co-operation that we envisage (see Section 7), EU member state police forces and/or customs agencies could establish systems of co-operation with their counterparts in one or more key producer countries so as to investigate the opportunities for joint action.

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2.3 Legislation on money laundering

Summary: Every country possesses legislation on money laundering – the disposal of the proceeds of criminal activity. This legislation has the potential to be very effective against the problem of illegal logging, so long as the legislation is sufficiently broadly defined.

If illegal logging and the trade in illegally sourced timber are criminal offences under member states’ law, then the proceeds of these activities could be subject to money laundering legislation, provided they were deposited or disposed of within the EU. The fact that the activities themselves may take place overseas and be carried out by non-EU nationals is not relevant.

To date, no EU country has attempted to use this legislation to tackle the proceeds of illegal logging. Governments should alert banks, lawyers, accountants, etc. to the possibility that clients with interests in the forestry sector, particularly in countries where illegal logging is widespread, may be engaging in money laundering.

Money laundering is the processing of the financial proceeds of crime in order to disguise their illegal origin. National legislation allowing authorities to tackle money laundering and seize the proceeds of criminal activity has grown in importance with the expansion of the illegal trade in narcotics. With the increasing focus on international organised crime and, particularly in recent months, on international terrorism, the scope of money laundering legislation has broadened accordingly.

The EC’s first Directive on money laundering dates from 1991. This Directive applied only to the proceeds of drug offences. In December 2001 a second Directive was adopted which extended the scope of the 1991 legislation. This new Directive obliges member states to combat the laundering of the proceeds of all criminal activities. In this instance, criminal activities are defined as narcotics related, those linked to organised crime, or ‘any other criminal activity designated as such for the purposes of this Directive by each Member State’. It will enter into force in June 2003.

The Directive extends the requirements for client identification, record keeping and reporting of suspicious transactions, which were previously limited to the financial sector, to a series of non-financial activities and professions that are vulnerable to misuse by money launderers, including external accountants and auditors, estate agents, notaries and lawyers.

EU member states are committed to agreeing a third Directive within a further three years, which is likely to expand the scope of the legislation even further. It is hoped that the new Directive would increase the onus on banks, from ‘banks having to report any activities they consider to be suspicious’ to ‘banks having to report on any activity that they should consider to be suspicious, given the information they have available’. Several member states have already adopted such text in their current legislation.

Could money laundering legislation be used to seize the proceeds of illegal logging?

As set out above, if the activity in question is illegal under EU or member state law, then the proceeds of the activity could be subject to recovery, provided they were deposited or disposed of within the EU. The fact that the activity itself may take place overseas and be carried out by non-EU nationals is

24 Directive 91/308/EEC.
25 Directive 2001/97/EC.
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not relevant. This is made explicit in the new Directive, in which Article 1 specifies that ‘money laundering shall be regarded as such even where the activities which generated the property to be laundered were generated in the territory of another Member State or in that of a third country’.

However, for money laundering legislation to apply, illegal logging has to be seen as a ‘criminal activity’. The definition of ‘criminal activity’ is up to the member states. It does include, however, corruption, fraud, and any offence which generates substantial proceeds and which is punishable by a severe sentence of imprisonment. The institutions that are likely to handle the proceeds of the crime – banks, accountants, lawyers, etc. – should therefore be alerted to the possibility that clients with interests in the forestry sector, particularly in countries where illegal logging is widespread, may be engaging in money laundering.

The Directive, and much member state legislation, places a requirement on such institutions to report to the authorities any suspicions they may have regarding their clients. Indeed, banks are currently the main source of such intelligence. It is likely, however, that many of these institutions are not familiar with the extent of criminal activity in the forestry sector, and EU member states should provide information and guidance.

In the case of offences committed in foreign countries, however, the success of action taken under money laundering legislation will require close cooperation with enforcement and judicial authorities in the country of origin, which may not always be forthcoming. Unlike the laws on stolen goods, the definition of what is criminal is determined by the importing states, not by the countries of origin.

- **The UK** is generally regarded as having one of the toughest approaches in implementing the EU Directive. The Proceeds of Crime Act, adopted in July 2002, formally defines the offence of ‘money laundering’ as relating to the proceeds of any criminal conduct, defined as ‘conduct which a) constitutes an offence in any part of the United Kingdom, or b) which would constitute an offence in any part of the United Kingdom if it occurred there’ – which includes illegal logging. The Act also gives extra investigatory powers to police and customs agencies, and establishes a new Assets Recovery Agency to enhance the authorities’ powers to recover the proceeds of criminal activities, however they are disposed of. It also enables civil action to be taken against the proceeds of criminal activities in the absence of a criminal conviction. Regulated institutions are obliged to have systems in place to detect cases of money laundering and report their suspicions to law enforcement. It would become difficult for companies engaged in illegal logging to move finances through the UK, if UK financial institutions were alert to the fact that this constituted a money laundering offence. The Proceeds of Crime Act also makes provision for the seizure or restraint of criminal proceeds at an early stage of investigation.

- **In Germany**, the government states that illegal logging is not considered a relevant offence under money laundering legislation because, in Germany, illegal logging is negligible. It appears that this understanding has so far prevented any deeper analysis of the potential of the money laundering legislation to tackle illegal logging. The government’s response also suggests that contraventions of the legislation covering stolen goods (theft, receipt of stolen goods) and fraud might be considered a precursory offence to money laundering.26

The Financial Action Task Force (FATF), created by the G7 in 1989, develops and promotes policies, both nationally and internationally, to combat money laundering. It monitors the building of effective

26 Under §§261 StGB.
anti-money-laundering systems in its member countries, reviews laundering techniques, and promotes
the adoption and implementation of money laundering countermeasures in non-member countries. The
FATF’s Forty Recommendations is a comprehensive blueprint for action against money laundering: it
covers the criminal justice system and law enforcement, the financial system and its regulation, and
international co-operation. Each FATF member has made a firm political commitment to combat
money laundering based on these recommendations.

The FATF also publishes an annual blacklist of Non Co-operating Countries and Territories, which
have critical deficiencies in their anti-money-laundering systems or a demonstrated unwillingness to
coop-operate in anti-money-laundering efforts. As of June 2002, 27 four timber producers were included
on the list: Indonesia, the Philippines, Russia and Burma.

Recommendations

• As member states are likely to expand the list of offences in the third Directive on money
laundering, it is important: 1) that governments ensure that illegal logging falls within the revised
definition; and 2) that the burden of proof is shifted so that banks have to report on any activity
they should consider suspicious based on the information they have available.

• Governments should inform and give guidance to institutions that may handle the proceeds of the
crime – banks, accountants, lawyers, etc. – about the possibility that clients with interests in the
forestry sector, particularly in countries where illegal logging is widespread, may be engaging in
money laundering.

• The ongoing discussions between timber-consuming and timber-producing countries on forest-
related issues and on forest law enforcement and governance should always include the issue of
money laundering.

2.4 CITES

Summary: CITES is currently the only worldwide legal agreement that could be used to control a part
of the trade in illegally logged timber. It is also the only legal agreement to have been used by some
member states to halt the import of illegally sourced timber. The big advantages of CITES are
therefore that it is already in existence and is widely, if imperfectly, implemented. Although the treaty
has had some success in preventing the extinction of particular endangered species, weaknesses in the
checking of export permits has undermined its ability to operate effectively. To extend its coverage to
a substantial volume of international trade in timber species seems unlikely to be feasible. However, it
can and should be used as a safety-net mechanism in protecting individual endangered tree species.

The 1973 Convention on International Trade in Endangered Species (CITES) aims to protect
endangered species from over-exploitation by controlling international trade, under a system of import
and export permits. Species are placed on different lists: Appendix I includes all species that are
threatened with extinction; Appendix II includes species that are not necessarily threatened with
extinction now but may become so unless trade in such species is subject to strict regulation; and
Appendix III includes species that a party identifies as being subject to regulation for the purposes of

27 See www.fatf-gafi.org/NCCT_en.htm
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preventing or restricting exploitation, and where it needs the co-operation of other parties in controlling trade. Amendments to Appendices I and II are implemented by the Conference of the Parties, whilst state parties themselves can place species on Appendix III.

- For Appendix I species, trade must not be detrimental to the survival of the species and must not be for primarily commercial purposes. Any trade in listed specimens must obtain both export and import permits, and certificates are also required for re-export of specimens.

- Commercial trade in Appendix II specimens is allowed if it is not detrimental to the survival of the species. An export permit is required, and must be provided to the importing state’s customs authorities.

- Trade in Appendix III specimens requires the management authority of the exporting state to issue an export permit. Importers must verify that an export permit accompanies the shipment, if the shipment is from a state that has listed that species on Appendix III, or a certificate of origin, if from another state.

Countries may enter a reservation to CITES for a specific listed species, either upon becoming a party to CITES or upon an amendment to the appendix by the Conference of the Parties.

At EU level, CITES is implemented by Regulation 338/97. In general, the EU Regulation follows the requirements of CITES, but covers more species, listed in four Annexes: Annex A includes all CITES Appendix I species, plus some Appendix II and III species to which the EU gives a higher level of protection; Annex B includes all other CITES Appendix II, some Appendix III and some non-CITES species; Annex C includes all other CITES Appendix III species; and Annex D includes CITES Appendix III species for which one or more EU member states has entered a reservation, plus some non-CITES species.

Import restrictions for Annex A and B species are stricter than those required under CITES: import permits are required for all species listed (only export permits are needed for Appendix II species under CITES) and there are additional requirements for conditions of transport and housing. Annex C and D species require an import notification – a declaration signed by the importer – and are also subject to conditions of transport. For timber species, the EU listings are the same as under CITES.

**Weaknesses in CITES**

A key weakness of CITES is that the export and import permits effectively acquire a value, opening up possibilities for fraud, theft and corruption. In theory, for an export permit to be issued, the Management Authority of the exporting state must be satisfied that the specimen was not obtained in contravention of the state’s laws for the protection of fauna and flora. In practice, however, this is often not observed, thanks to corruption and/or a lack of capacity.

A second weakness lies in the cross-checking of the documents against each other. The World Conservation Monitoring Centre (WCMC), part of UNEP, monitors the legal trade taking place under CITES, receiving copies of all import and export permits issued. Simple inspection of the permits sometimes reveals fraud. However, CITES lacks a comprehensive and independent system of monitoring and verifying the issuance and use of permits and the central reporting of data.

The third weakness lies in the checking of the documents against what is actually in the shipment. Only a tiny fraction of the huge volume of goods in international trade can ever be physically
inspected, and in the case of CITES there are obvious problems in correctly identifying illegally traded species out of the almost 25,000 listed in its appendices.

An analysis of mahogany imports into the US in 1997–98 (mahogany being the most commonly traded timber species listed under CITES) estimated that at least 25% of sawnwood imports (worth more than $17 million per year) was illegal. This figure did not include trade unreported to US Customs and the true magnitude is therefore likely to be much higher.

The question of the validity of export permits has arisen in particular in recent months with regard to exports of big-leafed mahogany from Brazil. The species is listed under Appendix III of CITES, and in 2001 the Brazilian government ordered a complete ban on logging and export. Nevertheless, shipments continued to be exported to Europe and North America in the first few months of 2002. Shipments reaching the US, Canada and a number of EU countries, including Germany, the Netherlands and Belgium, were seized by the authorities pending further enquiries. In March, the European Commission issued advice to EU management authorities that they should not accept imports of Brazilian mahogany since reasonable doubt existed over their legality.

The UK government nevertheless declined to take action. The arguments in a subsequent court case brought by Greenpeace against the UK revolved around whether the export permits had been validly issued and under what circumstances the authorities in the importing state would be justified in delaying the shipments and requiring further information on the validity of their export permits. Greenpeace lost their application for judicial review in the Court of Appeal: in a ruling issued on 25 July 2002, two of the three judges concluded that to allow importing countries to query the validity of export permits, even when some doubt existed over their validity, would introduce too great a level of uncertainty into international commerce. The third judge, however, dissented, accepting the argument that the survival of endangered species should take a higher priority. It should be clarified – if necessary through an amendment to the EU Regulation – under what circumstances importing authorities are justified in querying export permits.

**CITES and timber**

Nineteen tree species are currently listed on CITES appendices, including Brazilian rosewood on Appendix I and small-leafed mahogany on Appendix II; different regional populations of the monkey-puzzle tree appear in both appendices. As a result of a decision taken at the recent Conference of the Parties in November 2002, Latin American populations of big-leafed mahogany will be added to Appendix II from November 2003. However, an evaluation of 255 tree species carried out in 1998 against the CITES listing criteria found that about 15 new species could be added to Appendix I and almost 100 to Appendix II.

Such additions to the appendices would need to be agreed by the Conference of Parties, and any proposal to add substantial numbers of new species, particularly those important in international trade, would almost certainly rouse strong opposition. Furthermore, a significant expansion of the coverage of the agreement would place strains on its operation.

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29 World Conservation Monitoring Centre, *Contribution to an evaluation of tree species using the new CITES listing criteria* (WCMC, December 1998). The species evaluated were chosen to provide ‘a reasonable representation of tree species from various regions, climates and grades of commercialisation and conservation’ (p. 2). The availability of information on individual tree species varied considerably.
Appendix III of CITES includes species subject to regulation only within the jurisdiction of a party and for which international co-operation is needed to control trade. Indonesia, for example, listed its population of ramin on Appendix III in April 2001, with a zero quota, and the measure became effective four months later. An immediate side-effect was to increase smuggling of ramin into Malaysia, which has entered a reservation with regard to the listing.  

Recommendations

- EU governments should attempt to include more timber species on the annexes to CITES, and should encourage producer countries to list more timber species under Appendix III of CITES.

- A more coherent approach to checking the validity of CITES export permits at the point of import should be adopted, if necessary through an amendment to the EU Regulation clarifying under what circumstances importing authorities are justified in requiring more information on the validity of export permits.

- Potential linkage with the provisions of the OECD Bribery Convention (see Section 2.5) should be investigated. This may give governments additional powers to take actions against companies involved in illegal acquisition or use of CITES export permits.

2.5 The OECD Convention on Bribery and Corruption

Summary: The OECD Convention on Bribery is a legally binding instrument whose requirements must be incorporated into or implemented in national legislation by its parties (OECD members and other signatory governments). The Convention makes it a criminal offence to bribe a foreign public official. As illegal logging in a number of cases involves bribery, the OECD Convention clearly has a role to play in controlling illegal logging. The problem often lies in proving that bribery has taken place. The Convention’s effectiveness would increase if all parties to the Convention implemented the recommendations made by the OECD, such as excluding companies that have been found guilty from bidding for public contracts.

The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions entered into force in 1999. It is an instrument to prevent bribery in international business transactions and requires signatory countries to enact legislation that criminalises the act of bribing a foreign public official. It comprises two parts: the Convention, which contains legally binding provisions, and the 1997 Revised Recommendations which, whilst non-binding, represent an expression of common political will. The Convention states that the offences of bribery and

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30 This means that Malaysia should be regarded, for the purposes of trade in the species concerned, as a non-party to CITES. Trade with non-parties is not permitted except where documentation equivalent to CITES permits (or, in this case, a certificate of origin) is provided. Whether this is likely to be required in practice remains to be seen. However, the reservation does mean that Malaysia is under no obligation under CITES to regulate trade in ramin into and out of its own territories.

31 All EU member states have ratified and introduced amendments to their legislation to implement the Convention.

32 In countries that already have the legal framework to prosecute their nationals for crimes committed abroad (e.g. the USA), this existing legislation must be amended to include bribery offences. In countries where the bribery of civil servants is listed as a criminal offence under money laundering legislation, this legislation must be amended to include bribery of
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corruption are to be punished by effective sentences. These sentences differ between member states: for example, in Portugal they vary from one to eight years and in France they go up to ten years.

The OECD has set up a process of monitoring the Convention’s translation into national legislation as well as its implementation. This monitoring aims to review the actual implementation of the Convention and identify any obstacles to instituting prosecutions. It includes a nineteen-point questionnaire that governments need to fill in.33

The OECD Council has also adopted a recommendation that companies cannot claim a reduction in their taxes to offset bribes given to foreign civil servants,34 as is the case in donations to charities. Most of the signatories have adopted legislation to implement this recommendation. Only Belgium still allows companies to claim tax returns for some bribes. Another OECD recommendation that might be relevant to illegal logging is for its members to allow authorities to bar companies from bidding for public contracts if they have been found guilty of bribing a foreign civil servant. The OECD Council further recommends including anti-corruption clauses under bilateral and multilateral aid-funded procurement.35

Some positive examples:

- Portugal has inserted an article in its legislation that bans from tendering for public contracts any legal person that has committed an offence that is punishable with a prison sentence of over six months.

- In Greece, in 2000, the Ministry of Justice circulated a questionnaire to every prosecutor’s office in order for them to report back about all cases that involved applying bribery and corruption law.

Current application of the Convention

In the forestry sector there are several areas where bribery and corruption can occur: for example, in the allocation of a forest concession, in the setting up or running of a pulp and paper mill that does not respect standards of health and environment protection or that cannot source sufficient legal timber for its operations; or in the procurement of official documentation legalising ‘illegal’ timber, particularly export licences (e.g. CITES permits).

The difficulty will be for EU governments to obtain sufficient evidence to prosecute nationals for bribery offences. However, the parties to the Convention are obliged to co-operate and provide each other with legal assistance in criminal investigations and prosecutions. To support these investigations, guidelines that help identify the types of bribery or corruption that occur in the forestry sector should be developed based on a model provided by the OECD Committee on Fiscal Affairs.

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33 These questions cover issues such as public procurement sanctions, export credit agencies, blacklisting, codes of conduct, and accountability provisions (such as clear and accurate reporting).

34 Recommendations of the Council on Tax Deductibility of Bribes to Foreign Public Officials, adopted by the Council on 11 April 1996

Recommendations

- EU governments should develop – at national or EU level – forest sector guidelines for tax inspectors and public prosecutors to help them identify the possible forms that bribery and corruption can take in the forestry sector.

- EU governments should send a questionnaire to all public prosecutors to ensure that they report on all cases involving the application of bribery legislation to forestry sector-related crimes. Problems preventing prosecutions should also be reported.

2.6 Influencing corporate behaviour: OECD Guidelines for TNCs

Summary: The OECD Guidelines are a set of recommendations that governments make to corporations who operate in or from their national territory. Although they are voluntary for enterprises, they are legally binding on the signatory governments, which are required to set up a National Contact Point to promote the guidelines.

The main application as regards controlling illegal logging is through a whistle-blowing mechanism: anyone can complain to the National Contact Point about the behaviour of a company in a signatory state. The National Contact Point then starts a procedure if the case is found eligible, and the results are made public. The Guidelines and complaints pursuant to them do not lead to criminal investigations; however, they should encourage enterprises to improve their practices.

The overall aim of the OECD Guidelines for Multinational Enterprises is to encourage companies to promote sustainable development, from an economic, social and environmental perspective. This means that they should respect national legislation and human rights, develop social capital, and refrain from accepting or seeking exemptions from existing statutory or regulatory frameworks. The Guidelines further require that such enterprises support and promote good corporate governance principles and apply good corporate practices, including applying high standards to the disclosure of information, and to accounting and auditing. The Guidelines are not binding on companies in OECD countries, but are legally binding on the signatory governments, which include the thirty OECD members plus Argentina, Brazil, Chile, Estonia, Lithuania and Israel.

The most recent version of the Guidelines, in 2000, puts the onus firmly on governments at the national level to make sure that companies observe the Guidelines. In order to promote and facilitate the application of the Guidelines, governments are legally obliged to create National Contact Points. These are organised in different ways. Some involve only one single government agency, whilst others involve several ministries, and some are even tripartite bodies including government, labour and business representatives. To date, only two include NGOs. The Contact Points have to prepare a report:

36 Enterprises are also encouraged to apply high standards to the disclosure of non-financial information including environmental and social reporting, where they exist. The section on the environment promotes environmental management systems that provide an internal framework necessary to control an enterprise’s environmental impacts and to integrate environmental considerations into business operations. Environmental management is meant to encompass the direct and indirect environmental impacts of a company. This would include natural resource management such as forests.

37 Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.
on their activities and present it to the OECD’s Committee on International Investment and Multinational Enterprises (CIME). They meet annually to share their experiences with their counterparts. However, fewer than half the signatory countries yet have functioning National Contact Points.

The Guidelines include a ‘whistle-blowing system’, which is activated when a company is believed to be in violation of the Guidelines. Any legal body, including NGOs and trade unions, can bring a case to the attention of the National Contact Point. However, the French contact point insists that complaints are channelled through trade union representatives and the German contact point told a German NGO it would have to produce a power of attorney before the case could be submitted.38 There is no need for the company to state that it is abiding by the Guidelines or even to be aware of their existence. The Contact Point must make an initial assessment as to whether the case merits further investigation. Whether it decides to proceed or not, it must then inform the interested parties of its decision and the reasons behind it. Where a case does go ahead, the National Contact Point is supposed to help the parties resolve the case. A range of options is available, including offering a forum for discussion, conciliation and mediation. The Contact Point should also seek advice from the relevant authorities, NGOs, trade unions and other experts. If the parties are unable to resolve their differences then the Contact Point is required to issue a public statement about the case. If appropriate, it can recommend to the company ways in which to ensure that it adheres to the Guidelines.

At present, twenty complaints have been submitted to different National Contact Points, but as yet no case involves a forestry company. This is partially a result of the relatively low visibility of the Guidelines as compared to some other instruments such as the UN Global Compact. In addition, the cases appearing before the National Contact Points are often being dealt with very slowly. In the UK, for example, a well-documented case against a leading mining company has been allowed to gather dust for nearly nine months.39

The real test of the Guidelines is a recent report to the United Nations Security Council on the illegal exploitation of natural resources in the Democratic Republic of Congo.40 The expert panel appointed by Kofi Annan, the United Nations Secretary General, lists 85 multinational companies mainly based in the UK, Belgium, Canada and the US for violating the Guidelines. The report states that: ‘OECD governments have the obligation to ensure that enterprises in their jurisdiction do not abuse principles of contract they have adopted as a matter of law. They are complicit when they do not take remedial measures.’41

Application of the Guidelines to illegal logging

Since the primary aim of the Guidelines is to promote the application of any national legislation in the country of operation, illegal logging cases would almost certainly come under their remit, as illegal logging would constitute a clear case of violation. A classic example of this would be if a forestry company had been fined for illegal activities or was being investigated by the government.42

38 P. Feeney, Making Companies Accountable: An NGO report on implementation of the OECD Guidelines for Multinational Enterprises by National Contact Points (2002).
39 Ibid.
41 Ibid., para. 178.
42 Personal communication from OECD, 2 October 2002.
As regards international instruments, enterprises must currently consider international agreements such as the Convention on Biological Diversity but need not actually apply best available standards on natural resource management and conservation. The Guidelines therefore need to be strengthened to promote adherence to best available practice on environmental, social and economic issues.

It is worth considering whether the Guidelines should become binding. This could happen at national level, through member state governments requiring the acceptance of the Guidelines by enterprises applying for support, whether to export credit agencies or to any other public or private credit or insurance company. It could also happen at EU level through a Directive on corporate social responsibility.

However, in the longer term, a separate accountability and liability convention could provide a more useful tool for governments to ensure that publicly traded companies are no longer involved directly or indirectly in illegal logging activities. Binding corporate accountability would introduce duties on corporations, extend their liability, introduce rights of redress for citizens, establish community rights to resources, establish consistently higher standards of behaviour, introduce sanctions, extend the role of the international criminal court and improve monopoly controls.

**Recommendations**

- National Contact Points should promote and evaluate the use of the Guidelines amongst the forestry companies based in their countries (including the companies’ overseas operations) and make the results publicly available.

- OECD governments should investigate companies listed in relevant UN Security Council reports.
3 Promoting legal products in the market

3.1 Introduction

As an alternative approach to taking legal action against the products of illegal logging, or the behaviour involved, governments and the EU have at their disposal a range of instruments that can be used to increase the market share for products that can be positively identified as having been legally produced. These include certification (considered in Section 3.2), government procurement policies (Section 3.3) and industry action to identify legal sources (Section 3.4).

3.2 Certification

Summary: The crucial link between forest certification and verification of legality lies in the tracking of the production and movement of the timber and wood products. Only forest certification schemes which have a rigorous chain of custody control from the forest through to the point at which the product is labelled, and which have a certification standard specifying legal compliance, will contribute to controlling the trade in illegally sourced timber.

Forest certification is a tool to help consumers choose ethical and environmental products from responsibly managed forests. The process of certification involves the assessment of a particular forest against publicly available criteria, and only if the forest meets these standards is it certified. For forest certification to work, consumers need to be able to identify timber, wood products or paper that come from well-managed forests. These products therefore need to be labelled. Once a forest is certified, the forest owner obtains the right to label products from that forest with the certifier’s name or logo. There is, however, a long and often complicated path from the forest to the point of sale: the product supply chain. To be able to guarantee the consumer that a particular product comes from a well-managed forest, this supply chain needs to be certified as well. The ownership and control aspect of the product supply chain is referred to as the ‘chain of custody’ (see also Section 7.3).

Certification of responsible forest management is different from legal verification. Legally sourced timber may not come from well-managed forests – indeed, often does not. It is clear that ‘legal’ does not mean ‘sustainable’, as there are many further requirements linked with sustainability other than simply legality. The award of a Forest Stewardship Council (FSC) certificate, for example, requires ten principles and fifty-six specific criteria of good forest management to be met. Only the first principle relates specifically to legal compliance – the others relate to other essential requirements of sustainability.

If a label stating that the forest product is coming from well-managed forests is to be used as verification that the wood is legally sourced, three conditions have to be fulfilled: 1) the forest certification standard needs a clear requirement that national laws have to be abided by; 2) the standard needs to be implemented effectively; 3) there needs to be effective chain of custody control from the forest to the point at which the product is labelled.

In order to effectively exclude non-certified content, a credible chain of custody should include three main elements: identification, segregation and documentation (see Section 7.3). Segregation requires
clients to physically keep certified wood separate from uncertified wood at all phases of transportation, production, distribution, sale and export. Accurate records need to be maintained for the production of certified products.

Of the five operational forest certification schemes – the Forest Stewardship Council (FSC), the Pan-European Certification Scheme (PEFC), the Canadian Standards Association’s Sustainable Forest Management Standard (CSA), the American Sustainable Forestry Initiative (SFI) and the Malaysian Timber Certification Scheme (MTCC) – only the FSC and PEFC meet most of these requirements.43

The FSC, PEFC and MTCC require timber to be harvested whilst respecting national and forestry laws and regulations. The SFI and CSA assume that all Canadian and US-produced timber is legally produced, which may or may not be the case, and have no such requirement.

All schemes, with the exception of the SFI, do require chain of custody certification in order for a product to be labelled. The SFI does not require any chain of custody control, although it has developed a label and – as of September 2002 – is now using it. There is therefore no way of checking that SFI-certified timber actually comes from the certified forest. This practice is in strong contrast with the statement made by the AF&PA (American Forest and Paper Association) that ‘illegal logging undermines the viability of legally harvested and traded forest products’.44

FSC, MTCC, CSA and PEFC do require a chain of custody in order for a product to be labelled. FSC requires segregation for all products that will carry the FSC label, with the exception of products made from multiple sources – such as paper. For these products it is still necessary to track the quantities of certified and uncertified material entering the production line. The PEFC’s chain of custody only requires segregation if the claim ‘from sustainably managed forests’ is used.45 It allows for minimum average percentage schemes (see Box 3.1) and input-output schemes if the claim ‘promoting sustainable forest management’ is being used.

Box 3.1 Chain of custody requirements of different forest certification schemes

There are different ways of certifying chain of custody. The three most widely used are: 1) segregation, 2) minimum percentage average, and 3) input-output.

- **Segregation** requires physical separation or segregation – via bar-coding of individual logs, etc. – of certified wood and non-certified wood during all phases of production, transportation, export, distribution and sale.

- The **minimum average percentage** scheme allows for mixing certified and non-certified wood in the course of production if minimum average percentages of certified wood are met. To accommodate different industry types, most certification schemes have varying applications of the minimum average percentage system, which vary from 30% (FSC, MTCC) to 70% (PEFC).

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43 Despite many reports that there are numerous forest certification schemes, the only five operational certification schemes in the world are the FSC, PEFC, SFI, CSA and MTCC. There are only a few more under development.


45 There are problems with both these claims, as ISO 14021 states that ‘at this time there are no definitive methods for measuring sustainability or confirming its accomplishments. Therefore no claim of sustainability shall be made.’
• Under the input-output scheme, when a known percentage of certified wood enters into processing, the same percentage of the production output is considered to be certified. This does not have to be – and is quite likely not to be – the same timber that was originally certified.

To ensure that there is little possibility of illegally sourced timber entering the chain of custody, segregation is essential.

• The FSC requires segregation for its solid wood products to be labelled as certified, but also has an option for a production line to include up to 30% uncertified wood as long as this is clearly stated on the label. Multiple-sourced products such as plywood, fibre material and paper must contain a minimum average of 30% of virgin wood fibre from certified sources.\(^\text{46}\) FSC also requires that any uncertified material in a labelled product must not come from a controversial source – this is designed to exclude, among others, illegally logged timber. Companies have to have systems in place to assure themselves they are not using controversial sources, and be committed to de-listing suppliers if it can be shown that the sources are controversial.\(^\text{47}\)

• The MTCC does not require segregation but allows for input-output schemes in its chain of custody. For solid wood, the percentage of certified material should be a minimum of 70%, based on a rolling average; for wood fibre the minimum percentage of certified material should be 30%.

• The PEFC’s chain of custody demands segregation only if the claim ‘from sustainably managed forests’ is used and allows for minimum average percentage schemes and input-output schemes if the claim ‘promoting sustainable forest management’ is being used.

• The SFI has no chain of custody at all.

In short, it is therefore unlikely (though not impossible) that illegally sourced timber will be found in solid wood products with an FSC label or in products with a PEFC ‘from sustainably managed forests’ label. The same cannot be said of the SFI label, the MTCC label or the PEFC’s ‘promoting sustainable forest management’ label.

Last, although there has been an exponential growth in the area of certified forests, leading to 109 million hectares certified in January 2002, this still means that less than 3% of the world’s forests is certified as ‘well managed’.\(^\text{48}\) This is a small figure, particularly considering the fact that most of the forests included in this figure have been certified by schemes which do not, in fact, meet the requirements for a credible forest certification scheme that can truly contribute to excluding illegally sourced timber from the market. The contribution of forest certification to addressing illegality is therefore currently still small.

**Recommendations**

• EU governments should ensure that all certification schemes operational within the EU have: 1) a forest certification standard that requires clearly that national laws have to be abided by; 2) a  

\(^{46}\) FSC has recently changed its policy and will soon also be certifying 100% recycled products as well as products containing both recycled and certified virgin material – the percentage of each will have to be shown on the label.  

\(^{47}\) FSC policy, section 3 on ‘uncertified contents and controversial sources’.  

\(^{48}\) This figure includes forest certification that cannot be seen as credible as it lacks a chain of custody. Simula M, Indufor, *Tropical Forest Certification Schemes* (ITTO 2002).
system in place to ensure that the standard is implemented effectively; 3) an effective chain of custody control from the forest to the point at which the product is labelled. To date, only the FSC meets these requirements.

- A clear distinction should be made between certification and labelling for sustainable forest management, and certification (possibly without labelling) for legal compliance. Legal compliance is not and should not be an eco-label.

### 3.3 Government procurement

**Summary:** As major buyers of timber and wood products, governments and local authorities can be used to affect the market in a significant way. Many member states are developing procurement policies, all of which have to be in line with the EU Procurement Directive, which is currently in the process of being adopted. EU procurement policies and government procurement policies could be used to give preference to legally produced timber, guaranteeing a substantial share of the market. This is, however only possible if the EU Directive allows for such measures.

Current EU legislation in the field of public procurement dates back to the early 1970s and is covered by four different Directives dealing with services, supplies, works and utilities. These four Directives will eventually be replaced by two Directives, the contents of which are currently in the process of being adopted. The application of the old and new Directives to ‘green procurement’ is disputed. It is clear that some environmental criteria can be included in the technical specifications of a tender when it is drawn up, but the Commission has argued that such criteria cannot be considered at the award stage, as they do not necessarily bring an economic advantage that directly benefits the public authority.

Legal action has been taken against a number of public authorities that have tried to do this, but in the most recent case, dealing with the purchase of low-emission buses by the City of Helsinki, the EU Advocate-General concluded that the Commission’s position was mistaken, and that extra points could be given to low-emission vehicles at the award stage. In September 2002, the European Court ruled that when a contracting authority decides on the award of a contract it may only take into consideration criteria (which could relate to the environment) that are linked to the subject matter and which do not confer an unrestricted freedom of choice on the authority. Therefore the Court ruling allowed the City of Helsinki to consider non-economic factors (such as noise levels or pollution) while choosing its buses. The Court therefore held that environmental criteria could be taken into account at the award stage, so long as they satisfied a number of criteria, such as being linked to the subject matter of the contract, and being applied in a transparent and non-discriminatory manner.

The ruling relates to current law; however, according to DG Internal Market the new Directives do not contradict this ruling. On the contrary, recital 31 in the political agreement from 21 May states explicitly that award criteria may be of a qualitative nature and address environmental concerns, provided that they are justified by the subject matter of the contract, are objective and are measurable.

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49 ECJ on 17 September 2002 in case C-513/99 ‘Stage Coach’.
50 Comments on draft FERN RIIA report by DG Internal Market, 29 November 2002.
Member states develop their own public procurement policies under the umbrella of the EU Directives. A number of member states have attempted to incorporate sustainability criteria, though only one, the UK, is explicitly intending to use legality criteria as well.

- **In the UK**, on 27 July 2000, the government announced that ‘current voluntary guidance on environmental issues in timber procurement will become a binding commitment on all central government departments and agencies actively to seek to buy timber and timber products from sustainable and legal sources.’\(^{51}\) This commitment has been repeated on several occasions, most recently in a letter from the Government to Greenpeace UK\(^ {52}\) stating that it was UK policy to ‘implement a government timber procurement policy that seeks to procure forest products only from legal and sustainable sources’. Implementation of this commitment to date has been slow, however, and has revealed how little information departmental buyers actually possess on where they source their timber.

A report paper issued by ERM, the UK government’s consultants, in July 2002, outlined a possible scheme to implement the UK policy statement.\(^ {53}\) It proposes a stepwise approach, with three variants, ‘Legal’, ‘Legal and Progressing to Sustainable’ and ‘Legal and Sustainable’, each defined against a set of criteria. ‘Legal’ is defined as: i) the producer has legal usage rights to the forest; and ii) the producer complies with the laws and codes of practice of the country in which the forest is situated and that are relevant to the management of forests and the mitigation of the impacts of forest management on people and the environment. In addition, it is proposed that a clause requiring compliance with CITES should be inserted into all specifications.

The ultimate objective is that all purchases should be ‘legal and sustainable’. As a result, it is recommended that this level is set as the standard, and only if bids cannot meet ‘legal and sustainable’ will bids against the other variants be considered. In addition, the report recommends establishing a ‘central point of expertise’ to provide guidance and advice to government purchasers on which certification schemes and other types of evidence meet the criteria.

In our opinion, some existing schemes, such as FSC, would meet these criteria; but it is important to note that suppliers would also have the opportunity to prove that their products met the criteria even if they were not so certified. This is an important point about procurement policy, under both EU law and the WTO: it needs to define the criteria it requires to be met, and not simply the scheme(s) that meets them.

The UK government is currently considering the consultants’ recommendations and is expected to issue a statement at the beginning of 2003. As the report has been the subject of wide consultations, it is expected that the government will adopt most of the recommendations.

- **In Germany**, several government authorities at federal, state and municipal levels have public procurement policies in place that only allow the use of tropical timber products if they are certified as coming from well-managed forests. However, this does not necessarily exclude illegally sourced timber – and is in many cases only a requirement for timber originating from tropical forests.

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\(^{51}\) Michael Meacher (Environment Minister), DETR News Release 516, 28 July 2000.

\(^ {52}\) Letter from Michael Meacher MP to Stephen Tindale, Executive Director Greenpeace UK, 26 June 2002.

\(^ {53}\) *Procurement of timber products from legal and sustainable sources by government and its executive agencies.* Environmental Resources Management (July 2002).
The WTO implications of procurement policy are considered below in Section 7.5.

**Recommendations**

- All EU member states should adapt their government procurement policies to incorporate legality criteria – and, ideally, sustainability criteria.

- The current draft EU Directive on Government Procurement needs to make it clear that legality and sustainability criteria are permissible at both tender and award stage.

### 3.4 Industry initiatives

**Summary:** The timber importing industry in Europe can take steps to ensure that its products come from legal sources, without any intervention from government and particularly where they develop relatively long-term relationships with suppliers in the producer countries. Some industry bodies, like the UK Timber Trade Federation, have developed a code of conduct, and many have made statements denouncing illegal logging. We have not, however, found any more concrete action taken so far by the timber importing industry.

Industry is, of course, free to take action without any intervention by government, or it can be encouraged to do so without any change in regulations.

- **In the UK**, the Timber Trade Federation (TTF), which represents the majority of UK importers, published a code of conduct in the summer of 2002.\(^{54}\) It includes the statements that: ‘Members shall conduct their businesses lawfully and comply with all relevant legislation and trade fairly and responsibly’\(^{55}\) and ‘Members are committed to sourcing their timber and timber products from legal and well-managed forests. Members unreservedly condemn illegal logging practices and commit themselves to working with suppliers and other stakeholders towards their complete elimination.’\(^{56}\) Failure to observe the Code could lead to the imposition of fines, suspension of membership or expulsion from the Federation. In reality these do not amount to particularly severe sanctions. Nevertheless, the Code is an encouraging sign of British industry’s awareness of the issue. TTF staff are due to visit Indonesia to spread awareness of the Code among their suppliers.

- **In the Netherlands**, the timber industry is working on a new Code of Conduct, which will include a position against illegally sourced timber. Details are not currently available.

An alternative route towards the same end would involve importers and/or retailers sourcing only from **certified** products, where these guarantee legality (see the discussion in Sections 3.2 and 7.3):

- IKEA, the world’s largest retailer by solid wood volume, uses a phased approach to ensure that its timber is legally sourced and that forest management operations meet environmental standards.

\(^{54}\) See www.ttf.co.uk

\(^{55}\) TTF Code of Conduct, para. 8.1.

\(^{56}\) TTF Environmental Code of Practice, para. 1.
• In the UK, the retailer B&Q made a commitment in the late 1990s to purchase timber products only from forests independently certified as well managed. 80% of their products are now FSC certified, with the remainder being certified timber (by the Finnish Forestry Certification Scheme) from Finland.57

• The industry associations CEPI, ATIBT and AF&PA have made statements but – as far as we know – have taken no further action.

Recommendations

• As a very first step, EU governments should encourage industry associations in their own countries to make public commitments to the elimination of illegal logging and to develop and implement codes of conduct to that end.

57 See www.diy.com/aboutbandq/sustainability/history/Timber_history.pdf
4 Controlling sources of investment

4.1 Introduction

Finance from public and private sources in the EU is an important source of investment for many logging companies and other sectors of the forestry industry in producer countries. Since much of this activity is illegal, it is inevitable that a proportion of this money is helping to sustain illegality. We consider in this section the range of options which governments have available to them to try and steer investment flows away from potentially illegal sources. This covers export credit agencies (Section 4.2), banks and other private sources of investment (Section 4.3) and insurers (Section 4.4).

4.2 Export credit agencies

Summary: Many EU-based export credit agencies (ECAs) are financially supporting companies and projects that are involved in illegal logging. Unlike export credit agencies in the US and Japan, some of which have some basic environmental guidelines, most European ECAs are not bound by any environmental or social guidelines. To ensure that ECAs do not exacerbate illegal logging, EU governments should adopt binding environmental and social rules for ECA involvement, as well as ensuring that ECAs increase transparency and allow for independent evaluation and monitoring of their practices.

Export credit agencies and investment insurance agencies, commonly known as ECAs, are public or semi-public agencies that provide government-backed loans, guarantees and insurance to corporations seeking to do business in countries where the investment climate is judged to be too risky for conventional corporate financing.

Most countries of the OECD possess at least one ECA. Worldwide, ECAs currently support an estimated $432 billion in trade and investment – nearly 10% of world exports. Longer-term loans and guarantees by ECAs increased four-fold between 1988 and 1996, from $26 billion to $105 billion annually – twice the amount of total worldwide official development assistance. ECAs provide the single largest source of taxpayer support for projects in the South and in Eastern Europe, underwriting projects several times greater in value than the combined annual funding of all Multilateral Development Banks. However, unlike most of these banks, most ECAs are not subject to any binding environmental, human rights or development guidelines. Not surprisingly perhaps, ECAs are involved in many destructive projects.

With the exception of Ireland, all 15 EU member states have ECAs. Most EU-based ECAs have no criteria for assessing the environmental and societal impacts of the projects they support; the EU lags behind the US and Japan in this respect. ECA-backed projects contribute to illegal forest exploitation either directly, as in Indonesia where pulp and paper mills are estimated to source up to 40% of the

58 The Berne Union (International Union of Credit and Investment Insurers) Yearbook, 2002. Between 1982 and 2000, the members of the Berne Union provided support for exports worldwide amounting to $6,888 billion, some $350 billion a year, and supported foreign direct investments of $112 billion. Members paid claims over this period amounting to about $169 billion; see http://www.berneunion.org.uk/about.html#contact details.
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wood they consume from illegal sources,\textsuperscript{59} or indirectly by opening forest areas to infrastructure projects and pipelines or using illegally harvested timber for construction.\textsuperscript{60}

**Box 4.1 Some examples of EU ECAs supporting illegal logging and forest destruction**

Many EU-based ECAs support projects that contribute to illegal logging. Examples include:

- Finnvera, the Finnish Guarantee Board, and ECAs from Spain, Denmark, Belgium, Sweden and Germany all supported the construction of pulp and paper mills in Indonesia, which have obtained as much as 40% of the wood they have consumed from illegal sources.\textsuperscript{61}

- Asia Pulp and Paper (APP) is a clear-cut case: APP owns the Indah Kiat pulp mill in Perawang, Sumatra, financed through a $500 million investment package supported by Finnvera, the Finnish Guarantee Board, Spain’s CESCE, Denmark’s Exportkreditfonden, and Canada’s Export Development Corporation. For years, the mill has been embroiled in conflicts about the source of its timber for pulping. In 2001, APP called a debt standstill after it was unable to continue paying back debts of $13.4bn. APP is suspected of buying timber from illegal sources.

- The Belgian export credit agency, Office National du Ducroire, and the Italian export credit agency, SACE, provided support for petrochemical projects\textsuperscript{62} that led to illegal logging activities either directly for construction purposes or indirectly by opening up new areas.

**EU legislation on export credit agencies**

The EU Directive on harmonisation of the main provisions concerning export credit insurance for transaction\textsuperscript{63} is intended to harmonise the laws of the member states on official medium- and long-term export credit insurance systems, in order to avoid distortions of competition amongst enterprises in the Community. Its scope is purely financial. The Commission recently published a report\textsuperscript{64} on the experienced gained and the convergence achieved under the Directive. The Commission is proposing to amend the Council Directive with amendments including issues such as transparency and disclosure of information. Further amendments could be introduced, requiring that all relevant EU legislation on financial institutions and environmental and social protection should be directly applicable to ECAs.

**Recommendations**

- EU member states should ensure that EU legislation regulating the financial sector and protecting social rights or the environment is effectively applied to the operations and projects financed and insured by European export credit agencies

- EU governments should ensure that European export credit agencies apply best available environmental and social rules and procedures to all their operations; should increase the

\textsuperscript{59} Chris Barr, \textit{Profits on Paper: The political economy of fiber, finance, and debt in Indonesia’s pulp and paper industries} (CIFOR and WWF, 2000).

\textsuperscript{60} Chantal Marijnissen, \textit{Export Credits Fuelling Illegal Logging} (FERN briefing note, 2002).

\textsuperscript{61} Ed Matthew, \textit{Paper Tiger, Hidden Dragon} (FoE, June 2001).

\textsuperscript{62} Chantal Marijnissen, \textit{op. cit.}

\textsuperscript{63} 98/29/EC of 7 May 1998.

\textsuperscript{64} Commission COM (2002) 212 final: \textit{Experience gained and the convergence achieved in applying the provisions laid down in the Directive on medium and long term export credit insurance.}
information disclosure practices of their ECAs on basic project information and on environmental, social and human rights impact assessments and economic analyses; and should implement independent third-party monitoring of the projects against the above-mentioned rules, once in force.65

4.3 Banks and other sources of investment

Summary: Finance from private sources – banks, investment and pension funds – can be an important source of revenue for logging companies and other sectors of the forestry industry. Some, notably ABN-AMRO, have already announced that they will not fund any forestry companies involved in, colluding with, or purchasing timber from illegal logging operations. Other financial institutions should follow this example. EU and member state authorities should take action to encourage, and in due course require, financial institutions to draw up policies and action plans to ensure that they do not finance companies involved in illegal logging practices. This would also facilitate the implementation of any money laundering legislation.

Alongside public sources of finance for investment in logging activities, private sources such as banks, pension and investment funds, are highly significant. In many developed countries, such institutions are increasingly under pressure to ensure that their investments are socially and environmentally responsible, and the ‘ethical investment’ sector is itself growing rapidly, albeit from a very low base.

One of the key elements of this pressure is to ensure that banks adopt more stringent due diligence measures in circumstances where they have reason to believe that their client may be engaged in criminal activities. Given that the majority of logging activities in many countries are generally accepted to be illegal, this should be a strong signal to a bank that any of its clients operating a forestry business in those countries may be committing forestry crimes. Such due diligence measures would in fact be good business practice, as illegality, by definition, means increased risk. Two main suspect companies in Indonesia, for example, have defaulted on million-dollar loans from the banking community.

In response to these pressures, a number of institutions are developing specific policies for handling investments in the forestry sector. The Netherlands-based bank ABN-AMRO, for example, has adopted the following measures: no finance for companies or projects in primary and/or high conservation value forests; no collusion with illegal logging; no illegal or uncontrolled use of fires; a clear policy and practice of respecting indigenous rights; and a broad ‘sustainability scale’, with a number of criteria, to assess potential investments. This is clearly a valuable initiative, and could be adopted by other banks and financial institutions.

At an international level, the Basel Committee of the Bank of International Settlements formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements – although its activities have no legal force in themselves. Over the past few years the Committee has moved more aggressively to promote sound supervisory standards worldwide. In

65 A coalition of over 60 European NGOs has presented a list of environmental and social guidelines for ECAs, available at www.fern.org.
October 2001, the Committee published a report on *Customer Due Diligence for Banks*. Key elements included thorough customer acceptance and identification practices, ongoing transactions monitoring and a robust risk management programme. In September 2002, the International Conference of Banking Supervisors, representing regulators from nearly 120 countries, recognised the report as the agreed standard, acknowledged that customer due diligence is a prudential responsibility and agreed to promote the report’s principles for adoption by their banks and other deposit-taking financial institutions.

There is a limit, however, to the extent to which banking institutions can control illegal logging by themselves. A company could engage in back-to-back lending, whereby a bank in good faith would fund projects in a non-forestry company, thus freeing other funds within that company, which could be invested in a (violating) forestry company. Also, a company could be funded from other sources apart from corporate lending, for example by the issuance of equity.

**Recommendations**

- European financial sector regulators should issue specific industry guidelines for forestry sector activities, which specify that companies wishing to raise equity on EU financial markets must disclose potential risks linked to forestry crime. This should encourage all financial institutions in the EU to adopt specific policies and guidelines for investments in the forestry sector.

- EU banking regulators should promote this approach worldwide within the Basel Committee and the International Conference of Banking Supervisors.

### 4.4 Insurers

**Summary:** Ships carrying timber are almost invariably insured, but it is quite possible that the insurance policy would be voided if the cargo were found to be illegal. This issue should be subject to further discussion with insurance companies and underwriters.

Ships carrying tropical timber are almost always insured. Normally insurance costs supersede the value of the timber by about 10%. Insurance can be organised by the buyer (i.e. the timber trade), the seller or both. The insurance policy is, in almost all cases, drafted by an insurance broker, who will subsequently arrange for insurance companies to buy into the policy for a certain percentage, using a standard insurance policy.

It should be possible to include a provision in the insurance policy to allow for the cancellation of any insurance if the ship contains illegal material. However, existing law governing marine insurance may already provide for this in some cases.

- **In the UK,** the standard insurance policy contains no specific reference to the issue, but the relevant legislation suggests that an essential requirement of the insurance contract is that the

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66 See http://www.bis.org/publ/bcbs85.htm.
67 If timber is bought FOB (Free on Board) the transport and insurance will have to be arranged by the buyer, if timber is bought CIF (Cost Insurance Freight) the seller will have to organise and pay for transport and insurance.
cargo is legal. Whether the contract would still be void if the carrier could show that they did not know the illegal nature of the cargo is not clear.

- **In the Netherlands**, the standard insurance policy used for shipments\(^{69}\) contains a specific provision on illegal narcotics.\(^{70}\) The provision reads that the insurance company is not liable to pay for damage or loss if the cargo falls under international agreements related to narcotics, no matter whether the Netherlands is a party to these agreements or not. This provision might have been added due to the adoption of the EU Money Laundering Directive of 1991, which applied only to narcotics.

**Recommendations**

- This is a complex area which requires further study and discussion with insurance companies and underwriters. Nevertheless, it may provide another weapon in the armoury of measures that can be used against illegal logging and the trade in illegal timber.

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\(^{69}\) De Algemene Voorwaarden 'Nederlandse Beurs-Goederen Polis' 1991.

\(^{70}\) Article 16. Verdovende Middelen.
5 Global frameworks

5.1 Introduction

On a wider canvas than the EU, there is a series of global agreements and institutions that are potentially relevant to the control of illegal logging and the trade in illegal timber. These include, most importantly, the Convention on International Trade in Endangered Species (CITES), considered above in Section 2.4, and a range of international forums in which discussions around illegal logging are ongoing (Section 5.2). A number of international agreements already apply trade controls, such as licensing systems, in the pursuit of their objectives, and some of the lessons there may be relevant to the control of illegal logging (Section 5.3).

5.2 International forums

**Summary:** A range of international institutions and agreements have in recent years begun to discuss the issues surrounding illegal logging, though few of them have actually taken any concrete action as a result. Nevertheless, broad discussion of the issues can be valuable. More action-oriented initiatives, such as the Forest Law Enforcement and Governance (FLEG) process, should be encouraged.

In addition to CITES (see Section 2.4), the key institutions and agreements include:

- The *Food and Agriculture Organisation*, the lead UN agency on agriculture, fisheries and forests, is currently considering what contributions it can make to tackle the problem of illegal logging. Its experience of dealing with illegal fishing may be of use, as there are some parallels with illegal logging.

- The *United Nations Forum on Forests* was established in 2000. Although it provides a forum for the discussion of all forestry-related issues, deep divisions exist within its membership on issues such as trade and environment, technology transfer, governance and illegal trade.

- The *International Tropical Timber Organisation* (ITTO), with a membership of 57 countries representing 95% of world trade in tropical timber and 75% of the world’s tropical forests, acts as a forum for discussion and policy-making and also funds projects. ITTO is currently undertaking a series of studies on timber trade statistics, attempting to examine the large discrepancies between import and export data around the world and the extent to which these may be due to illegal timber trade (not declared at the point of export). The International Tropical Trade Agreement (ITTA), the legal basis for ITTO, will expire in 2006 and negotiations on a new ITTA will start in 2003.

- The *Convention on Biological Diversity* establishes a general framework for the conservation of biodiversity. Illegal logging was discussed at the Sixth Conference of the Parties in April 2002, but proved controversial. Even the term ‘illegal logging’ roused some opposition; in the end

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71 Although the report of an experts’ meeting on ‘Policy options for improving forest law compliance’, held in January 2002, has still not appeared on the FAO website.
parties agreed to use the phrase ‘unauthorised harvesting’. A number of case studies will be developed addressing the impact of unauthorised harvesting on local fauna, communities and revenue loss, and the studies will also ‘identify the relationship between consumption in consumer countries and unauthorised harvesting activities, including through international trade.’ 72

- In 1998, the foreign ministers of the G8 group of countries73 agreed an Action Programme on Forests. The UK agreed to act as the focal point for action on illegal logging, a development which in due course led, amongst other things, to the UK–Indonesia bilateral agreement (see Section 6.2). The Action Programme concluded in 2002; it noted the actions taken by G8 countries, such as a review of public procurement policies, and the provision of technical assistance to producer countries, and acknowledged that ‘progress to date on forest law enforcement and governance is only the beginning. Illegal logging, associated trade and corruption are issues that will continue to be addressed in various international forums as a matter of priority.’ 74

- The World Summit on Sustainable Development took place in Johannesburg in August/September 2002. The Summit’s final Plan of Implementation includes the commitment to ‘take immediate action on domestic forest law enforcement and illegal international trade in forest products, including in forest biological resources, with the support of the international community, and provide human and institutional capacity building related to the enforcement of national legislation in those areas.’ 75 In addition to the formal outcomes, the Summit saw a wide range of informal (so-called ‘Type 2’) outcomes, or partnerships for implementation, announced, bringing together governments, intergovernmental organisations and non-governmental actors such as businesses, NGOs and community groups. A number of these are relevant to illegal logging, including in particular the Asia Forest Partnership – which includes developing log tracking and verification systems, measures to eliminate the export and import of illegally harvested timber, and data sharing and information exchange on illegal logging and the trade in illegal timber – and the partnership for Forest Management and Conservation in the Congo Basin.

The FLEG process

Probably of more significance than any of the above is the World Bank-sponsored Forest Law Enforcement and Governance (FLEG) process. In September 2001, countries from East Asia and other regions (including the UK and US) participated in the FLEG ministerial conference in Bali, an initiative designed to establish a framework through which producer country governments could work together with each other and with governments of consumer countries to tackle illegal activities. In Bali, ministers resolved to ‘take immediate action to intensify national efforts, and to strengthen bilateral, regional and multilateral collaboration to address violations of forest law and forest crime, in particular illegal logging, associated illegal trade and corruption, and their negative effects on the rule of law.’ 76

The topic of trade in illegally logged timber featured in the discussions; the final ministerial declaration included a commitment to ‘explore ways in which the export and import of illegally

72 CBD Decision VI/22, ‘Forest Biodiversity’, para. 19(e).
73 Canada, France, Germany, Italy, Japan, Russian Federation, UK, US.
75 WSSD Plan of Implementation, para. 43(c).
harvested timber can be eliminated, including the possibility of a prior notification system for commercially traded timber’. The section on trade and customs in the ‘Indicative list of actions for the implementation of the declaration’ annexed to it included:

- ‘Harmonised customs commodity codes;
- Protocols for sharing of export/import data;
- Complete chain of custody audit and negotiation systems;
- Initiatives for improved and timely trade statistics;
- Prior notification between importing and exporting countries.’

The conference established a regional task force to ‘advance the objectives’ of the Declaration, and an advisory group of NGOs and industry was also formed. Both had initial meetings in May 2002, and further ones are planned. Ministers also agreed to meet again in 2003 to review progress. Further FLEG conferences are hoped to be organised in other regions with significant forest resources. The next is scheduled for Africa in April 2003, for which a preparatory meeting was held in Brazzaville in June 2002.

**Conflict timber**

The term ‘conflict timber’ was first coined, though not defined, in the report of the United Nations Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth of the Democratic Republic of Congo. The British NGO, Global Witness, has provided a working definition of conflict timber as ‘timber that has been traded at some point in the chain of custody by armed groups, be they rebel factions, regular soldiers or the civilian administration, either to perpetuate conflict or take advantage of conflict situations for personal gain.’

Currently, timber harvested by oppressive regimes, occupying forces or rebel factions in countries or regions of countries, such as in Burma, the Democratic Republic of Congo and Liberia, could fall under this definition. Companies and factions involved in this trade are often linked to international organised crime and terrorist networks. International efforts to secure peace can be undermined by a failure to choke off this source of funding for conflict. Following the Kimberley Process on conflict diamonds (see Section 5.3), there is growing interest in the adoption of a similar process on conflict timber, and possibly on other resources often traded to fund conflict. The EU could play a useful role in promoting this issue in the UN and other suitable forums, such as the G8. In the shorter term, the UN Security Council could place embargoes on conflict timber on a case-by-case basis – though attempts to do this in the case of Liberia have met opposition from France and China (both major importers of Liberian timber).

We have included a clause on conflict timber (Article 4) in our draft EU Regulation on the control of imports of illegal timber included in Annex 1.

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77 Ibid., p. 2.
78 Indicative List, p. 3.
79 *Economies of Conflict: Private Sector Activity in Armed Conflict;* Fafo Institute for Applied Social Science; 2002.
80 Security Council Resolution 1408 of 2002 merely calls on the Government of Liberia to ensure that revenue derived from ‘the Liberian Shipping Registry and the Liberian timber industry is used for legitimate social, humanitarian and development purposes, and is not used in violation of this resolution’ (para. 10).
**Recommendations**

As can be seen, there are many opportunities for discussing the topic of illegal logging at an international level – though as can also be seen from the experience of the UNFF and its predecessors, there is limited value in discussions for their own accord. We recommend that:

- The EU and its member states should continue to promote discussions on illegal logging and the control of trade in illegal timber in appropriate forums.

- The ITTO and its member countries should accelerate work on timber trade data so as to better identify illegal timber flows and facilitate international understanding and action on FLEG. As part of the negotiations for a new ITTA, starting in 2003, ITTO members should press for action to eliminate trade in illegal timber as part of ITTO’s mandate under the new agreement.

- Financial assistance should be made available to initiatives designed to take action (rather than just further discussion) on illegal logging, including the ITTO trade studies, and in particular the FLEG conference initiative and follow-up.

- The EU should call on the UN General Assembly to adopt a resolution to define conflict timber and to recognise a multilateral mechanism to tackle the issue of resources funding conflict. The introduction into the Community of any of the timber or wood products listed from any state for which the Security Council of the United Nations has recommended the application of sanctions in order to prevent the use of timber revenues to fund conflict must be prohibited.

### 5.3 Lessons from international licensing systems

**Summary:** Several international agreements impose various forms of trade controls – mainly licensing or permit schemes – in the pursuit of environmental goals or in an attempt to control illegal behaviour. Lessons can be learned from them.

**Multilateral environmental agreements**

In addition to CITES (see Section 2.4), several multilateral environmental agreements (MEAs) have been agreed in order to impose various controls on international trade in cases where the unregulated trade was causing, or was likely to cause, significant environmental damage. The most relevant are:

- The Montreal Protocol on ozone-depleting substances, which uses a system of import and export licences, adopted primarily in order to reduce illegal trade.

- The Basel Convention on transboundary movements of hazardous wastes, which uses a system of ‘prior notification and consent’.

- The Rotterdam Convention on hazardous chemicals and pesticides in international trade (not yet in force), which will establish a system of ‘prior informed consent’.

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81 About 20 of the 200 MEAs currently in existence contain trade measures (requirements, restrictions or complete bans on trade).
The Cartagena Protocol in biosafety (also not yet in force), which will establish a system of ‘advanced informed agreement’ to control the trade in genetically modified products.

The purpose of all these trade instruments is to establish a system in which either or both exporting and importing countries (and in some cases countries of transit) have to agree to the trade’s taking place before it can proceed. Unregulated trade is therefore eliminated, or at least made more difficult.

The problems with CITES have been outlined above. Its reliance on paper certificates to accompany the traded goods in question opens up possibilities for fraud, theft and corruption, and the permits are not adequately cross-checked against each other or against the goods they are accompanying. The Basel Convention suffers from similar problems: the vast majority of the illegal trade in hazardous waste is believed to involve falsified documentation, and hazardous waste can often be difficult to distinguish from non-hazardous waste (indeed, the two are sometimes deliberately mixed together). Any system for controlling any part of the international trade in timber therefore needs to avoid these problems.

The Kimberley Process

In recent years the trade in so-called ‘conflict diamonds’ has helped to fuel civil wars in Angola and Sierra Leone, with rebel movements in the latter being supported by the government of Liberia in exchange for consignments of rough diamonds. UN Security Council sanctions, including controls on imports of rough diamonds from those three countries, proved ineffective, and conflict diamonds continued to enter the legitimate trade. The Kimberley Process to identify and eliminate the trade in conflict diamonds had its origins in the decision of southern African countries, in early 2000, to take action to stop the flow of conflict diamonds to the market while at the same time protecting the legitimate diamond industry. The aim of the Process was to establish minimum acceptable international standards for national certification schemes relating to the trade in rough diamonds, and it eventually came to involve almost forty governments and the EU, together with the diamond industry and civil society.

The Kimberley Process completed the first phase of its work in November 2001, with broad agreement on the details of an international certification scheme, and was formally adopted at Interlaken, in Switzerland, on 5 November 2002 and is due to come into effect on 1 January 2003. It adopted the definition of ‘conflict diamonds’ as meaning ‘rough diamonds used by rebel movements or their allies to finance conflict aimed at undermining legitimate governments, as described in relevant United Nations Security Council (UNSC) resolutions insofar as they remain in effect, or in other similar UNSC resolutions which may be adopted in the future, and as understood and recognised in United Nations General Assembly (UNGA) Resolution 55/56, or in other similar UNGA resolutions which may be adopted in future’.

The system revolves, like CITES, around the certification of exports. Producer countries will control the production and transport of rough diamonds from mine to point of export. Shipments of rough diamonds will be sealed in tamper-resistant containers and a forgery-resistant Kimberley Process certificate issued for each shipment. Importing countries will inspect the seal and the certificate at the time of import, and prohibit the import of rough diamonds not accompanied by a certificate issued by a Kimberley Process participant. Similarly, transit countries will ensure that only rough diamonds accompanied by a Kimberley Process certificate are permitted to enter the chain of transactions from

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82 Kimberley Process Certification Scheme Section 1 (see www.kimberleyprocess.com).
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import to export. Imports from and exports to non-participants in the Process will be prohibited, though it is expected that all countries producing and trading rough diamonds will participate.

Participants undertake to establish internal systems to implement and enforce the certification scheme, including establishing suitable penalties for transgressions. The Process recommends, amongst other things, that the names of individuals and companies convicted of breaches of the certification scheme should be made known to all other participants. The diamond industry has undertaken to introduce a system of self-regulation to support the Process, involving a system of warranties underpinned through the verification of individual companies by independent auditors and supported by internal penalties set by the industry.

The EU had followed the UN Security Council in attempting to prohibit the import of conflict diamonds from individual named states; a Council Regulation in February 2002 prohibited, under certain conditions, the import of rough diamonds from Sierra Leone. In August 2002 the European Commission published a proposal for a Council Regulation designed to implement the Kimberley certification scheme within the EU.

The draft Regulation essentially incorporates the Kimberley Process Certification Scheme into EC law. It requires each member state to designate a competent authority to implement the relevant provisions of the Regulation, and also to determine the penalties applicable in the event of breach of the Regulation. Monitoring of the trade into and out of the EU is quite strictly controlled. For imports, not only does the relevant member state authority need to satisfy themselves that the diamonds are accompanied by a valid certificate, but the diamonds plus certificate must then be examined by a Community authority, which will only release the diamonds into the EU once it is satisfied that neither container nor certificate have been tampered with, and that the certificate is valid. Similarly, the Community authority will only permit exports of rough diamonds once it is satisfied that all the procedures, for container and certificate, have been properly followed, and that the exporter can prove that the diamonds have been validly imported. The latter procedure is made slightly easier for organisations representing traders in rough diamonds that fulfil a long list of criteria set out in the Regulation – essentially, effective self-regulation for compliance with the aims of the Kimberley Process – for which a signed declaration of lawful import will be considered sufficient.

There are obvious parallels between the aim of the Kimberley Process, to exclude conflict diamonds from the legitimate diamond trade, and moves to exclude illegally sourced timber from legal markets. There are also, of course, important differences: diamonds are traded in far lower volumes than is timber, and can be sealed in tamper-proof containers; the number of countries involved in major imports and exports is lower; and the industry is largely united, worldwide, on the desirability of the system.

Despite these differences, there are lessons that can be learnt from the Kimberley Process, and also from the experience of MEAs with licensing systems. The Kimberley Process inspection scheme for certificates, particularly in the EU draft Regulation, is far stricter than in CITES and other MEAs, and should avoid many of the weakness of CITES import and export permits. The co-option of the industry, essentially through giving favourable treatment to organisations that promise to fulfil particular criteria, is a useful precedent.

84 2002/0199 (ACC).
Above all, perhaps, the sheer speed of action displayed by the international community on this issue is a powerful demonstration of the ability to mobilise the political will to regulate, through certification, the entire global trade in an important traded commodity and to exclude illegal production from the marketplace.
6 New approaches

6.1 Introduction

It should be clear from Sections 2, 3 and 4 that there are a wide range of policies and measures available to the EU and its member states that could reduce the trade in illegally logged timber – but none of them is precisely targeted at the problem. There is no question that more could be done with existing legislation, or with relatively straightforward adaptations of it – for example, that on money laundering – but there are drawbacks to this approach. The main drawbacks are:

- Existing legislation requires close co-operation with enforcement authorities in the producing and exporting countries, which may not always be forthcoming, as a result of lack of capacity, corruption or intimidation, etc.

- Existing legislation requires the involvement of enforcement and other authorities in the consumer and importing countries, which, similarly, may not always be forthcoming under the current framework, given other priorities such as the fight against terrorism or against the drugs trade.

- Any action that relies on court cases – for example, anything brought under money laundering legislation – may take several years to show results.

- In most cases it is impossible to tell through simple inspection whether a particular shipment of timber or wood products has been produced illegally.

We therefore believe that further options for legislation directly targeted at the importing of illegal timber should be considered. The new EU Regulation on conflict diamonds, which establishes a licensing system in order to exclude illegal production (see Section 5.3), shows that such legislation is possible, even in a relatively short period, if all countries and the forestry industry see the need for such legislation.

Ideally new legislation would, like that on conflict diamonds, be based on an international agreement on the control of illegal logging and the trade in illegal timber. Unfortunately, this seems highly unlikely in the short term. Compared to the Kimberley Process, the numbers of countries involved is much greater, the industry is far more fragmented, and the history of the discussions on a global forests convention is not encouraging. International initiatives – particularly the FLEG process (see Section 5.2) – should clearly be encouraged, but it seems far more likely that progress will be made in the short and medium term through bilateral and regional agreements. In the longer term, these can pave the way towards a global, multilateral agreement.

This section looks at the following approaches: at bilateral agreements between individual producer and consumer countries (Section 6.2), at an EU-wide system for licensing imports which would be open to any producer country to join (Section 6.3), and at the possibilities for a broad prohibition on imports of illegal timber, perhaps based on the model of the US Lacey Act (Section 6.4).
**6.2 Bilateral agreements**

| Summary: The bilateral agreement between Indonesia and the UK, signed in April 2002, aims to establish a system of legality identification and verification in Indonesia, and to move towards excluding products not so identified from the UK/EU market. Although by itself it can have only a limited impact on the trade in illegal timber, it is highly significant both for the practical lessons that will be learned from the experience of its implementation, and from the demonstration of political will that it represents. Other bilateral agreements are beginning to be negotiated and should be encouraged, though it would make much more sense for them to be negotiated between producer countries and the EU as a whole, rather than with individual member states. |

The Memorandum of Understanding between the Government of the Republic of Indonesia and the Government of Great Britain and Northern Ireland on co-operation to improve forest law enforcement and governance and to combat illegal logging and the international trade in illegally logged timber and wood products was signed in London on 18 April 2002. It represents a significant development in the evolution of attempts to control the import of illegally sourced timber.

Following discussions within the G8 (see Section 5.2), the UK government began in 2001 to consider the possibility of a bilateral agreement with a major timber exporting country. The idea was firmed up at the FLEG conference in Bali in September 2001, where the British minister Hilary Benn MP\(^\text{85}\) stated that ‘there is one specific course of action we can take, and that is to reach voluntary bilateral agreements between producer and consumer countries’. The possibility of such voluntary agreements was included in the ‘Indicative list of actions for the implementation of the declaration’ annexed to the ministerial declaration. British officials began talks with Indonesia on the possibility of a bilateral agreement; a draft Memorandum of Understanding was prepared in February 2002 and finally agreed in April, and an Action Plan to implement the agreement was agreed in August 2002.

The Memorandum of Understanding and Action Plan contain six key sets of commitments:

1. Identification of key legislative reforms and other actions designed to prevent illegal harvesting, export and trade. Activities in Indonesia have so far included: a multi-stakeholder consultation designed to build broad support for an operational definition of ‘illegal logging’; a long-term review of forest and forest-related legislation; and moves to improve forest management by concessionaires. Within the UK, actions have included: identification of necessary changes to trade-related legislation, and, therefore, promotion of new legislation at EU level; and, internationally, encouragement for major trading partners to join efforts to curb illegal logging.

2. The establishment of systems for the verification of legal compliance based on independently verified chain of custody tracking and identification systems – in practice, the core of the agreement. Implementation of this is just beginning, with a pilot study of practicalities covering three Indonesian districts with different forest law enforcement characteristics. The intention is to see a country-wide system become operational in 2004.

3. The provision of capacity-building assistance by the UK to support these initiatives. The various studies referred to above are being funded by the UK.

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\(^{85}\) Then Parliamentary Under Secretary of State for International Development.
4. Support by both governments for the involvement of civil society. Consultation meetings have been held in both Jakarta and London with industry and NGO representatives, and work will proceed in identifying the possible roles civil society groups could play in implementing and monitoring controls on illegal logging.

5. The joint development of data exchange systems and of effective collaboration between enforcement agencies in both countries. Both countries are participating in the ITTO study of discrepancies in timber trade data, and further research will be carried out, in collaboration with the industry, on detailed trade data.

6. Encouragement, on the part of both governments, of action by the timber industry to reduce and eventually eliminate the trade in illegal timber. In the UK, the Timber Trade Federation produced its own code of conduct in the summer of 2002 (see above, Section 3.4) and further discussions will be held with both UK and Indonesian industry.

NGOs in both the UK and Indonesia have broadly welcomed the agreement, though some concerns have been expressed over targeting illegal logging in isolation from other urgent and more fundamental issues such as reform of the Indonesian forestry law to address the issue of land rights for local people66 (see also Section 7.2). Other producer countries have expressed interest in following the development of the agreement, possibly with a view to signing similar ones themselves, and other consumer countries, such as France, have begun to consider negotiating similar agreements themselves. Norway and Finland have both negotiated bilateral agreements with Indonesia, as have Malaysia and China.

Clearly there are limits to bilateral agreements such as the UK–Indonesia Memorandum of Understanding. They are relatively easy to evade, through the simple trans-shipping of products via third countries either near the country of origin or near the country of destination; and the complex nature of trade patterns in timber and wood products, particularly for processed and finished products using wood from several sources, make the timber difficult to track.

Nevertheless, even if it is relatively easy to evade, such an agreement has value: it changes the accepted levels of illegal behaviour; it offers opportunities to NGOs and local communities to expose evasions of the agreement and embarrass the governments involved; and it provides a signal to the timber industry of likely future developments. Perhaps above all, it paves the way towards – and irons out many of the practical difficulties involved in – a wider, regional or multilateral, agreement. Since the control of imports must be carried out at an EU level, it makes a good deal of sense for any future bilateral agreements to be negotiated between producer countries and the EU collectively.

**Recommendations**

- The EU should negotiate a series of bilateral or regional agreements with as wide a range of producing and exporting countries as possible. The UK–Indonesia Memorandum of Understanding provides a model that can be adapted to suit local circumstances. These agreements

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66 In a joint statement (April 2002) welcoming the agreement, the Indonesian NGOs and AMAN (Indonesian network of indigenous peoples) argued also for action to tackle over-capacity in the timber industry, to secure tenurial rights in indigenous peoples’ forest areas, to strengthen forest governance and to address the role of the UK government as investor and consumer.
should be built around establishing a system of independently monitored legality verification in the producer country.

### 6.3 Controlling imports: an EU licensing scheme

**Summary:** Trade controls at the EU border must be applied EU-wide. A licensing system for imports of timber and wood products – requiring imports of timber and wood products from participating producer country governments to be accompanied by a certificate of legality, similar in principle (though different in detail in key respects) to the approach adopted under CITES, and under the Kimberley Process on conflict diamonds – offers a relatively simple and targeted means of excluding illegal timber from EU markets.

The core of the UK–Indonesia bilateral agreement discussed above revolves around the establishment of systems for the verification of legal compliance based on independently verified chain-of-custody tracking and identification systems in Indonesia, and then the refusal of entry to the UK of any timber and wood products from Indonesia that are not positively identified as legal.

Clearly, the UK cannot take the second step by itself. International trade policy is an area of exclusive EU competence and individual member states cannot erect such trade barriers by themselves. Even if it were possible, UK-only trade controls would be almost entirely pointless, as the single European market has created a trading area without internal frontiers, and simple trans-shipping of Indonesian timber through neighbouring EU states would avoid the controls.

Therefore, if these systems are to work, new legislation is required at EU level which establishes a licensing system for the import of timber and wood products from countries which agree to participate in the system. The European Commission, operating under a mandate from the Council, would need to enter into negotiations with individual producer countries to establish the conditions under which they would be prepared to participate in the system.

It is important to stress that this does not represent a unilateral imposition of trade controls by the EU on producer states. Not only would this probably fall foul of WTO rules (see further in Section 7.5), but it would be almost impossible to operate effectively, as it would lack any co-operation from the producer country government in setting up and operating the necessary identification systems.

In principle, this proposal is similar (though different in important respects in detail) to the approach adopted under CITES, with its requirement for a movement document (export and/or import permit) to accompany any consignment of controlled species (see Section 2.4). The Kimberley Process on conflict diamonds, with its proposal for export certificates (see Section 5.3) provides another example. The main difference is that these two frameworks are global in scope, whereas the new EU system would begin at a more limited level. However, if it worked well, it could form the core of a new international agreement to which all countries, producer and consumer, could be signatories.

**A new EU Regulation**

The new EU legislation that is required to operate this system therefore needs to create a requirement that imports of timber and wood products from participating producer countries be accompanied by a
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certificate (or licence) of legality at the point at which it enters the EU. Annex I contains elements of a draft Regulation.\textsuperscript{87} It is modelled on the EU’s CITES Regulation, of which the key requirement is that:

‘The introduction into the Community of the species listed in Annex A shall be subject to completion of the necessary checks and the prior presentation, at the border customs office at the point of introduction, of an import permit issued by a management authority of the Member State of destination.’\textsuperscript{88}

Adapting this to a new EU Regulation on trade in illegal timber might result in a provision that (see Article 5 of Annex I):

The introduction into the Community of any of the timber and wood products listed in Annex A from any of the co-operating states listed in Annex B shall be subject to completion of the necessary checks and the prior presentation, at the border customs office at the point of introduction, of a certificate of legality issued by or on behalf of the competent authorities of the state of export and independently verified by an accredited verification authority.

(Changes from the CITES regulation highlighted in \textit{italics}.)

The Regulation would thus need to define:

- The types of products to be controlled, listed in the Regulation’s Annex A. The EU CITES Regulation already defines some types – e.g. carvings, sawn wood, timber – though not all.

- The states whose exports would be controlled, listed in the Regulation’s Annex B. The Regulation would also have to be accompanied by an outline of the necessary mechanism for allowing states to join up to the system – including criteria such as the need for agreement by both producer country and the EU on the type of verification system necessary to provide proof of legality.

- The type of proof of legal production – the proposed ‘certificate of legality’ and how this is defined.

- The competent authorities for issuing and verifying the licence. The topic of proving legality is considered below in Sections 7.2 and 7.3; an important element of this for many producer countries is independent third-party auditing of the process, thus avoiding many of the problems with CITES permits.

- The type of trade to be controlled – for example, whether transit through the EU to another destination is covered as well as entry to the EU for free circulation. The draft Regulation in Annex I assumes that only entry for free circulation is included, as the agreement is only with the EU.

Further practicalities that may need to be addressed include: the possible need to amend the EU’s Combined Nomenclature (CN) system of customs codes, in order to flag up to customs at the point of

\textsuperscript{87} A Regulation rather than a Directive would be needed, as trade controls have to be implemented identically throughout the EU. Unlike a Directive, a Regulation applies directly within member states, without the need for national implementing legislation.

\textsuperscript{88} Council Regulation 338/97, Article 4.
entry any imports requiring the additional licence; the possible need for a data exchange system providing advance notification of exports of licensed products (particularly where a large number of exporting and importing countries participate in the system); the need for clear policy responsibilities in the EU and its member states; and decisions to be taken on what to do with seized shipments.

Additional customs capacity would probably be needed to carry out the necessary checks on licences – though it should be noted that in one respect this system is distinctly simpler than CITES, requiring no identification of products on a species by species basis, since all timber from the participating countries is covered, not just endangered species.

Each of these matters requires careful consideration and consultation with all the stakeholders in the new system. But problems should be solvable. Customs agencies are already well used to operating licensing systems (e.g. under CITES), and, as has been seen in Section 5.3, more international licensing systems are being introduced.

**Recommendations**

- An EU licensing system, requiring imports of timber and wood products from participating producer country governments to be accompanied by a certificate of legality, offers a relatively simple and targeted means of excluding illegal timber from EU markets. The EU should adopt it without delay.

### 6.4 Controlling imports: Lessons from the US Lacey Act

**Summary:** The US Lacey Act is an example of legislation which allows action to be taken against fish and wildlife obtained illegally in a foreign country. It is a possible model for EU legislation directed against timber produced illegally overseas. Legislation prohibiting the import, export, transport, sale, receipt, acquisition or purchase of timber of illegal timber and wood products should be considered for adoption in the EU, to provide a ‘back-stop’ against imports of illegal timber entering from countries with whom no licensing system has been agreed.

As mentioned in Section 2.2, the import of stolen goods into the EU is not in itself a customs offence. In many ways the simplest option to control imports of illegally sourced timber would be to change the law to make these imports themselves illegal. In this respect an important model is provided by the US Lacey Act, which makes it “unlawful for any person … to import, export, transport, sell, receive, acquire, or purchase in interstate or foreign commerce … any fish or wildlife taken, possessed, transported, or sold in violation of any law or regulation of any State or in violation of any foreign law.”

The Lacey Act was first adopted in 1900, being named after its sponsor, Iowa Congressman John Fletcher Lacey, a well-known naturalist. Its original purpose was to outlaw intra-US traffic in birds and other animals illegally killed in their state of origin. It was amended on a number of occasions, most notably in 1981 when its scope was expanded and its enforcement provisions and penalties strengthened.

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89 16 USC; SS 3372(2a).
The Act treats animals and plants differently: whereas animal species can be subject to the Act where they are taken in violation of another country’s law, the import or possession of plant species can only be prohibited where there is a violation of a law or regulation within the US. Furthermore, under the Act plants are restricted to species listed on CITES appendices or identified as endangered under a US state law, whereas animals are subject to no such restriction. Both plants and animals taken in violation of a treaty (such as CITES) would be subject to the Lacey Act. Timber, therefore, is not covered apart from species listed under CITES or identified as endangered in a US state. There is, however, some current interest in the US about expanding the Lacey Act to try and prohibit imports of illegal timber.

A two-tiered penalty scheme exists, creating both ‘misdemeanour’ and ‘felony’ offences, partially dependent on the level of knowledge of the laws violated on the part of the accused. The penalties can involve imprisonment and/or fines, and forfeiture of equipment involved in the offence. In each case, the defendant need not be the one who violated the foreign law – the fact that the fish or wildlife were obtained illegally is the important point.

The Lacey Act also requires that shipments of fish and wildlife be accurately marked and labelled on the shipping containers. Failure to do so (a ‘marking offence’) is a civil offence punishable by a fine. In all cases, federal agents are authorised to seize any wildlife which they have reasonable grounds to believe was taken, possessed, transported, or imported in violation of any provisions of the underlying laws. This is true even if the defendant can show that they were not aware that the wildlife was illegally obtained.

The Lacey Act is often used by US prosecutors. In 1999, for example, the US Fish and Wildlife Service was involved in almost 1500 cases. It has been used, in co-operation with a number of South Pacific countries which are members of the Forum Fisheries Agency, to tackle illegal fishing, and US action has been taken against foreign-flagged vessels carrying fish illegally caught in the exclusive economic zones of Agency states. A number of Agency member states, including Papua New Guinea, Nauru and Solomon Islands, have incorporated Lacey Act-type provisions in their fisheries legislation.

Adapting the Lacey Act model

The model provided by the Lacey Act is of obvious relevance to illegal logging, and could inform legislation outlawing the import, transhipment, purchase, sale and receipt of timber obtained or sourced in violation of the laws of a foreign state or of an international treaty.

Even if the licensing scheme outlined above in Section 6.3 is introduced, it is reasonable to assume that some producer countries will not join it – either because they do not wish to, or because the EU would not wish to enter into an agreement with them (for example, because their domestic legislation was inadequate to afford effective protection of their forests). Therefore it would be desirable to enhance the EU’s current ability to take action against imports of illegally logged timber. As we have seen in Section 2, the current range of laws and regulations, though of some use, is not adequate, and adopting a general prohibition on the import, transhipment, purchase, sale and receipt of timber sourced illegally (adapting language from the Lacey Act) would be very valuable.

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90 Animal Welfare Institute Quarterly 49:4 (Fall 2000); it is difficult to acquire precise figures, as cases may often be coded as import violations or CITES violations.
This could be included in the Regulation we advocate above in Section 6.3, and is included in our draft in Annex 1 (see Article 3.) Justice and home affairs is not a matter of EC competence, so it would be up to member states to define the penalties applicable in cases of violation (as in the CITES legislation, for example) – but the basic prohibition itself can be set at EC level, because otherwise the single European market would make a prohibition applied only partially throughout the EU pointless.

Proving the illegality would not always be straightforward, not least because of a lack of knowledge, or a lack of clarity, about the foreign laws in question. US courts have interpreted the term ‘any foreign law’ broadly, including regulations as well as statutes, and not restricting the laws in question to those aimed directly at wildlife conservation. In a Lacey Act proceeding, the determination of a violation of foreign law is made by the judge presiding over the case; it is not a question of fact presented to the jury for determination. Courts are given broad discretion in these proceedings because of the general lack of availability of foreign law materials and expert opinion. Sources used by courts have included: affidavits and expert testimony from foreign judges, government ministers and lawyers; foreign case law; law review articles and translations of foreign decrees; information obtained from foreign officials; and the court’s own research and analysis.

In addition to the practical problems, this type of provision might be vulnerable to a producer country lowering the threshold of illegality to get round the law (indeed, it might increase the incentive for countries to behave in this way). It would also rely on successful court cases to prove its deterrent effect, which could take years – though the act of giving additional powers to customs to make seizures might have quite a rapid deterrent effect.

Despite these caveats, however, there is obvious value in determining what is illegal through legislation even if enforcement of the law is not perfect. It provides a clear signal to participants in the market, and shifts the balance of what is perceived to be acceptable behaviour. This type of legislation would clearly work better in countries that had established the kind of legality identification system described in Sections 6 and 7. It also argues for the establishment of co-operative international frameworks between producer and consumer countries similar to that operated under the Forum Fisheries Agency.

**Recommendations**

- The new EU Regulation should include a clause making illegal the import, export, transport, sale, receipt, acquisition, or purchase of timber produced in violation of the laws of foreign countries.

- The practical application of Lacey Act in the US should be studied and lessons learned for customs and other enforcement agencies.
7 Practicalities and conditions

7.1 Introduction

A number of practical issues must be addressed if the measures outlined above are to be successful. Section 7.2 looks at the problems surrounding definitions of legality and illegality in producer countries, and Section 7.3 examines possible systems for identifying and tracking legal production. Section 7.4 deal with the improvements likely to be necessary to put these systems into effective operation, and Section 7.5 deals with the WTO implications of trade-restrictive measures.

7.2 Defining legality

An immediate problem facing any attempt to control the trade in illegal timber and wood products lies in defining what constitutes illegality. In many countries, including in the EU, there may be no clear definition of what is and is not illegal. In some countries, existing forestry regulations are inadequate or unjust: many undesirable practices in the forestry sector – such as the allocation of concessions on indigenous peoples’ lands – may in fact be legal, under existing laws, whilst in other countries, overlapping jurisdictions obscure the definition of illegality.

Box 7.1 What is legal – what should be legal?

In many countries forestry legislation is clearly inadequate. For example, a 1998 review of Cambodian forest legislation by the legal firm White & Case found that the legislation was ‘difficult to obtain, difficult to analyse, provides few objective standards for forest protection and provides no integrated guidelines or standards for forest management.’ An overview of Indonesian forest governance in 2001 revealed inconsistencies between laws and between government department decrees.

Even more fundamental questions arise when a forestry law is seen by many in a society as being unjust. In Indonesia, the 1945 constitution determined that the state has control over all forests. The 1999 forestry law builds on this and explicitly classifies indigenous peoples’ forests as state forests and gives the Ministry of Forestry primary legal jurisdiction to manage these forest resources. This has led to logging, mining and plantation companies being granted rights over vast tracts of forest lands which local people had considered to be theirs – with forest destruction and human rights conflicts as a result.

In a country like Canada the legal situation is complicated. In areas where no treaty has been signed with the indigenous peoples, e.g. large parts of British Columbia, indigenous peoples still hold the rights and titles to their ancestral lands. The existence of these rights has been confirmed in the Supreme Court of Canada. However jurisdiction over resource management, including forest concessions, remains in the hands of the government. This has led to disputes over unceded lands: the UN Human Rights Committee has twice condemned the Canadian government for undermining indigenous peoples’ legal rights to land.

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92 Nana Suparna, Forest Governance and Forest Law Enforcement in Indonesia (paper for Forest Law Enforcement and Governance East Asia Ministerial Conference, September 2001).
If the underlying causes of forest loss are not addressed, then any action against illegal logging is unlikely to prevail over the vested interests that gain from illegal logging.

As Box 7.1 shows, the question of what is legal is not always simple. Moreover, the question of what is legal should not be separated from the question of whether the legal is actually grounded in rules over which most people feel some sort of ownership. Law, like morality, is inherently a normative concept: there is an ‘ought’, a sense of what is right and what is fitting. Rather than being the order of a sovereign person or body, law should be grounded in rules or standards of behaviour to which the members of a social group share an allegiance. Whereas power is often the privilege of the few, legitimacy should be the product of the agreement of the many.

In countries where forestry laws are not regarded as legitimate by large numbers of people, focusing on these laws when addressing illegality may perpetuate both societal inequities and corrupt resource allocation processes. Although illegal logging is often presented as an enforcement issue, forest laws often reinforce unfair relationships or disregard customary rights, and illegality in the wood extraction business is often a symptom of deeper underlying causes. A simple crackdown on illegal practices without addressing these underlying causes could do more harm than good. As Dykstra et al note: ‘Without addressing underlying causes, actions against illegal logging are unlikely to prevail over the diverse array of interest groups that gain from illegal logging or are motivated to get what they can from the forests, due to political instability. Attempts to enforce central government forestry laws are likely to encounter resistance from district-level politicians and officials, local entrepreneurs and community leaders who receive revenue from the informal logging sector. Actions designed to stamp out illegal logging will need to take these interests into account and provide alternative livelihood strategies.’

**Recommendation**

- Any action undertaken by EU governments should take into account the underlying causes of illegal logging, which can include over-capacity of the forestry industry, unclear land rights and tenure rights, lack of transparency in the allocation of concessions etc., as well as difficulties in defining what is legal and whether what is legal is also just. A simple crackdown action might backfire.

### 7.3 Identifying and tracking legal production

**Summary:** Chain of custody systems are essential in any effort to reduce illegal logging and related trade. A chain of custody has three essential elements: identification, segregation and documentation. However, even a well-designed chain of custody alone is not enough to halt illegal logging, although it will make log laundering and theft more difficult. In order to reduce the opportunities for fraud, a number of issues need to be considered, including the design of the chain of custody, governance, transparency, and the capacity of the system. Efforts to ensure that the forestry industry complies with the laws and forestry regulations must go well beyond the chain of custody system and examine the general legal environment. The forestry industry does not exist in a vacuum; if the underlying system is corrupt it is likely that forest governance is corrupt as well.

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93 Dykstra, *op. cit.*
Verification of legality

A certificate of legality is one means to verify legally produced timber. The Swiss-based surveillance company SGS is currently promoting the establishment of a system of ‘Independent Validation of Legal Timber’, based on the independent monitoring and verification of land use changes, timber flows and resource management at both the national and producer level. It could lead on to sustainability certification, but does not have to. Annex 2 explains the main components of the system.

A stepwise, pragmatic approach is proposed to address the problems of illegal logging through the compulsory Independent Validation of Legal Timber (IVLT) – whilst providing a link to or possibly integration with the voluntary Sustainable Forest Management (SFM) certification.

To illustrate this approach, a three-step ‘Sustainable Timber Trade’ labelling system is suggested: 1) ‘Timber from a Legal Origin’; 2) ‘Validated Legal Timber’; and 3) ‘Sustainably Produced Timber’. Each step is conditional on a certificate issued independently by an accredited third-party verifier/certifier at different stages of the process. See Annex 2 for details.

Chain of custody control

If the legality of wood products is to be guaranteed, detailed tracking of the production and movement of timber and wood products is necessary. Therefore to prove timber is legally harvested, certification of the chain of custody is needed (see also Section 3.2).

A chain of custody system comprises a set of technologies, procedures, and documents that are used to manage the wood supply chain. Using a well-designed chain of custody system, the manager of a wood supply chain should be able to determine where the wood supply is coming from, where it is at any point in time, where it is intended to go and when it is scheduled to arrive there. Properly applied chain of custody systems can be used to expose log theft and to prevent unscrupulous operators from mixing illegally sourced logs with legally sourced timber. Chain of custody systems are thus an essential component of any effort to reduce illegal logging.

The three essential elements for any effective chain of custody used to track legally sourced timber are:

- **Identification.** Logs (or bundles of logs) must be individually identified using some type of labelling technology, and the labels must be tied in with any associated documents.

- **Segregation.** At any point where logs from a known source could become mixed with logs from other sources, they should be segregated and handled or processed separately. However, a possible exception to this may be made if technologies can be used that allow for suitable identification throughout the chain.94

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94 Depending on the technology used, segregation is not an essential element of product tracking. It is essential to be able to demonstrate which products come from where, but through the use of bar-coded log tags and bar-coded product labels it is not necessary to segregate the tagged logs from the untagged logs in the log yard. Segregation is not a prerequisite if products are indelibly marked with suitable identification markings. Andrew Mitchell, personal communication.
• **Documentation.** Labelling by itself is insufficient to provide the information needed for a comprehensive chain of custody system. Additional documentation is required.\(^{95}\)

The system must furthermore incorporate regular monitoring to ensure that the system is being correctly applied and that employees are adequately trained and are rigorously following the established procedures.

Even so, all chain of custody systems are open to fraud,\(^{96}\) and any chain of custody can be annulled by unscrupulous operators. This is particularly true of paper-based systems. Certified chains of custody are often only audited annually and advance notice of the audit is given. In order to reduce the possibility of fraud, the design of the system, and its governance, transparency and capacity are all issues to be considered, as are independent random audits. To further minimise the fraud risk, any chain of custody should provide information about quantities of wood; have in-built control of critical control points, such as forest storage and log yards, where mixing can easily take place; and provide adequate training and control of personnel. The latter is particularly important, as the system will be implemented by people and so it is those people who will determine whether or not it works.\(^{97}\)

Independent monitoring can strengthen legality compliance verification systems by highlighting any jurisdictions, localities, or actors that should be treated with suspicion. It also maintains the credibility of robust chain of custody schemes by exposing bogus or easily manipulated systems. Independent monitoring combined with log tracking technology can also be used to verify compliance with legality on a random audit basis (see further below in Section 7.4).

Efforts to ensure that loggers and other entities in the forestry industry comply with the laws and forestry regulations must go well beyond the chain of custody system and examine the general legal environment. The forestry industry does not exist in a vacuum. If the underlying system is corrupt it is likely that forest governance is corrupt as well. Verification systems can note any flaws in the relevant laws and clearly state the basis on which verification has been assessed, including, where possible, the rationale for its interpretation of the law. Rationalisation and clarification of issues of legality – who is responsible, etc. – need to be addressed (see also Section 7.2).

Last, some argue that it is essential to implement and enforce an obligatory system at the producer country level in order to verify ownership, origin and whether all the necessary forest charges have been paid. Otherwise people such as producers not interested in volunteering for the system, illegal loggers and those converting the forest to other land uses will be overlooked.

**Techniques**

There are many different techniques available to identify and monitor the timber flow. These vary from ‘low-tech’ solutions, such as ordinary paint, branding hammers, conventional labels, nail-based labels and magnetic strip cards to ‘high-tech’ smart cards, RF/ID labels, microtaggant tracers, chemical tracer paint, chemical and genetic fingerprinting. However, none of them is yet applicable for

\(^{95}\) This includes place of origin of the forest (cutting block etc.), reference to cutting permits or sales documents, log quality etc. A key point of chain of custody is not just the documentation but how the documentation is stored, analysed and retrieved. With bar-coded tags and labels using unique numbers and a relatively simple computer database it is possible to routinely track products back to the stump. The information can be summarised and consolidated at whatever level required, i.e. forest, logging, mill, export, import and final consumer levels.

\(^{96}\) Information in this section mainly from Dykstra, *op. cit.*, and Andrew Mitchell, personal communication.

\(^{97}\) Dykstra, *op. cit.*
general use. It goes beyond the remit of this report to go into detail on all these techniques. Other reports are available that detail the pros and cons of different systems.  

**Recommendations**

- Capacity-building assistance should be provided for the design and establishment of legality verification schemes; this may include some elements of law reform in the producer countries, and should include fully participatory processes with all stakeholders.

- The EU should support and facilitate producer country governments in carrying out a detailed assessment of existing chain of custody schemes and define and develop custody schemes at national or regional level.

- Chain of custody activities must not be dealt with as separate issues but as part of a larger plan to address the underlying causes of illegal logging, which can include: over-capacity in the timber/pulp and paper industry; lack of clarity about land rights and user rights; and lack of transparency in the allocation of concessions.

### 7.4 Capacity building in producer countries and independent monitoring

**Summary:** Capacity-building assistance in producer countries is essential to the success of the initiatives discussed in this report. This includes building capacity for the design and establishment of legality verification schemes, for independent monitoring and for producer country customs agencies.

In many countries there is neither a framework nor sufficient capacity for independent monitoring of the companies operating in the forests. Recently, governments and other donors have started to fund and promote independent monitoring.

However, there are a series of preconditions that are necessary for countries to reap the benefits of independent monitoring. First, human rights must be effectively protected, as it is only then that communities and individuals are able to report illegal logging activities and independent monitors can work with local staff to prevent abuses by logging companies. Second, there needs to be an adequate legal system, including forest law, to prevent corruption opportunities. There is also a need for the official publication of concession holders to prevent confusion and fraud, and companies must be expected to meet all operational standards set by the law. Third, there must be sufficient political will to pursue illegal logging investigations to their final resolution. The judicial system therefore needs to be both independent and transparent. Fines and sentences must be made public and applied effectively to fraudulent companies and their directors. Finally, adequate compensation should be paid to local communities for the damages that they have been subjected to.

On behalf of the government of Papua New Guinea, SGS was contracted to inspect and monitor all exports of logs from the country and determine the amount of tax payable by exporters. All relevant shipping and commercial documentation was checked. The process included physical checks (such as species identification, log measurement and grading), market value verification and a tally of what was

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loaded in each shipment. Information was entered into a database from which monthly reports were provided to the relevant authorities.

Governments and donors are now also turning towards NGOs. In Cambodia and Cameroon, Global Witness has been given a mandate by donors and the national governments to become the independent monitor. Their aim is to help the government develop the capacity: a) to effectively monitor forestry infractions; b) to build a network of local communities, local and national NGOs, industry members and government officials that can pool their information on forestry infractions and government actions; and c) to provide local NGOs and officials with a confidential avenue for making information public.

In Indonesia, the NGOs EIA and Telapak have formed a partnership, funded by DFID, with a mandate to strengthen the civil sector in Indonesia in order to campaign on forest issues. The project provides basic training in documentation – developing photographic and video materials and campaigns. EIA and Telapak have also worked in the field with a number of groups to provide field-monitoring experience. The aim is that by the end of the programme EIA/Telapak will have facilitated the creation of a network of visually literate, campaign-experienced NGOs working on forest issues across Indonesia. Whether this could be the basis for a future government-sanctioned independent monitoring function remains to be seen.

**Local communities**

For local communities to be able to monitor illegal activities in their neighbouring forests, they need their territorial rights to be recognised and respected. The government should also respect the ‘international Bill of Rights’, and the core ILO Conventions, as well as ILO Convention 169. If this is the case, then it is in the interest of local communities to monitor the exploitation of their forest resources. Local communities in Kampong Thom province in Cambodia have organised themselves in committees and patrol the forests to monitor the resin trees that are protected under Cambodian law. Resin trees are marked and if logging companies attempt to cut them down then the committee is informed and in turn informs local government officials. These then help organise meetings between the communities and the illegal loggers. This mechanism has helped reduce illegal logging.

**Customs capacity**

A key element of capacity building in producer countries must be building up the capacity of customs agencies to control exports. If the legality licence system described above in Section 6.3 is to work effectively, it would be helpful if the customs agencies in the countries of origin possessed the ability to monitor exports and to prevent illegal imports. Effective systems of co-operation and data exchange need to be established between customs agencies in importer and exporter countries.

In the East Asia FLEG conference in September 2001, ministers committed themselves to explore ‘prior notification’ systems for the timber trade, and a number of NGOs have since called for ‘the establishment of a new mechanism to initiate a system of prior notification (of large volume shipments of timber).’ Such a system would require exporting countries to notify importing countries that

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99 The three fundamental human rights instruments: the Universal Declaration of Human Rights; the International Covenant on Civil and Political Rights; and the International Covenant on Economic, Social and Cultural Rights.

100 ILO 169, the Indigenous and Tribal Peoples Convention.

‘large value’ shipments were en route; if another ‘large value’ shipment came in without notice, it would be treated as of doubtful provenance – though, in the absence of the new legislation in importing countries discussed in Section 6.3, the options open to the authorities would be limited. Nevertheless, this would help in building the kind of co-operative framework for data exchange necessary for any action against the trade in illegal timber.

**Recommendations**

- EU governments should support and facilitate independent monitoring activities by local communities and local and national NGOs and, where these are not possible, by international NGOs. Many existing models exist which should be evaluated and, where effective, replicated.

- A key element of capacity building in producer countries must be building up the capacity of customs agencies to control exports. Effective systems of co-operation and data exchange need to be established between customs agencies in importer and exporter countries.

### 7.5 WTO implications

**Summary:** Any restrictions on trade are potentially subject to the disciplines of the trade agreements administered by the World Trade Organisation (WTO). This section looks at those elements of the WTO agreements that would be relevant to the types of measures discussed elsewhere in this report. In general, the systems we contemplate, which revolve around bilateral agreements between the EU and producer country governments to license trade, should raise no WTO implications.

Any restrictions on trade, including labelling requirements, tariffs and taxes, trade embargoes, or any form of discrimination, are potentially subject to the disciplines of the trade agreements administered by the World Trade Organisation (WTO) and centred around the General Agreement on Tariffs and Trade (GATT). However, the main form of trade restriction we contemplate in this report, the licensing system described in Section 6.3, will arise in the context of voluntary bilateral agreements between the EU and individual producer countries.

Essentially, this represents governments agreeing to additional trade controls between themselves, as a means of enforcing their own laws. The WTO dispute settlement system does not produce rulings in the abstract, it acts only when a complaint is raised. It is inconceivable that one of the same countries would mount a WTO challenge, on the basis of impairment of trade, to a voluntary measure it had itself agreed to.

However, disputes can be initiated by countries not directly affected by the trade restriction in question.\(^{102}\) It is possible that a country not participating in such an agreement could decide to mount a challenge for fear of it eventually becoming multilateral in scope. Or, and perhaps more likely, if an agreement was extensive enough to affect the market for non-participating countries indirectly (e.g. if retailers became so used to the idea of sourcing timber identified as legal that they stopped buying

\(^{102}\) For example, Thailand, in the latest stage of the shrimp-turtle dispute, challenged the US regulations as a matter of principle, even though its fishing practices had been certified as acceptable by the US and its shrimp exports were therefore not embargoed.
timber not so identified even when there was no obligation on the particular country to do so), then again a challenge could be mounted.

It is therefore worth considering how such a system might be treated under WTO rules. The question of issuing labels or certificates or applying other trade restrictions on the basis of illegal origin has not, so far as we are aware, been discussed within the WTO. Neither are corruption and bribery issues addressed specifically in the WTO agreements. It should be emphasised, therefore, that considerable uncertainty exists over almost every issue discussed in this section, and it is not possible to reach a firm conclusion over whether a WTO challenge to any given trade-restrictive measure would or would not succeed. It is possible, however, to reach some general conclusions about the design of trade measures, and these are listed at the end of the section.

**Process-based trade discrimination**

Generally speaking, WTO agreements follow the principles of non-discrimination between ‘like products’ originating from any WTO member, and between domestic and foreign production. The core WTO agreement, the GATT, does not define precisely what it means by a ‘like product’. Originally incorporated into the GATT in order to prevent discrimination on the grounds of national origin, dispute panels have in general interpreted the term more broadly to prevent discrimination in cases where process methods (‘non-product related processes or production methods’, or PPMs), rather than product characteristics, have been the distinguishing characteristic of the product and the justification for trade-restrictive measures. This has aroused much concern among the environmental community, where policies designed to regulate PPMs (such as controlling emissions from manufacturing processes, or promoting sustainable production) are seen as important.

However, the GATT contains a ‘savings clause’, Article XX, under which exceptions can be made to the other provisions of the agreement, as long as they are not applied ‘in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade’. The sub-paragraphs of Article XX list a series of measures that may be allowable, including those:

- (a) necessary to protect public morals;
- (b) necessary to protect human, animal or plant life or health; …
- (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement …
- (e) relating to the products of prison labour; …
- (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption; …

Paragraphs (b) and (g) of Article XX provides possible environmental justifications for trade measures that would otherwise be in breach of the GATT, as long as the measures are applied evenly to WTO members, and do not discriminate between them. In recent years WTO dispute panels, and its Appellate Body (to which dispute panel findings may be referred), have shown an increasing tendency to accept these arguments, and to find in favour of discrimination between like products on environmental grounds.

Can illegality of production be considered a PPM? Although superficially it relates to the way in which the products in question are produced, it is of course quite different in principle to the common
understanding of the term, which relates primarily to physical impacts stemming directly from the process employed to produce the product (e.g. sea turtle deaths from shrimp fishing, or greenhouse gas emissions from energy use). After all, legally produced timber and illegally produced timber are grown and logged in essentially the same ways; the differences relate mainly to questions of whether the logging should be permitted or whether appropriate fees and taxes are paid. No paragraph of Article XX relates explicitly to illegal production, though possibly a case might be made under Article XX(d). In fact, it may be the case that trade measures based on sustainability of production would be easier to justify, under Article XX(g).

**MEAs and the WTO**

As seen in Sections 2.4 and 5.3, several MEAs, including CITES, the Montreal Protocol and the Basel Convention, require parties to control or restrict trade in various ways, including imposing requirements for import and export licences or for different forms of prior informed consent, and applying total or partial bans in trade (in the products controlled by the agreement) with non-parties or with non-complying parties. The past few years have seen much debate about the extent to which these trade measures are compatible with WTO disciplines. Since there has never been a WTO dispute involving an MEA-mandated trade measure, the answer to this question is not clear.

The latest development in the long-running shrimp-turtle dispute contains a potentially important development of WTO jurisprudence. In October 2001 the WTO Appellate Body found that the US was entitled to maintain its embargo on imports of shrimp fished by methods that killed sea turtles, even though it was a unilaterally applied measure, as long as it was engaged in serious good-faith efforts to reach a multilateral agreement. It did not accept Malaysia’s contention that such an agreement had to be concluded before a trade restriction could be enforced.103 This has clear implications for the application of trade measures while an MEA is in the process of being negotiated.

**Technical Barriers to Trade Agreement**

The Technical Barriers to Trade (TBT) Agreement is one of the specific agreements developed after the GATT was written and agreed, developing and codifying specific sets of trade rules. It is designed to ensure that technical regulations and standards which may affect trade are applied in ways that distort trade as little as possible. It is relevant to the timber trade because labelling or certification seem likely to qualify as technical regulations (if mandatory) or standards (if voluntary), and any dispute concerning them would probably relate to the TBT Agreement rather than the GATT.

Annex 1 to the TBT Agreement defines a technical regulation as a ‘document which lays down product characteristics or their related processes and production methods’. There has been much dispute over whether this means that non-product related PPMs (i.e. PPMs that are not detectable in the final product) are covered by this definition or not (are they ‘related’ to the product characteristics?). Article 2.2 is the Agreement’s ‘saving clause’, recognising the right to take necessary measures to fulfil a legitimate objective such as ‘the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment’ – though the article’s relationship to the rest of the Agreement nevertheless does not appear to allow countries to derogate from the core principles. The questions discussed above in relation to the GATT – the application of requirements on the basis of PPMs, whether measures aimed at controlling illegal logging can be seen

as protecting the environment, issues of extraterritoriality – are therefore also relevant in the case of the TBT Agreement.

**Agreement on Government Procurement**

Government procurement measures are subject to another WTO agreement, the Government Procurement Agreement. This is a plurilateral agreement, to which not all WTO members are parties, though all EU member states have ratified it. Its basis rests on the familiar WTO principles of non-discrimination between like products from foreign and domestic suppliers. The discussions above of whether legality is an appropriate measure to include as a product characteristic, and whether environmental protection is a stronger justification, are again relevant. Article XXIII of the GPA includes exceptions to its obligations for reasons of public morals or protection of human, animal and plant life.

**Conclusions**

The WTO-compatibility of trade measures taken to control illegal timber would not be settled definitively until an appropriate case came before the WTO dispute settlement system – though it should always be remembered that many potential disputes between WTO members are resolved by consultation and negotiation without recourse to the formal dispute process. The negotiations on further modification of the WTO agreements launched at the WTO ministerial conference at Doha in November 2001 will also focus attention on a number of specific environmental issues.

Nevertheless, it is possible to reach some tentative conclusions about the design of policy instruments on illegal logging which affect trade:

- The less trade-disruptive the measure involved, the lower the chance of a successful challenge under the WTO – government procurement policy, or a requirement simply for labelling, would be less likely to fail than an import ban.

- The more it can be shown that less trade-disruptive measures – such as preferential tariffs – have been attempted and have not proved effective, the greater the chance of more trade-disruptive measures being found acceptable. This possibly even extends to non-trade related efforts, such as capacity-building assistance to the exporting countries concerned, forestry-related negotiations, and so on.

- Similarly, the more precisely targeted the measure, the less the chance of a successful challenge. An embargo applied against an country’s entire timber exports because some of them were believed to be illegal would be more vulnerable to WTO challenge than an embargo applied only against products which could be proved to be illegal, or not shown to be legal. In the latter case, adherence to an accepted means of determining legality – e.g. a requirement for chain-of-custody documentation audited by an independent third party (see Section 7.3) – would also help to justify the measure.

- The less discriminatory the measure is, the lower the chance of a successful challenge. A very strong challenge could be made under the WTO if a country was applying more restrictive measures (e.g. a requirement for legality identification) to imports than it was to its own production.
The greater the effort to ensure that a measure is multilaterally acceptable, the less it is likely to be challenged. And the latest shrimp-turtle decision implies that even unilateral measures applied while a multilateral agreement is in the process of being negotiated may be acceptable.

**Recommendations:**

- The WTO implications of any trade-restrictive measure must be taken into account, but the systems we contemplate, which revolve around bilateral agreements between the EU and producer country governments to license trade, should raise no WTO implications. Nevertheless, it would be valuable for EU negotiators to raise the issues within the WTO trade talks, and promote awareness and discussion of the issues.
Annex 1: Elements for a draft EU Regulation

Section 6 sets out the arguments for new EU legislation to control imports of legal timber. This Annex includes suggested elements for inclusion in the EU Regulation that would be needed to implement it. Clearly we cannot hope to cover everything that would eventually be required, but the following text should be useful, we hope, for advancing discussion.

Note that this draft Regulation assumes that bilateral agreements will be reached between the EU and individual producer countries on implementing the licensing system. These agreements would cover, inter alia, the means of verifying legality of production in the producer country, and the capacity-building assistance to be provided in establishing and operating these systems.

Article 5 establishes the licensing system (see Section 6.3 for a fuller description); Article 3 creates a general prohibition on the import of illegally sourced timber (see Section 6.4); and Article 4 deals with conflict timber (see Section 5.2).

Proposal for a

COUNCIL REGULATION

implementing schemes for controlling imports of illegally sourced timber and wood products

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 133 thereof,

Having regard to the proposal from the Commission,

Whereas:

(1) The World Summit on Sustainable Development, meeting in August/September 2002, resolved to ‘take immediate action on domestic forest law enforcement and illegal international trade in forest products, including in forest biological resources, with the support of the international community, and provide human and institutional capacity building related to the enforcement of national legislation in those areas’.

(2) Many timber producer countries are displaying increasing concern with the loss of government revenue from illegal forestry operations, with the damage such widespread illegality is causing to the institutions of civilised society, and with the need, for environmental, economic and social reasons, to control the rate of exploitation of forest resources.

(3) Many timber consumer countries are displaying increasing awareness of the role of imports in fuelling the demand for illegally logged timber and wood products, and the lack of an adequate legal framework by which to control such imports.
(4) The Forest Law Enforcement and Governance East Asia Ministerial Conference in Bali, Indonesia, in September 2001, concluded with ministerial commitments to ‘take immediate action to intensify national efforts, and to strengthen bilateral, regional and multilateral collaboration to address violations of forest law and forest crime, in particular illegal logging, associated illegal trade and corruption, and their negative effects on the rule of law’, to ‘undertake actions, including co-operation among the law enforcement authorities within and among countries, to prevent the movement of illegal timber’, and to ‘explore ways in which the export and import of illegally harvested timber can be eliminated’.

(5) In February 2002, the Communication of the European Commission to the Council and the European Parliament, ‘Towards a global partnership for sustainable development’ provided that the European Union would ‘develop a European Union action plan by end 2002 on forest law enforcement, governance and trade (FLEGT) to combat illegal logging and associated illegal trade and to strengthen international co-operation to address violations of forest law, and forest crime’.

(6) The Memorandum of Understanding between the Government of the Republic of Indonesia and the Government of Great Britain and Northern Ireland on co-operation to improve forest law enforcement and governance and to combat illegal logging and the international trade in illegally logged timber and wood products, signed on 18 April 2002, provides a model for the bilateral co-operation between producer and consumer countries that will be needed to control the international trade in illegally logged timber and wood products.

(7) Other such Memorandums of Understanding have been signed or are currently under negotiation, with other producer countries and other Member States.

(8) Control of imports of timber must be applied in a uniform manner throughout the Community.

HAS ADOPTED THIS REGULATION:

Article 1

Object

The object of this Regulation is to enable the Community to exclude illegally sourced timber and wood products, wherever they originate, from Community markets. The Regulation provides for the establishment of systems by which imports of timber and wood products from co-operating states must be accompanied by independently verified proof of legality.

Article 2

Definitions

‘Certificate of legality’ means the certificate required to accompany imports of products from co-operating states, which acts as proof of legality at every stage of the chain of custody of the products prior to import.

‘Chain of custody’ means ownership and control aspects of the product supply chain; stages in the chain of custody include forest management, harvesting, processing and export.
‘Competent authority of the state of export’ means the authority designated by a co-operating state to issue licences of legality.

‘Conflict timber’ means timber that has been traded at some point in the chain of custody by armed groups, either to perpetuate or take advantage of conflict situations for personal gain.

‘Co-operating state’ means any of the states, listed in Annex B, which have agreed to enter into an agreement with the Community by which the export to the Community of all products of types listed in Annex A shall be accompanied by a certificate of legality.

‘Legality’ and ‘illegality’ are established in reference to the national laws and regulations, and obligations under international law, of the co-operating state.

‘Management authority’ means a competent authority designated by a Member State to be responsible for implementing the provisions of this Regulation.

‘Products’ means all timber and wood products listed in Annex A.

‘Verification authority’ means an accredited verification authority operating independently in the state of export, monitoring the chain of custody of the products in order to establish their legality or otherwise.

Article 3

Introduction into the Community

The import, export, transport, sale, receipt, acquisition or purchase of any of the timber or wood products listed in Annex A which have been taken, possessed, transported or sold in violation of any law or regulation of the Community, its Member States or any foreign state is prohibited.

Article 4

Conflict timber

The introduction into the Community of any of the timber or wood products listed in Annex A from any state for which the Security Council of the United Nations has recommended the application of sanctions in order to prevent the use of timber revenues to fund conflict is prohibited.

Article 5

Licensing scheme

The introduction into the Community of any of the timber and wood products listed in Annex A from any of the co-operating states listed in Annex B shall be subject to completion of the necessary checks and the prior presentation, at the border customs office at the point of introduction, of a certificate of legality issued by or on behalf of the competent authorities of the state of export and independently verified by an accredited verification authority.
**Article 6**

**Certificate of legality**

1. The certificate of legality required to accompany imports of products from the co-operating states listed in Annex B shall act as a proof of legal behaviour at every stage of the chain of custody of the products, including forest management, harvesting, processing and export.

2. The precise form of the certificate of legality shall be determined by the Commission after consultations with the co-operating states and with the management authorities of the Member States; except that it must be identifiable by a unique serial number and, as far as possible, be tamper-proof.

3. The certificate of legality shall be issued by or on behalf of the competent authority of the state of export according to its own procedures.

**Article 7**

**Independent verification of legality**

1. The validity of each certificate of legality shall be verified by an accredited verification authority operating independently in the state of export, monitoring the chain of custody of the products.

2. Only when the verification authority is satisfied as to the absence of illegal behaviour throughout the chain of custody shall it validate the certificate of legality.

3. The Commission shall be responsible for accrediting verification authorities and for establishing systems of rapid data exchange and communication on the issuance and validation of certificates of legality.

**Article 8**

**Refusal of introduction**

1. If an attempt is made to introduce, without a certificate of legality, any products into the Community from any of the co-operating states listed in Annex B, the customs office of the state of import shall impound the products immediately.

2. If the customs office of the state of import establishes that a certificate of legality accompanying any products introduced into the Community from any of the co-operating states listed in Annex B has not been issued validly in accordance with the procedures set out in Articles 6 and 7, or has been tampered with after it has been issued, or if the contents of the shipment of products are not in conformity with the accompanying certificate, the customs office shall impound the products immediately.
Article 9

Places of introduction

1. Member states shall designate customs offices for carrying out the checks and formalities for the introduction into the Community of products from co-operating states.

2. All offices designated in accordance with paragraph 1 shall be provided with sufficient and adequately trained staff and equipment.

3. All offices designated in accordance with paragraph 1 shall be notified to the Commission, which shall publish a list of them in the Official Journal of the European Communities.

4. Member States shall ensure that at border crossing points the public are informed of the implementing provisions of this Regulation.

Article 10

Transit

The introduction into the Community of the products listed in Annex A for the purposes only of transit, re-export or inward processing shall not be subject to the requirements of Article 5.

Article 11

Management authorities

1. Each Member State shall designate a management authority with primary responsibility for implementation of this regulation and for communication with the Commission.

2. Each management authority shall provide the Commission with a monthly report on all imports of products accompanied by certificates of legality, including their type, value, country of origin, unique certificate number, the name of the issuing and validating authorities, and the date of issue and validation of the certificates.

Article 12

Monitoring of compliance and investigation of infringements

1. The management authorities of the Member States shall monitor compliance with the provisions of this Regulation.

2. If, at any time, the management authorities have reason to believe that these provisions are being infringed, they shall take the appropriate steps to ensure compliance or to instigate legal action.

3. The Commission shall draw the attention of the management authorities of the Member States to matters whose investigation it considers necessary under this Regulation. Member States shall inform the Commission of the outcome of any subsequent investigation.
4. An enforcement group shall be established consisting of the representatives of each Member State’s management authorities. The group shall be chaired by the representative of the Commission.

Article 13

General provisions

This Regulation shall enter into force on the day of its publication in the *Official Journal of the European Communities*.

The Commission shall report annually to the Council on the implementation of this Regulation and the need for a review of the Regulation.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels …

Annex A (products)

Bark, carvings, chips, paper and paperboard, plywood, sawnwood, secondary processed products such as furniture, flooring or tools, timber, veneer sheets, and wood pulp …

Annex B (co-operating states)

…
Annex 2: Verification of legality

Extract from SGS’ proposal:

1. The ‘Certificate of Legal Origin’ (CLO) requires the successful verification – essentially through the implementation of a log tracking system – of whether the logs or timber products are: a) legally purchased from the rightful owner and have legally been sold and transferred down the chain of custody to the point of reference of the certificate; and b) in conformity with national or international product-specific regulations such as those covering protected species and/or minimum diameters. The system would also periodically verify that duties have been paid and that any quotas have been respected. Past, unsettled non-compliances may block the whole process. In the suggested labelling system, compliant logs and timber products could be labelled as ‘Timber from a Legal Origin’.

2. The ‘Certificate of Legal Compliance’ (CLC) is awarded where the forest management is compliant with specified national legislation and regulations, including the terms of the concession agreement or permit. This essentially refers to the preparation and implementation of the management and harvesting plans, including the forest inventories. Logs or timber products already certified as from a ‘Legal Origin’ (CLO) could at this stage be labelled as ‘Validated Legal Timber’ if the CLO for the timber can be linked with a CLC for the forest the timber comes from.

3. The ‘Certificate of Sustainable Forest Management’ (CSFM) refers to the certificate awarded or maintained as a result of the forest management system having been successfully auditing against the principles, criteria and indicators of an international forest certification scheme such as the Forest Stewardship Council (FSC). It is suggested that logs or timber products already certified as ‘from a legal origin’ (CLO) and originating from a forest certified both as ‘legally compliant’ (CLC) and, in addition, ‘sustainably managed’ (CSFM) could at this stage be labelled as ‘Sustainably Produced Timber’. Note: a certificate of chain of custody issued under the forest certification scheme would not be enough to replace a Certificate of Legal Origin (CLO), whose scope is wider and which is based on advanced log tracking systems.

Independent Validation of Legal Timber (IVLT) covers the first and second steps, i.e. verification of the legal origin of the timber (CLO) and verification of the legal compliance of the timber source (CLC). From producer to consumer, the IVLT system has the potential to provide three key aspects for the control of illegal logging: an effective tool to aid law enforcement by the Government; a powerful market-based instrument, both for producers (market access and fair competition) and buyers (a sound, transparent timber trade); and reliable information for all stakeholders, locally and internationally.