



**UK impact assessment of the EC's proposal
for a regulation laying down the obligations
of operators that place timber and
timber products on the market**

**Additional Scenario Analysis of UK Wood Import Costs
For UK Department of Environment, Food and Rural Affairs**

Rupert Oliver
Forest Industries Intelligence Limited
May 2009

"INFORMING THE SUSTAINABLE WOOD INDUSTRY"

VAT Registered No: 746311248 – Registrar of Companies for England and Wales Company No: 4689869

The Little House • 18 Church St • Settle • North Yorkshire • BD24 9JE • United Kingdom
Tel: +44 (0)1729 822191 / www.forestindustries.info / rupert@forestindustries.info

Introduction

This paper has been prepared in response to a request from DEFRA for a sensitivity analysis of the price premium data used to assess the potential additional costs of importing wood on implementation of the European Commission's proposed regulation. It is a supplement to the earlier UK impact assessment prepared jointly by Liz Betser (360 Responsibility) and Rupert Oliver (Forest Industries Intelligence Ltd).

Rationale and methodology

As in the original impact assessment, the additional costs of importing wood are calculated directly from UK import data. It is assumed that likely price premiums required for sourcing legally verified wood products from a particular country rise as the proportion of forest land that is already certified or has been assessed against legality standards falls. As far as possible the data for certified forest area is given separately for softwoods and hardwoods, as in some countries (e.g. Brazil), the situation with regard to certification of each wood type is very different.

This study draws on the "most likely" Scenario 2 assumptions from the original assessment. It is assumed that price premiums would only be required for sourcing wood from "high risk" countries and that the costs of providing confirmation of "low-risk" of illegal logging (for example through a nationwide or sector-wide peer-reviewed risk assessment such as that recently published by the American Hardwood Export Council) would be negligible. Therefore, the assumption is that the legislation would be based on the original text proposed by the European Commission in October 2008 which requires only that EU operators minimise the risk that wood is sourced from an illegal source. It does not have any bearing on the (potentially much higher) costs of implementing the legislative proposal as subsequently amended by the European Parliament¹.

In this study, different scenarios simply assume a different rate of escalation in price premiums. Table 1 compares the Scenario 2 assumptions of the original study (2007-2) with the assumptions for the 3 scenarios in this study (2008-A, 2008-B, 2008-C).

The original assessment assumed price premiums will rise up to 8% in "high risk" countries with less than 10% of forest land that is already certified or legally verified (Scenario 2007-2). These price premiums are reckoned to be at the top end of the range in this study (Scenario 2008-A). Market research has shown that price premiums for legally verified wood in the UK in the current market rarely exceed 4%. However, a significantly higher price premium was assumed in the original study for the following reasons:

- It is believed that just about all legally verified products placed on the market to date has derived from large centrally managed concession areas. Extending requirements for legality verification to more fragmented forest ownerships is likely to be more costly.

¹ The European Parliament's amended text would place an obligation on EU operators to "ensure that only legally harvested timber and timber products are made available on the market", implying a reversal of the burden of proof. While the parliamentary text still allows for the use of risk assessment, it is not clear in this text how the risk assessment approach may be reconciled with a specific obligation on operators to "ensure" legality. Due to comprehensive mixing of wood raw material from different forests during grading and processing, particularly when sourcing from small non-industrial forest owners, the challenge of "ensuring" legality is considerable, even when procuring wood from countries where there is little risk of illegal logging.

- Existing legally verified products all tend to be relatively simple (comprising logs and sawn lumber) The costs of implementation are likely to be higher when dealing with composite and more highly processed products which mix wood from numerous sources.
- The existing price premiums apply to conditions of relatively limited demand for legally verified wood products. The assumption was that more significant price premiums would be demanded in circumstances where the new due diligence requirements create stronger demand for legally verified wood.
- Some of the cost savings from purchasing wood products from emerging economies like China are very considerable. For example, non-legally verified plywood may be 15-20% cheaper than an equivalent unverified product from Malaysia. Therefore the opportunities for substitution may be limited and the premium costs of sourcing verified product significantly higher than 4%.

Table 1: Price premiums assumed for various scenarios depending on proportion of certified or legally verified forest in each supply country

Proportion of commercial forest land in a supply country that is already certified or part of a legality verification programme (including TFT, GFTN, SGS TLTV etc.)	Price premium expected in order to secure independent assurance of legality			
	2007-2	2008-A*	2008-B*	2008-C*
>=80%	0%	0%	0%	0%
>=70 and < 80%	1%	1%	1%	0%
>=60 and < 70%	2%	2%	2%	0%
>=50 and < 60%	3%	3%	3%	1%
>=40 and < 50%	4%	4%	3%	1%
>=30 and < 40%	5%	5%	4%	1%
>=20 and < 30%	6%	6%	4%	2%
>=10 and < 20%	7%	7%	5%	2%
< 10%	8%	8%	5%	2%

*A variant "with FLEGT" scenario is also included for each of the scenarios A, B and C. Under this scenario, the price premium for wood imported from countries that have signed a FLEGT VPA, or are currently in negotiations towards signing a VPA, never exceeds 2%. Current VPA countries are Ghana, Congo Republic, Cameroon, Malaysia and Indonesia.

Scenarios 2008-B and 2008-C assume that price premiums escalate at a slower rate, rising to a maximum of only 5% and 2% respectively. It may be that the actual increases in wood import costs resulting from imposition of the legislation will be dampened for various reasons. For example:

- Substitution effects are likely to come into play so that as prices rise over a certain amount, EU operators will be encouraged to search for lower cost alternatives.
- There may be unexpected cost savings resulting from more widespread moves to legality verification, for example through improved supply chain management. Companies may respond to pressure to supply legally verified and certified products with a complete overhaul of their product lines and supply chains which can ultimately result in cost-savings.

- While the imposition of legality verification to more complicated semi-finished and finished products may be more expensive, this increased cost is partly offset as wood raw material cost forms a lower proportion of the final purchase price of these products. For example, for a typical set of hardwood garden chairs and table, the cost of wood raw material might contribute only 25% of the finished set price (the other major cost being labour). In this instance, a 20% price premium for verified raw material paid by the manufacturer would translate into only a 5% increase in the finished set price.

This analysis also includes 3 variant “With FLEGT Licensing” scenarios which aim to model the possible effects of FLEGT VPA Licensing Systems. In each case it is assumed that premiums never exceed 2% for products imported from those countries that have recently finalised - or that are currently engaged in - formal VPA negotiations (Ghana, Congo Republic, Cameroon, Malaysia and Indonesia). For these countries it is assumed the additional costs of sourcing VPA Licensed wood products will remain low since much of the extra cost will be borne by the public rather than private sector. Nationwide implementation of legality verification through a VPA may also result in relatively lower costs for individual exporters.

Of course each scenario is a considerable over-simplification and in practice these various effects will interact in complex ways. The extent to which products may be substituted and the costs of implementing legality verification will vary widely between product groups and by supply region.

In practice, the short term costs may be high (more in line with Scenario 2008-C). Immediately following implementation of the legislation, demand for legally verified product may greatly exceed supply. It is likely to take time to develop legality verification capacity in supply countries or for EU operators to identify appropriate substitutes and develop alternative sourcing strategies.

However the costs can be expected to decline over time (so that they are more closely aligned with the FLEGT VPA variant of Scenario 2008-A) as VPA Licensing systems are developed, as independent legality verification becomes the norm in other high risk countries, and as EU operators develop new products and sourcing strategies that reflect the new market requirements.

It should also be noted that this assessment makes no distinction between the price increases that may result from the imposition of new verification procedures and controls on overseas suppliers and those that may result from the removal of low cost illegal wood from the supply chain. For some supply countries, at least part of the price “premium” separating legally-verified wood from unverified wood is due to a proportion of the latter deriving from unregulated sources. This raises questions over the appropriateness of treating all the extra price of sourcing legally verified wood as a “cost” to the UK wood industry and is a moral argument for basing the impact assessment on lower price premium estimates.

Data sources

The original assessment used 2007 import data while this study uses 2008 import data. The 2007 Scenario B data is also presented for comparison.

The original assessment used the latest data for legally verified/certified forest area, the date of which varied to some extent depending on the certification system used. Most was dated from the third quarter of 2008. This same data for verified/certified forest area is used for the current

analysis. In other words no attempt has been made to take account of changes in verified/certified area between December 2007 and 2008. However this will have no significant impact on the results for several reasons:

- Very large changes in the proportion of a nation's verified/certified forest area would be required to significantly alter the % premiums assumed in this study.
- The growth in global certified forest area has slowed considerably in recent years. During 2008, the area of forest certified by FSC, PEFC and other credible national systems (like MTCC in Malaysia) increased by only 25 million hectares (around 6%) to reach 326 million hectares. Around 19 million hectares of this increase was in North America, an area considered low risk with respect illegal logging and therefore not requiring additional measures under the terms of the EC legislation and so having no impact on the results.
- During 2008, there was little or no change in verified/certified forest area in those high risk regions where costs of implementing measures to conform to the new legislation are expected to be high (notably China and Vietnam).

Results

Table 2: Total import value and added costs of importing wood into the UK under various scenarios on implementation of EU legislation by product

All data £1000	2007 data		2008 data						
	Total import	Scen 2 Added Cost	Total import	Scen A Added Cost	Scen B Added Cost	Scen C Added Cost	Scen A Added Cost	Scen B Added Cost	Scen C Added Cost
				Without FLEGT			With FLEGT		
Hardwood logs	57586	1006	51826	867	565	219	770	509	219
Hardwood sawn	258309	4928	253676	4071	2856	961	2710	2011	961
Hardwood veneers	33748	438	35302	460	314	124	452	309	124
Softwood logs	57354	398	44406	221	139	55	221	139	55
Softwood sawn	1324457	10338	843727	4978	3174	1253	4978	3174	1253
Softwood veneers	6744	106	5289	108	67	27	52	40	27
Particleboard	221742	30	181054	25	16	6	25	16	6
Fibreboard	285005	528	242106	522	351	131	474	319	131
Softwood plywood	136195	5422	137654	5674	4086	1325	5456	3945	1325
Hardwood plywood	229511	12443	228999	11820	8165	2856	9482	6675	2856
BJC	411284	9685	435595	10333	6860	2578	7071	5121	2578
Flooring	137421	6119	140050	7229	4544	1807	6943	4391	1807
Fuelwood, charcoal, frames, boxes and barrels	82753	3118	107598	785	1971	3077	785	1942	3022
Wooden seating	843960	39034	746790	37808	23771	9416	37046	23313	9416
Other finished wood furniture	1471126	61563	1453224	62053	39755	15452	56895	36803	15452
Wooden furniture components	262074	2133	267334	2161	1356	541	2147	1349	541
Other wood products	524865	18167	514345	20200	11371	2186	19049	10767	2240
TOTAL	6344135	175455	5688974	169316	109361	42014	154556	100823	42014

Due to the economic crises, the overall value of UK wood products imports declined by 10% from £6.34 billion to £5.68 billion between 2007 and 2008, feeding through into a slightly lower overall import cost estimate for implementation of the legislation. An estimated additional import

cost of £169 million for Scenario 2008-A compares to an equivalent figure of £175 million for scenario 2007-2. Overall additional import costs for the scenarios calculated from 2008 data range from a high of £165 million to a low of £42 million.

Table 2 highlights that in all the scenarios well over half of all additional import costs are attributable to wooden furniture. Table 3 shows that much of the additional import costs are attributable to China in all the scenarios. Due to the major impact on the analysis of wood furniture imports from China (a non-FLEGT VPA country), overall cost estimates are not strongly reduced by the anticipated development of VPA Licensing procedures.

Table 3: Total import value and added costs of importing wood into the UK under various scenarios on implementation of EU legislation by supply country (£1000)

All data £1000	2007		2008						
	Total import	Scen 2 Added Cost	Total import	Scen A Added Cost	Scen B Added Cost	Scen C Added Cost	Scen A Added Cost	Scen B Added Cost	Scen C Added Cost
				Without FLEGT			With FLEGT		
CHINA	1168634	93491	1177189	94175	58859	23544	94175	58859	23544
VIETNAM	125916	10073	138559	11085	6928	2771	11085	6928	2771
MALAYSIA	208131	10407	211056	10553	8442	2111	4221	4221	2111
INDONESIA	144409	11553	126888	10151	6344	2538	2538	2538	2538
BRAZIL	165812	10434	157998	10002	7371	2631	10002	7371	2631
RUSSIA	163548	13084	99903	7992	4995	1998	7992	4995	1998
THAILAND	67572	5406	66832	5347	3342	1337	5347	3342	1337
INDIA	32832	2627	30991	2479	1550	620	2479	1550	620
HONG KONG	27077	2166	30285	2423	1514	606	2423	1514	606
TAIWAN	23190	1855	27896	2232	1395	558	2232	1395	558
SOUTH AFRICA	27587	1931	24210	1695	1210	484	1695	1210	484
SINGAPORE	27959	2237	20562	1645	1028	411	1645	1028	411
TURKEY	10560	845	19426	1554	971	389	1554	971	389
CHILE	30598	2142	21623	1514	1081	432	1514	1081	432
IVORY COAST	13490	1079	13229	1058	661	265	1058	661	265
CAMEROON	22296	1115	14536	727	581	145	291	291	145
PHILIPPINES	6094	487	5945	476	297	119	476	297	119
UKRAINE	6713	470	6432	450	322	129	450	322	129
ARGENTINA	6025	482	4460	357	223	89	357	223	89
UNITED ARAB EMIRATES	4008	321	4210	337	211	84	337	211	84
GHANA	8296	415	6099	305	244	61	122	122	61
BOLIVIA	4110	329	3768	301	188	75	301	188	75
CONGO REPUBLIC	2932	176	4888	293	196	98	98	98	98
OTHER HIGH RISK	31304	2333	31649	2166	1407	520	2166	1407	520
LOW RISK INTRA-EU	3630071	0	3124934	0	0	0	0	0	0
LOW RISK EXTRA-EU	384969	0	315406	0	0	0	0	0	0
TOTAL	6344135	175455	5688974	169316	109361	42014	154556	100823	42014

Note FLEGT VPA countries are emboldened