

Summary: Intervention & Options

Department /Agency:
Department for Environment,
Food and Rural Affairs

Title: Impact Assessment on the FLEGT (Forest Law Enforcement Governance and Trade) licensing scheme, implementing FLEGT Regulation 2005

Stage: Consultation

Version: 1

Date: 17 September 2009

Related Publications: European Commission FLEGT Action Plan and Impact Assessment

Available to view or download at:

<http://www.defra.gov.uk/corporate/consult/flegt2009/>

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What is the problem under consideration? Why is government intervention necessary?

Any attempt to exclude illegal timber products from international markets is challenged by the problem that it is generally impossible to distinguish legal from illegal products at the border. The intention of the FLEGT (Forest Law Enforcement Governance and Trade) Regulation is that FLEGT-licensed timber products will be considered to have been legally harvested, will not require any further legality assurance within the EU, thus stimulating the market for FLEGT timber. FLEGT addresses a market failure to exclude illegal timber at the European level, in order that illegal timber cannot be diverted to, or through, other Member States.

What are the policy objectives and the intended effects?

The FLEGT Regulation aims to change the behaviour of European timber and timber product importers by requiring them to alter their mechanisms for sourcing timber products from international suppliers, creating demand for legally verified (FLEGT) timber, and thereby also providing assurance to VPA countries that their efforts in implementing the licensing system will not place them at a competitive disadvantage with non-VPA countries. This will have broader benefits in terms of tackling illegal logging, and avoiding the serious economic, environmental and social problems of deforestation at the global scale.

What policy options have been considered? Please justify any preferred option.

Five options were considered at the FLEGT Regulation negotiation stage: i.) Oppose the Proposed FLEGT Regulation and 'Do nothing'; ii.) Oppose the proposed Regulation and introduce a multi-lateral agreement; iii.) Oppose the proposed Regulation and introduce a ban on illegal timber; iv.) Accept the proposed Regulation; v.) Seek amendments to the proposed Regulation. Options i-iii are now not possible because the UK has agreed the FLEGT Regulation, indeed the UK was a key supporter of legislation at the negotiation stage. Due to the serious problems caused by illegal logging, we supported the Commission in driving forward the FLEGT Regulation in 2005, as well as further initiatives to support governance reform in key forest nations, and now the UK is required to implement the FLEGT Regulation.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

We will review the implementation of this scheme two years after the entry into force of the first VPA.

Ministerial Sign-off For Consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

..... Date:

Summary: Analysis & Evidence

Policy Option: 1

Description: delayed full cost recovery scheme to verify the legality of timber from VPA countries

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Costs result due to a charge from year three onwards, to UK importers who import timber and timber products from current (Ghana and Republic of Congo) and future countries which sign a Voluntary Partnership Agreement (VPA) with the EU, to verify the legality of their timber exports. A charge from year three is aimed at full cost recovery for the Government to cover the costs of checking and verifying shipments. This is expected to be low as a proportion of shipment values. Also includes costs to importers, at the procurement stage, of negotiating contracts to ensure that shipments will be FLEGT licensed. One off cost of I.T. set up, publicity for the scheme etc is also incorporated into cost recovery.
	One-off	Y	
	£	1	
	Average Annual Cost (excluding one-off)		
	£ 356k	6	Total Cost (PV) £ 1.9m
Other key non-monetised costs by 'main affected groups' Nil			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' These are difficult to disaggregate for the UK's impact as a proportion of the changes driven by FLEGT, but benefits accrue to VPA countries in terms of governance reform, forest sector reform, avoided corruption, avoided loss of livelihoods, avoided deforestation, avoided greenhouse gas emissions and avoided biodiversity loss.
	One-off	Y	
	£ not quantified	1	
	Average Annual		
	£ not quantified	6	Total Benefit (PV) £ not quantified
Other key non-monetised benefits by 'main affected groups' As described above, but in summary: (i) Avoided illegal logging due to controls on exports of timber from FLEGT VPA countries (ii) Avoided loss of taxes and government revenues in VPA countries.			

Key Assumptions/Sensitivities/Risks Assumption that further VPAs will be signed which will increase the workload for checking FLEGT licensed shipments; a key factor in the cost effectiveness of the Government's charging scheme, and would be expected to keep costs low. If no further VPAs come on board, the charge might never become relevant, and costs to importers reduced accordingly.

Price Base Year 2009	Time Period Years 6	Net Benefit Range (NPV) £ not quantified	NET BENEFIT (NPV Best estimate)
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		September 2010		
Which organisation(s) will enforce the policy?		AH, UKBA and HMRC		
What is the total annual cost of enforcement for these organisations?		£ dependent on penalties		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ see Annex 1 GHG test		
What is the value of changes in greenhouse gas emissions?		£ not quantified		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro unknown	Small unknown	Medium unknown	Large unknown
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)		
Increase	£ 15,800	Decrease	£	Net Impact £ 15,800 p.a.

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Impact Assessment on the FLEGT (Forest Law Enforcement Governance and Trade) licensing scheme, implementing FLEGT Regulation 2005

1. Introduction and Background

What is the problem under consideration? The global significance of the problem being tackled by the FLEGT Regulation

1.1. Illegal logging, alongside slash-and-burn agriculture, industrial commodity production, mining and infrastructure development are major drivers of global tropical deforestation¹. Deforestation and the overexploitation of forest ecosystems globally pose serious challenges to the international community. Global deforestation, at a rate of 13 million hectares every year, which constitutes the annual loss of an area the size of England², causes enormous environmental and other damage, for example threatening:

- the livelihoods of over 90% of the 1.4 billion people globally who currently live in extreme poverty³;
- about 80% of the world's remaining terrestrial biodiversity, representing a catastrophic effect on global biodiversity, which itself has further detrimental impacts on human welfare, livelihoods and resource availability⁴;
- the stability of the global climate, contributing approximately 18% of global greenhouse gas emissions which lead to climate change, greater than those of the entire transport sector worldwide, with a number of feedbacks in the Earth's climate system which drive further emissions⁵;
- 10 million jobs provided by the forest products industry and perhaps 50 million in the informal forest products sectors.

1.2. Illegal logging and the damaging deforestation that it drives are therefore serious issues to the global community. The UK government has a longstanding commitment to tackling illegal logging.

1.3. Illegal logging undercuts the competitiveness of legitimate forest industry operations in exporting and importing countries. Its scale and pervasiveness reduce the contribution forests can make to overall development. Globally, the World Bank⁶ estimates that

¹ Butler, R.A. and Laurance, W.F., New strategies for conserving tropical forests Trends in Ecology & Evolution, Volume 23, Issue 9, September 2008, Pages 469-472

² Mitchell, A. *et al.* 2008. Forests NOW in the Fight against Climate Change; Forest Foresight Report 1.v3. Global Canopy Programme, Oxford, p10

³ <http://www.globalcanopy.org/main.php?m=120>

⁴ <http://www.grida.no/publications/vg/forest/page/3795.aspx>

⁵ Ibid, (Global Canopy Programme *forest foresight report* p5

⁶ http://siteresources.worldbank.org/INTFORESTS/Resources/ForestLawFINAL_HI_RES_9_27_06_FINAL_web.pdf

about \$10 billion per year (GBP£6-8 billion) is lost through lost assets and revenue. In addition, (roughly GBP£3-4billion) per year is lost to governments because of evasion of tax payments and royalties for timber harvests (both those which are legally sanctioned, and those of which authorities are not aware). The two combined are more than eight times the global overseas development assistance for forests. Modelling suggests that illegal logging depresses world prices for forest products by 7% to 16% depending on product type.

Why is government intervention necessary?

- 1.4. Deforestation occurs for a range of reasons linked to market failures and poor governance. The failure of domestic and international markets to value environmental benefits is the most pervasive market failure. Ineffective regulation and corrupt practices lead to capture by elites of the benefits that forests provide. Inequitable access to forests undermines local livelihoods. More than half of the world's tropical forests are found in locations of on-going or recent conflicts. Illegal logging is intrinsically linked to these governance issues driving deforestation.
- 1.5. Work to promote governance reforms in countries that suffer from illegal logging is making progress but requires sustained, long-term, support, from all major importers which provide a demand pull for timber. The private sector is gradually changing practices in response to legislation and consumer demands. Other large importing countries beyond the European Union are also currently taking steps to tackle illegal logging.
- 1.6. The UK's response began with work to better understand the nature and extent of illegal logging. The Government recognised that it was essential to tackle the demand for illegal forest products as well as the problems affecting supply - and that the UK, as one of the world's largest importers of timber and timber products had a particular role to play. The UK is one of the largest consumers of these products in the world. Approximately two-thirds of UK consumption of timber and timber products is supplied by imports, and while much of this is from European sources, some evidence produced by WWF⁷ suggests that the UK is one of the largest importers of illegal timber and timber products. Such evidence is very difficult to prove, given the nature of an illicit trade, however the study, carried out by WWF in Germany, drew out a number of salient statistics:
 - 1.6.1. Almost one-fifth of wood imported into the European Union in 2006 came from illegal sources, the UK importing 3.5m cubic metres of illegal wood making it the second biggest importer behind Finland. This included the largest quantities of furniture, finished wood products, sawn wood and plywood of all EU states.
 - 1.6.2. In total the EU imported between 26.5m and 31m cubic metres of illegal wood and related products in 2006, equal to the total amount of wood harvested in Poland in the same year. Most came from Russia, Indonesia and China.
 - 1.6.3. an estimated 23 per cent of wood-based products from illegal or suspect sources were imported from Eastern Europe, 40 per cent from South-East Asia,

⁷ <http://assets.panda.org/downloads/failingforests.pdf>

30 per cent from Latin America and 36 per cent to 56 per cent from Africa. Finland, UK, Germany and Italy were the main destinations.

- 1.7. UK policy effort designed to tackle the trade in illegal timber is therefore expected to positively impact on those countries where illegal logging is a problem.
- 1.8. Results from a pilot assessment⁸ to measure the effectiveness of the global policy response to illegal logging, suggest that the impact has been very large. In only two countries (Cameroon and Indonesia) in which indicators of effectiveness have been tested, the majority of those indicators have demonstrated positive trends. It is estimated that for the period 2001 to 2006, efforts to control illegal logging in Indonesia alone, have avoided tax losses of \$4 billion and emissions of 1.6 billion tonnes of greenhouse gas emissions (CO₂ equivalents).

What are the policy objectives and the intended effects?

- 1.9. The causes of the problem of illegal logging are complex, but can be attributed broadly to failure of international markets, which continue to accept illegal timber products, and failures of governance which allow commercial and political elites to benefit from forest exploitation by evading national forest laws in producer countries. Consumer countries have a key role in putting in place policies to control the flow of illegal timber into the European Union. The range of activities undertaken by the EU to target this complex problem is captured in the Forest Law Enforcement Governance and Trade (FLEGT) Action Plan, 2003⁹.
- 1.10. The main objective of the FLEGT Licensing Regulation and Implementing Regulation is to establish the structures necessary to implement EU policies to target illegal logging and the consequent trade in timber and timber products.
- 1.11. Any attempt to exclude illegal timber products from international markets runs into the problem that it is generally impossible to distinguish legal from illegal products at the border. The intention of the FLEGT Regulation is that FLEGT-licensed timber products will be considered to have been legally harvested. As a result, such timber will not require any further legality assurance, thus stimulating the market for FLEGT timber, and thereby also providing assurance to VPA countries that their efforts in implementing the licensing scheme will not place them at a competitive disadvantage with non-VPA countries.
- 1.12. The FLEGT Regulation aims to change the behaviour of European operators by requiring them to alter their mechanisms for sourcing timber products from international suppliers.

⁸ <http://www.illegal-logging.info/uploads/2008PilotAssessmentofResponsetoIllegalLoggingSummary.pdf>

⁹ <http://ec.europa.eu/environment/forests/flegt.htm>

What policy options have been considered? Please justify any preferred option.

- 1.13. Five options were considered when the FLEGT Regulation was being negotiated in the European Union¹⁰ at the end of 2005. Five options were then considered: i.) Oppose the Proposed Regulation and ‘Do nothing’; ii.) Oppose the proposed Regulation and introduce a multi-lateral agreement; iii.) Oppose the proposed Regulation and introduce a ban on illegal timber; iv.) Accept the proposed regulation; and v.) Seek amendments to the proposed Regulation. As a result of the consultation, we accepted the FLEGT Regulation as proposed, and are now required to implement it.
- 1.14. We now also support the European Commission’s proposal for a Regulation setting out the responsibilities of all operators placing timber on the European Community market, known as the timber Due Diligence Regulation¹¹.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

- 1.15. We intend to include a provision requiring periodic biennial evaluations of the operation of the FLEGT licensing scheme in UK legislation putting the scheme into effect. Article 9 of the FLEGT Regulation also includes provision for reporting and proposals for improvement, where appropriate, two years after the first VPA country is added to Annex two of the FLEGT Regulation. Evaluation and monitoring will therefore also be undertaken at the European level.

2. Benefits and Costs

2.1. As indicated in the introductory section above, the primary benefits of reduced illegal logging will fall predominantly outside UK borders, so the FLEGT licensing scheme needs to be seen in this context of wider development, environment and climate change policy. Secondary benefits in terms of nature conservation and climate change mitigation are global benefits.

2.2. It is clear that eliminating illegal logging will also help nations avoid major losses of government revenue. A number of studies have estimated the cost of illegal logging to forests nations. The World Bank estimates costs of illegal logging at \$15 billion per year reporting that “where illegal logging in public lands alone causes estimated losses in assets and revenue in excess of US\$10 billion annually” and that “As much as US\$5 billion is lost annually to governments because of evaded taxes and royalties on legally sanctioned logging”¹². Forestry-based industries contribute about 10% of GDP in 19 African countries, as well as roughly 10% of trade in ten African countries.

2.3. The FLEGT licensing scheme will involve a small (£15.8k per annum; see 2.22 for detail on how this was calculated) additional administrative burden per annum for industry and Government, given that it will build on existing systems used for implementing the

¹⁰ http://www.illegal-logging.info/item_single.php?item=document&item_id=192&approach_id=26

¹¹ http://ec.europa.eu/environment/forests/pdf/proposal_illegal_logging.pdf

¹² http://siteresources.worldbank.org/INTFORESTS/Resources/ForestLawFINAL_HI_RES_9_27_06_FINAL_web.pdf

European Wildlife Trade Regulations¹³, and the Convention on International Trade in Endangered Species of Flora and Fauna (CITES)¹⁴, as well as building on good practice in the industry across the EU on working with suppliers to raise legality standards in the procurement of timber and timber products. UK industry is recognised as a leader in the area of developing supply chain management and legality verification systems.

Benefits

2.4. The benefit associated with implementing the FLEGT Regulation is in tackling the serious problems caused by illegal logging globally. The FLEGT Regulation will only apply to those countries which have gone through the process of signing a Voluntary Partnership Agreement with the European Union, and therefore the initial benefits of this Regulation, on a narrow analysis might appear quite modest. However, there is evidence that the VPA signed with Ghana has been an important part of wider governance reform, and has had positive impacts on the country, in terms of the development of new stakeholder engagement processes, and which should lead to improved management of the forest sector generally. It is however very difficult to quantify this benefit with a robust or recognised economic methodology. We explain these benefits in detail in the section which follows.

The importance of the VPA process for governance reform in the VPA partner country

2.5. Ghana was the first country to sign a VPA with the European Union. It is therefore possible to make preliminary assessments of the potential benefits arising from its implementation. We expect that similar benefits will accrue for other VPAs, but have focussed our attention here on Ghana.

2.6. A recent investigation into the likely benefits from the VPA process in Ghana was undertaken by the International Institute for Environment and Development. This illustrated the potential to alter global timber market conditions by reducing demand for illegal timber in the EU, as well as setting standards that are likely to influence other markets¹⁵. By removing illegal timber from markets in VPA countries through effective legality assurance, the risks of purchasing timber from countries where illegal logging is a problem are reduced. This could improve access to key markets, lower transaction costs by removing illegal timber from producer country markets, and increase prices where buyers in consumer countries are willing to pay.

2.7. Governance reform involves several elements, such as improved stakeholder engagement in decision making, increased transparency and accountability, and improved definition and clarification of land and resource tenure. This reform, and a

¹³ The 'European Union Wildlife Trade Regulations' is a term used in respect of a number of Regulations which implement CITES, and covers: Council Regulation (EC) No. 338/97; Commission Regulation (EC) No. 865/2006 and Commission Regulation (EC) No 811/2008

¹⁴ <http://www.defra.gov.uk/animalhealth/cites/> The Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) is an international agreement between governments that came into force in 1975. Its purpose is to ensure that no species of wild fauna or flora becomes or remains subject to unsustainable exploitation because of international trade. CITES accords varying degrees of protection to over 30,000 species of animals and plants, whether they are traded as live or dead specimens, parts (such as ivory or leather), or derivatives (such as medicines made from animals or plants). The member countries act together by regulating trade in species listed under the three appendices to the CITES Convention.

¹⁵ <http://www.illegal-logging.info/uploads/FLEGTAddingValuereport.pdf>

more transparent business environment in VPA countries, is expected to enable investors to measure business risk more effectively, thereby making longer-term investments with confidence, and potentially bringing more capital investment into the country.

2.8. Removal of competition between legally produced timber and cheaper illegal timber should also enhance the viability of capital investment in sustainable forestry, attracting investors that are seeking long term yields or socially and environmentally ethical outcomes. A summary of the benefits and losses for Ghana under different scenarios of forest sector reform has been developed by the Forest Governance Learning Group of the International Institute for Environment and Development¹⁶.

2.9. Further, the Forests and the European Union Resource Network, (FERN), an independent commentator has asserted that, notwithstanding suggested strengthening and improvements to the VPA process, 'the signed VPA is a remarkable step towards defining a framework to improve forest governance in Republic of Congo'¹⁷.

2.10. It is likely that over time, as FLEGT licensed timber becomes increasingly available, it will become recognised as a standard in the trade for responsible timber production, encouraging other countries to start VPA negotiations.

Secondary benefits

2.11. A key driver of the trend towards legal timber production, and ultimately sustainable forest management, will be the desire by partner countries to maximise the opportunities presented by future potential forest carbon payments, such as Reducing Emissions from Deforestation and Degradation (REDD) and similar markets for ecosystem services. Entering into the VPA process, and installing an effective legality assurance system, may go some way to demonstrate sound forest governance principles which are required for effective realisation of REDD approaches.

2.12. The IIED Impact Assessment on the VPA process in Ghana does not claim that the strategic interests of investors in carbon markets alone will change the outlook for forest management, but there was some evidence to suggest that the needs of investors are beginning to coincide with the needs of timber markets and forest communities, creating a nexus between legal and sustainable timber supplies, good governance, forest carbon programs such as REDD and community economic development. The VPA can be a valuable catalyst in the governance reform process.

Benefits in development of the forest products sector, including efforts to eliminate illegal timber products from supply chains globally

2.13. There is a direct interaction between the FLEGT licensing scheme required by the FLEGT Regulation 2005, and the proposed European Union's Due Diligence

¹⁶ <http://www.iied.org/pubs/pdfs/G02284.pdf>

¹⁷ http://www.illegal-logging.info/item_single.php?item=presentation&item_id=371

Regulation¹⁸. This includes a specific provision in the current draft proposal that FLEGT-licensed timber and timber products will be considered to have been legally harvested for the purposes of the Regulation.

- 2.14. Assuming that the UK takes a share of illegal timber relative to its share of the global timber market, this would imply that by importing illegal timber from all nations globally, the UK is indirectly responsible for losses of approximately £425m per year being inflicted upon the governments, economies and societies of forest nations where illegal logging occurs.
- 2.15. We do not have data which would allow us to disaggregate the proportion of these benefits that would accrue only to those countries which have already signed a VPA, and we therefore do not feel that it is possible at this stage to break down benefits in a robust way.
- 2.16. Although initially Voluntary Partnership Agreements with the EU will only cover a small proportion of the wood imported into the UK, to the extent that the production and import of FLEGT licensed timber replaces illegally logged timber it could have significant benefits for those countries involved. If trade in illegal timber is prevented, as opposed to being transferred to other countries which have not signed a Voluntary Partnership Agreement with the European Union, this will result in significant development benefits. This is because a reduction in illegal logging will help the UK to deliver the wider international development and environment objectives of the UK Government.
- 2.17. In summary then, we believe that there is a convincing case that the FLEGT scheme offers net benefits. These emerge in a number of ways, although it is extremely difficult to quantify such benefits reliably. The consultation document asks stakeholders for any data which might allow us to perform any analysis and extract that portion of the UK's effort to the total benefits of tackling illegal logging.

Benefits accruing to importers of FLEGT licensed timber shipments

- 2.18. As indicated there may be additional administrative costs incurred by timber and timber product traders, and related operators, associated with purchasing the FLEGT verified legal timber. However, there may also be business benefits in terms of the use of certified legal timber, in terms of increased market share, and reputational and Corporate Social Responsibility benefits that they might gain for sale of such timber and timber products. We ask stakeholders for any evidence they might have on this in the consultation document.
- 2.19. Business benefits might also be supported through the changing policy context in Europe, including through further instruments such as the European Commission's proposal for the timber Due Diligence Regulation (described above at 2.13), and the UK Government's timber public procurement policy, which states that from April 2009 only legal and sustainable or FLEGT timber will be demanded for use on the Government

¹⁸ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0644:FIN:EN:PDF>

Estate. This means that FLEGT licensed timber and timber products will be accepted on the Government estate, which will help incentivise further countries to sign VPAs, as well as support the implementation of the Government's procurement targets for sustainability on the Government estate.

Costs accruing to importers of FLEGT licensed timber shipments

2.20. The table below illustrates how a delayed Full Cost Recovery model might work, starting from year three onwards. Charging operators from year three onwards, when we expect an increasing number of shipments will arrive in the UK, enables the UK Government to recoup its own running costs. The table demonstrates how an estimated number of shipments, when multiplied by an initial estimation of this possible charge for checking each licence, results in Full Cost Recovery. Please note these are not definitive charges and will be reviewed at the time of implementation.

Table 2. Cost per licence, the number of shipments and delayed Full Cost Recovery

Year	VPA signed - Countries of Export	Defra consultant's unpublished 2007 Study (Includes furniture)	2008-2009 number of shipments – the Malaysia does not include furniture at this stage	Projected number of shipments based upon past volumes	Cost per licence (GBP)	Total cost to industry (Government charge plus admin cost) (GBP)
1 (2010-2011)	Ghana AND/OR Republic of Congo	520	330	600	£0	£15,800 *
2 (2011-2012)	Ghana, Republic of Congo, Cameroon, Malaysia	34,100	2,700	2,000	£0	£15,800 *
3 (2012-2013)	As above, plus Indonesia	47,000	16,785	15,000	£25	£390,800 *
4 (2013-2014)	As above, plus Liberia	47,000	16,790	16,000	£25 (charge to be reviewed at year 4)	£415,800 *
5 (2014-2015)	As above	47,000	16,790	17,000	£25	£440,800 *
6 (2015-2016)	As above, plus Vietnam, and others?	62,000	32,000	35,000	£25	£890,800 *
7 (2016-2015)	End of third two-year period. Review the FLEGT licensing scheme in its entirety, taking into account the administrative burdens, operational implementation and the implications of this for operators. This would also include a review of costs if this was needed after year 4.					

*these figures indicate the total charge to importers, plus the administrative costs that we have estimated. We invite evidence of any additional administrative burdens.

- 2.21. Column five, in table 2, provides a projected number of shipments based upon past import volumes (in columns three and four), and uses these figures to come to a rough estimate of the number of future shipments. Multiplying the number of shipments by the estimated licence charge provides an initial estimate of the total costs to industry. We have also added the estimated administrative costs to these figures.
- 2.22. The Government's estimate of its running costs has been produced by taking into account a Government administrator's time to check the licence for its completeness and validity, data input time to communicate receipt of this licence to the UK border authorities, and an intelligence-led investigations regime (which is described in section 11 of the consultation document). Costs would remain under periodic review.
- 2.23. We propose that there will be no charge for years one and two of the FLEGT licensing scheme, but that a charge be revisited, and perhaps imposed from year three onwards. The licence charge which might be incorporated from year three, has been estimated to cover the total sum of the full cost to Government of checking and verifying FLEGT licences over the first seven years of operation, on a working assumption of increasing flows of FLEGT timber to the UK (based upon further VPAs having been signed). NB. We further explain the rationale behind this licence charge, which is the result of a Full Cost Recovery model, at 2.33 to 2.36 below, and at section 9 of the public consultation document.
- 2.24. To estimate the administrative burden imposed by the Regulation, we have undertaken an analysis based upon one manager's work to ensure that shipments will be accompanied by a licence. We envisage that operators would gain assurance that shipments will be accompanied by a licence at the stage when contracts are being negotiated, and would not represent a large or regular ongoing cost (i.e. a cost accrued periodically), because contract negotiation would be undertaken as business as usual. We assume that a particular proportion of operators also undertake a certain amount of negotiation of contracts or ask questions to verify the legality of products purchased, which further reduces the additional cost to businesses above business as usual costs. We have therefore estimated that at least 50% of the work necessary to ensure that a FLEGT licence will be included with each licensable shipment would be undertaken as part of business as usual for the majority of operators.
- 2.25. Note, these administrative costs to industry, plus the costs of making extra checks for compliance when signing contracts, need to be better understood. We ask for any industry evidence on the administrative (and other) costs which might accrue in the public consultation document.
- 2.26. We envisage that the cost imposed by the licence charge will represent a small proportion of the total value of each shipment. This is especially relevant to niche operators which might only import timber and timber products from existing and prospective VPA countries. If the charged levied per shipment for each licence were higher, than such niche operators might be disproportionately affected by the FLEGT

licensing scheme. However, because the licence fee is likely to represent such a low proportion, we are confident that such impacts will be minimal.

2.27. Further, the European Commission estimated in its own Impact Assessment that the costs to industry of implementing the FLEGT licensing scheme are proportionate to the need for the European Community to improve the efficiency of its policies against illegal logging and the related trade. The approach means that over time, UK, and other European, operators will benefit from the elimination of illegal timber products from the market, and therefore be increasingly confident in the legality of production of the raw materials in their supply chains.

2.28. Finally, the number of companies likely to be affected is difficult to judge; we do not have disaggregated data on companies which import timber to the Community market from the FLEGT VPA countries. Rather, we have an aggregated estimate of the total number of shipments likely to be imported annually. Any data from stakeholders on this point would be valuable to us in our impact assessment.

2.29. We would also like to hear from any particular industry sectors that believe that their sector might be disproportionately affected by the FLEGT licensing scheme e.g. if there are niche importers which only or mainly import from VPA countries.

2.30. The costs presented in this summary table represent those costs as they would fall on business; the total costs as faced by government are similar (as this is a Full Cost Recovery scheme), but differently profiled (accounted for) over the financial year. We may find it appropriate to consult stakeholders closer to the time ahead of the implementation of any new charge.

Assumptions used to produce the delayed Full Cost Recovery analysis (Table 2)

2.31. There are a number of assumptions used to produce the figures in the Impact Assessment, which we hope to be able to refine following input from stakeholders:

2.1.1. It is only possible to get projected data for timber volumes, as opposed to projected figures on number of shipments, and we have therefore based our analysis on extrapolating data on the number of shipments arriving in the UK in previous years.

2.1.2. We have not captured, or put in any kind of correction / adjustment to take account of the fact that in the past, a particular percentage of undeclared shipments from the countries in question could have cleared UK customs. The shipments included in the data in Table 2 are simply the shipments from those countries which Customs have been made aware of.

2.1.3. Changing market conditions over time have not been factored into the future shipment volumes in a significant way. We have factored in a very small increase in shipments received (from year three onwards), over the number expected if shipments had stayed level (i.e. same as 2008-9). We have not yet factored in a potential future reduction in the number of future shipments due to the economic downturn, but have dampened our estimate of increased demand for FLEGT timber and timber products. Therefore a slight increase in volumes received is an

optimistic estimate, taking into account increased demand for FLEGT timber above other non-legally verified timber.

2.32. What is clear, however, from our data and analysis is that the Government will recover both running and set up costs over time, and the payback will therefore accrue as soon as the charge begins, even if that is at a modest level. Full cost recovery will therefore operate over a seven year time period. Waiving any fee for the next two years could therefore be in effect considered a benefit for the 'early' or 'first-movers'.

Costs accruing to the UK Government

2.33. There will be ongoing costs to Government associated with the checks, administration, verification of legality of the licence, and communications with HMRC clearance processes, as well as one-off costs of additional information technologies, communications systems and administrators needed to run and update current systems in the Competent Authority. We currently propose to recover these costs, both one-off and running costs through a full cost recovery model. These costs are incorporated in to the Government's initial estimate of the charge to be applied to each shipment from year three onwards, which we have summarised at Table 2.

2.34. These costs are accrued through a fee to be charged to businesses at the onset of a charging regime from year three onwards, and thereby represent the cost to Government of running the FLEGT licensing scheme. This fee reflects the estimated total cost to the UK Government of checking, processing and investigating (where necessary, a number of) FLEGT licences.

2.35. There will also be other costs associated with training UK CITES Licensing Management Authority, UK Border Agency and HM Revenue and Customs officers in these new responsibilities, prosecuting those guilty of an offence associated with failure to present a valid FLEGT licence, running auctions for seized shipments, and other elements of running the scheme, and we will be working with the Competent Authority, the UK Border Agency, Her Majesty's Revenue and Customs and the Ministry of Justice to develop options for these elements.

2.36. Finally, it is worth noting that implementing the FLEGT Regulation enables the Government to avoid the cost of infraction proceedings, which would be a significant potential future cost. We are mitigating the risk of infraction proceedings through implementing the FLEGT Regulation.

3. Issues of equity and fairness

3.1. The FLEGT Licensing Scheme introduces questions of equity or fairness to the degree that a level playing field will be created in the marketplace for timber and timber products, because unscrupulous operators who trade in illegal timber will be held to account for their actions. Because the FLEGT Regulation puts in place a European Scheme, UK operators will not be disproportionately affected as a result of this scheme.

Specific Impact Tests: Checklist

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Annex 1: Outcome of Impact Tests not referred to in the Evidence Base

Competition assessment

All timber and timber product importers in the UK will be subject to the requirements of the FLEGT licensing scheme. It is not felt that these requirements will reduce the number or range of importers of the relevant products nor limit the ability of consumers to choose the price, range, quality and location of their products. The measures will not impose additional costs on new entrants compared to incumbent firms, other than the need for all operators to ensure that timber and timber products will be exported legally, and potentially to write this in to their contracts with supplying exporters in VPA countries. The industry is not characterised by rapid technological change per se, but UK timber importers are world leaders in chain of custody monitoring and legality verification, and the legality verification of a FLEGT licence will support this competitive advantage internationally (outside of the EU) for any value-added manufactured exported products from the UK. All EU Member States will need to implement the legislation so there will be a more level playing field for EU competition, and the gradual elimination of unscrupulous operators who import illegal timber will also level the market playing field.

Small Firms Impact Test

There are no exemptions for small firms from implementing the FLEGT Regulation. The Government is not currently planning to charge for its work to check, administer and verify FLEGT licences, in the first two years of operation of the FLEGT scheme. This will help to reduce the burden on small business, as per all businesses, by providing them with two years to ensure that they put in practice measures to ensure a FLEGT licence is provided. On the introduction of a possible charge for the FLEGT licence check from year three onwards, there may be uneven impacts on niche importers, which only import from VPA countries, but given that the likely scale of a charge on operators is almost certain to be a small proportion of the total value of any shipment, we are confident that no operator will be disadvantaged by the FLEGT licensing scheme.

Legal Aid

New domestic legislation putting into effect the FLEGT licensing scheme [in the UK] may create a new penalty for producers who fail to comply with the requirement to produce a FLEGT licence for licensable shipments. We are consulting stakeholders on whether such a new offence is necessary. The penalties for such an offence could take a number of forms, such as a monetary offence. A producer who refused to pay a penalty would risk prosecution. A producer who faced prosecution in this circumstance would not be eligible for legal aid.

Sustainable Development

The FLEGT Regulation is in accordance with UK principles of sustainable development.

Carbon Impact Assessment

The FLEGT Regulation supports the European Union's efforts to tackle global deforestation, given that it supports a process of governance reform in the VPA countries. To this extent, and because of avoided illegal logging, the FLEGT Licensing scheme contributes to reducing carbon emissions. It is not possible to quantify the exact reduction due to the complexity of the sector.

Other Environmental Issues

As the FLEGT licensing scheme will still involve harvesting timber, some environmental impacts are likely to remain the same. However, because it is part of a wider programme of reform which could lead to sustainable forest management, the FLEGT licensing scheme could have beneficial secondary implications in relation to climate change, landscape preservation, water and floods, habitat and wildlife. Waste management and noise pollution are unlikely to be affected.

Health Impact Assessment

The FLEGT licensing scheme could potentially have a secondary positive impact on health by an increased level of concern for health and safety practices in logging operations. We do not currently have any data to support this.

Race /Disability/Gender

The FLEGT licensing scheme does not introduce any questions of equity or fairness in terms of race, disability or gender, other than that the governance reform in VPA countries could have a number of positive impacts for all citizens of those countries, as well as levelling the playing field for European operators generally, through reducing the number of unscrupulous operators who undercut their businesses.

Human Rights

The FLEGT licensing scheme is consistent with the Human Rights Act 1998.

Rural Proofing

The FLEGT licensing scheme will not have any impact on the rural community in the UK, although rural businesses in VPA countries will benefit from the wider reform process of which the FLEGT licensing scheme plays a part.

Annex 2: Note on costs which remain difficult to quantify

Transaction costs at point of import into the EU

The FLEGT Regulation involves a control at the Community (therefore including the UK) border, but we are working with Customs authorities to ensure that any administration costs that might accrue as a result of delays, due to any enforcement or compliance checks, are minimised.

Costs of Trade Diversion

There is the potential for trade diversion away from the UK into other EU countries if legislation is not applied equally within the EU. This point was made strongly by the trade associations and companies interviewed for the impact assessment prepared for the UK Government consultation on the proposed timber Due Diligence Regulation¹⁹. Provided that there are no differences in the application of the Regulation throughout the EU, then limited trade diversion is anticipated. To mitigate the risk of such trade diversion, we are working with our counterparts in other Member States to attempt to ensure the even enforcement of the FLEGT licensing scheme across the EU.

If the Regulation is unevenly applied, however, with specific EU Member States seen as 'soft', then it is quite possible that timber and timber products from FLEGT VPA countries will arrive in UK via other EU Member States without the necessary FLEGT licence (with a caveat that this is mitigated somewhat through associated increased transport costs), with two key implications:

- An impact on UK agents and importers as UK customers may seek to purchase cheaper products (due to a lack of checks or verification work at the border) elsewhere in the EU.
- UK exports of manufactured goods may also be affected by trade diversion through other EU ports, because there is a risk that countries with less robust enforcement of the FLEGT licensing scheme will carry out value added manufacturing at a reduced cost, thereby providing competition to UK companies.

Tropical hardwood products and manufactured products will probably be affected most by these eventualities, but we do not expect these impacts to be large for the UK, because the effort necessary to comply with the FLEGT Regulation, and the associated costs of doing so, have been demonstrated to be relatively low through this Impact Assessment.

¹⁹ <http://www.defra.gov.uk/corporate/consult/ddr/index.htm>

