

Regulation Impact Statement

This Regulation Impact Statement (Reference 9816) has been approved by the Office of Best Practice Regulation.

Addendum to the Regulation Impact Statement on the Australian Government policy on illegal logging.

Introduction

A Regulation Impact Statement (RIS) on the government's illegal logging policy was finalised on 7 May 2010 and publically released on 9 December 2010. On the basis of the matters considered in this RIS, it was recommended that the government utilise a due diligence co-regulation approach for identifying illegally logged timber and restricting its importation into Australia.

This Addendum describes how the government's policy has evolved since the date of completion and finalisation of the RIS, to incorporate a number of recommendations arising from a Senate Inquiry and stakeholder feedback.

Draft Bill

Following the release of the RIS, the Illegal Logging Prohibition Bill 2011 was drafted based on a co-regulation approach—option two of the RIS—and the government's policy announcement. The draft Bill included a prohibition on regulated timber products and legal logging requirements, comprising of industry codes of conduct and risk management with underlying due diligence principles.

Senate inquiry

On 23 March 2011, the Minister for Agriculture, Fisheries and Forestry Senator the Hon. Joe Ludwig referred an exposure draft and explanatory memorandum of the Illegal Logging Prohibition Bill 2011 to the Senate Committee on Rural Affairs and Transport (the Committee) for public inquiry. Approximately 30 submissions were made to the inquiry along with a public hearing on 16 May 2011 which further informed the Committee. The Committee released a report on 23 June 2011 that included seven recommendations (Appendix 5) and a dissenting report from the Australian Greens (Appendix 6). The recommendations included:

1. The committee recommends the Government consider alternatives to provisions for timber industry certifiers and the certifier requirements in relation to them from those listed in the bill.
2. The committee recommends that importers provide a mandatory and explicit declaration of legality of product at the border and that such a requirement be incorporated into the bill.
3. The committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that the declaration requirements are consistent, to the fullest extent possible, with those in the US Lacey Act and European Union Timber Regulation and others that meet a similar standard.
4. The committee recommends that the Department of Agriculture, Fisheries and Forestry in consultation with the Australian Customs and Border Protection Service adapt the current Customs declaration to incorporate the bill's declaration requirements.

Australian Government Policy on Illegal Logging

5. The committee recommends that the Department of Agriculture, Fisheries and Forestry give consideration to providing visibility to the declaration process and that transparency is assured by way of:
 - A requirement that the importer regularly publish, or provide publication of, the declarations in a publicly accessible form;
 - A requirement that at a minimum, an annual audit of the importer be undertaken to determine the legality of their timber;
 - A requirement that the importer publishes, or provides for publication, a report outcome of the audit; and
 - A requirement on the part of the Commonwealth Government to undertake random audits of the importer declarations, and where warranted (based on risk assessment) undertake further investigation of the supply chain from forest to importer.
6. The committee recommends that regulations prescribe that importers and processors should demonstrate due diligence under one of the following:
 - a) an internationally recognised third-party certification scheme, or
 - b) an individual country initiative, or
 - c) have in place a management system to ensure legal compliance.
7. The committee recommends that the Department of Agriculture, Fisheries and Forestry conduct a review of the bill's provisions five years after enactment. The committee recommends that consideration be given in the five-year review to further periodic reviews.

Government response

The government reviewed the Committee recommendations and stakeholder feedback and provided a formal government response. This will be made available through the Australian Parliament House and the Department of Agriculture, Fisheries and Forestry's (the department) websites. The government's approach for restricting the importation of illegally logged timber into Australia remains consistent with option 2, recommended by the RIS. The two key regulatory elements from option 2 still apply under the government's current policy, that is (i) a prohibition on illegally logged timber and wood products (with an additional prohibition on the processing of illegally logged raw logs) and (ii) a requirement for industry to carry out due diligence to mitigate the risk of importing illegal logged timber into Australia. Industry will retain its role in the development of due diligence requirements—to be prescribed in subordinate legislation—to provide flexibility in how these requirements are applied to reduce compliance and administration costs.

Revisions to the Bill based on recommendations of the Senate inquiry

Industry codes of conduct and timber industry certifiers were viewed by the Senate Committee as an unnecessary layer of bureaucracy that would impose additional costs and administrative requirements on industry. Based on this view, codes of conduct and timber industry certifiers were removed, however the underlying principles of due diligence, outlined in option 2, remain in the current policy. Key changes to the Illegal Logging Prohibition Bill 2011 reflects the government's response to the report's recommendations, including:

- Prohibition on the importation of all illegally harvested timber and wood products to be introduced on commencement of the legislation;
- Prohibition on processing illegally logged raw logs to be introduced on commencement of the legislation;

Australian Government Policy on Illegal Logging

- Removal of timber industry certifiers, codes of conduct and related industry certifier and Ministerial approvals processes;
- Legal logging requirements to be replaced with due diligence requirements for the importation of regulated timber products and processing of domestically grown raw logs, the manner and form of which is to be prescribed in regulations;
- An explicit and mandatory declaration at the border for imports of regulated timber products, similar to the US Lacey Act requirement;
- New reporting and publishing requirements; and
- Broadening of the offences to include non-compliance with due diligence requirements and increased penalties to ensure compliance of importers and processors in the absence of timber industry certifier and ministerial approval processes that would have provided additional levels of intervention to ensure compliance.

The above revisions have been developed in consultation with key stakeholders through a series of meetings with members of an Illegal Logging Working Group comprising a representative cross section of private businesses, industry association and non-government stakeholders. The department has also held numerous one-on-one meetings with other industry associations, businesses, conservation and social justice groups.

Australian Government policy on illegally logged timber

This Regulation Impact Statement (RIS) assesses the costs and benefits of viable regulatory and non-regulatory policy options to give effect to the government's election commitment for restricting imports of illegally logged timber.¹ Five measures were identified in the election commitment to encourage the sourcing of timber products from sustainable forest practices and to seek to ban the sale of illegally logged timber products:

1. Build capacity within regional governments to prevent illegal harvesting;
2. Develop and support certification schemes for timber and timber products sold in Australia;
3. Identify illegally logged timber and restrict its import into Australia;
4. Require disclosure at point of sale of species, country of origin² and any certification; and
5. Argue that market-based incentives aimed at reducing emissions from deforestation and forest degradation should be included in a future international climate change agreement.

Whilst the above suite of measures represents the government's overall policy response to the issue of illegal logging, the RIS focuses on measures 3 and 4 which involve potential regulation. The effectiveness and cost of any regulatory approach proposed will be dependent on its consistency with measures taken by consumer and producer countries to promote trade in legally logged timber and the capacity of timber suppliers to meet the proposed regulatory requirements. Government

¹ Securing the Future of Tasmania's Forest Industry (2007).

² Country of origin in this context refers to 'country of harvest'.

Australian Government Policy on Illegal Logging

investment in capacity building and bilateral and multilateral engagement, therefore, will be an integral part of each option available to the government.

Recommended policy response

On the basis of the matters considered in this RIS, it is recommended that the government utilise a due diligence (co-regulation) approach for identifying illegally logged timber and restricting its importation into Australia. The co-regulation option would include targeted investment in capacity building and maintaining Australia's bilateral and multilateral engagement with other countries in the Asia-Pacific region. This conclusion is supported by the findings of the cost-benefit analysis and a consideration of the intangible costs and benefits and potential effectiveness of the policy options available to the government.

1. Assessing the problem

For many years illegal logging has been recognised as a significant global problem³. Stakeholders have repeatedly called for effective national and global action to mitigate the social, economic and environmental impacts of illegal logging⁴. Globally, the issue of illegal logging in developing countries is now considered critical as the significance of its impacts on forest degradation, climate change, habitat loss and community livelihoods are becoming more widely recognised and better understood.

In Australia, domestic timber harvesting is controlled through a comprehensive framework of laws, regulations and policies⁵. However, in relation to the control of imported timber, where a regulation exists, e.g. under the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) management, only a limited number of timber products would need to comply and therefore indirectly meet the government's election commitment to restrict illegally logged timber imports. Under this arrangement, timber continues to be imported into Australia without any requirement for verifying its legality, other than through voluntary industry measures.

Illegal imports, often trade at lower prices, create unfair competition for Australian producers and suppliers who source their products from legally and sustainably managed forests. As a consequence domestic market prices are undercut, impacting on business decisions, industry investment, business profitability and jobs.

The ongoing deforestation and degradation of tropical forests in the Asia Pacific region through illegal logging represents a threat to Australia achieving its goal of promoting sustainable forest management and sustainable livelihoods for forest-dependent communities in countries of this region.

Defining illegal logging and associated trade

³ Chatham House (2009).

⁴ Joint Statement on illegal logging (2009) by industry and NGOs.

⁵ URS Forestry (2009).

Australian Government Policy on Illegal Logging

Illegal logging and associated trade is traditionally defined within a ‘criminal’ context. In developing this policy the Australian Government considered illegal logging⁶ as occurring when:

- Timber is stolen
- Timber is harvested without the required approvals or in breach of a harvesting licence or law
- Timber is bought, sold, exported or imported and processed in breach of law, and/or
- Timber is harvested or trade is authorised through corrupt practices.

The lack of rigorous legality and forest certification schemes and lack of technical capacity for producers and suppliers to implement them contributes to the problem of illegal logging. Yet, if the market requires legality verification, companies may change their practices and develop appropriate systems to demonstrate compliance with the forestry laws in the individual countries of harvest.

Importantly though, not all illegal logging involves criminal intent. Illegal logging may also occur at a technical level where those harvesting timber may breach logging codes of practice or where there are disputes over land tenure. For example, it might be claimed that illegal logging arises where there is no clear land tenure arrangements in place. Illegal logging may therefore be a product of technical limitations, noting that there have been recent efforts within producer countries to address this problem.

It is generally acknowledged that, as the forestry laws in developing countries are sufficiently robust to stop illegal logging if they were adequately enforced⁷, it is not the legal framework that is the problem. A lack of capacity of governments to enforce those laws or to monitor compliance with the regulatory regimes applying to forestry has subsequently led to consumer countries taking action to address the illegal logging problem.

A critical opportunity exists for governments and industry to reduce the extent of illegal logging by encouraging the use of forest certification and legality verification schemes (or similar procedures) by industry to demonstrate that the timber is logged in compliance with the relevant laws of the country of harvest, and for government to ensure that their laws and regulations are properly enforced.

International context for action

National governments and international organisations have made considerable recent investments in combating illegal logging and associated trade. However, progress has been slow. For example, agreement was reached only in 2009 on a licensing scheme for the export of legal and sustainably produced timber to the European Union (EU) under a bilateral voluntary partnership agreement between the EU and Indonesia. Negotiations with respect to this agreement commenced in 2003⁸.

⁶ Definition of legality in *Securing the Future of Tasmania’s Forest Industry* (2007).

⁷ Auer et al (2006); Reeve (2007).

⁸ EU Forest Law Enforcement, Governance and Trade Action Plan (2003).

Australian Government Policy on Illegal Logging

At a multilateral level, governments have achieved only limited success in attempting to reach agreement on processes for combating illegal logging and associated trade⁹. Significant recent advances, however, have been made through a more focussed approach involving bilateral cooperation between countries. This approach has been employed by the United States (US) and EU, in particular, which have developed policies and regulations aimed directly at combating illegal logging and associated trade.

Under the 2008 United States Lacey Act Amendments, it is unlawful to import certain timber products into the US without an import declaration or to import these products in contravention of the laws of the country where the timber was harvested. The Council of the EU is currently developing a new regulation aimed at minimising the risk of placing illegally harvested timber into that market. A due diligence¹⁰ regulation is being developed to enable operators to manage the risk of sourcing illegal timber. A key element of both these approaches is their focus on capacity building in developing countries to support their direct domestic policy measures.

Many key producer countries, including Indonesia and Papua New Guinea, are also developing legality verification, chain of custody and forest certification schemes in response to direct pressures from consumer countries to demonstrate the legality of their timber products¹¹.

Complementary regulatory and non-regulatory measures have now reached a point of development where a new international policy environment has been established. These efforts create an environment which enables individual nations, such as Australia, to more effectively combat illegal logging and associated trade by establishing domestic policy settings to allow a differentiation of legally and illegally-sourced timber products. The effectiveness and costs of these domestic policy settings will be strongly influenced by the government's commensurate investment in regional capacity building and bilateral and multilateral engagement.

Global extent and cost of illegal logging

It is important to recognise the level of uncertainty involved in deriving robust estimates of the global extent and cost of illegal logging. Limited transparency of regulatory environments in producer countries, coupled with imprecise export and import trade statistics make current methodologies unreliable¹². The small number of estimates regarding the extent and cost of illegal logging commonly quoted in the literature are out-of date and do not take into account recent developments in consumer and producer countries to reduce the extent of illegal logging and associated trade.

⁹ East-Asia Pacific Forest Law Enforcement and Governance initiative; Resolution 16 of the UN Commission on Crime Prevention and Criminal Justice, UN Forum on Forests Non Legally Binding Instrument.

¹⁰ Due diligence will require operators (timber importers and domestic producers within the EU) to determine the risks their timber product and log purchases, respectively, have been obtained from illegally-harvested sources and to put in place systems for verifying the legal origins of those products commensurate with the identified risks.

¹¹ FLEGT Briefing Note Number 08 Market participant based legality and FLEGT licensing.

¹² Poyry (2010). Legal Forest Products Assurance - a risk assessment framework for assessing the legality of timber and wood products imported into Australia.

Australian Government Policy on Illegal Logging

Financial costs of illegal logging

Multiple business costs have been described for illegal logging. Studies used by the Centre for International Economics (CIE) estimated that between 20 – 80 per cent of timber was illegally sourced in high risk countries¹³. Seneca Creek and Associates (2004) estimated that illegal logging undercuts global prices for legally produced timber by between 7 to 16 per cent.

The World Bank (2006) estimates financial losses to the global market from illegal logging of more than US\$10 billion a year and losses of government revenues of about US\$5 billion a year. These figures are based on undeclared values and may therefore represent a significant under-estimation of the global cost of illegal logging. They equal only 1.5 per cent of global timber production. The CIE, in their assessment of the global problem, assumed that illegal logging and trade in illegally logged timber was 10 percent of the respective totals of total timber production and global timber products trade. That is, world trade in illegally logged timber products is valued at US\$15 billion per annum.

The CIE estimated that traded and non-traded output from those sectors of the global industry dependent on illegally-sourced timber as being worth US\$91 billion per annum, or 6% of total industry output. This estimate was derived on the basis of global efforts being effective in stopping illegal logging.

Production costs associated with the supply of wood derived from illegal logging operations are far cheaper than those for legal logging because many of the cost components are not paid. Illegal loggers might only pay the cost of harvesting and transportation, without internalising the costs of legal and sustainable activities. These avoided costs include the costs associated with forest management planning, environmental protection and silvicultural treatment, combined with the reduced investment by industry in the delivery of social infrastructure.

In an analysis of the trade impact of the Voluntary Partnership Agreement for Indonesia, the costs of legal log production were estimated at between US\$63-76 per cubic metre compared to illegal log production costs of between US\$19-29 per cubic metre¹⁴.

The financial impacts of illegal logging alone, however, do not provide a complete picture of all the costs associated with illegal logging. They do not include environmental, social or intangible impacts.

¹³ The CIE (2010). Final report to inform a Regulation Impact Statement for the proposed new policy on illegally logged timber (Chapter 2); provided as an attachment to the final RIS.

¹⁴ EU (2008). Analysis of the trade impact of the VPA for Indonesia.

Australian Government Policy on Illegal Logging

Social and environmental costs

The CIE estimated the social and environmental costs of illegal logging from various studies and their own analysis to be around US\$60.5 billion per annum.

Estimates of social and environmental costs of illegal logging

<i>Source</i>	<i>Estimate</i>
	\$ billion a year
Social costs	
Loss of non-wood forest products	<1
Wasted resources	7.5
Displacement of forest communities	<1
Environmental costs	
Greenhouse gas emissions	43.0
Loss of ecosystem services (biodiversity)	4.5
Soil and water degradation	5.0
Total non-market costs	60.5

Source: The CIE

These costs are based on FAO and World Bank estimates, whilst the cost of annual greenhouse gas emissions caused by illegal logging is based on estimates of global emissions prepared by the CIE. However, the assessment of social costs by the CIE is likely to be substantially underestimated as only a one-off relocation cost for individuals displaced by illegal logging was included (see Chapter 3 and Appendix C of the CIE report for details).

Further assessment of the social impacts of illegal logging indicated a much wider range of social costs of illegal logging and therefore potentially greater benefits from stopping it¹⁵. For example, fees and other benefits associated with legal and sustainable logging, which would normally be returned to the community in various forms of social benefits beyond some arbitrary payments for harvested timber, are foregone due to illegal logging. These include government taxes and charges which may be transferred to forest-dependent communities, the delivery of government services, and the social services provided directly to communities by legal logging companies, such as roads, education and health services, as part of their logging agreements¹⁶. The figure presented in Attachment 1 describes the multiple social impacts of illegal logging.

Intangible costs

Illegal logging imposes a number of intangible costs on forest-dependent communities in developing countries. Intangible values impacted by illegal logging include a reduction in the standard of living, erosion of sustainable livelihoods, destruction of customary, spiritual and heritage values of forest dependent communities, human rights abuses, use and exploitation of illegal foreign workers, and reduction in the quality of the forest environment, including contamination of food and water

¹⁵ Coakes (2010) A review of the social costs of illegal logging.

¹⁶ *Ibid.*

Australian Government Policy on Illegal Logging

sources¹⁷. These intangible costs extend to the citizens of consumer countries such as Australia, who place an immeasurable value on the existence of forests and the sustainable use of those resources. Stopping illegal logging, therefore, will have potentially significant intangible benefits.

In their cost-benefit analysis, the CIE did not include an assessment of the intangible costs or benefits. They were of the view that intangible benefits would not be large enough to alter the cost-benefit outcome of domestic action to address illegal logging¹⁸. Concerns with this approach were noted in the stakeholder comments on the draft RIS and identified as a major deficiency in the CIE analysis (Chapter 5). These concerns have been addressed in Chapter 5 of this final RIS.

Australia's share of the problem

Australia imports approximately A\$4.4 billion (US\$3.75 billion) of timber and wood products (excluding furniture) annually. Australia's proportion of illegally sourced timber products has been estimated at 9 per cent of total imports or around A\$400 million¹⁹ (US\$340 million). This is equivalent to 0.034 per cent of global production. On this basis, and as many processing mills supply their manufactured products for domestic consumption and exporting to other countries, the illegal logging problem for consumer countries such as Australia extends beyond the impacts associated with just the traded products. **Australia's share of the problem is therefore estimated at US\$21 million per annum** (0.034% of US\$60.5 billion).

2. Objective of current and future government action

Since 2007 government (and industry) action on combating illegal logging has been guided by the five elements of the election commitment. This commitment provides a framework to support an assessment of the regulatory options for identifying illegally-logged timber products and restricting their imports into Australia. Where possible, any new approach will seek to build on existing industry initiatives.

The Australian Government's current approach

The Australian Government currently addresses the issue of illegal logging in other countries through non-regulatory measures, including capacity building and bilateral and multilateral engagement. The following provides a brief summary of Australia's activity in these areas.

Capacity building

The Asia Pacific Forestry Skills and Capacity Building Program provides institutional and technical support for developing countries to combat illegal logging and to promote better management of their forests. Areas of support include improving and strengthening forest law enforcement and governance, forest industry practices,

¹⁷ Australian Conservation Foundation (2006). *Bulldozing Progress: Human Rights Abuses and Corruption in PNG's Large Scale Logging Industry*.

¹⁸ The CIE (2010). *Final report to inform a Regulation Impact Statement for the proposed new policy on illegally logged timber* (Chapter 6).

¹⁹ Poyry (2010) *Legal Forest Products Assurance - a risk assessment framework for assessing the legality of timber and wood products imported into Australia*.

Australian Government Policy on Illegal Logging

logging codes of practice compliance, legality verification and certification, and forest industry training²⁰.

Bilateral cooperation

Australia has signed bilateral agreements with China, Indonesia and PNG which include cooperation arrangements for combating illegal logging and promoting sustainable forest management. The government is seeking to strengthen the current level of cooperation with Indonesia on combating illegal logging, has arrangements in place to work with Malaysia in this policy area and is engaged in discussions to formalise cooperation with Vietnam and New Zealand on similar issues²¹.

Multilateral engagement

Australia is a signatory to a large number of multilateral agreements and processes that include forest-related objectives and a focus on illegal logging, including the United Nations Forum on Forests, the Asia Pacific Forestry Commission of the Food and Agriculture Organization, and the International Tropical Timber Organization²². Effective measures for combating illegal logging also have strong implications for efforts to address climate change. The government is a strong advocate of reducing emissions from deforestation and forest degradation in developing countries (REDD). A key objective of Australia's International Forest Carbon Initiative is to demonstrate that REDD can be an equitable and effective part of a global agreement on climate change. This includes supporting partnerships to establish national policies and systems that underpin credible emission reduction from deforestation and forest degradation in developing countries.

Industry's approach

Under the existing policy of self-regulation, there is no national approach or consistent use of measures that provide industry-wide assurance of legality for timber products imported or sold in Australia. Only a small number of businesses and industry associations have implemented legality assurance measures²³. Some parts of industry may feel that the costs of any action by the government would be prohibitive whilst generating negligible benefits and therefore, the government should do nothing.

Industry is uncertain as to what constitutes an adequate level of legality verification for timber products and is concerned that not all business enterprises undertake equivalent levels of legality verification. Industry is concerned that some businesses undertake no legality verification of their products (free-riders) and may obtain an unfair market advantage from sourcing cheap, potentially illegal, timber as well as the impacts that illegally-sourced timber products can have on market prices. This provides an economic benefit over companies which seek to ensure the legality of their products, thereby creating distortions in the market place.

²⁰http://www.daff.gov.au/forestry/international/asia_pacific_forestry_skills_and_capacity_building_program.

²¹ <http://www.daff.gov.au/forestry/international/regional>.

²² <http://www.daff.gov.au/forestry/international/fora>.

²³ Australian Plantation Products and Paper Industry Council Code of Conduct, Australian Timber Importers Federation Code of Ethics, World Wide Fund for nature Australian Forest Trade Network and Bunnings Ltd Procurement Policy.

Australian Government Policy on Illegal Logging

Any consideration of future government action needs to take into account these existing industry efforts and the capacity for buyers to verify the legal origins of timber products. Industry self-regulation using voluntary measures is implemented through a mix of guidelines, codes of conduct and procurement policies for the purchase and sale of legally sourced timber. However, there is limited independent auditing or monitoring of performance against those scheme and system requirements²⁴. The effectiveness of these current measures in excluding imports of illegal timber is difficult to determine.

Legality of Australia's domestic timber products

The national policy framework surrounding Australia's forest and timber industry is provided by the *Environmental Protection and Biodiversity Conservation Act* (1999), the *Regional Forest Agreements Act* (2002), and the *National Forest Policy Statement* (1992). This national policy framework is underpinned by relevant legislation in the States and Territories. Each State and Territory has responsibility for defining and regulating legal timber harvesting within their jurisdictions.²⁵ Compliance with these forestry laws would ensure that domestic timber products are derived from legally-harvested sources.

Voluntary forest certification standards, such as those of the Forest Stewardship Council or Australian Forestry Certification Scheme, can be used to provide an assurance that domestic timber is legally (and sustainably) produced. Under these arrangements, approximately 90 per cent of timber produced in Australia is sourced from certified forests. The remaining 10 percent of timber product that is not certified comes from wood supplied by small forest growers who are, nevertheless, required to comply with the relevant state and territory regulations for growing and harvesting wood.

Future government action

The Australian Government's policy objective is *to combat illegal logging and associated trade by establishing systems that will promote trade in legally logged timber and, in the long term, trade in timber and wood products from sustainably managed forests.*

The government is seeking to meet this objective by identifying illegally logged timber and restricting its import into Australia and requiring disclosure of species, country of harvest and any certification at the point of sale. Any regulation to identify and restrict the importation of illegal timber into Australia would similarly apply to domestic industry. The objective distils the multiple elements described in the election commitment for what would be defined as illegally sourced timber. To provide a workable definition that can be assessed using legality verification systems, it is proposed that legally sourced timber products are defined as those where timber suppliers have:

- Right of access to the forest;
- Complied with the legal right to harvest; and
- Paid all taxes and royalties.

²⁴ Timber Development Association (2010). A generic code of conduct to support procurement of legally logged wood based forest products.

²⁵ URS Forestry (2009).

Australian Government Policy on Illegal Logging

Establishing a framework for promoting trade in legally logged timber is an important step towards achieving the government's ultimate goal of promoting trade in timber and wood products from sustainably managed forests. The illegal logging policy objective provides a further demonstration of the government's commitment to the principles of environmental protection and sustainable forest management.

3. Options that may achieve the objective

The regulatory options analysed in the RIS are aimed at changing the behaviour of timber producers by directly limiting opportunities for the production and trade of illegal timber. In the absence of any multilateral agreement in this area, utilising the available processes for legality verification and forest certification provides an enabling environment which will allow producers to benefit from being part of the legal timber market.

The preferred option of the RIS should complement the government's broader suite of non-regulatory measures outlined in its election commitment. The capacity building costs required for the government to achieve its policy objective will be determined by the nature of each regulatory option and the capacity of producers to comply with the proposed domestic regulatory approaches. For this reason, the non-regulatory elements need to be considered alongside the costs and benefits of each regulatory option. In assessing the implementation requirements of each of these options, it is apparent that the more demanding the compliance requirements of an option, the larger the costs of capacity building for the Australian Government.

The total costs and effectiveness of the government's overall policy response will be determined by the combination of the regulatory and non regulatory measures to meet the government policy objective. A detailed description of the regulatory and non-regulatory options available to the government can be found in chapter three of the CIE final report. The following clauses add to those descriptions, noting that the government has capacity to select or phase-in the range of products covered in each option.

Option 1 - Quasi-regulation - codes of conduct enforced by industry

Under quasi-regulation, industry would be responsible for managing compliance and enforcement of codes of conduct for undertaking adequate due diligence to verify the legal origins of the timber products they sell. This would remain a voluntary arrangement for industry to manage. A generic code of conduct for completing adequate due diligence has been recently developed (with funding from the government) and made available to industry.

Industry has shown no willingness to utilise the generic code (unless it is forced to do so by the government) as a means of demonstrating that timber products are sourced from legally-harvested forests or to substantiate that efforts are being made to identify and restrict imports of illegally-logged timber products. On that basis, implementing quasi-regulation on its own is not likely to achieve the government's policy objective for promoting trade in legally-logged timber products.

To fulfill its policy objective, the government would be heavily reliant on the non-regulatory elements of the policy. That is, bilateral cooperation with other countries, promoting a consistent approach to legality verification through the existing

Australian Government Policy on Illegal Logging

multilateral forestry forums and investing in capacity building in producer countries to support the credible legal verification of timber products. Estimates in Appendix 2 indicate a cost to government for the capacity building element of \$270 million over 5 years. The estimates were based on costs of helping other countries in the Asia-Pacific region to introduce effective legality verification systems and then determining Australia's share of those costs as a proportion of the volume of timber products imported into Australia.

Option 1 was recommended by the Centre for International Economics (although they did not provide any costing of the capacity building element for this option). Option 1 would only meet the policy objective if other governments similarly contributed on a proportional basis to the substantive capacity building requirements for verifying the legal origins of timber products.

Option 2 - Co-regulation using a prohibition element and a requirement for due diligence

Option 2 would contain two regulatory elements – a prohibition on illegal timber imports and a requirement for companies or other organisations placing timber on the market in Australia to be signatories to Commonwealth-accredited codes of conduct for undertaking due diligence in verifying the legal origins of timber products. For the prohibition on illegal timber imports, it would be an offence to import timber products into Australia that have been derived from illegally-harvested forests. Offences and penalties already exist under State and Territory legislation for illegally harvesting wood within Australia.

The due diligence requirement would apply to the first point of entry for timber products onto the market in Australia. That is, the importers of timber products and timber mills processing domestically-grown wood. Industry would develop their codes of conduct in response to new legislation defining the due diligence requirements. Those codes would be accredited by the Commonwealth. To gain accreditation, codes would be administered by industry-run code administration bodies which would require individual signatories to have their due diligence systems assessed by third-party independent auditors each year and for those audit reports (and their recommendations) to be provided to the code administration body.

Each code administration body would need to establish processes for dealing with non-conformance by their signatories and for addressing complaints raised about the activities of signatories. These bodies would present an annual report to the Commonwealth for assessment in order to retain accreditation of their respective codes. Once the codes of conduct are accredited, companies could undergo pre-audits to determine if their due diligence systems meet the requirements of the code. Companies that obtain signatory status would need to conform to each code administration body's requirements in order to retain their signatory status, which will be required to place those timber products covered by the policy onto the market in Australia.

As part of the code requirements, signatories would need to provide information on the species, country of harvest and any certification in their annual compliance reports. This essentially addresses the fourth element of the illegal logging election commitment. It will incur a small additional cost for industry, which will have to

Australian Government Policy on Illegal Logging

provide new information that is not currently required within existing forest certification and chain-of-custody schemes. The election commitment proposed that this information be provided at the point of sale. However, preliminary consideration of this matter indicates that it would be costly for the final sellers to comply with this point of disclosure requirement. Enforcement of the disclosure requirement by government at point of sale would require working with a large set of stakeholders in addition to the group required to fulfill the due diligence obligation. It is therefore proposed that this information is disclosed at the first point of entry onto the Australian market.

Overseas capacity building would be required to support compliance with any new requirements proposed by Australia and to ensure that developing countries, in particular, are in a position to meet those requirements. This is consistent with the election commitment to ‘build capacity within regional governments to prevent illegal harvesting’. It would be based on addressing critical gaps in producer countries for supporting the legality verification processes. For example, assisting with training of compliance auditing for logging codes of practice, verifying that sustainable yield harvest volumes are not being exceeded and improving the traceability of financial transactions and the harvested wood (or other forest products) from forests right through to the point of export. Further capacity building support may be required where forest dependent communities shift their income dependence from illegal to legal forest operations.

Domestic capacity building might include support for developing industry codes of conduct for legality verification. Under this approach, the government may register a trademark for use by code signatories to demonstrate their conformance with the due diligence requirements as accredited code signatories.

This option allows both producers and suppliers to seek out cost-effective means of formalising their existing or new arrangements for legality verification in order to achieve compliance with the code requirements. These efforts would be guided by the requirements for supplying other markets, such as the US and EU, and be assisted by the development of credible legality verification systems in some producer countries.

It is proposed that the Category III timber products (defined in [Appendix 1](#)) would be covered by the prohibition and due diligence elements of the policy. The prohibition element of the policy would become effective immediately on the enactment of legislation. Industry could be given a period of up to 2 years to comply with the due diligence requirement (the EU will give industry a period of 2 years to establish the necessary systems for meeting the due diligence requirements once that regulation has been agreed by the European Parliament).

Review elements of the policy necessary to meet the government’s policy objective would include consideration of the range of timber products that are covered and the possible timing of a shift from a legality requirement to one based on sustainability.

Australian Government Policy on Illegal Logging

Option 3 - Explicit regulation requiring a minimum standard for legality verification

Under explicit regulation, the government's approach would be to:

- Create an offence for importing or supplying illegal logged timber products in Australia;
- Specify a minimum standard of legality verification with Commonwealth accreditation of acceptable schemes; and
- Establish a separate system for disclosure of species, country of harvest and any certification of imported and domestic timber products.

The coverage of timber products (from Categories I to III as described in Appendix 1) and a minimum standard of legality verification could both be phased in. The standards of legality verification could change from the less onerous SDL²⁶ to VLO, VLC and full certification over time.

Under this option, it would be an offence to place timber products on the market in Australia that were illegally logged and/or did not meet the specified standard of legality verification. The minimum size of businesses required to comply with such a regulatory approach could be based on the value and/or volume of products they trade in order to avoid unintended economic consequences for small businesses.

The Commonwealth would be required to assess and accredit the systems of legal verification available to industry. There are over 21 such schemes already used by industry in the Asia-Pacific region alone. Accreditation of these schemes would be complex and expensive. This approach would represent action by Australia that was not consistent with the approaches being adopted by major consumer countries and may create sensitivities among Australia's trading partners. As part of the enforcement component of the policy, the Commonwealth would need to assess company compliance with the requirements of the standard to ensure that only those meeting the legality verification requirements retain their right to place timber products on the market in Australia.

Substantive capacity building assistance would be required to establish the systems underpinning legality verification and forest certification in producer countries, in order for their suppliers to meet the requirements for entry onto the Australian market. Domestic capacity building investment would also be required to help Australian producers (particularly small-scale growers) meet the rigorous compliance requirements of this explicit regulatory approach.

The existing systems of legal verification do not include information on species or the country of harvest. An additional compliance system would therefore need to be established for monitoring conformance with disclosure element of the policy.

²⁶ The CIE described four levels of legality verification – SDL (self-declared legal), VLO (verification of legal origin), VLC (verification of legal compliance) and FC (full certification).

Australian Government Policy on Illegal Logging

4. Impact analysis – costs, benefits and risks

Assessments of the costs and benefits of the potential regulatory options were initially undertaken by the CIE²⁷ using:

- CIE assumptions for estimating compliance costs for developed countries, developing countries and Australia;
- Four levels of legality verification – SDL, VLO, VLC and FC; and
- The timber products to be covered by the policy options falling into three groups:
 - Category I solid timber and wood products and some paper products (12% of Australia’s timber imports),
 - Category II partially processed/processed timber and wood products plus category I products (39% of Australia’s timber imports), and
 - Category III highly processed/composite timber and wood products from multiple sources plus category II products (70% of Australia’s timber imports).

More detail on the products covered in each of the three categories is provided in Appendix 1. The remaining 30 percent of Australia’s timber imports not included in Category III are those products where the timber pieces are small in volume or are minor components, making them difficult to identify and therefore regulate. These might include some furniture products with wood components, small consignments of decorative wood or complex composite products. It should also be noted that the US has delayed requirements for compliance with their import declarations on complex composite products due to the difficulties with verifying the multiple sources of wood inputs²⁸.

Modelling approaches

A GTAP model²⁹ was initially used by the CIE to analyse the costs and benefits to the world and the Australian economy of stopping illegal logging. The CIE modelling captured the effects of the actions taken in the form of supply shocks introduced as ‘export taxes’ in producer countries or increased production costs for Australian suppliers.

This analysis was supplemented with additional modelling undertaken by ABARE using GTEM model³⁰. Differences between the CIE and ABARE analytical approaches and the assumptions used for the assessment of costs and benefits revealed major differences in the economic outcomes for Australia from combating illegal logging.

²⁷ Details of the CIE analysis can be found in Chapters 4 and 5 of the CIE final report.

²⁸ One year delay (on or after September 1, 2010) in the enforcement of import declaration requirements for certain composite products by the US Department of Agriculture. Federal Register Vol 74, No. 169, September 2 2009.

²⁹ Global Trade Analysis Project.

³⁰ General Trade Equilibrium Model.

Australian Government Policy on Illegal Logging

The assumptions employed by the CIE are described in their report. Assumptions underlying the additional ABARE analysis are described in Appendix 1. Compliance cost estimates used in the ABARE analysis were derived from overseas studies by ITTO (2004), EU (2008) and *Cabbage et al.* (2009)³¹.

Costs and benefits to the global economy from stopping illegal logging

The CIE estimated that stopping illegal logging would benefit legal producers by US\$46 billion per annum in addition to providing social and environmental benefits of US\$60.5 billion per annum. These total benefits of US\$106.5 billion per annum would be off-set by a decline in the illegal sector of US\$91 billion per annum. From these results, the CIE indicated a benefit: cost ratio of 1.2:1 (106.5/91) from global action to stop illegal logging. In effect, it demonstrates a global benefit from eliminating illegal logging.

However, when using the GTEM and the same assumptions as those employed by the CIE, ABARE found that at equilibrium, the legal forestry sector's output would increase by US\$33.7 billion per annum at the new equilibrium with a decline for the illegal sector of US\$34.5 billion per annum. After taking into account this small global decline in GDP and the net global economic, social and environmental benefits from eliminating illegal logging, there would be a net global benefit from stopping illegal logging of approximately US\$60.5 billion per annum after the industry adjusts and restructures itself following the initial shock of shifting to only legally-sourced timber. Global benefits would be US\$101.3 against the economic losses of US\$34.5 billion per annum.

The status quo

In assessing the costs and benefits of the different regulatory options, the Office of Best Practice Regulation (OBPR) requires an assessment of the costs and benefits of each option, using the status quo as a benchmark for comparison. On the basis that an estimated 10 per cent of Australia's timber imports are suspected as being derived from illegally-logged sources, the CIE concluded that voluntary arrangements were therefore 90 per cent effective. No estimate was provided by the CIE of the cost to industry for the existing systems of voluntary self-regulation. Without industry self-regulation, the CIE proposed that illegal imports might account for 20 per cent of Australia's total imports.

In terms of the costs to government at present for activities associated with combating illegal logging, there would be approximately US\$5 million per annum being delivered through capacity building, bilateral cooperation and multilateral engagement, and the on-going policy work of the Department of Agriculture, Fisheries and Forestry (DAFF).

³¹ An additional report from ABARE is available which addresses the department's concerns with CIE compliance cost estimates, which were confirmed by the EU in their submission on the draft RIS. An example of the uncertainty arising from the GTAP modelling results was the scale of the impacts for China from global action to eliminate illegal logging. GTAP estimated the costs at US\$31 billion per annum or 2% of that country's GDP – the global financial crisis did not decrease China's GDP by more than 2% in 2008 or 2009 (ABARE, 2010).

Australian Government Policy on Illegal Logging

Costs and benefits of the three possible regulatory options

The costs and benefits of the three potential regulatory options available to the government are described using the outputs of the CIE and ABARE analysis³². Estimates of the capacity building investment requirements are provided for each of the regulatory options (rather than being presented as a separate non-regulatory option) together with the relevant estimates of the government enforcement costs.

Option 1 - Quasi-regulation - codes of conduct enforced by industry

It is assumed that there would be no cost for the Australian economy from a quasi-regulatory policy response. This approach would be expected to have minimal impacts on industry or industry structure as the small and large companies currently using legality verification systems would continue to do so. Those companies that don't invest in legality verification would see no incentive for taking on this extra cost. As such, there is no justification to support the CIE estimate of increased costs to Australian businesses and the economy with this option.

It is possible that under this option that a greater volume of illegally logged timber products could be diverted to Australia as the regulatory requirements imposed by the EU and US on their timber imports come into effect³³. Such a policy response by Australia might therefore undermine the effectiveness of other global approaches to combating illegal logging.

Government costs

The costs to government associated with quasi-regulation would require maintaining the existing level of bilateral and multilateral engagement (costing around \$1 million per annum) and investment in capacity building. There would be no requirement for increased costs to any of the regulatory or enforcement agencies.

Quasi-regulation would not meet the government's election commitment or achieve its illegal logging policy objective. In order to meet that objective, Australia and other consumer countries would need to invest in the forest governance systems within developing countries to provide credible legal verification for timber products. It was estimated that Australia's share of the capacity building effort for the Asia-Pacific region alone would be at least US\$270 million over five years (or A\$300m with an exchange rate of AUD1=USD0.90) (Appendix 2). It is important to note that this approach would only be effective if other countries contributed their share of the capacity building costs with respect to supporting the development and use of suitable legality verification systems.

³² The CIE analysis of the costs of illegal logging (and therefore the benefits of stopping illegal logging) provide an important input for the cost-benefit analysis presented in this RIS. Those cost estimates were derived from published reports and the CIE's own analysis, determined separately from the GTAP modelling results.

³³ From the FAO Yearbook (2009), imports of sawnwood, wood panels, pulp and paper into the US and Europe in 2009 represented two-thirds of the global imports of those products. As the US and EU approaches take effect, it would be highly likely that illegally-logged timber products would be diverted to less discerning markets. Pursuing option 1 could lead to Australia's imports of illegally-logged timber products actually increasing.

Australian Government Policy on Illegal Logging

Overall additional costs for this option of approximately US\$52 million per annum with limited benefits unless other countries pay their share of the legality verification capacity building costs in producer countries. Australia's overall benefits would be expected to remain significantly below Australia's share of US\$21 million per annum until the credible systems are in place. Without that commitment, Australia's policy response may not have any impact on the rates of illegal logging in overseas countries.

Option 2 - Co-regulation using a prohibition element and a requirement for due diligence

A due diligence regulation will allow industry to verify the legal origins of timber products at the first point of entry onto the Australian market and at minimum cost. In terms of estimating the compliance costs for this approach, it is important to note that targeting the first point of sale in Australia would limit the points along the supply required to incur the costs of legality verification. 'Like 'measures for imported timber would also be applied to domestic products³⁴, in line with Australia's commitments under the World Trade Organization and obligations under its free trade agreements.

The costs to Australian consumers, businesses and the economy will increase from requiring importers and domestic producers to verify the legal origins of timber products at the first point of sale or entry onto the market in Australia. However, the costs of the due diligence approach were not directly assessed by the CIE. In the additional analysis completed by ABARE, and using the assumptions described in Appendix 1, the economic impacts for Australia, high risk countries, low risk countries and employment in Australia were provided.

The costs for the Australian economy with category III product coverage were estimated as US\$8.9-17.9 million per annum once the new equilibrium is reached. For category II product coverage costs were estimated as being in the range of US\$4.4-9.8 million per annum, and US\$2.1-5.1 for category I product coverage. It is important to note the size of these net costs compared to the size of the Australian forest industry, independent of whether it is domestic mill production (\$2.5-\$3 billion per annum) or industry turnover (\$23 billion per annum).

Under this option, the costs to consumers will increase as a result of higher timber prices associated with a reduction in the volume of illegally-logged timber products entering Australia. The Australian industry will gain from these higher prices, which have the capacity to off-set part if not all of the increase in production due to the new legal verification compliance costs. From the government's domestic action, there will be costs for the Australian economy. However, most of the benefits from this action will accrue to overseas countries. According to the ABARE analysis, the legal timber producers in developing countries will benefit and GDP in developing countries (where there is high risks of illegal logging) will fall although this will be

³⁴ From the ABARE Forest and Wood Products Statistics (2009), the value of timber products manufactured in Australia's mills is approximately \$2.5-\$3 billion per annum. If the additional compliance costs to the Australian industry for Option 2 represent 0.1% of the final product price, the costs of legality verification to the domestic industry using the point of entry onto the market in Australia would be 0.1% of \$2.5-\$3 billion or \$2.5-\$3 million per annum.

Australian Government Policy on Illegal Logging

offset by those countries receiving a significant share of the social and environmental benefits from Australia's actions to stop illegal logging.

The range of potential benefits arising from Australia's actions to combat illegal logging using Option 2 is US\$0-21 million per annum (based on the CIE estimates of benefit). Given that the proposed due diligence approach for Australia would combine the US and EU regulatory mechanisms, it is possible that Australia could claim that it is generating a significant proportion of these potential annual benefits.

Impacts on industry

It is anticipated that large businesses would be in a better position than small businesses to absorb the additional costs associated with a co-regulation option based on the use of legality verification due diligence systems. This is not expected to have a significant effect on industry structure, particularly small businesses, as the rebound in market prices for legal timber products that would occur if the sale of illegally-sourced product was severely restricted in Australia, would be expected to cover at least part of the due diligence costs. It is expected that Option 2 would have a lesser impact on industry structure than Option 3.

Government costs

Costs to government with the due diligence option would include the administration costs for DAFF associated with the accreditation of due diligence codes of conduct, the assessment of code administration body compliance with the regulatory requirements, and some post-border surveillance activities (less than US\$1 million per annum). Capacity building would be targeted at addressing critical gaps in producer countries, assisting industry develop the codes of conduct and an outreach program to inform governments and industry of Australia's approach (US\$8-14 million over the first four years of the regulation coming into effect). The capacity building activities would be designed to assist developing countries to implement legal verification systems that are appropriate for meeting the requirements for gaining access to the Australian market. Enforcement costs for the Australian Customs and Border Control Service (Customs) would include developing the capacity to differentiate accredited and non-accredited suppliers and providing information to DAFF on product imports.

In a cost-benefit sense, the potential costs and benefits of Option 2 are similar in size even after allowing for the costs to government, noting the potential variability in these estimates.

Option 3 - Explicit regulation requiring a minimum standard for legality verification

The CIE modeling presented in the draft RIS indicated an increase in costs to Australia of US\$13-168 million per annum, depending on the legality verification system employed and the range of products to be covered. The cost of US\$168 million (plus or minus 50%) represented the costs for using full certification to verify legality with category III product coverage. When the same variables were applied to the GTEM, ABARE estimated the costs to the Australian economy as being US\$100 million per annum.

As described in Appendix 1, DAFF and ABARE cited a number of international references which provided justification for using considerably lower legality verification costs in developing countries to achieve each of the minimum standards

Australian Government Policy on Illegal Logging

of legality verification that might be required for entry onto the Australian market. Using the DAFF/ABARE cost estimates, the costs for the Australian economy from requiring suppliers to meet a standard of full certification and category III product coverage was reduced to US\$32.7 million per annum.

Costs to consumers would be expected to rise as a result of the higher costs of compliance associated with requiring a minimum standard of legality (compared to a due diligence approach) plus the additional costs of buying legal timber in a market where cheaper illegally-logged products have been excluded.

The CIE estimates of compliance were based on the same proportional costs for forest management certification applying to all stages along the various chains of custody for suppliers. Based on the reasons outlined in Appendix 1 and in ABARE (2010), this is unlikely to be the case. Alternative cost estimates for chain-of-custody costs based on the complexity of the supply chains in producer countries, indicate the costs to the Australian economy being reduced to the range of US\$6.8-16.8 million per annum. This is similar in size to the Option 2 economic costs from GTAP.

The benefits arising under option 3 across the range of US\$0-21 million per annum, would be relatively small as this option would represent a response by Australia that is inconsistent with approaches being pursued by producer and consumer countries. This would be the case independent of the legality verification system adopted or the category of product coverage, as there would be considerable capacity for product leakage to less discerning markets. As such, the option would have limited effectiveness, generating relatively small economic, social or environmental benefits.

Impacts on industry

This approach would be expected to have significant impacts on the domestic and overseas industry. With only a small proportion of products carrying credible forms of legality verification, it is anticipated that there would be significant restrictions on imports from developing countries (which do not yet have these systems in place)³⁵. Domestically, around 90% of the timber harvested each year is supplied from certified sources. As a consequence, large companies would be able to meet any specified standard of legal verification. However, there would be significant cost impacts under Option 3 for small-scale growers who are not yet certified. As a consequence, this approach may lead to a larger impact on industry structure than option 2 if small businesses find it is too expensive to comply with the minimum specified standards of option 3. Australian importers may also be affected if the products they import are not certified to the specified standards.

Government costs

Significant additional costs to government, beyond those for option 2, would be associated with scheme accreditation, assessing compliance with the government's regulatory requirements, and the costs of capacity building. DAFF would have a significant role in the on-going monitoring and accreditation of the numerous legality verification schemes currently available in the Asia-Pacific region. The compliance assessment approach would require that assessment being undertaken both at and beyond the border. Capacity building would be required both domestically and

³⁵ 2009 study estimates that only 26% of global industrial roundwood is supplied from certified forests and of this, 96% comes from Western Europe and northern America.

Australian Government Policy on Illegal Logging

overseas. A significantly larger proportion of the overseas capacity building costs would need to be incurred by Australia than was estimated for option 1 because by setting a prescribed standard of legality verification, Australia would be acting in way that is not consistent with approaches being pursued by other producer and consumer countries.

Compliance costs for product disclosure

An additional system would need to be established to meet the requirement for disclosure of species, country of harvest and any certification. The CIE modeling of the disclosure element compliance costs for full certification and category III product coverage (using the assumption that the cost of product disclosure would increase across the board by 0.5 per cent) indicated the impacts for the Australian economy would rise by 43 per cent.

Overall the additional costs to the economy and compliance and capacity building costs associated with Option 3, combined with a reduced share of the benefits arising with limited policy effectiveness, indicate a benefit to cost ratio of significantly less than one.

5. Consultation

The CIE was commissioned to consult stakeholders during the RIS process and to prepare a public consultation statement³⁶. Stakeholders representing forest, wood products, paper and construction industries, retailers, non-government organizations, academic institutions, certifiers, consultants, and federal and state government agencies were engaged in this process. Three rounds of consultation were conducted. Steps in the consultation process included:

- Individual meetings with sixty five stakeholders to introduce key issues and questions likely to influence the outcome of the RIS. An issues paper was prepared and made available on the CIE's website as the basis for providing a structured discussion during the individual stakeholder meetings;
- A second round was undertaken with a select group of stakeholders and certifiers via telephone to test the initial CIE estimations of the cost of forest certification. Stakeholders were sent a document with the general assumptions and costing per certification component. Input from this stage contributed to the CIE's understanding of the cost of achieving full certification of forest management (which includes legality verification); and
- A third round over a seven week period, seeking input on the draft report from the CIE (which described the problem and its size, policy options, modeling, the costs of regulatory options, the benefit-cost analysis and conclusions). A set of questions were posed in order to gain feedback from stakeholders.

Twenty one submissions were received on the findings and methodology of the RIS. Eighteen of these were made available on the CIE's website with the authors' permission. Twelve thousand, two hundred and fifty one 'postcards' were received over the 7-week period, which demanded the Government fulfill its election promise of banning illegally logged timber imports. The CIE sought to address stakeholder issues from the perspective of their cost-benefit analysis in the final report to DAFF.

³⁶ Chapter 8, CIE final report.

Australian Government Policy on Illegal Logging

Stakeholder response to three options

A summary of the stakeholder concerns, their preferred approach(es) and views on implementation are provided at Appendix 3. It is important to note that stakeholders did not always demonstrate a preference for a single option. The views of stakeholders with respect to the three options, summarised from Appendix 3, are:

- Option 1 – Quasi-regulation - A voluntary approach with investment in capacity building, bilateral and multilateral engagement (the CIE recommended options) was favoured by six stakeholders, of whom four offered qualified support for Option 2;
- Option 2 – Co-regulation - A due diligence approach backed by some form of mandatory requirement was supported by eight organisations; and
- Option 3 - Explicit regulation - requiring full certification of timber products received support from four stakeholders, with three indicating support for Option 2.

General stakeholder issues with the draft RIS

Stakeholders consistently identified three broad areas of concern with the draft RIS and the impacts of the 3 options. These issues were consistently raised in the industry and NGO submissions:

- Illegal timber production should not be seen as an economic benefit:

In this RIS, illegal timber production is not viewed as providing an economic benefit. It is noted that illegal logging can have a significant impact on industry structure, employment, investment and profitability. Where it has been separately assessed, it is noted that illegal timber production is significant and if illegal logging is reduced, it will impact on communities and the structure and activities of the legal forest industry sectors. These impacts could also be negative where communities are dependent on the income from illegal activities. Australia's capacity building activities might therefore need to include improving the capacity of these communities to identify alternative sources of income.

- Intangible and social impacts/costs in the cost-benefit analysis should be given more emphasis:
 - A more detailed social assessment undertaken by DAFF to support the completion of the RIS highlighted the social impacts associated with illegal logging. Significant tangible and intangible costs were noted. In particular, the loss of human, resource and other forms of capital for forest-dependent communities, the loss of payments for timber and the lack of social services supplied by industry and government where there are illegal forestry operations. Beyond the forest-dependent communities, other sections of society note the loss of intangible benefits where forests are illegally logged.
- Moral and treaty obligations for Australia including Australia's political leverage should be included in the cost-benefit analysis:
 - If Australia, through its strategic location in the Asia-Pacific region, is able to influence governments to take action on combating illegal logging through the domestic measures it employs to identify and restrict illegally-logged timber imports, there may be some justification for claiming a

Australian Government Policy on Illegal Logging

greater proportion of the benefits than 0.034%. That is, the benefits might be greater than US\$21 million per annum.

- A comprehensive assessment of the policy options available to the government for combating illegal logging requires an examination of both the tangible and intangible costs and benefits:
 - Under Option 2, an assessment of the range of intangible benefits adds weight to the benefits component of the benefit to cost ratio, although they remain similar in size; and
 - Under Option 3, the variation in benefits and costs is sufficiently large as to indicate that even with the inclusion of intangible benefits of taking action to combat illegal logging, the benefit: cost ratio may still not be close to one.

Industry concerns

A number of more specific issues were identified in the industry submissions on the draft RIS:

- Illegal logging suppresses product prices and provides unfair competition to Australian producers and suppliers:
 - Australian businesses should gain a price rise from preventing trade in illegally-logged timber products under Options 2 and 3 because of price adjustments to a legally operating market where the full value of timber is paid.
 - It is possible that these price rises will offset at least part of the additional industry compliance costs under Options 2 and 3.
- Minimise disruption to trade:
 - Option 2 - disruption to trade will be minimised by allowing importers and domestic suppliers to determine the most effective means for verifying the legality of products from potentially multiple sources based risk assessment of the potential illegality of timber using a framework for due diligence system developed by industry;
 - Option 3 - a minimum standard of legality verification is expected to incur some level of disruption to trade. This will depend on the minimum standard of legality verification required by regulation and the capacity of suppliers to utilise the schemes accredited by the government. In those cases where exporters cannot use acceptable schemes (for example, where no acceptable schemes are available in the producer countries) the suppliers would not be able to provide products to Australia;
 - A 2-year lead time after the introduction of legislation for Option 2 or 3 should give industry sufficient time to establish the necessary systems and processes to minimise trade disruption. Providing capacity building support to assist industry develop acceptable codes of conduct under Option 2 would help address concerns that suitable codes may not be available for use by the various domestic industry sectors;
 - The proposed date of enforcement would be consistent with the timing proposed for implementation of the EU due diligence regulation; and

Australian Government Policy on Illegal Logging

- It is important to note that Option 2 would not restrict imports into Australia from any particular source or country. The limitation is that only importers that are signatories to government-accredited codes of conduct would be able to import the timber products specified in regulation.
- Minimise compliance costs to industry:
 - Compliance costs may be at least partially offset by the recovery in prices if products derived from illegally-logged sources are prevented from entering Australia. This is the reverse of arguments raised by stakeholders that prices are depressed due to the availability of illegally-logged products. The CIE estimated that if illegal logging was stopped, the prices for timber products would rise by 3 per cent;
 - Industry submissions noted the importance of maintaining the reputation of timber with buyers. There would be some benefit (tangible and intangible) to timber product sellers from being able to claim that their products are derived from legally-harvested sources;
 - Not all costs to industry associated with meeting the requirements of Option 2 will be new, as timber exporters in producer countries will need to establish these same systems for trading to the EU and US markets. The costs of adapting their systems to meet any similar requirements from Australia for timber legality would be limited;
 - Producers in other countries are increasingly required to demonstrate compliance with forestry laws. As such, the new costs they would incur to meet the requirements of Option 2 would be potentially limited to formalising their current processes into a systematic fashion that supports legality verification. Even if they do not have the systems currently in place to verify legality, they will have some systems already being used to support conformance with forestry laws;
 - Meeting the requirements for Option 3 would be expected to raise new costs for overseas and domestic producers. They would not face these same requirements to supply alternative markets;
 - Mandatory timber legality verification may create an incentive for suppliers to formalise existing arrangements for demonstrating proof of legality for their products as the basis for maintaining market access. However, if industry were required to administer codes of practice or other elements of a due diligence approach, government support should be provided to develop their capacity in this area;
 - Expanding product coverage to more than 70 per cent of timber-containing products may raise the compliance costs for industry. GTEM and GTAP modeling results indicate that the costs will rise exponentially as the range of products to be covered increases.
- Uneven distribution of costs and impacts across industry sectors - small business versus large business:
 - Costs of compliance under Options 2 or 3 will not be incurred by all companies in the supply chain – only for first point of entry onto the Australian market;

Australian Government Policy on Illegal Logging

- In response to the Option 2 or 3 legality verification requirements, fewer companies (e.g. small businesses) might import timber directly due to the higher costs of meeting those requirements. As an alternative, they might rely on larger timber merchants bring in goods in bulk.
- Relative cost versus effectiveness of the measure:
 - Consistency of Option 2 (for regulating illegal timber imports) with the actions of EU and US will improve its effectiveness relative to action under Option 3, which is inconsistent with these approaches.
- Potential for unfair competition for domestic manufacturers and suppliers if some timber imports are included and not others, e.g. raw materials to make furniture and not pre-packaged timber furniture imports:
 - The range of products to be covered by Options 2 and 3 will take into account the costs and effectiveness of including complex and composite wood products, with the capacity for phasing in the range of products to be covered.
- Concerns regarding free-riders who do not verify the legality of their timber and take advantage of cheap imports from potentially illegal sources:
 - Option 1, which relies on voluntary measures, does not address this concern and may have the opposite effect of encouraging the diversion of illegally-logged products to Australia until producer countries fully implement systems for achieving legality verification;
 - Options 2 and 3, which involve mandatory requirements will stop free riders and ensure that the cost advantage for these product suppliers does not continue.
- Potentially perverse outcomes from restricting illegal timber imports resulting in a reduced demand for timber and increased demand for wood substitutes:
 - It will be important to design legality verification requirements in a way that minimises disruption to timber products trade and supply;
 - Option 2 is designed to address this matter, whilst option 3, with its more onerous requirements for legality verification, is unlikely to address this concern.

6. Conclusion and recommended option

A regulatory approach for using due diligence or establishing a minimum standard of legality verification could be effective in preventing illegally-sourced timber products from being placed on the market in Australia. However, the effectiveness of the policy in stopping illegally logged imports from entering Australia and helping other countries to combat illegal logging will depend on whether Australia is taking action that is consistent with or goes beyond approaches of producer or other consumer countries and is consistent with Australia's international trade obligations. Identifying the preferred option also requires an assessment of the costs and benefits of each policy option and ensuring that the concerns of stakeholders are given adequate consideration.

The CIE noted that because Australia's imports account for such a small share of illegally logged timber and restricting imports has limited effect in reducing illegal

Australian Government Policy on Illegal Logging

logging, Australia incurs all of the costs of restricting imports without achieving commensurate benefits of reducing the damaging effects of illegal logging. This conclusion, however, is heavily dependent on no other countries taking action.

If the ultimate policy outcome of eliminating illegal logging could be achieved, ABARE estimated that Australia's GNP would increase by US\$155 million per annum. This estimate does not include the compliance costs associated with legal verification, which have previously been shown to be significantly less. Therefore, there is a benefit to Australia taking action and action that is consistent with other approaches, especially given that the US and Europe account for two-thirds of the world's imports of timber products.

Where global action is not complete in eliminating illegal logging, the findings in this RIS indicate there are costs to Australia and benefits to overseas countries. While Australia's share of this global trade is small, its strategic location and regional engagement in combating illegal logging and associated trade should add to the process of change.

The complementary benefits of actions by both consumer and producer countries, therefore, need to be taken into account in the cost-benefit analysis of Australia's action. In addition to the small net financial cost to Australia and a reduction in GNP in high risk countries, the economic benefits of stopping illegal logging largely accrue to other developed countries that increase their supply of legal timber products. It is expected that these costs will reduce and the benefits accruing to Australia will increase incrementally over time as the world moves to stop illegal logging.

Stakeholders, in their response to the draft RIS, indicated significant support for moral reasons for change and an acceptance of small costs for Australia from removing illegally sourced products from Australia's market.

Option 1 - quasi regulation – codes of conduct enforced by industry

This option maintains the status quo, but does not meet the government policy objective given its voluntary nature. Whilst quasi regulation offers a low cost option to industry and government (in terms of the enforcement costs), substantial investment in overseas capacity building would be required to provide credible systems of legality verification in producer countries. This option would only be effective if other countries contributed on a proportional basis to the legal verification capacity building programs, although there would be long lead times before acceptable legality verification schemes would be available in all producer countries. As indicated by submissions on the draft RIS, limited support for this option was based on it being a low-cost approach for industry compliance for those sectors made up largely of small businesses.

Option 2 – co-regulation using a prohibition element and a requirement for due diligence

Co-regulation in the form of a due diligence regulation is recommended as the most effective option. The benefit-cost analysis presented in Chapter 4 indicates that the costs and benefits of implementing a due diligence regulation would be of a similar size. When the intangible costs and benefits of stopping illegal logging together with Australia's capacity for encouraging action by foreign governments are taken into account, this option should generate benefits to industry, the economy and the

Australian Government Policy on Illegal Logging

community that outweigh the costs. Applying similar measures to domestic suppliers and importers would ensure the approach is consistent with Australia's trade law obligations whilst providing a comprehensive policy response at both domestic and global levels.

The due diligence element of this option provides industry with a least-cost approach for meeting the objective. This proposal combines the US and EU initiatives, with the due diligence element supported by a prohibition on illegal timber imports that could carry significant penalties for non-conformance. It is anticipated this proposal would be highly effective in meeting the legality component of the policy objective. At some future time, it would be possible to consider whether the legality verification requirement could be replaced with due diligence applied to the sustainability of the underlying forestry practices.

Australia's implementation of a regulatory approach that is consistent with the efforts pursued in producer and consumer countries should ensure that the regulatory elements of Option 2, supported by targeted capacity building and bilateral and multilateral engagement will make a significant contribution to global effort for combating illegal logging. Building on the existing systems and processes employed by industry would further ensure that the costs associated with this approach are minimised. Support for this option was provided directly in eight of the eighteen submissions on the draft RIS, with qualified support in a further seven submissions.

Option 2 should minimise disruptions to trade, allow a recovery of depressed prices (which will help offset the additional compliance costs), minimise industry compliance costs, limit potential impacts on small businesses (and the industry structure), address the free-rider problem, remove unfair competition and provide assurances to Australian consumers of the legal origins of the timber products they are purchasing. The use of a licensed trademark by industry would assist consumers to identify legally-sourced timber products.

Stakeholders noted that if industry was required to implement a due diligence approach, government support should be provided to establish codes of conduct.

Option 2 does not involve the testing of domestic industry compliance with State and Territory forestry laws (or those of overseas jurisdictions) as each domestic jurisdiction has separate measures for legal compliance and law enforcement. Similar to the EU due diligence regulation, this approach seeks to ensure that all suppliers of domestic and imported timber in Australia undertake assessments of the risks of sourcing illegally-harvested timber products and employing legality verification measures commensurate with the level of risk identified. This approach is consistent with the overarching policy directions described in Australia's *National Forest Policy Statement* (1992).

Costs to government for this option would be relatively small. While the government may invest in targeted capacity building and an outreach program, the costs for government enforcement, accreditation of codes and monitoring of compliance would be relatively low (when compared to option 3), with industry bodies having responsibility for administering the codes of conduct which are accredited and monitored by the Commonwealth.

Australian Government Policy on Illegal Logging

Support for developing countries through the capacity building element of the policy would assist the suppliers of those countries to comply with Australia's proposed new requirements. This investment in capacity building is consistent with the government's election commitment 'to build capacity within regional governments to prevent illegal logging'. These capacity building activities could be identified through the cooperative approach established with other governments in the region under the forestry bilateral agreements currently in place and being pursued by the government.

Capacity building costs to Australia would be complementary to the approaches taken by the EU and US and broader global efforts to address illegal logging and associated trade. Both the EU and US have invested substantially in capacity building programs as part of their efforts to address illegal logging, and jointly, these efforts may contribute to reduce the cost burden on Australia in meeting its election commitment and policy objective.

Option 3 – explicit regulation requiring a minimum standard for legality verification

This option offers considerable certainty in meeting the government's policy objective. However, a minimum standard for legality verification would have high government administration and industry compliance costs because of the high levels of intervention. Relatively high annual costs for the Australian economy (relative to the possible benefits) were identified in the CIE and ABARE analyses for this option and need to be considered alongside the additional government capacity building costs plus the additional costs for implementing a system to fulfill the product disclosure element of the election commitment. These costs are expected to significantly outweigh the potential benefits arising from action by Australia to combat illegal logging that is inconsistent with the approaches of all other producer and consumer countries. There was some stakeholder support for implementing option 3.

7. Implementation and review

Option 2 would be implemented by introducing new legislation administered by DAFF and supported by the Australian Customs and Border Protection Service and DAFF. New legislation would provide domestic and overseas stakeholders with a clear understanding of the government's requirements for the importation and sale of legally logged timber in Australia. A more detailed outline is provided in Appendix 4.

Industry would be required to develop and implement legality verification codes of conduct through new code administration bodies which describe the processes for assessing the risks of sourcing illegally-logged timber. Individual companies, as signatories to the due diligence codes of conduct, would undertake third-party independent auditing of compliance with the codes' requirements, in terms of identifying the risks of sourcing illegal products and implementing approaches that are relevant to minimising those risks. The code administration bodies would report on the findings of the signatory audits, the signatory responses to adverse audit reports and complaints against their signatories as the basis for retaining their Commonwealth accreditation.

Legally compliant timber suppliers, who already use a range of voluntary legality verification measures for imported and domestic timber, would formalise their current

Australian Government Policy on Illegal Logging

arrangements to meet the legality verification requirements of the relevant codes of conduct.

Business enterprises that do not have these systems in place ('free-riders') will need to implement new due diligence procedures. Industry codes of conduct and supporting procedures would help minimise the administration and compliance costs for all industry stakeholders. The generic code of conduct prepared by industry in 2010 with funding from the Commonwealth provides a template for preparing sectoral codes of conduct. Importers and domestic timber processing mills, as the first points of entry for timber products onto the market in Australia, would be required to provide appropriate documentation of their due diligence arrangements to enable auditing and reporting of compliance. Industry signatories to the Commonwealth-accredited codes of conduct would be required to use a Commonwealth registered legality trademark.

The prohibition elements of the due diligence approach would apply from the date the legislation comes into effect. To minimise the impact on stakeholders with respect to the code of conduct elements of due diligence, transitional arrangements would be put in place for a two-year period prior to these requirements being fully enforced. After that time, timber products could only be placed on the domestic market by code of conduct signatories. This should provide government agencies, importers and domestic suppliers' sufficient time to establish the operational and administration arrangements to meet the requirements of the legislation. A comprehensive awareness raising outreach program would be implemented in advance of the code of conduct legislation being enforced to facilitate compliance by industry.

Suitable constitutional heads of power are available to the government for implementing the code of conduct compliance elements of option 2³⁷. The Government could review the due diligence arrangements within 5 years to determine their effectiveness, including (a) effectiveness of the industry codes of conduct; (b) effectiveness of the enforcement and compliance procedures; (c) the range of timber products covered by the regulatory elements of the policy; (c) the economic impacts of the due diligence compliance requirements; (d) potential for increasing the legislative requirement from 'legality' to 'sustainability' of timber products (to meet the long-term objective of the policy); and (e) the effectiveness of the arrangements in reducing illegal logging in producer countries.

³⁷ Advice provided to DAFF by Australian Government Solicitor (April 2010).

Australian Government Policy on Illegal Logging

References

Auer, M., Karr-Colque, C., McAlpine, J., and Doench, B. (2006). *Forest law enforcement and governance: resolve needed from all sides*. Paper for Georgetown Public Policy Review, 2006.

Chatham House (2009). *Illegal logging update and stakeholder consultation No.14*. June 2009.

CIE (2010). *Final report to inform a Regulation Impact Statement for the proposed new policy on illegally-logged timber*. Prepared for DAFF by the Centre for International Economics, January 2010.

Coakes (2010). *A review of the social costs of illegal logging*. Report prepared for DAFF by Coakes Consulting, March 2010.

Cubbage, F., Moore, S., Henderson, T., and Araujo, M. (2009). *Costs and benefits of forest certification in the Americas*. In: Natural Resources: Management, Economic Development and Protection. Ed: J.B. Paulding. Nova Sciences Publishers.

EU (2008). *Analysis of the trade impact of the VPA for Indonesia. Main Report*. Report prepared as part of the EC-Indonesia FLEGT support project.

FAO (2009). *FAO Yearbook: Forest Products 2007*.

ITTO (2004). *Report on financial cost-benefit analysis of forest certification and implementation of phased approaches*. Report prepared for International Tropical Timber Organisation thirty-seventh session, Japan, December 2004, by M Simula, S.Astana, R.Ishmael, E.Santana and M.Schmidt.

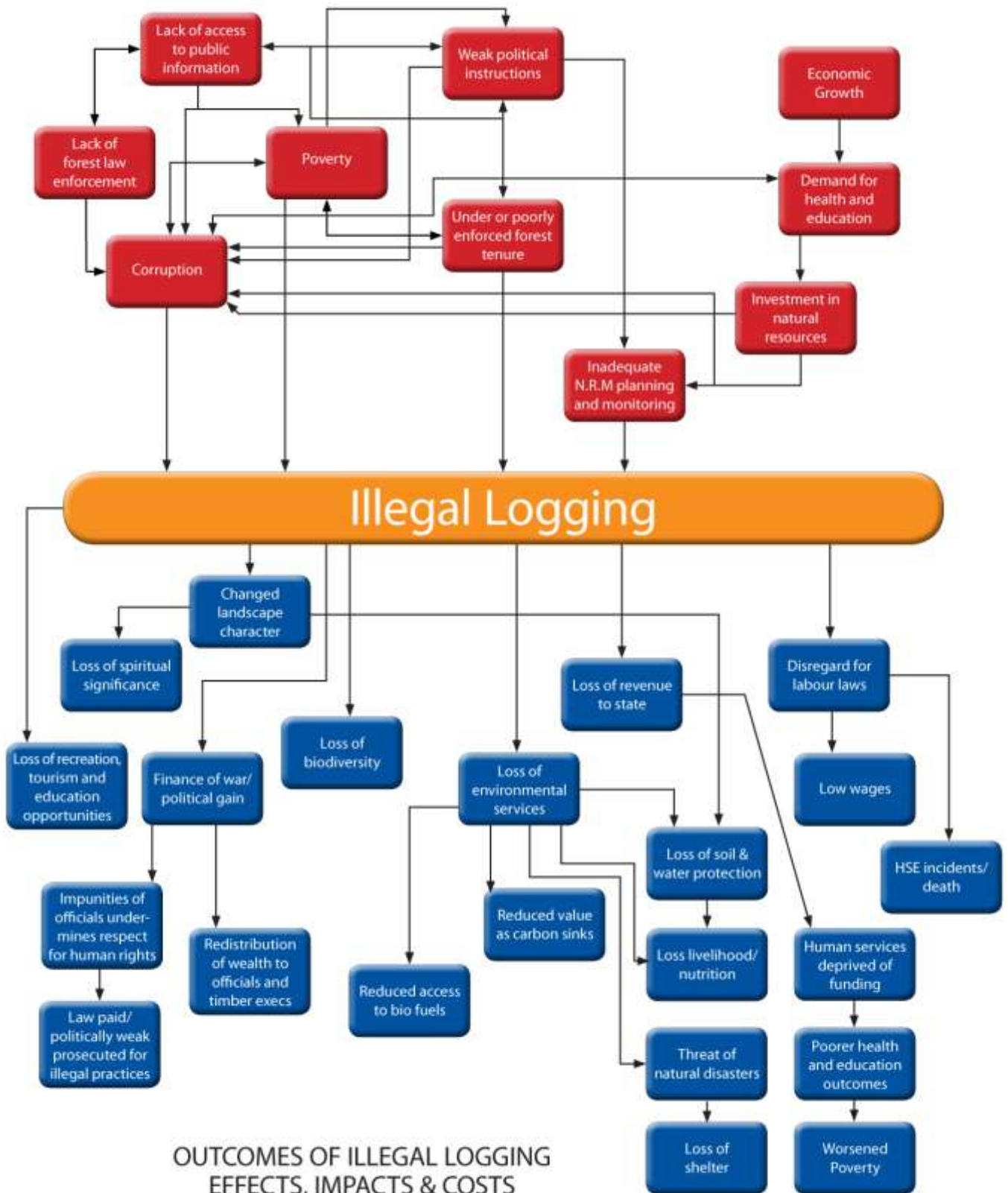
Joint Statement on illegal logging (2009). *Eliminating illegal forest products in Australia*. A joint forest industry, wood product sector and conservation group statement. June 2009.

Poyry (2010). *Legal Forest Products Assurance: a risk assessment framework for assessing the legality of timber and wood products imported into Australia*. Report prepared for DAFF.

Reeve, R (2007). *Enforcement: challenges and lessons learned*. The Growth and Control of International Environmental Crime, Chatham House workshop, 10-11 December, 2007.

URS Forestry (2009). *Review of the regulatory frameworks and documentation relating to legality of timber production in Australia*. Report prepared for DAFF.

DRIVERS OF ILLEGAL LOGGING EFFECTS



Assumptions provided by DAFF for ABARE analysis of policy options

Assumptions and modelling approaches

The CIE modelling assumptions were used as inputs to a GTAP model that was used for estimating the effects of various options available to the government for combating illegal logging. These effects were presented in the draft RIS. Additional modelling was undertaken by ABARE to complement that initial work and to address the views raised in stakeholder submissions and IDC comments on the draft RIS. DAFF provided ABARE with compliance cost estimates, collated from published reports, as inputs for modelling the impacts with the trade equilibrium model GTEM.

GTAP and GTEM outputs

The GTAP model used in the CIE analysis provided estimates of the immediate shocks associated with the introduction of new compliance systems for combating illegal logging. The outputs of that modelling were presented as annualised impacts. As noted elsewhere (EU, 2008) the immediate effects of stopping illegal logging represent major initial shocks to the legal and illegal sectors of the industry.

The immediate shocks need to permeate through the industry, affecting industry structure and outputs from the various industry sectors. GTEM estimates the total impacts of the proposed changes. For example, when using the same inputs for GTAP and GTEM, GTAP estimated a global output loss from stopping illegal logging of US\$91 billion per annum for the illegal sector and a benefit of US\$46 billion per annum for the legal sector. With GTEM, the total loss for the illegal sector was US\$34.5 billion with total benefits to the legal sector of US\$33.7 billion.

DAFF and CIE compliance cost assumptions

- The CIE assumed that brand new legality verification schemes would need to be established to meet the proposed legality verification requirements for options 2 and 3 in the RIS. This assumption, however, resulted in a significant over-estimation of the compliance costs, given that there are:
 - Legal loggers who already have systems in place to verify the legality of their timber and will incur no new costs of compliance;
 - Legal loggers who do not have systems in place but have the basic legal approvals for their operation may formalise those arrangements at a substantially reduced cost compared to the full costs of achieving legality verification ; and
 - Loggers who seek to minimise costs by not following due legal process, but are willing to implement a basic level of legality verification, can do so at a cost considerably below that of full implementation of new systems.
- The CIE based their legality compliance costs and percentage export tax estimates of timber produced in high risk countries on the costs of implementing ‘full certification’. However, an assessment of the international literature, including

Australian Government Policy on Illegal Logging

work carried out by Cabbage et al(2009), ITTO (2004) and EU (2008), indicates the range of compliance costs for achieving certification in developing countries is substantially lower than the CIE estimates. Consequently, the range of compliance costs estimates (low to high) proposed by DAFF based on the above international reports (with CIE estimates in parentheses) were:

Full certification (FC)	0.67-3.33%	(10%)
Verified legal compliance (VLC)	0.33-1.67%	(5%)
Verified of legal origin (VLO)	0.2-1.0%	(3%)
Self-declared legal (SDL)	0.07-0.33%	(1%)

Note: only the higher of the DAFF cost estimates for each compliance system were used to generate the ABARE modelling results presented in the final RIS.

Chain of custody costs

- The CIE assumed the ‘chain of custody’ compliance costs (presented as a percentage ‘export tax’ increase for timber products from exporting countries sold to Australia) were the same as the percentage cost increases for companies to achieve full forest management certification. The CIE assumed that the full costs of achieving forest certification in developing countries added an additional 10 per cent to the costs of timber production and that this same percentage cost increase applied to all steps in the supply chain (and for all products included in the assessment).
- This assumption did not adequately address the differences between the costs of achieving sustainability certification and the costs of chain-of-custody certification for timber products once they leave the forest. Nor did this estimate account for the supply chain complexities for the various countries and regions, based on the range of products they supply to Australia. DAFF estimates of the ‘export tax’ rates to be used in GTEM were based on the length and complexity of supply chains as being simple, intermediate or complex in the producer countries. It was assumed that where the chain-of-custody costs were included, they would be less than (on a percentage basis) than the costs of forest management sustainability certification so that the ‘export tax’ rates for countries with relatively simple, intermediate and complex supply chains are estimated as being:
 - Simple supply chain sources – 80 percent of the export tax rate for each compliance system for timber products with a short and direct route from the forest to the points of processing and export;
 - Intermediate supply chain sources – 60 percent of the proposed export tax for each compliance system for products which have intermediate supply length and complexity;
 - Complex supply chain sources – 40 percent export tax for countries that supply a large proportion of complex products such as furniture and highly processed composite products with relatively long supply chains.

Supply chain complexity	% estimated compliance costs	Countries/Regions
Simple	80	Australia, NZ, Rest Oceania, Russia, Latin America, Africa
Intermediate	60	Indonesia, Malaysia, Rest SE Asia, Canada, Brazil
Complex	40	China, Japan, South Korea, South Asia, EU, Rest Europe,US

Australian Government Policy on Illegal Logging

Assumption for modelling impacts of due diligence

The CIE did not model the compliance costs for the due diligence option. ABARE undertook this analysis for high risk and low risk countries, including Australia, using upper and lower cost estimates provided by DAFF. These estimates take into account that not all producers will incur the new costs because some already have legality verification systems in place.

For developed countries, including Australia, the average percentage compliance costs were assumed to be within the range of 0.025-0.1 per cent. These are the same estimates of compliance cost as used by CIE for developed countries to verify the legal supply of products. These estimates recognise that a small number of suppliers in each country would need to put in place some form of legality verification where the options would range from self-declared legal through to full certification.

For developing countries, there is assumed to 5 per cent of products already certified and another 5 per cent of products supplied with some other form of credible legality verification. For the remaining 90 per cent of products, producers could use any of the available systems (from self-declaration of legal through to full certification) for verifying the legal origins of timber products. For developing countries, it was assumed that legality verification under a due diligence regulation would lead to the legality verification compliance costs adding between 1-1.67 per cent to the cost of products. With 10 per cent of supplies backed by some form of credible legality accreditation, the ‘export tax’ percentage used for developing countries was assumed to be 0.9-1.5 per cent.

Timber product categories used in the economic analysis

The following table describes the type and range of timber products, based on World Trade Organization Harmonised Tariff Codes, within each of the three product categories considered in the economic analysis for each of the policy options.

<i>Category I</i>	<i>Category II</i>	<i>Category III</i>
Solid timber and wood products	Partially processed/processed timber and wood products	Complex products – e.g. highly processed/composite timber and wood products/from multiple sources
Wood in rough (4403) Sawn wood (4407) Plywood (4412) Newsprint (4801) Printing & writing (4802-03; 4808-11; 4823)	Category I plus Particleboard (4410) Fibreboard (4411) Mechanical pulp (4701) Semi-chemical (4705) Chemical pulp (4702-07)	Category II plus Household and sanitary (4803, 4818) Packaging & industrial (4804-08, 4810-11, 4823) Paper manufactures (4811-23) furniture (9403) Veneer (4408) Continuously shaped wood (4409)

Capacity building costs for illegal logging policy options

Food and Agricultural Organization forestry statistics³⁸ have been used to provide an estimate of Australia's share of Asia-Pacific trade in timber products derived from countries without operational legality or certification systems in place. It is then necessary to estimate the proportion of that trade which is imported by Australia and therefore, our share of the costs for building capacity to combat illegal logging by encouraging trade in legally harvested wood products. These costings will apply to the capacity building elements for meeting the policy objective through policy option 1 (or quasi-regulation) or policy option 3 (explicit regulation). Separate capacity building cost estimates are provided for option 2 (co-regulation).

Total wood supply

Asia-Pacific Region total wood supply equals 291 million cubic metres per annum

Wood supply in countries that have credible legality verification (or higher requirements) already in place (Australia, New Zealand, Malaysia, Japan) equals 87 million cubic metres per annum

Asia-Pacific region wood supply without legal verification equals approximately 200 million cubic metres of wood per annum.

Australia's share of this resource (in terms of traded wood products)

Estimates of Australia's estimated share are derived by estimating the total regional exports and subtracting exports derived from Australia, New Zealand, Malaysia and Japan across the four major product categories of sawnwood, panels, paper and paperboard, and pulp. The volume of product is multiplied by a conversion factor of 2 to obtain an estimate of the volume of harvested wood required to manufacture those products. That is, it is assumed that 2 cubic metres of wood are required on average to produce 1 cubic metre (or tonne in the case of paper) of final product.

Regional exports

	<i>Million cubic metre or tonne</i>		<i>US\$million</i>	
	Asia	Oceania	Asia	Oceania
Sawnwood	7.4	2.3	2,581	683
Panels	29.5	1.4	10,386	468
Paper + P'board	18.1	1.3	13,598	782
Wood pulp	3.0	1.0	1,376	458
Totals	58.0	6.0	27,941	2,391

In total, regional exports are equivalent to 64 million cubic metres of final product (using approximately 128 million cubic metres of wood input) with a value of US\$30.3bn per annum.

³⁸ FAO Yearbook: Forest Products 2007 (FAO, 2009)

Australian Government Policy on Illegal Logging

Exports from Australia, New Zealand, Malaysia, Japan

	<i>m cubic metre or tonne</i>	<i>US\$million</i>
Sawnwood	4.3	1,418
Panels	8.5	3,031
Paper + P'board	3.2	3,102
Wood pulp	1.1	595
Totals	17.1	8,146

Approximately 34 million cubic metres of wood would be required to manufacture these products. After adjusting the regional export figures to account for exports from countries where legal verification would already be in place, the value is estimated at US\$22.5bn per annum and would require some 94 million cubic metres of wood input to manufacture.

Australia's share of traded products from Asia-Pacific countries (apart from Japan, Malaysia and New Zealand) using ABARE statistics³⁹ is A\$2.02bn for 2006-07. Assuming an exchange rate of \$A1=\$US0.9, this is equivalent to US\$1.8bn per annum. In value terms, at least 8 per cent of the total exports from Asia-Pacific countries are consumed by Australia each year.

Estimated costs of legal verification

Current capacity building efforts to establish legality verification systems for timber products – note that these estimates of cost relate to legality verification for all timber produced in Voluntary Partnership Agreement countries for the EU where cost information is available:

Indonesia – annual total wood harvest equals 32 million cubic metres per annum and investment in capacity building by the EU equals 130 million euro or US\$175m⁴⁰ over a period of five years. With total wood production in that period of approximately 160 million cubic metres, investment in legality verification is equivalent to US\$1.10 per cubic metre of wood. Aside from this investment, there has been considerable recent funding of legality verification efforts and combating of illegal logging by the US and other donors during this period. Indonesia will still require significant investment in developing their capacity to implement the new timber legality assurance system (the SVLK). This does not take into account Indonesia's own investment in legality verification capacity building.

³⁹ Statistics taken from ABARE Forest and Wood Products Statistics 13 May 2009. It is important to note that not all countries in the Asia-Pacific region are individually identified in this report. The values referred to in the estimates provided in this appendix represent those for the identified countries and would therefore represent an under-estimation of the value of Australia's imports from Asia-Pacific countries (excluding estimates from Japan, Malaysia and New Zealand).

⁴⁰ Based on an exchange rate of 1.35 euro per USD.

Australian Government Policy on Illegal Logging

Ghana – annual total wood harvest equals 1.3 million cubic metres per annum and investment in capacity building by the EU equals 20 million euro or US\$27m in the first year. It is expected that this cost will apply for three years and the system will be operational for 10 years off the back of that investment. That is, an investment of approximately US\$81m for 13 million cubic metres of timber or US\$6.20 per cubic metre of harvested wood. This does not take into account the investment by other donors or industry in improving the legal verification systems.

Taking the mid-point of these estimates, it is proposed that the donor-country capacity building investment required to support developing country efforts to achieve legality verification would be USD3.35 per cubic metre of harvested wood (with a range of US\$1.10 to US\$6.20).

Given that approximately 200 million cubic metre of wood is harvested annually in the Asia-Pacific region without credible forms of legal verification or certification, estimated capacity building requirements to assist developing countries achieve that outcome would be approximately US\$670m (US\$220m-US\$1,240m) per annum. Across the next five years, that would equate to US\$3.35bn (US\$1.1bn-US\$6.2bn). To assist countries achieve full certification, the investment in capacity building might be approximately 3 times greater (given the relative difference in estimates of achieving VLO and full certification used by DAFF and ABARE in this RIS).

Australia's share of the legality verification capacity building cost, based on Australia purchasing a minimum of 8 per cent of the products exported by Asia-Pacific countries (excluding Japan, Malaysia and New Zealand) would be at least US\$270m over five years (or A\$300m with an exchange rate of \$A1=USD0.90).

Capacity building cost estimates for Option 2 (co-regulation)

Under Option 2, Australia would seek to implement a regulatory approach that is consistent with the approaches being taken by producer and consumer countries at present. However, a considerable effort is required to assist developing countries achieve some form of credible legality verification for their timber products.

Australian support for capacity building is necessary to ensure that affected developing countries are assisted in complying with legality verification requirements of the regulation. Under the co-regulation option, it is proposed that Australia would invest in targeted capacity building activities with its existing and proposed bilateral partners on combating illegal logging – Indonesia, China, Papua New Guinea and Vietnam).

Australian Government Policy on Illegal Logging

Stakeholder comments on the draft Regulation Impact Statement

Appendix 3

<i>Organisation</i>	<i>Areas of Concern</i>	<i>Preferred Approach</i>	<i>Views on Implementation</i>
Australian Timber Importers Federation	<ul style="list-style-type: none"> - Net overall cost from taking action that is inconsistent with producer and other consumer countries - Minimise disruption to trade in legal timber products 	<ul style="list-style-type: none"> - Mandatory due diligence code of conduct compliance requirement - Establish industry body for code administration with third-party and independent auditing 	<ul style="list-style-type: none"> - Due diligence code of conduct compliance to be mandatory for timber product importers - Imposition of a mandatory code should be phased in with funding and technical support from the Commonwealth
Furniture Industry Association of Australia (Vic/Tas branches)	<ul style="list-style-type: none"> - Need to 'price' the intangibles - Some industry costs relate to protecting timber's reputation 	<ul style="list-style-type: none"> - Code of conduct for due diligence 	<ul style="list-style-type: none"> - Seeking a mandatory code of conduct
Australian National University	<ul style="list-style-type: none"> - So-called intangible benefits of combating illegal logging should be the basis for Australia's policy position 	<ul style="list-style-type: none"> - Support the use of credible forest certification schemes to verify forest management practices and track products 	<ul style="list-style-type: none"> - Requiring certification is consistent with policy option 3 (setting a minimum standard of legality verification)
Uniting Church of Australia	<ul style="list-style-type: none"> - Highly deficient in social analysis - Recognising illegal logging as a net economic benefit should be off-set by commentary on social or human rights dimensions - Need to analyse Australia's political leverage within the region - Who gains from illegal logging wealth transfers? 	<ul style="list-style-type: none"> - Distinguish legal and illegal product - Use anti-corruption treaty obligations to fight corruption - Ban the importation and sale of timber from illegally-logged sources - Utilise voluntary systems for independent monitoring such as through the use of certification systems - Maintain multilateral action 	<ul style="list-style-type: none"> - Approach consistent with using a due diligence response or setting a minimum standard of legality verification - action would be consistent with EU and US approaches
Australian Forest Growers	<ul style="list-style-type: none"> - Domestic private growers should not be subject to increased regulation - No support for developing legal and sustainable certification schemes applying to products sold in Australia - Burden on Australian growers to be no higher than on importers 	<ul style="list-style-type: none"> - Include bilateral and multilateral agreements with capacity building - Support for minimal and low cost measures that are not costly to comply with - No support for rigorous regulations 	<ul style="list-style-type: none"> - Self-declaration of legal origin for small-scale domestic growers (could satisfy a due diligence or minimum legality standard requirement)

Australian Government Policy on Illegal Logging

<i>Organisation</i>	<i>Areas of Concern</i>	<i>Preferred Approach</i>	<i>Views on Implementation</i>
Humane Society International	<ul style="list-style-type: none"> - Profits of illegal logging do not represent the same transfer of wealth as for legal logging - Social and environmental values are recognised in Australia's international treaty commitments - Treatment of intangible costs and benefits should not be dismissive 	<ul style="list-style-type: none"> - Australia can play a role model and send a message to trading partners - Commitment to international cooperation consistent with other efforts - Prohibition on imports of illegal timber - Moral obligations for Australia - Negotiate international action 	<ul style="list-style-type: none"> - Requirements are consistent with both due diligence approach and setting a minimum standard of legality verification
National Association of Forest Industries	<ul style="list-style-type: none"> - Action that is inconsistent with approaches of producer and other consumer countries is likely to have perverse outcomes – impact on domestic industry with little change in illegal logging - 'Blanket' ban could impact on trade in legal timber 	<ul style="list-style-type: none"> - Support a phased approach in policy development - Invest in capacity building to target the causes of illegal logging arising in producer and consumer countries 	<ul style="list-style-type: none"> - Too early to implement a mandatory code of conduct for responsible wood purchasing
Timber Queensland	<ul style="list-style-type: none"> - Consider reputational risks to timber from uncertainty about what is legal - Australian companies competing against cheaper imports 	<ul style="list-style-type: none"> - Establish a clear timetable to respond - No significant barriers to introducing a legality verification requirement for domestic producers - Seek comprehensive verification - Phasing-in of product coverage - Measure must be cost-effective 	<ul style="list-style-type: none"> - Preference for setting a minimum standard of legality verification but note the importance of having this requirement relate to the risk of illegal sourcing of products as aligned with the due diligence approach

Australian Government Policy on Illegal Logging

<i>Organisation</i>	<i>Areas of Concern</i>	<i>Preferred Approach</i>	<i>Views on Implementation</i>
A3P (Australian Plantation Products and Paper Industry Council)	<ul style="list-style-type: none"> - No support for the draft RIS conclusion that any action by Australia would be futile - Need to differentiate legal and illegal timber products - Need to account for intangibles - Illegal logging suppresses product prices - Minimise the impact on domestic industry 	<ul style="list-style-type: none"> - Mandatory application of the principles of due diligence in a risk assessment framework - Action by Australia to compliment efforts by other countries - Australia to demonstrate leadership - Government role in regulating system compliance - Broad product coverage - Accept domestic industry and importers meet equivalent requirements 	<ul style="list-style-type: none"> - Support for due diligence with mandatory government requirements backed by flexibility offered by due diligence approach for demonstrating compliance with the requirements - System applies to importers and domestic producers - Having a system that accounts for sustainability and legality (as proposed with trademark system and product disclosure elements)
Australian Window Association	<ul style="list-style-type: none"> - Costs should include estimates of protecting corporate and broader industry reputation - Balance benefits of reducing free-riders versus administrative costs for all businesses to comply 	<ul style="list-style-type: none"> - Need to consider supply chain risks - Seek inclusion of windows and doors - Documentation to support legal supply could be provided by most suppliers 	<ul style="list-style-type: none"> - Use of self declaration and chain-of-custody systems while minimising business costs (consistent with a due diligence approach)
Window and Door Industry Council	<ul style="list-style-type: none"> - Regulatory options outlined in the draft RIS could have a significant impact on members - Don't reduce access to imports of hardwood products - Possible impacts on price and supply - Potential significant impact on small business - Will small business be disproportionately affected? 	<ul style="list-style-type: none"> - Quasi-regulation (voluntary code) would have least impact on members 	<ul style="list-style-type: none"> - Ensure buyers in Australia retain access to what might be classified as 'risky' sources (due diligence could off-set risks) - Be wary of small business compliance costs and impacts across sectors

Australian Government Policy on Illegal Logging

<i>Organisation</i>	<i>Areas of Concern</i>	<i>Preferred Approach</i>	<i>Views on Implementation</i>
Greenpeace	<ul style="list-style-type: none"> - Australia acting in a way that is inconsistent with approaches of producer and other consumer countries is a flawed assumption - Key intangible costs and benefits have not been considered - Illegal logging suppresses real timber prices - Don't view illegal timber as an economic benefit - Moral value of ensuring timber products are legal outweigh costs of compliance 	<ul style="list-style-type: none"> - Need to ban illegal timber imports - Government to mandate requirements in legislation - Pursue multilateral efforts to eliminate illegal and unsustainable logging - Introduce increased performance requirements over time - Should seek to cover more than 70% of all timber product imports - Procurement policies to support purchase of legally-verified products 	<ul style="list-style-type: none"> - Ban illegal timber imports - Specify independent verification systems that could be used to verify legality (closer to option 3) - Shift to a sustainability certification requirement within two years - (These requirements could be satisfied with due diligence on legality and on sustainability at some future time which then capture the proposal for legal product procurement policies)
Decorative Wood Veneers Association	<ul style="list-style-type: none"> - 90% small-medium enterprises 	<ul style="list-style-type: none"> - Bilateral arrangements would be more cost effective (no cost estimates provided) - Support self-regulation option 	<ul style="list-style-type: none"> - Preference for lesser standard of self-regulation noting that if government action adds costs to industry then financial support should be provided
East Gippsland Shire Council	<ul style="list-style-type: none"> - Support for measures that reduce unfair competition on Australian businesses 		
Department of Infrastructure, Energy and Resources (Tasmania)	<ul style="list-style-type: none"> - Be aware of the costs to Australia and potential effectiveness of measures taken - Measures taken by Australia should be in scale with the costs and likely benefits achieved 	<ul style="list-style-type: none"> - No support from Tasmanian government for any approach that places additional compliance costs on State governments or domestic industry - Certification to recognised international standards should be sufficient proof of legality but not a mandated requirement 	<ul style="list-style-type: none"> - Australia to act in a manner consistent with other countries
European Union	<ul style="list-style-type: none"> - Structure used in cost estimates for analysis does not reflect the nature of existing certification schemes - Not generating all brand new costs by requiring compliance with any standard – forestry businesses have at least some of these requirements in place, leading to significantly lower costs estimates such 	<ul style="list-style-type: none"> - Benefits from Australia developing an approach consistent with other global initiatives - A solution to illegal logging requires demand-side measures - Need to consider alternatives to Australia taking action that is not consistent with producer and other consumer countries, and 	

Australian Government Policy on Illegal Logging

<i>Organisation</i>	<i>Areas of Concern</i>	<i>Preferred Approach</i>	<i>Views on Implementation</i>
	as those used by the EU - Analysis is extremely sensitive to the assumptions employed - How many enforcement regimes have a positive benefit-cost outcome?	moral and political dimensions in developing a policy response	
Construction, Forestry, Mining, Energy Union	- Australia has ethical and moral obligations to act - Need to be wary of costs to the domestic industry and the potential for perverse outcomes such as raising the demand for timber substitutes	- Capacity building, bilateral and multi-lateral engagement combined with domestic action, being a minimum threshold of legal compliance with eventual transition to full certification - Harmonise with EU and US systems	- Phase in a minimum standard and have coverage of all products identified in the draft RIS

Note1: 3 other stakeholder submissions were provided to CIE on a confidential basis.

Note 2. Letter/postcards were campaign letters asking the government to take action on banning illegal timber imports.

Due diligence regulation implementation

The 'due diligence' legislation will include requirements for:

1. A prohibition of trade of illegally sourced timber by Australian importers and domestic suppliers;
2. Government accreditation of industry codes of conduct (codes) outlining the risk assessment and legality verification procedures for importers and domestic suppliers;
3. Timber importers and domestic suppliers (wood processing mills) to become registered signatories to government accredited codes of conduct in order to place their products on the Australian market;
4. Signatories to undertake assessments of risk over the illegal origins of timber products and application of legality verification procedures commensurate with the risks identified;
5. Disclosure of species, country of origin (harvest) and any certification will reported by signatories as part of the code of conduct requirements, with disclosure applying to the range of timber products covered by the regulation and applied at the first point of entry onto the Australian market ;
6. Codes to be administered by industry including requirements for third party auditing of compliance with codes and dispute resolution processes;
7. Offences and penalties for importers and domestic suppliers who (i) place timber products on the Australian market when they are not signatories to a code of conduct; (ii) demonstrate reckless or negligent behaviour in importing or selling timber in Australia that does not meet due diligence requirements of the legislation; and (iii) knowingly or deliberately import or sell illegal timber products in Australia;
8. There could be a phased-approach for the range of products covered by the legality verification requirements (although it is not expected that such an approach will be required with industry having two years to establish appropriate systems);
9. Use of a registered a trademark by code signatories for products of 'legal' and 'legal and sustainable' origin;
10. A potential threshold for the size of businesses that might be required to comply with the legislation, with possible exemptions for small businesses;
11. Potential use of existing legislation - Criminal Code, Proceeds of Crime Act (2005), Anti-Money Laundering and Counter-Terrorism Financing Act (2006), and Financial Transaction Reports Act (1998) to enforce the due diligence legislation.