

The Bali Conference's Aftermath: Money doesn't grow on trees...unless they come from legal sources

THERE WERE FEW impressive moments at last December's UN Climate Change Conference in Bali. The developed nations failed to agree on a substantial emission target; and the US government was half-hearted in its response to calls for it to take concrete steps to curb its contributions to greenhouse gas (GHG) emissions – of which it is the world's largest producer – and action to mitigate climate change.

However, one breakthrough that can be hailed was a decision by the United Nations Framework Convention on Climate Change (UNFCCC) to address the issue of deforestation, which contributes approximately 20 percent to the world's GHG emissions. The Bali Conference's mandate includes a two-year negotiating period for addressing technical and policy issues associated with reducing emissions from deforestation. Developing countries now have opportunities to gain support for their capacity building, monitoring, reporting and other institutional requirements concerning this subject. The needs of local and indigenous communities, who have been suffering greatly from illegal forest logging, were also recognised.

How should these new global initiatives in the forestry sector affect the decisions of investors in the medium and long term? To answer this question, we need to bear in mind that, like other raw materials, the market for forest products is closely linked to the global economy. The entire industry has been negatively affected by the slowdown in the global economy and the decline in housing construction. These factors have reduced demand and put pressure on prices.

In the short term, the Bali mandate gives new momentum to attempts to combat

The forestry sector today:

Deforestation and Climate Change: The carbon-sinking function of forests plays a crucial role in global climate and weather patterns. According to the Intergovernmental Panel on Climate Change (IPCC), more carbon is presently locked up in forest ecosystems than the total amount in the atmosphere. On the other hand, greenhouse gas (GHG) emissions created by tropical forest deforestation account for one-fifth of the world's total.

Lost assets and revenue: According to a World Bank report, illegal logging on public land in developing countries creates an annual loss to those countries of US\$10 billion.

Financing: The forestry sector is mainly financed by banks, rather than equity markets. Since project financing is unpopular in the industry, the Equator Principles – a set of voluntary standards to ensure financial institutions invest in a socially responsible way by complying with environmental management best practices – are often not applicable. According to Banktrack (<http://www.banktrack.org>) the banks that have forest sector policies to guide their business operations include ABN AMRO, Banco do Brasil, Bank of America, Barclays, CITI, Fortis, Goldman Sachs, HSBC, ING, JPMorgan Chase, Morgan Stanley, Rabobank and Royal Bank of Canada.

The China factor: China is the world's factory for plywood, furniture and paper products. Its exports of wood-based products are growing at a faster rate than domestic consumption. Much of the wood China imports to produce these products originates in countries that are plagued by severe illegal logging and deforestation. In many cases, this illegal timber is imported, processed, and exported as "laundered" products. Ports and stores in the USA, Europe and Japan are being flooded by these "Made in China" products, which attract consumers with their low prices. In view of this situation, the Chinese government last year issued Guidelines on Sustainable Silviculture Overseas for Chinese Enterprises. This provides practice and evaluation standards for Chinese companies that engage in forest cultivation activities abroad. It also clearly stipulates that such enterprises should protect High Conservation Value Forests. The document was the first national guideline to recognise the rights of indigenous communities over their land and forests as a major principle. It requires companies to obey local laws and decrees concerning silviculture and forest management, and to observe international conventions, bilateral agreements and Chinese laws and decrees as well.

illegal and destructive logging, especially in developing countries. Intergovernmental bodies and international and local NGOs are now making greater efforts to target

illicit activities in this sector; and local and indigenous communities are gaining fresh support for their struggles on the ground.

As a result, investors are beginning to ask forest product companies more critical questions about the sources of their raw materials. Companies that have major operations or source raw materials in sensitive regions, such as Sarawak in Malaysia and the Paradise Forests of Papua New Guinea, are being exposed to greater regulatory and reputational risks. The government in Indonesia, where illegal logging is linked with money-laundering, is expected to punish poor environmental compliance more severely in the future.

If a company seems coy about releasing full data on its environmental performance and improving the traceability of its products, it probably lacks business strategies to address the latest developments within the industry and it is likely to trail behind its competitors.

Financial institutions like HSBC, CITI and ABN AMRO have been aware of these material risks for years, and they have forest policies in place to guide their business operations and lending practices. Other institutions, such as the International Finance Corporation, have taken swift action when problems have been uncovered (see the report about Olam in this issue).

In a broader sense, the disclosure of a company's environmental performance and its implementation of environmental policies should be a key factor in evaluating its future outlook. Unfortunately, many Asian forestry companies have poor track records on

Investors are beginning to ask forest product companies more critical questions about the sources of their raw materials.

these two topics. If a company seems coy about releasing full data on its environmental performance and improving the traceability of its products, it probably lacks business strategies to address the latest developments within the industry, and it is likely to trail behind its competitors.

On the other hand, businesses that have already undergone a certification assessment or audited their products via a credible chain-of-custody scheme, such as the one operated by the Forest Stewardship Council (FSC), will occupy increasingly stronger positions in the marketplace. The FSC reports that, as of February 2008, its principles and criteria were being used to certify timber and non-timber forest products from around 95 million hectares of the world's forests in 85 countries – roughly 7 percent of the world's production forests. Meanwhile, the FSC's supply chain grew by a record 40 percent during 2007. Demand for such products is surging, and the additional cost of certification is compensated for by the willingness of customers to pay a slight

premium to take action against climate change and deforestation (see the report on B&Q in this issue).

National governments are also taking action to ensure that the timber products they import come from legal and ethical sources. China has played a leading role in driving demand for wood during recent years. In fact, Greenpeace investigations reveal that half the trees now being traded in the global market

end up in China, where they are used either to meet domestic needs or to manufacture finished goods for export overseas. In 2007, the Chinese government's State Forest Administration took the lead by developing guidelines to regulate the overseas logging operations of Chinese companies. Obviously, this will not be the final action it takes on the subject. Customs officials and companies should – and will – do more in the future to

Changes in primary forest areas and illegal logging activities in major forestry countries

(Figures = 1,000 hectares)

Country	Primary Forest Area		Annual Lost Area	Total Lost Area	Illegal Logging Rate (%)
	1990	2005			
Indonesia	70,419	48,702	-1448	-21,717	70-80
Papua New Guinea	29,210	25,211	-267	-3,999	70-100*
Malaysia*	22,376	20,890	-99	-1,486	Up to 35
Russia (i)	N/A	N/A	N/A	N/A	10-15 (northwest) 50 (far east)
Brazil	460,513	415,890	-2975	-44,623	60-80*
Solomon Islands (ii)	2,768	2,172	-40	-596	N/A*
Equatorial Guinea*	1,860	1,632	-15	-228	N/A*

* Source: FAO Global Forest Resources Assessment; The World Bank Report No. 36638-GLB August 2006

* Data for Malaysia, Solomon Islands and Equatorial Guinea refer to total forest areas rather than primary forest areas

* The World Bank has estimated that the illegal logging rate in Papua New Guinea is 70-80%, whereas Greenpeace estimates it is 90-100%

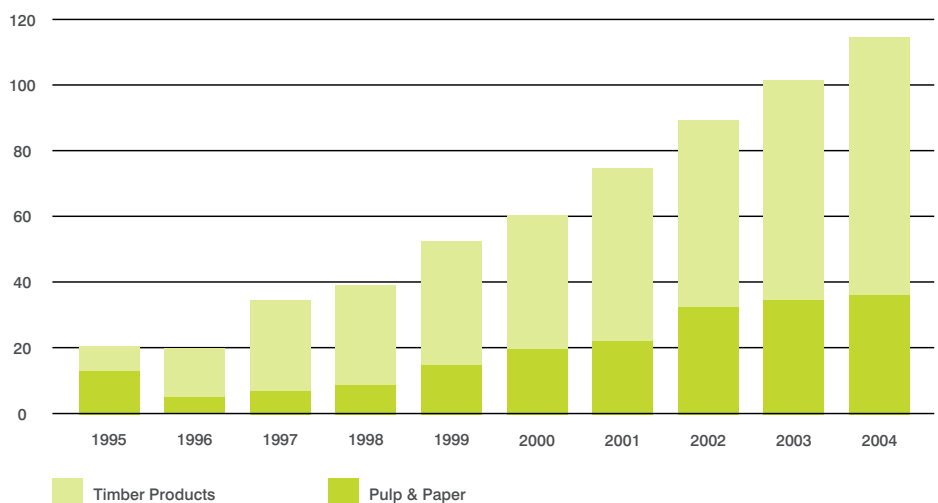
* Source for the illegal logging rate in Brazil: An Amazon Tree Saga: From the Forest to the Market, Greenpeace International 2005

i. The FAO's data for Russia are not cited, because we believe Russia supplied faulty statistics to the FAO by claiming that the area of primary forests increased, whereas in reality their destruction across the country continued throughout this period.

ii. No specific data is available for the illegal logging rate in the Solomon Islands. But in 2004, the total amount of logging reached a historical high, with over 1 million cum exported, which was four times the estimated sustainable level of 225,000 cum.

Trends in China's Wood Imports 1995-2004

(unit: million cum RWE)



ensure that China's wood imports come from legal and sustainable sources.

The heightened concerns expressed about climate change at the Bali conference are pushing developing countries to tighten their regulations and enforce laws to reduce emissions from deforestation. In return for this, their regulators will receive fresh incentives, in the form of new mechanisms that resemble the Kyoto Protocol's Clean Development Mechanism (CDM). The exact details of these are among the many technical questions that will be debated

and resolved in the course of the Kyoto II negotiations during the coming two years.

Even though it will take some time to create effective ways to substantiate emission reduction incentives, all the reasons mentioned above should prompt investors to re-evaluate and take the material issues that exist in the forest sector into account. They should ensure that they weed out companies with poor environmental performances in the course of their due diligence procedures.

Contact: Liu, Shang-wen
liu.shangwen@cn.greenpeace.org

B&Q: committed to greening the supply chain in China

CONSUMERS ARE SHOWING an increasing preference for certified forestry products, according to a report on the sector by Eurosif (the European Social Investment Forum), whose affiliate members account for over €100 billion-worth of assets. Furthermore, this trend is motivating retailers to enforce stricter environmental guidelines for their suppliers.

B&Q, the world's third-largest home furnishing retail chain, is taking a lead on this issue in its operations in China. At a press

The company is gradually tightening controls over its supply chain within the next two years, in order to ensure that all the product lines it sells in China come from certified ecologically responsible forestry operations.

conference hosted by Greenpeace China last June, the company announced it plans to overhaul its supply chain and take steps to guarantee the legality of all the timber products on the shelves of its 60 stores there.

B&Q Asia's Chief Executive Officer Steve Gilman said that his company recognised that problems existed after Greenpeace raised concerns about the sources of some of its products. "Certainly the supply chain challenges in China are not unique to B&Q," noted Mr Gilman. "However, despite these challenges and the additional costs, B&Q is committed to implementing measures to ensure we are part of the solution to deforestation, not part of the problem."

The company will gradually tighten controls over its supply chain within the next two years, in order to ensure that all the product lines it sells in China come from certified ecologically responsible forestry operations, such as those certified by the FSC. Greenpeace research in China, Africa,



Malaysian timber stored at the Shekou Port, Guangzhou, Guangdong Province, China. Timber from the ancient tropical rain forests of South East Asia is imported into China to be made into plywood and sold to local traders for the Chinese market.