Forest trade policies: how do they affect forest governance?

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Trade policies tend to magnify the governance impacts of existing forest policy and regulations – but extrasectoral factors such as agricultural trade liberalization, political stability and economic progress usually have a greater influence on forest governance.

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Forest crime has become one of the most important challenges for tropical forestry. Corruption and illegal logging undermine economic and social development by weakening the rule of law and state institutions. The environmental, social and economic impacts are enormous; for example, the World Bank (2002) estimates that illegal logging costs governments worldwide at least US$10 billion per year just in lost revenue.

Supply-side approaches to forest governance, such as strengthening law enforcement, are seldom effective without corresponding actions on the demand side. Among the potential demand-side instruments are trade policies established by producing countries or their trade partners.

Recently there has been great interest in the potential of trade liberalization – i.e. a reduction in costs and barriers to the free movement of goods and services – to improve forest governance (Rytkönen, 2003). Theoretically, it should increase the price to the exporter and reduce the price to the importer, and so encourage more trade. Trade can be liberalized through reduced import or export tariffs, removal of formal trade barriers such as log export bans, or limiting of other non-tariff measures such as phytosanitary regulations, quotas and product quality standards.

WEAK, INDIRECT AND UNINTENDED IMPACTS ON FOREST GOVERNANCE

There is a rather polarized debate on the governance impacts of liberalization. Free trade supporters claim that removing log export bans can lower corruption and that freer trade encourages "green market" pressures such as certification and country-of-origin governance standards. Many environmental nongovernmental organizations (NGOs), however, argue that freer trade increases the demand pressures on governance in poorer countries, for example by increasing the rewards of corruption for the political élite and the power of rent-seeking multinational companies.

The evidence is conflicting and ambiguous. The first problem is with the idea that there has been a clear trend towards forest trade liberalization in recent years. In fact most countries have continued to protect their forest industries, either through export restrictions (non-tariff measures) or through producer subsidies, and while import tariffs have fallen gradually, they were already low relative to those in other sectors, especially in most industrialized countries. A second problem is that it is unclear how much the removal or imposition of a trade restriction affects demand; for example, after Indonesia imposed a log and timber export ban in 1985, it developed the biggest plywood industry in the world in the early 1990s.

A study based on a literature review and field-based case studies for Brazil, Indonesia and Mexico (Richards *et al.*, 2003) revealed that in general, trade pressures have weak, indirect and sometimes unintended impacts on forest governance. Trade policies and pressures are unpredictable because they interact with other policies and structural factors that have a more direct influence on forest governance.

There seems to be considerable evidence that trade restrictions encourage corruption and illegality. Log and timber export restrictions tend to lead to industrial overcapacity which then fuels illegal logging, as has happened in Indonesia, Ghana and other countries. When the external market is important, trade restrictions depress domestic log prices, which discourages investment in forest management. Where the demand for land is high and forests are accessible, illegal clear-cutting for more profitable alternative land uses is likely. Conversely, where land is rela-

In Indonesia, log and timber export restrictions have led to industrial overcapacity, which fuels illegal logging

Forest management incentives stemming from the combination of trade policies and regulatory capacity: some case study evidence

Trade policies	Weaker regulatory capacity		Stronger regulatory capacity	
	Effect	Example	Effect	Example
Trade liberalization and higher prices/margins	Increased returns from corruption and illegal logging	Mexico (1994–1997): upsurge in illegal logging following deregulatory legislation and implementation of NAFTA Russian Federation: corruption and illegal logging, especially after Russian Forest Service disbanded (2000)	Sustainable forest management and more efficient use of wood encouraged by higher returns	Mexico (post-1997): improved governance in better (natural and social capital) community forestry enterprises (e.g. interest in certification) stimulated by NAFTA market opportunities
Trade protection and lower prices/ margins	Lower profit margins causing managers to cut compliance costs and/or convert forest	Indonesia: illegal trade, criminality and corruption increased by 2001 log/timber export ban	Reduced incentives for sustainable forest management and logging efficiency, but major illegalities prevented by better control	Brazil: a better regulated, law-abiding export sector and the adoption of certification

tively abundant and the forest resource distant or inaccessible, as in parts of the Amazon region and eastern Indonesia, the lower profitability of forest exploitation should favour conservation.

There is less evidence, however, that removing trade restrictions will improve forest governance. In theory, when a trade restriction is removed, high-level corruption among forest authorities should fall since discretionary powers are reduced and transparency increases. However, there is often an increase in rent-seeking by other public- and private-sector actors.

An important study of the effect of timber export booms in Southeast Asia (Ross, 2001) showed an empirical link between export demand pressures, corruption and institutional breakdown. However, even though the regional demand for timber has remained strong, and has probably increased with China's logging ban, the main causes of increased corruption and illegal logging in Indonesia since 1998 have been overly rapid decentralization, weak governance capacity, and chronic political and economic instability (Casson and Obidzinski, 2002).

TRADE POLICIES AND REGULATORY CAPACITY

The most important influence on the likely governance impacts of trade liberalization is existing institutional or regulatory capacity. Where this is weak or weakening, either freer trade or increased protection is likely to exacerbate forest governance problems. Where regulatory capacity is improving, trade liberalization tends to reinforce governance improvements. For example, reduced tariffs and a deregulatory forest law in Mexico in the run-up to the North American Free Trade Agreement (NAFTA) in 1994 resulted in a large increase in unregulated logging (Richards *et al*., 2003). But since 1997, when greater regulation was introduced, governance standards in the forest export sector have improved. Other examples are given in the Table, which presents a simplified view of the interactions between trade policies and regulatory regimes.

The Table also shows that freer trade naturally encourages lower-cost production; in general, the effectiveness of the regulatory system determines whether lower costs are achieved by reducing compliance costs or by more efficient but legal forest management. Another clear conclusion is that regulatory and institutional strengthening should precede trade liberalization. Governance quality is key to trade liberalization outcomes, not vice versa (Stiglitz, 1998).

Green market influences such as certification and private-sector bilateral partnerships have helped improve governance in Brazil's export sector

GREEN INTERNATIONAL MARKET PRESSURES AND THE "GOVERNANCE GAP"

In Brazil, Indonesia and Mexico, most industrial timber is consumed domestically (Richards *et al*., 2003). Green market influences such as certification and private-sector bilateral partnerships have helped improve governance in the export sectors of Mexico and Brazil. An important knock-on effect of certification in Brazil has been the formation of a national buyers' group, and the Forest Stewardship Council (FSC) national standard-setting process has encouraged civil society participation in forest policy development.

However, the governance gap between the higher-value export sector and the lower-value domestic sector has widened. For example, a cost of increased media and regulatory attention to mahogany and the export sector in Brazil has been reduced control of domestic trade (Richards *et al*., 2003). Governance problems were seen to be much greater in the domestic sector in all three countries. Therefore green international market pressures may have only a marginal impact on forest governance.

When the external market is important, trade restrictions depress domestic log prices, which discourages investment in forest management

TRADE RESTRICTIONS AND THE NEED FOR REGIONAL AND MULTILATERAL APPROACHES

Trade policies, especially trade restrictions, are unreliable for pursuing environmental objectives and can have unintended consequences (Barbier *et al*., 1994). For example, Brazil's ban on mahogany exports in 2001 probably increased corruption, especially species falsification, and resulted in the diversion of mahogany to less discriminating markets. Because of weak law enforcement capacity, the main effect of Indonesia's 2001 log export ban was to increase illegal exports rather than reduce the export flow (Richards *et al.*, 2003).

International trade and the availability of indiscriminating markets also favour the displacement of governance problems from one country to another. In Indonesia, for example, forest governance pressures increased as a result of China's logging ban and slightly improved forest governance in neighbouring Malaysia (Richards *et al*., 2003). Countries that impose logging bans greatly increase their timber imports (Asia-Pacific

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Because of weak law enforcement capacity, the main effect of Indonesia's 2001 log export ban was to increase illegal exports; shown, ramin timber seized by customs in Port Kelang, Malaysia after it was smuggled from Indonesia, 2003

Forestry Commission, 2001), thus increasing logging pressures on other countries with weaker regulatory systems; as Sedjo (1996) comments "logging restrictions in some places will simply be offset by logging increases elsewhere. In short, the issue is not whether to log but where to log".

This finding confirms the importance of the regional Forest Law Enforcement and Governance (FLEG) initiatives. However, consumer-country legislation against illegal wood imports, while essential, also runs the risk of unintended impacts on poorer producer countries unless domestic regulatory capacity is simultaneously improved and/or progress is made in raising ethical or environmental standards in (currently) non-discriminating markets. Where regulatory control is weak, the higher verification costs of legal production could increase incentives for non-compliance. This comes back to Stiglitz's point above.

EXTRASECTORAL IMPACTS AND THE BIGGER PICTURE

While it can be concluded that forest trade liberalization *per se* is unlikely to have major impacts on forest governance, trade liberalization in other sectors may have considerable forest governance impacts, although again the relationships are indirect and unpredictable. Freer trade of agricultural products, for which tariffs are much higher, can significantly affect land-use pressures and thence forest governance objectives (A. Contreras-Hermosilla, personal communication). If freer trade encourages capital-intensive export crops such as soybean, and if land is scarce, illegal clear-felling and conversion are likely. Workers displaced by capital-intensive agricultural production may also add to frontier pressures. However, if trade liberalization encourages labour-intensive agriculture, for example irrigated vegetable farming, this could reduce frontier conversion pressures. On the other hand, if trade liberalization encourages mining and thence roads into forest areas, frontier pressures are likely to increase.

Finally, forest governance has an important international political economy dimension. Most analysts agree that governance quality is strongly related to economic development, political stability and democratic progress. Poorer producing countries such as Indonesia depend heavily on natural resource exports, and thus suffer from "resource curse" governance problems. Therefore, while more stable, democratic middle-income countries like Brazil and Mexico are making some progress in the export sector, Indonesia appears to be trapped in a downward spiral. Although forest policy failures play their part, progress in forest governance depends more on factors and policies outside the forest sector. ◆

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