

## Workshop Identifies Issues and Opportunities as Vietnam Seeks to Meet Growing International Demand for Legal Wood Products

On October 8-9, 2009, 30 officials from the international cooperation, wood processing, forest protection, and management and planning departments of the Ministry of Agriculture and Rural Development (MARD), the customs department of the Ministry of Finance, and the Environmental Police of the Ministry of Public Security, together with representatives from the US Embassy, companies, business associations and NGOs, met in Nam Dinh to discuss the challenges Vietnam's wooden furniture exporters face in complying with new laws seeking to keep wood products made from illegal timber out of major international markets.

In 2008, Vietnam exported US\$2.8 billion of wooden furniture and other wood products, up from US\$2.4 billion in 2007 and US\$560 million in 2003. This phenomenal growth, coupled with domestic supply restrictions, has driven an equally rapid rise in Vietnam's timber imports, which supply 80% of the furniture industry's timber demand. In 2008, 63% by value of Vietnam's furniture exports went to the US and EU. However, changes in these markets in response to growing demand for legal wood products from governments, retailers, and consumers are putting pressure on Vietnamese exporters and creating uncertainty about future market access.

The Nam Dinh workshop was co-organized by IUCN, MARD, and the Vietnam Timber and Forest Product Association (VIFORES), which represents 151 timber and wood processing companies. It was the third in a series of meetings convened by IUCN over the past 18 months as part of a multi-stakeholder process, involving government, business, and civil society, to help Vietnam understand and respond to new market requirements. The workshop targeted government officials responsible for supporting industry efforts to comply with these requirements and thereby ensure continued access to major export markets.

The workshop included presentations on the furniture supply chain from the forest to the retailer; market trends and opportunities for Vietnam's wooden furniture industry, and local industry examples of managing the timber supply chain. Also included was a visit to the Nam Dinh Forest Products Joint Stock Company (NAFOCO), which has an exclusive furniture export agreement with IKEA, an international home products retailer with a turnover of US\$30 billion in 2008.

In 2003, the EU launched the Forest Law Enforcement, Governance, and Trade (FLEGT) Action Plan, a global initiative to improve forest governance and ensure that only licensed, legal timber enters the European market. The Action Plan offers Vietnam and other wood product suppliers the opportunity to negotiate a Voluntary Partnership Agreement (VPA), under which all of their wood products exports to the EU are licensed. VPAs have so far been signed with Ghana and the Republic of Congo.

In 2010, the EU is expected to approve a Due Diligence Regulation (DDR) requiring all timber

traders, domestic producers and importers, to demonstrate due diligence in ensuring that they do not place any illegally harvested timber or timber products on the market. If a country has signed a VPA, its licensed exports to the EU will be considered to have been legally harvested and so satisfy the DDR.

In 2008, the US Congress amended the Lacey Act, introducing amongst other things a new declaration requirement for importers of plant and timber products. The declaration, which requires details such as species name, country of harvest, and shipment value, is being enforced in phases: importers of wooden furniture have until the end of September 2010 to start submitting declarations for all of their shipments.

The FLEGT Action Plan and DDR are specific about what cannot be sold in the EU, and the Action Plan provides support to countries to help them meet the new requirements. The Lacey Act does not require chain of custody (COC) certificates, nor does it establish forest management standards. It does require, however, detailed product information and compliance with US and foreign forest and plant protection laws. The 2008 amendment broadens the application of the Act to a wider range of plants and plant products, and the new declaration provision makes it easier to prosecute importers, putting pressure on their foreign suppliers to provide accurate information about the shipment.

Though the Lacey Act has always allowed US authorities to target foreign entities, enforcement has proven difficult. Given its strict penalties, and that fact that ignorance will not be accepted as a defense in any prosecution, the amendment is expected to encourage importers, and by definition exporters, to rely on well-documented supply chains.

A major challenge facing Vietnamese wooden furniture companies that export to the EU and US is securing legal sources of timber. Vietnam's national logging quota from natural forests has declined rapidly to less than 200,000 m<sup>3</sup>. Timber production from natural forests could be increased, but to ensure sustainability would probably mean moving from an administratively set and allocated quota to production based on management plans. The bulk of Vietnam's domestic timber supply comes from its plantations, which produced 5 million m<sup>3</sup> of timber in 2008. Most of the 2.7 million hectares of plantation, however, were established to produce raw materials for pulp and paper, and wood chips.

About one-third of Vietnam's plantations belong to households. Though they could provide an important income source, there are no functioning examples of business-household joint ventures. One problem is that timber plantations require a minimum rotation of 10 years compared with 4 years for pulp and paper, which offers a quicker and more attractive cash flow. Other problems include tenure and contract security. The furniture company Pisico had half of its plantation in Binh Dinh taken back by the people's committee to reallocate to households. And even when contracts exist between companies and households, they can be broken with impunity because the government is unwilling to enforce them. KfW, the German development bank, is testing a household payment system that ties payments to compliance with agreed-upon production targets. This may offer a viable model to link businesses and households.

Truong Thanh, one of Vietnam's leading furniture exporters, and Pisico have established 20,000 and 10,000-ha plantations, respectively, to supplement their timber imports. NAFOCO, which does not use imported timber, buys from large numbers of plantations in four different provinces. This increases its transaction costs and the risks from incomplete documentation. Many plantations are household enterprises that struggle to comply with the extensive documentation required by commune authorities. These problems also make it difficult to secure FSC certification for household plantations. (Vietnam's only FSC-certified forest is a pulp and paper plantation in Quy Nhon.) Meanwhile, plantation timber quality is declining because of excessive demand. Whereas trees of 25-cm diameter were once common, only

trees with 20-cm diameter are now available; the smallest diameter that can be used to make furniture is 18 cm.

NAFOCO is therefore supply-constrained: to grow it needs access to more legal timber. In 2008, the President of IKEA met the Prime Minister of Vietnam to ask for permission to acquire 200,000 hectares on which to develop a plantation, but the negotiations failed. Indeed, there is currently no significant foreign investment in Vietnam's plantation sector. This has broader significance because if Vietnam could expand its domestic timber supply it would reduce pressure on countries with weak forest management and potentially allow it to benefit from an international REDD market.

Workshop presentations by Truong Thanh, Pisico and NAFOCO explained how they have already put in place supply chain management systems. Truong Thanh and Pisico have an FSC-certified COC. At present, 176 FSC COC certificates have been issued in Vietnam, of which 149 are for furniture companies. As there are about 700 wooden furniture exporters in Vietnam, this suggests that up to 20% of these companies could already meet EU and US import requirements. These companies could form a core group that supports modernization industry-wide. Since Truong Thanh, Pisico, and NAFOCO established supply chain management systems without consulting each other, there is clearly scope for greater business-to-business information exchange and learning.

Moving the whole industry, not just a few leaders, to a more legal footing is important because of the reputational damage that a few rogue companies can cause. This risk was demonstrated by last year's EIA/Telapak report on illegal timber exports from Laos to Vietnam, which damaged Vietnam's reputation, not just that of its wooden furniture sector. If similar reports were released, Vietnam's access to the EU and US markets would be jeopardized, threatening tens of thousands of jobs. The future of the industry is therefore linked to Vietnam's international standing as an exporter of legally and sustainably produced goods. Vietnam cannot continue to compete solely on price. It needs to build a respected national brand that capitalizes on a stable and relatively equitable society, a high level of tenure security, a functioning administration, and a rich natural and cultural heritage.

The workshop stressed that since VPAs were originally designed for countries that export unprocessed timber to the EU (whereas Vietnam is primarily an exporter of finished wood products), and given the variation in supply chain management among companies, Vietnam may not wish to negotiate a full VPA. In the short to medium term, other arrangements involving independently verified private sector COC systems may be more suitable, and would likely meet the forthcoming DDR requirement.

The workshop was an opportunity for government officials to hear from company representatives and industry associations about the progress they have made, the challenges they face, and how government can support them in meeting new international market requirements. Although some companies may already be in a position to meet these requirements, adjusting the sector as a whole will need an enabling environment of information, incentives, and regulation that only government can provide.

The workshop agreed upon the following next steps. First, IUCN will prepare and distribute a summary of the workshop's results and recommendations to senior MARD officials. Second, MARD will confirm a permanent FLEGT focal point (its International Cooperation Department is temporarily playing this role) and begin work on a National Action Plan on FLEGT and the Lacey Act. This will be prepared in consultation with other ministries, companies, business associations, civil society organizations, and international partners, and will be submitted to the Prime Minister for approval. MARD will also review and simplify the decisions specifying the documentation that households need to submit for permission to cut their own trees.

Third, VIFORES and HAWA have volunteered to coordinate industry input to MARD's Action Plan and to work with their members to prepare and disseminate COC guidelines and other practical information. Truong Thanh, Pisico, and NAFOCO have offered to work with other companies on FSC COC certification. Finally, IUCN in collaborate with WWF and other civil society stakeholders, is willing to continue to provide support to all stakeholders involved in exploring options for how Vietnam can best meet growing international demand for legal wood products.

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