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# Seeing the Forest for the Wood

## Investment Risks in Wood Products and an Uncertain Operating Environment

Driven by demand for construction materials and other uses such as pulp and paper, the global forestry sector is expected to experience greater than 6 percent growth annually through 2027.<sup>1</sup> Timber and wood products are also increasingly touted as a climate solution. With the building sector responsible for approximately 40 percent of energy-related carbon emissions,<sup>2</sup> many in the industry are searching for more climate-friendly solutions. Some propose to include timber in this mix as a seemingly easy solution for businesses and investors to hit sustainability benchmarks.<sup>3</sup> However, EIA's years of investigative fieldwork show that the reality is far more complex.

The global forestry sector is also beset by illegality at multiple levels of the supply chain, with the annual trade in illegal timber alone worth between \$50-\$150 billion.<sup>4</sup> Booming demand for wood and pulp combined with a sector where supply chains are plagued by illegality and often irresponsible harvesting practices creates significant risks for investors and poses challenges for governments. While legislation, such as the United States (US) Lacey Act and the European Union (EU) Timber Regulation, aims to address this challenge, to date implementation of these laws has yet to achieve the anticipated level of impact.

There are signs of change, however, as the regulatory state of play for wood

product imports is in significant flux in the United States and globally. The recently enacted EU Deforestation Regulation (EUDR) provides the most robust regulatory framework for deforestation- and degradation-linked commodities to date, requiring traceability back to the source.<sup>5</sup> New York State's proposed Tropical Deforestation-Free Procurement Act,<sup>6</sup> which was recently passed by the State Legislature, requires state contractors who deal in tropical forest-risk commodities to certify that their products do not drive tropical deforestation or degradation or abuses of Indigenous Peoples' rights, by demonstrating supply chain due diligence to their products' points of origin.



## Overview

- » Illegal sourcing of wood products and irresponsible harvesting practices creates significant risk for investors
- » Investment risks tied to wood products manifest in diverse sectors and geographies
- » Five principles of transparent traceability systems provide



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This brief makes the case that despite some short-term uncertainty in the regulatory environment, the trend is ultimately towards a world where requirements to be able to trace wood products to their origin will be the new normal. Investors and companies that act now to address the investment risks posed by systemic illegally- and unsustainably-sourced wood products will mitigate operational and reputational risks. The case studies that follow underscore how these risks materialize across sectors and geographies.

## Case Studies: Investment Risks on the Ground

### *Wind turbine manufacturers' dependence on illegal timber*

Energy transitions in the US, the EU, and China are set to drive huge growth in the wind industry, and balsa wood remains a critical component for turbine blades. A forthcoming report detailing an investigation by EIA shows that, due to the opacity of the supply chain, illegally harvested balsa from South America is making its way to major manufacturers of wind turbine blades, including in the US. The lack of transparency and traceability in the production of balsa wood exposes investors to significant risks due to downstream conflicts with local communities that increase operational costs, and legal risks since a significant portion of this wood is illegally sourced. These risks also introduce reputational risks for green energy companies and investors, who might otherwise benefit from consumers' positive views on green products.<sup>7</sup>

### *Tissue sector's continued reliance on forest fiber for single-use tissue*

NRDC's recent *The Issue with Tissue* Fifth Edition report and scorecard highlights how powerful companies behind the tissue sector's biggest brands, such as Procter & Gamble, Kimberly-Clark, and Georgia-Pacific, continue to rely on forest fiber to make their single-use tissue products, with devastating impacts for many Indigenous communities, wildlife, and the global climate. Now, compounding regulatory shifts and growing reputational pressure surrounding corporate impacts

on forests are fostering unprecedented risks for those tissue companies and their shareholders. With a growing number of sustainable tissue brands embracing solutions to halt the "tree-to-toilet pipeline" driving the loss of climate-critical forests like the Canadian boreal, addressing the use of forest fiber for single-use tissue and associated forest degradation and Indigenous rights violations is a critical task for brands looking to stay competitive in an increasingly sustainability-conscious marketplace.

## Five Key Principles of Transparency and Traceability Systems: Origin, Unbroken Supply Chain, Digitalization, Transparency, Functionality

For investors looking to mitigate these risks, the devil is in the details. With governments and companies looking for quick fixes, false solutions are likely to proliferate.

Five key principles of national transparent traceability systems for forest-risk commodities in both tropical and northern forests can help investors delineate between false solutions and meaningful mitigation. To be fully traceable, such systems must go back to the point of origin in the forest, and should document an unbroken supply chain. Digital input of records is also key. Failure to meet any of these traceability criteria creates ample opportunity for fraud. An essential criterion is real-time transparency. Making information about individual transactions available in real time allows forest communities, civil society, and others to ensure robust monitoring across the supply chain. Finally, such systems should be designed with functionality that accounts for the contexts in which they will be deployed, notably a low cost to implementation and the ability to function offline with auto-synchronization.

Transparent traceability systems that meet these criteria can provide digital, verifiable traceability back to the source via an unbroken supply chain, allowing investors to mitigate the legal and reputational risks of unsustainability, illegality, and corruption in the timber sector by independently auditing supply chain data.

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